The Economics of Credit Union Regulation

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Rationale for Financial Intermediary Regulation

- **Prudential:**
  - Control costs of share/deposit insurance schemes
  - Protect a continuously and smoothly functioning payments system
- **Consumer Protection:**
  - Ensure that borrowers and savers are treated fairly
  - Ensure that borrowers and savers are well informed so they can make wise decisions

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Cooperative Structure Modifies the Need for Regulation

- **Prudential regulation:**
  - Reduced risk aversion of cooperatives requires less intense prudential regulation
  - Mistakes can happen, and bad management can exist, but no pervasive incentive to exploit the moral hazard risk of deposit insurance
- **Consumer protection:**
  - Credit union members need less protection from the institutions they own than do customers of investor-owned firms

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Increased Regulation of US Credit Unions Since Financial Crisis

- Crisis caused in part by inadequate consumer protections
  - Credit unions didn’t engage in the abusive behaviors
  - Credit unions nonetheless subject to rules form new Consumer Financial Protection Bureau
- Significant increases in bank failures and losses to the bank deposit insurance fund
  - In comparison, credit union losses were modest
  - Credit unions’ prudential regulator mimicked bank regulators’ expanded regulations

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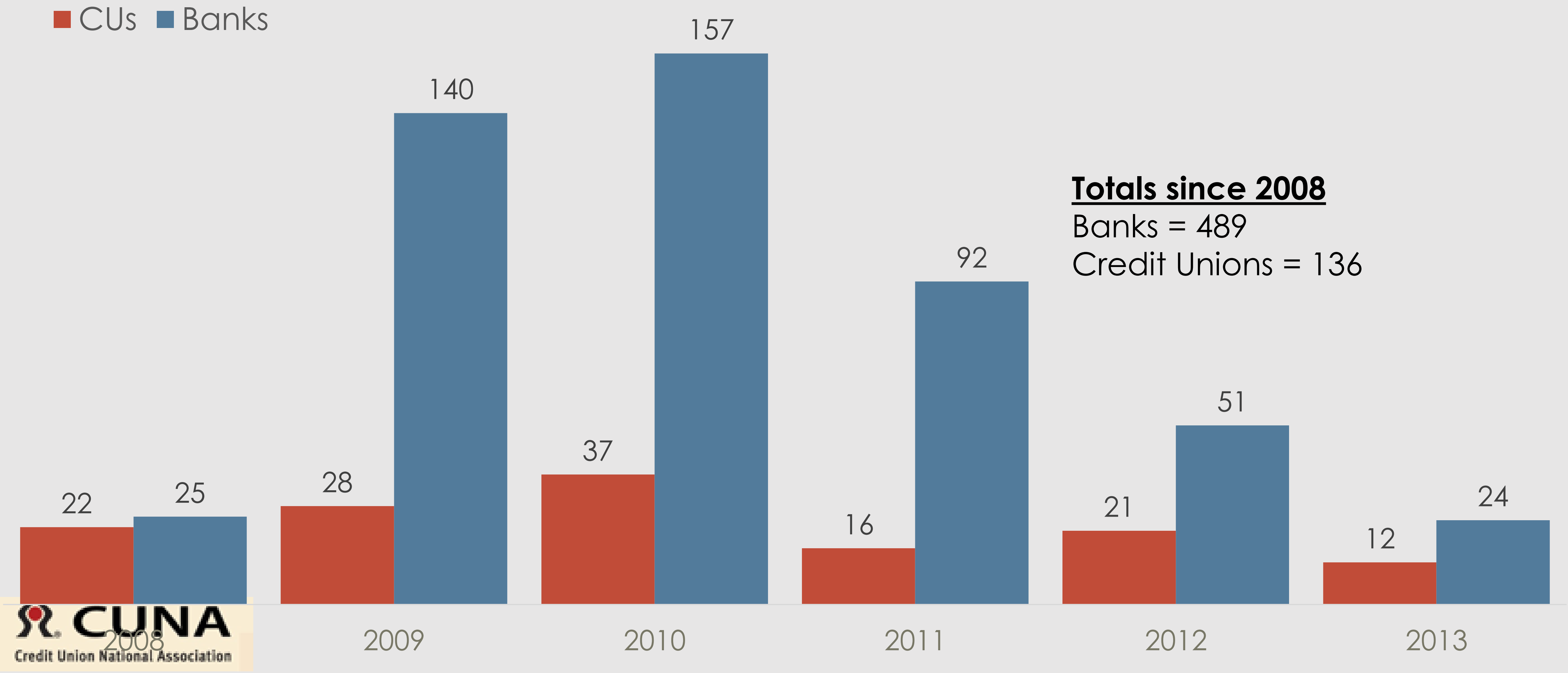
Number of Financial Institution Failures
Since Start of Downturn
Sources: FDIC, NCUA, CUNA.

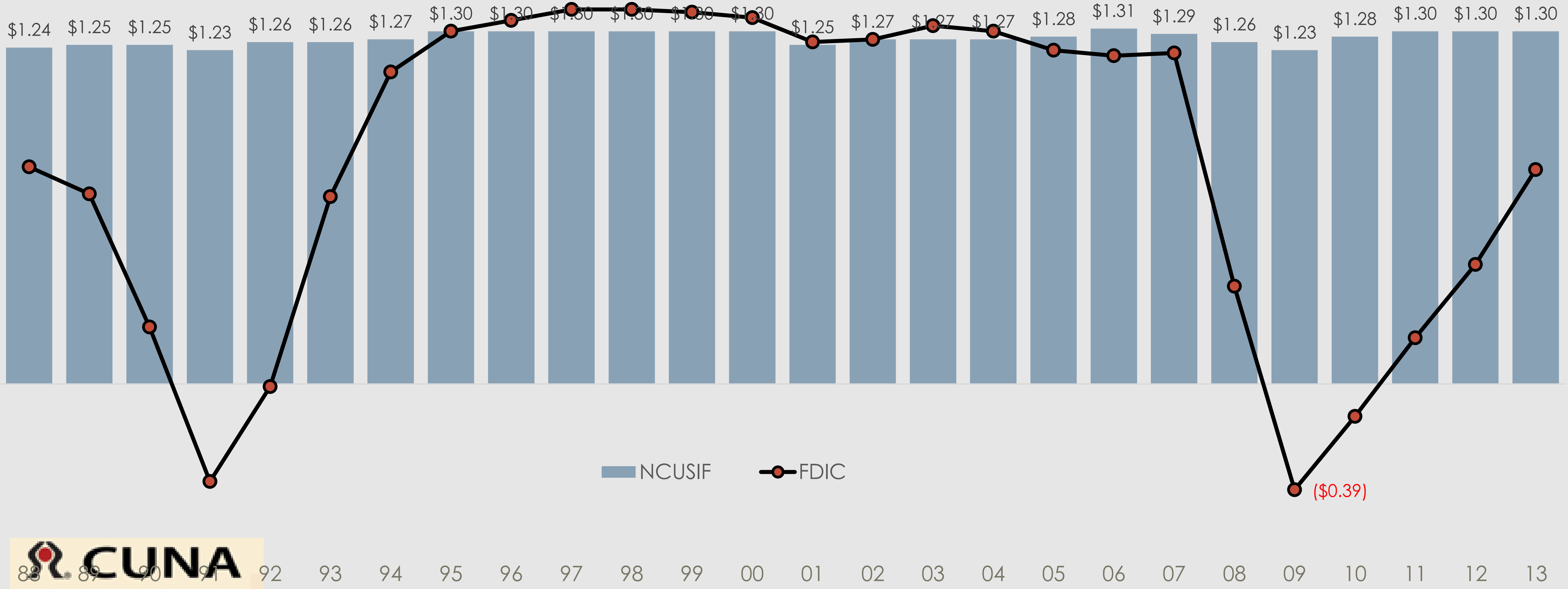


<u>Totals since 2008</u>
Banks = 489
Credit Unions = 136

Insurance Fund Ratios

Fund Balances per $100 in Insured Deposits

Sources: FDIC, NCUA, CUNA.



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CUNA Regulatory Burden Study

- Addressing the highest advocy priority expressed by credit unions: increased regulatory burden
- Recognition in Congress of adverse effects of regulation, but no hard data on actual costs
- CUNA engaged Cornerstone Advisors for a Two Phase Study
  - Phase I: Deep dive analysis of three CUs
  - Phase II: In-depth survey / data collection from volunteer participants

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Approach and Scope of Survey

- Covered all areas within credit unions
- Detailed data collection on regulatory impacts today and since 2010 (Dodd-Frank)
- Two main areas of impact
  - Costs
  - Lost Revenues

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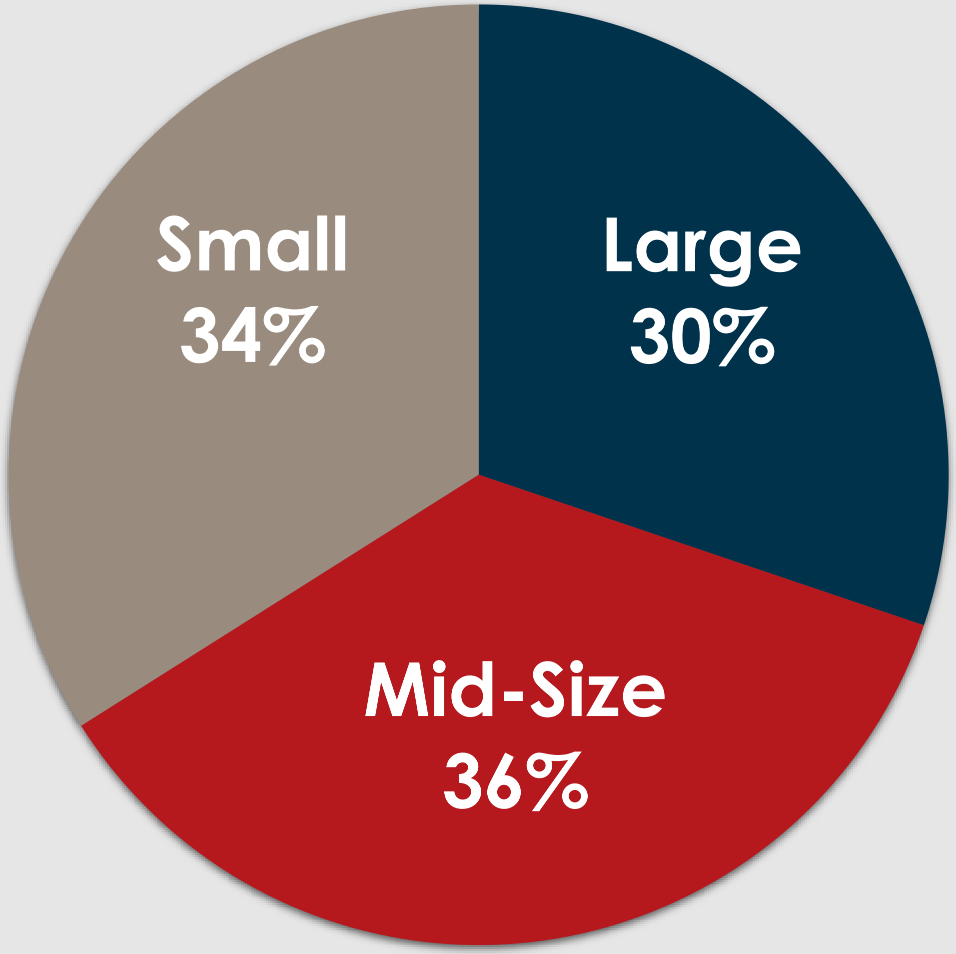
Survey Participants

53 credit unions across 28 states

Category	Asset Range
Small	$0 - $115M
Mid-Size	$115M - $1B
Large	$1B+



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Type of Impacts Reviewed

Impact Type	Description
Cost	Regulatory-related Staff and 3rd party expenses.
Lost Revenues	Revenue reductions as a result of regulations.
Strategic Impacts	Impacts from the viewpoint of the CEOs. Insight on how resources would have been allocated if not for regulatory cost.

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Overall Regulatory Impact

Regulatory Impacts	Annual Impact
Total regulatory Financial Impact	**$7.2 billion or 0.64% of assets**
Annual regulatory cost impacts	$6.1 billion or 0.54% of assets
Lost revenues (interchange income)	$1.1 billion or 0.10% of assets
Increase in staff time spent on regulatory activities since 2010	91%
Increase in regulatory cost since 2010	$1.7 billion or 0.15% of assets

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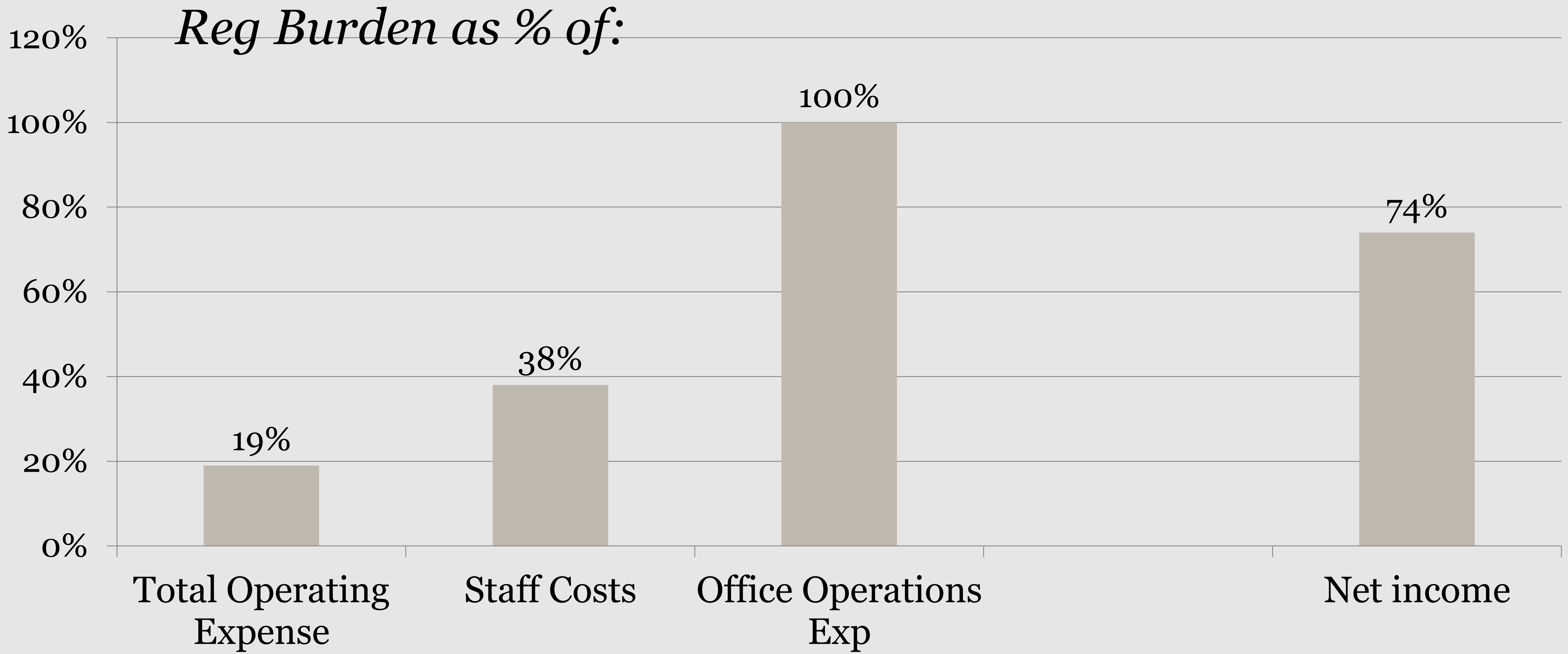
Putting Reg Burden into Perspective



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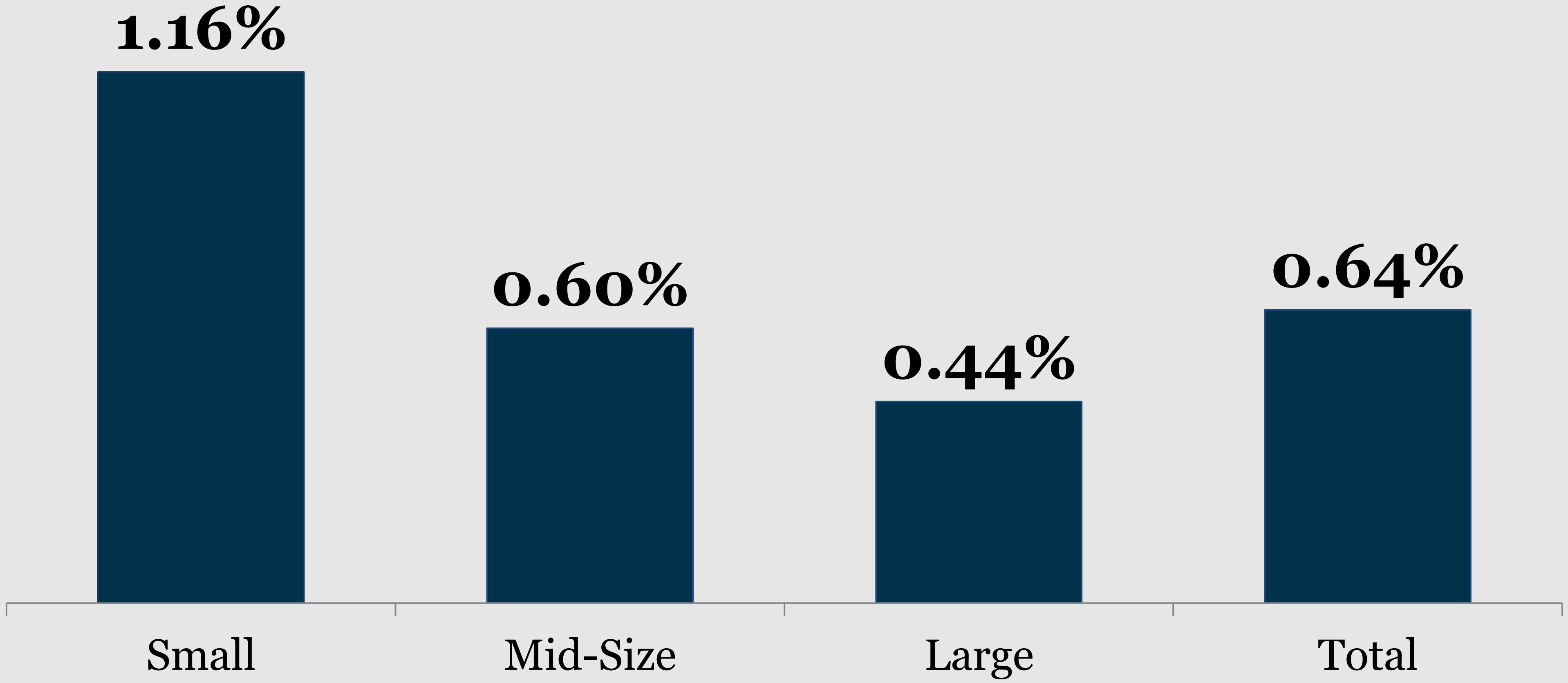
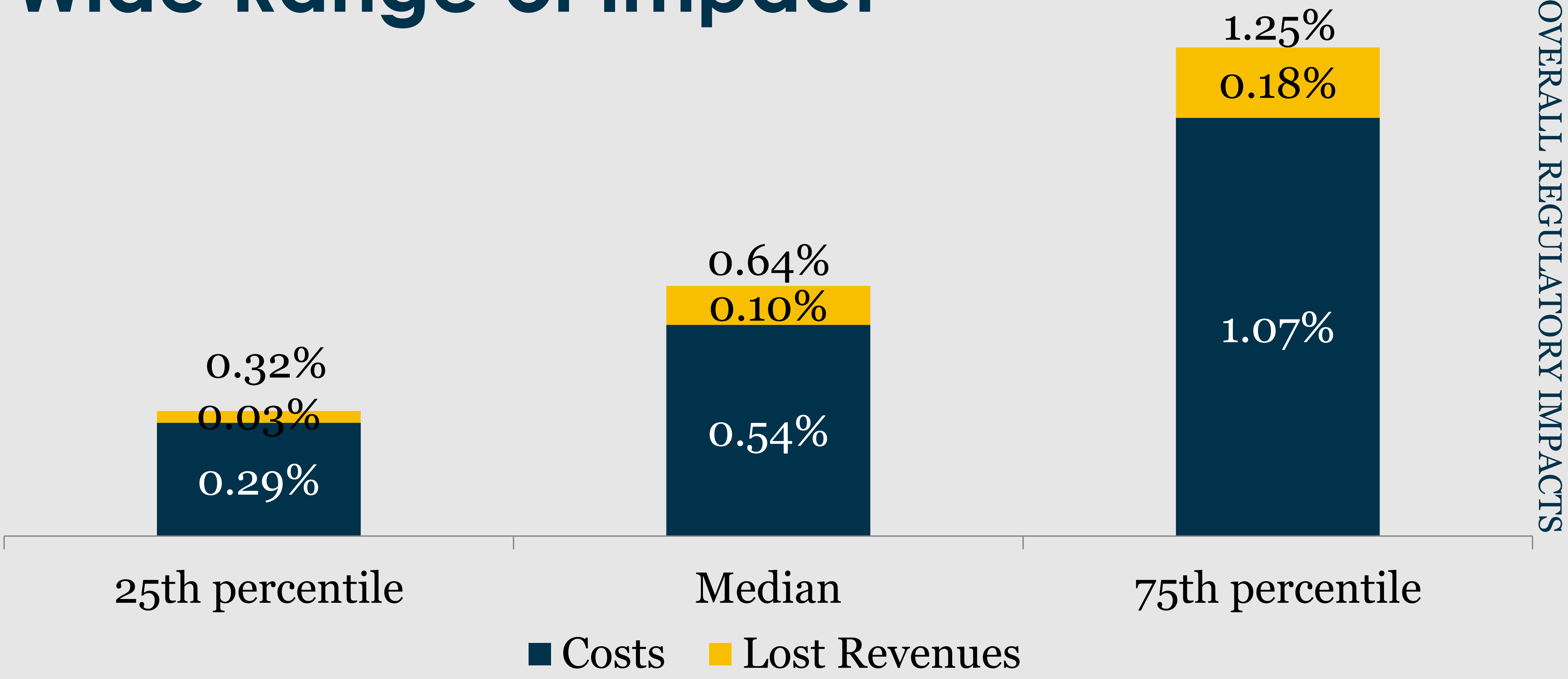
Size Does Matter



Wide Range of Impact



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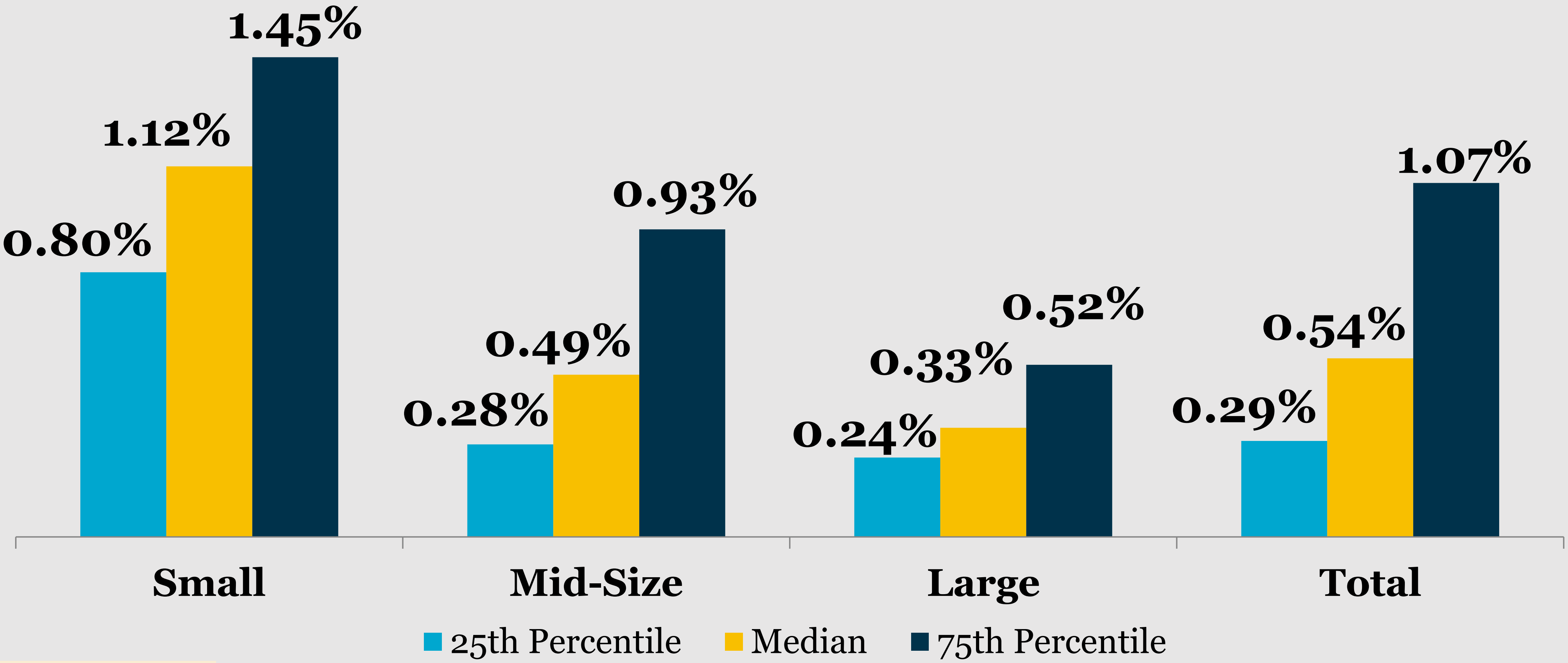
REGULATORY COSTS

Costs Vary by Size and within Size Groups



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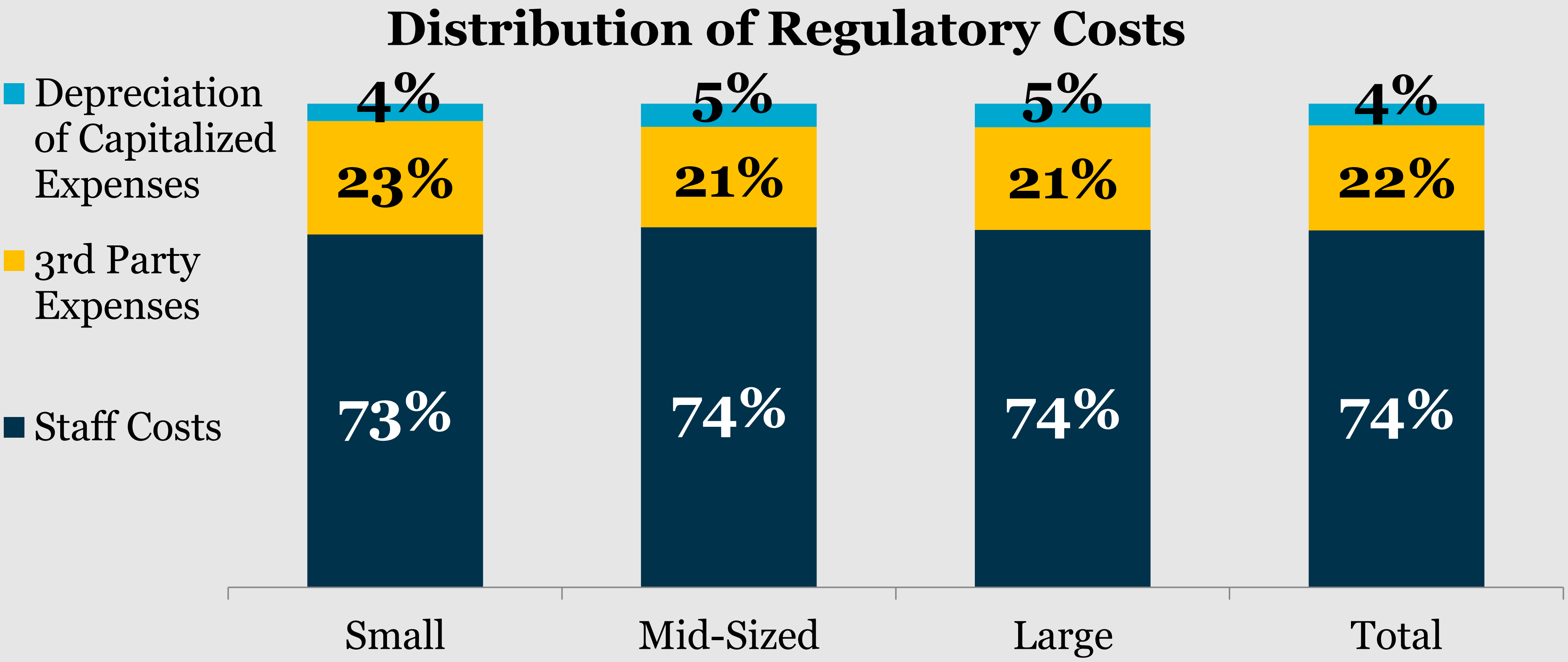
Mix of Costs Similar Across Size Groups



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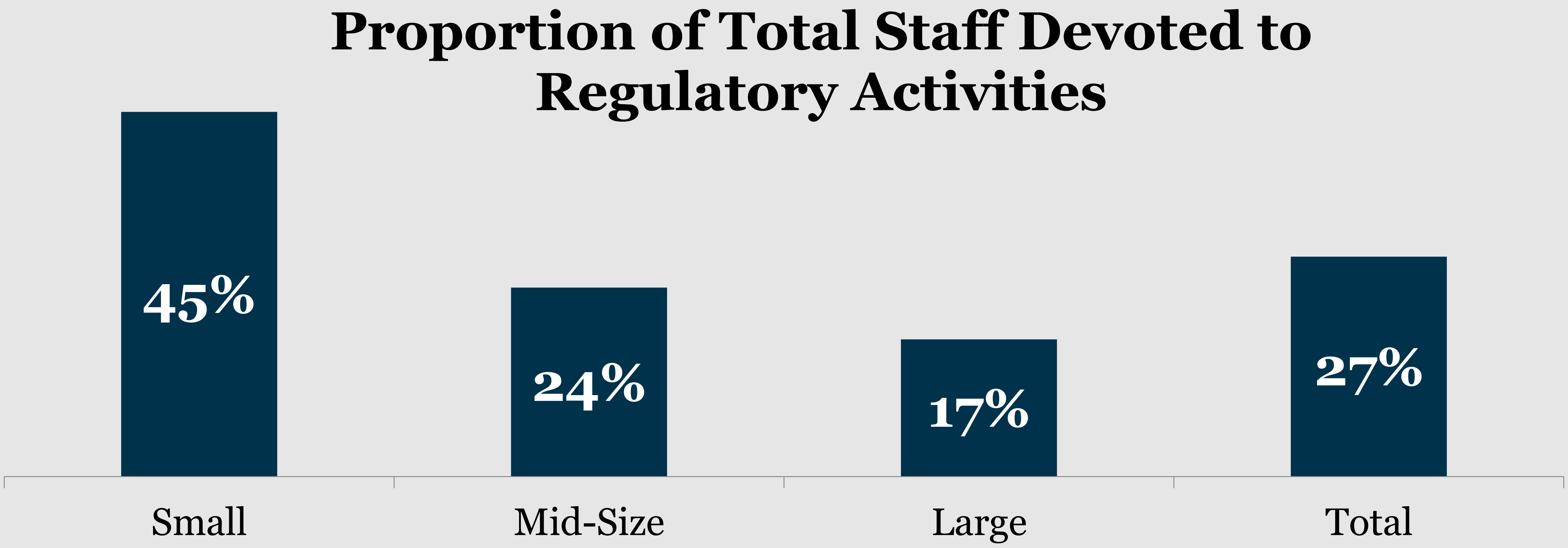
.....But the Staff Impact Is Relatively Higher for Small Credit Unions



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Staff Impact Is More Than Just Risk Dept

Risk
Back office functions dedicated to regulatory duties
e.g., Compliance, Audit, BSA / AML, ERM, Vendor Management

Member-Facing
Employees who directly interact with members
E.g., Branch, Call Center, Loan Origination, Collections

Support
All other back office functions
E.g., Finance, IT, HR

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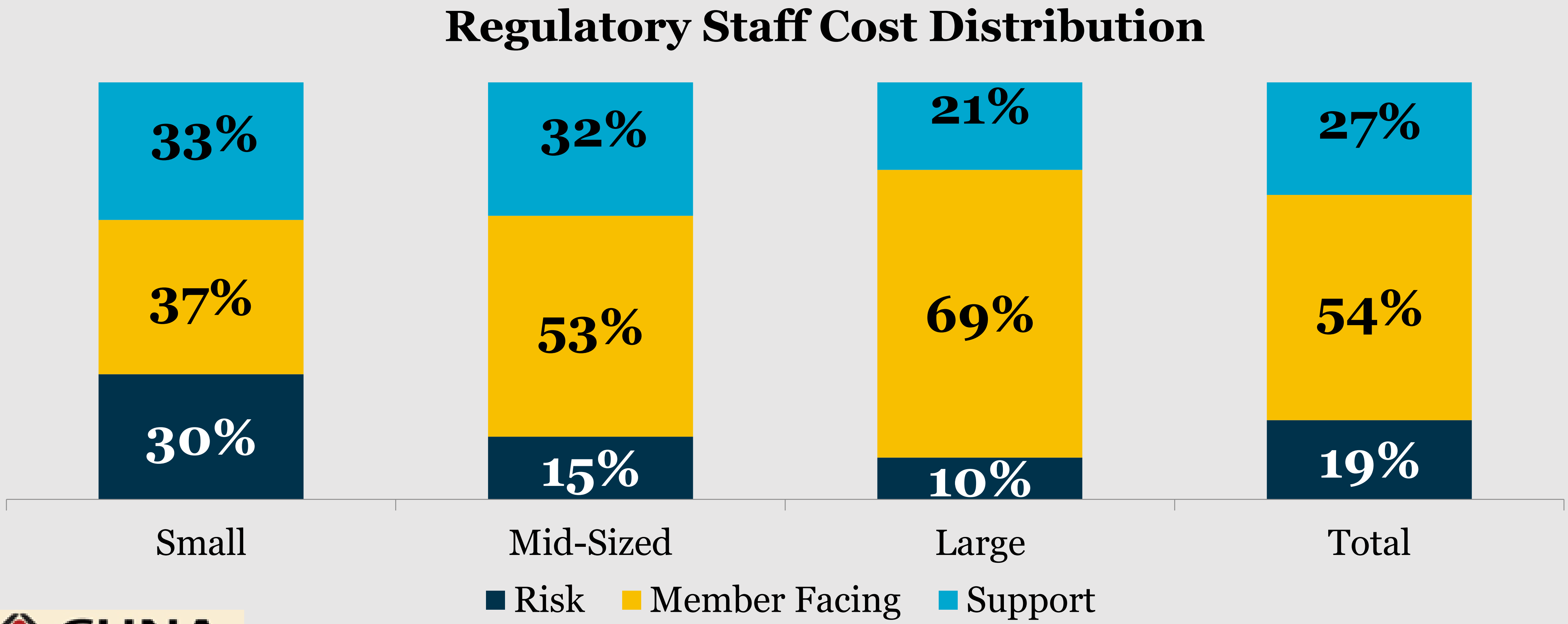
Highest Impact on Member-Facing Staff ....And Members



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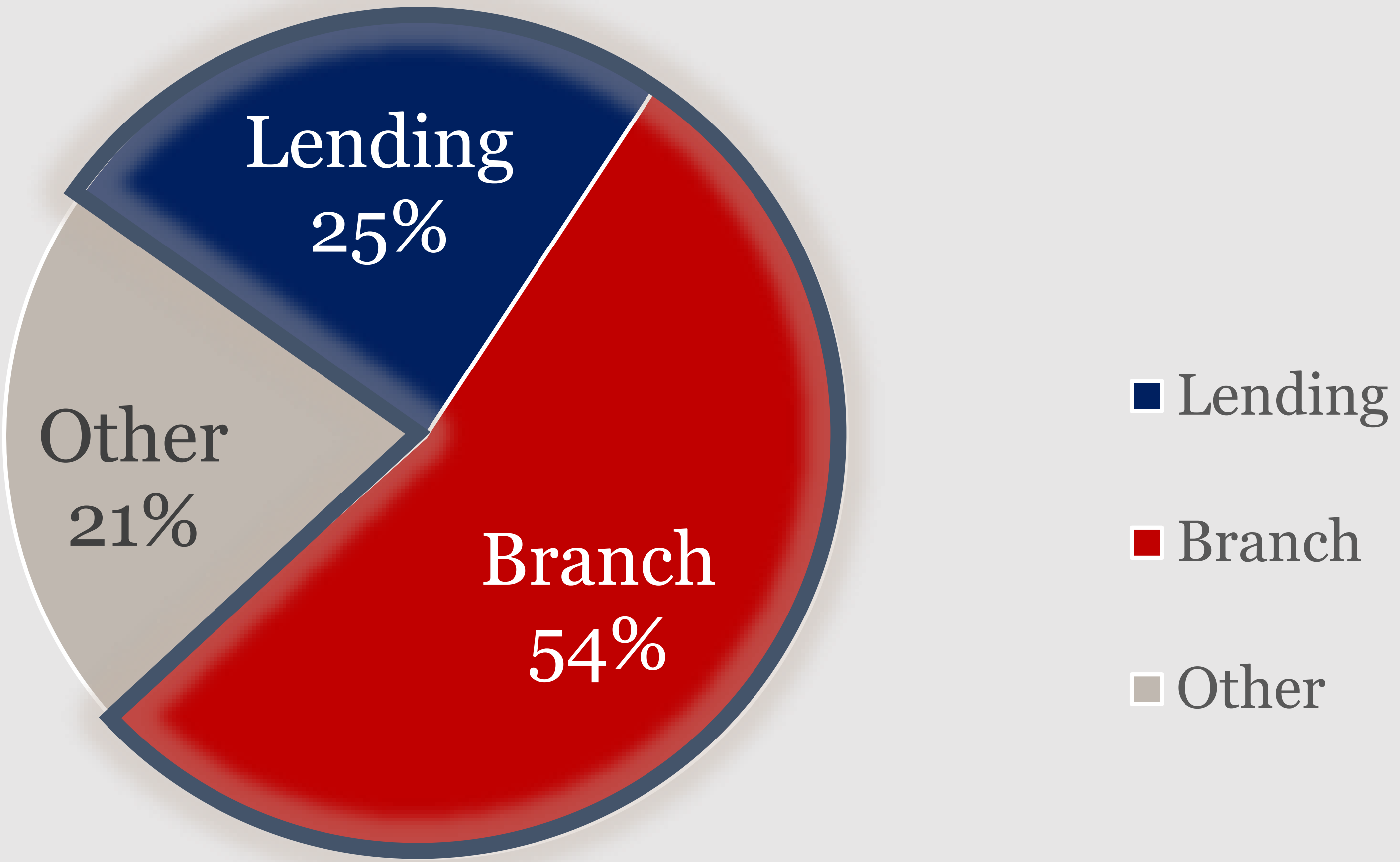
Member-Facing Staff Impact

Outsized impact on branches and lenders



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INCREASE IN COSTS SINCE 2010

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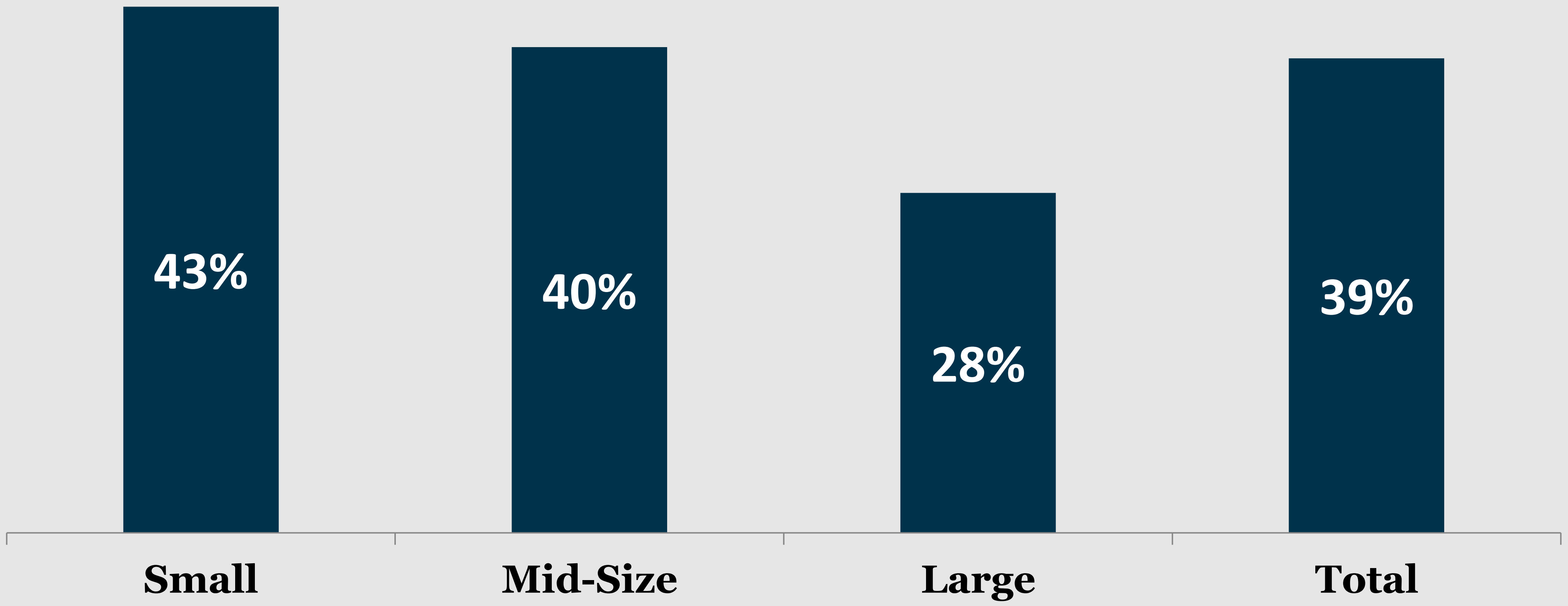
Increase in Regulatory Cost Since 2010



Changes from 2010 to 2014

	Assets ($ billions)	Median Reg Cost to Assets	Regulatory Expense	Total Staff Expense	Total Operating Expense
2010	$934	0.39%	$3.6	$14.3	$29.3
2014	$1,145	0.54%	$6.2	$17.1	$34.0
Change	$211	0.15%	$2.5	$2.8	$4.7
Percent Change	23%	39%	70%	19%	16%

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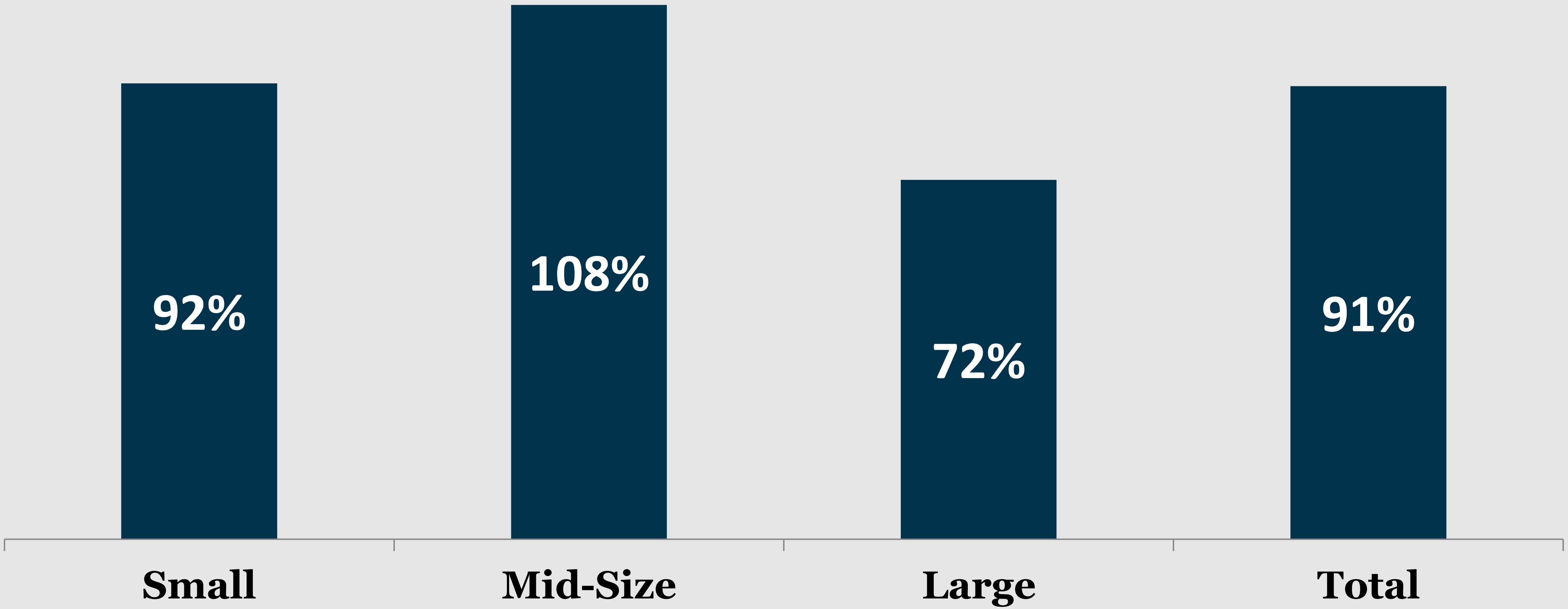
Increase in Regulatory Staff Since 2010



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STRATEGIC IMPACTS

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CEO View of Regulatory Impact – Mortgage Is Most Impacted Business Area

CEO Top Five Impact Areas

Areas with Highest Reg Costs	Areas with Highest Lost Revenues	Areas with Greatest Productivity Loss
Compliance	Mortgage	Compliance
Mortgage	Debit Cards	Mortgage
Internal Audit	Payments	Consumer Lending
ERM	Credit Cards	Internal Audit
Consumer Lending	Consumer Lending	ERM

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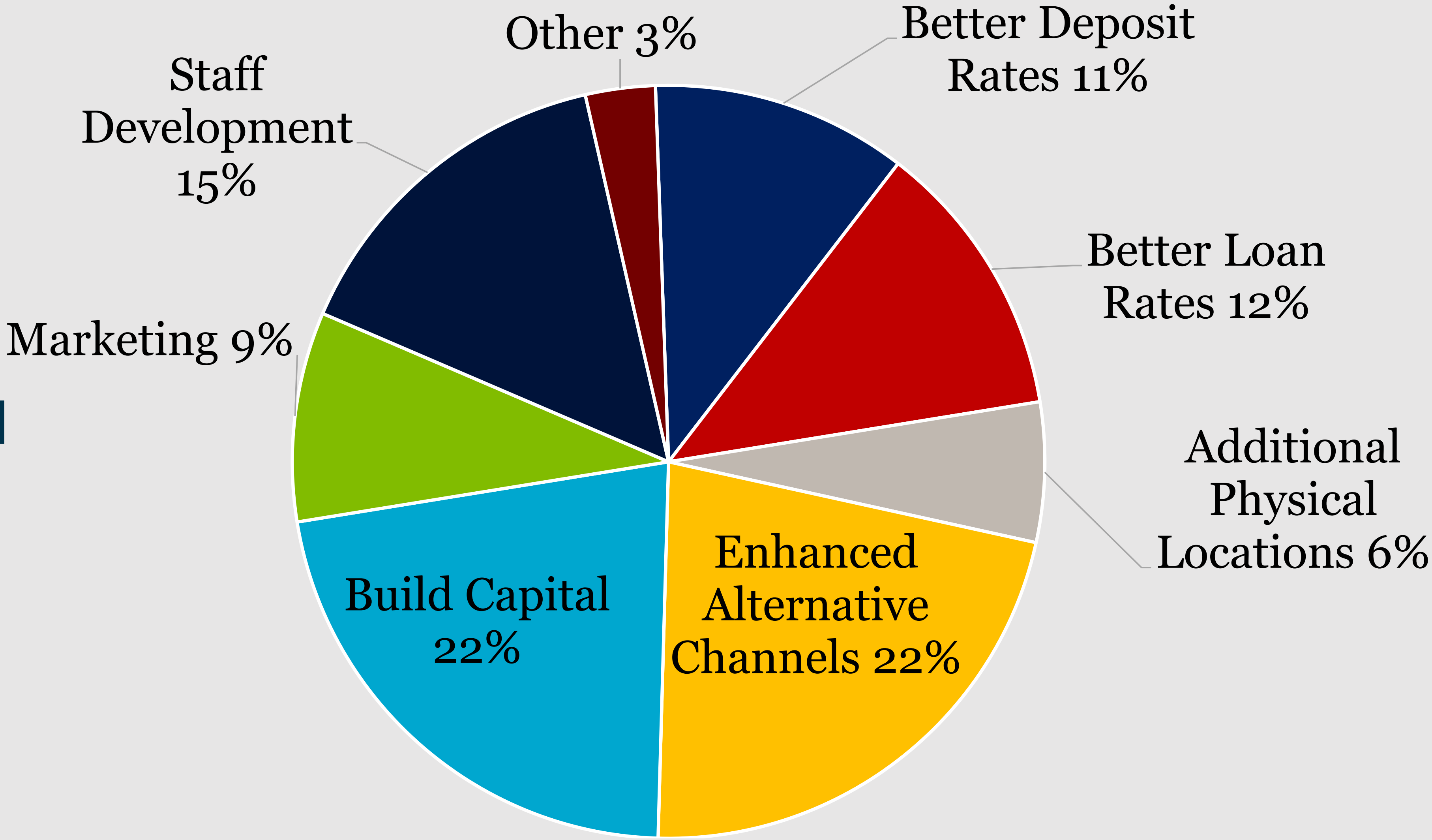
How Would Credit Unions Reinvest?

Over 75% of resources dedicated to regulation would be used for member benefits and growth



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Impacts on Credit Unions by Size

CU Performance by size, 2010-2015

Changes in totals based on 2010 asset size

2010 Assets	# CUs	Members	Assets	Total Loans	1st Mtges
LT $25 Mil	-26%	-17%	5%	6%	27%
$25 to $100	-11%	-7%	10%	9%	13%
$100 to $500	-5%	8%	25%	31%	35%
$500 to $1 Bil	-1%	19%	33%	45%	42%
GT $1 Bil	-2%	28%	41%	48%	53%
Total	-18%	13%	32%	39%	44%

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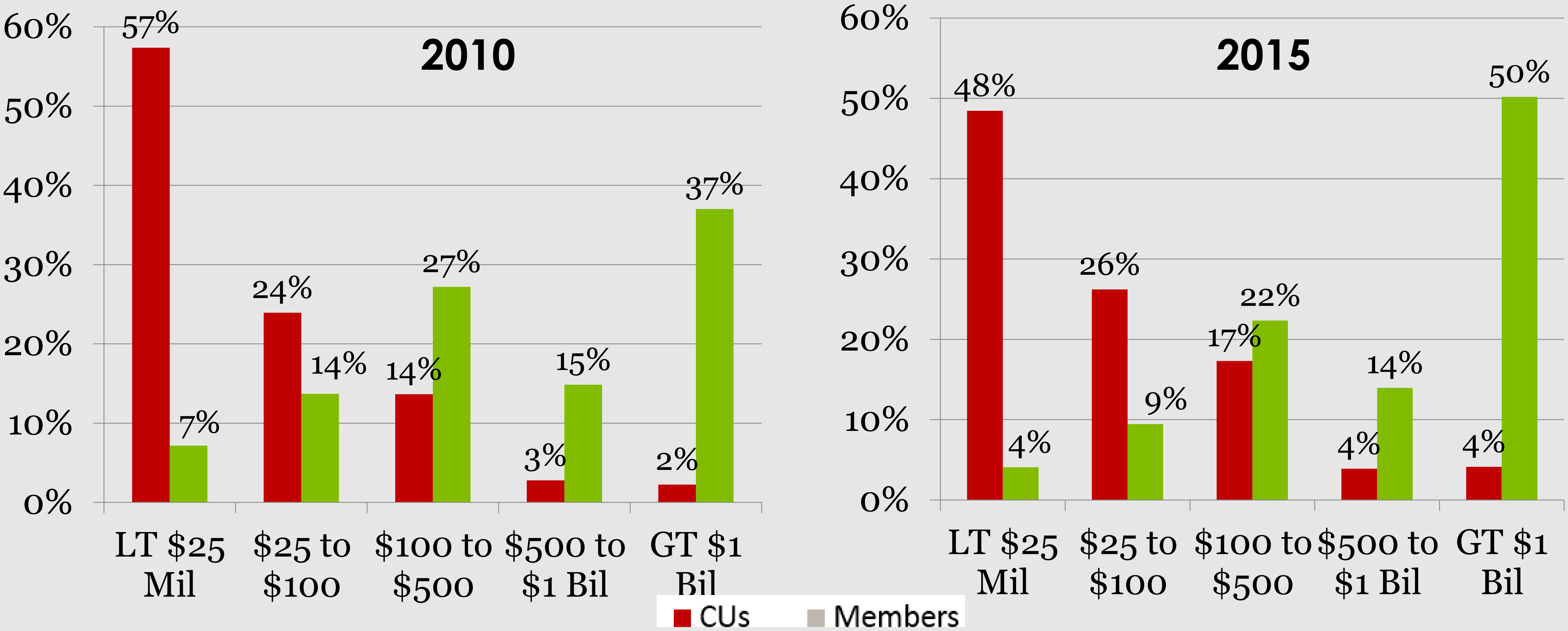
Distribution of CUs and Members



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Comments and Questions

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