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Regs, Regs, and More Regs

Are You Up to the Task Ahead?

By Dennis Child

One might be lulled into thinking that after the last five years, regulators might take a brief hiatus from cranking out a proliferation of regulations. But, alas, regulatory agencies have made it clear – they are just warming up. Now is the time for financial institution managers to prepare for what lies ahead by lining up training and management tools necessary to not only comply with new regulations but thrive in what promises to be a challenging environment.

This article takes a brief look at just <u>some</u> regulations affecting credit unions that are about to be implemented as well as <u>some</u> regulations being proposed, and <u>some</u> regulations under consideration. With each we'll recommend training and management tools executives will probably want to consider to assure sure they are in a position to make the best of regulatory changes.

For the most part, this article will focus on regulatory issues pertinent to the National Credit Union Administration (NCUA) and the Consumer Finance Protection Board (CFPB).

Risk Based Capital (NCUA):

RBC is going to affect some credit unions adversely. Managers will see at least a temporary hit to their profitability and growth as they bring their institution into compliance with RBC. Restoring profitability and growth will require improvements in efficiency, marketing, and product pricing.

We recommend managers prepare by investing in stochastically-derived management tools including: Credit Migration; Risk Based Loan Pricing; Deposit Pricing; Asset/Liability Management; and Member Relationship Based Product Pricing. Also, if management hasn't already, they should seek effective Strategic Planning training.

Member Business Loans (NCUA):

NCUA is considering loosening their rules on MBLs to help interested credit unions move toward originating more small-business loans. Also under consideration is easing waiver restrictions leading to credit unions being granted by NCUA, on a case by case basis, approval to hold a higher percentage of MBLs in their total loan portfolios than previously allowed. Member Business Loans hold great opportunities. They also come with much greater risks. For the unwary and unprepared – MBLs can sink a credit union.

For those considering MBLs or already into MBLs, we recommend executives have stochastically-derived management tools in place, including: Credit Migration; Delinquent-Loan Tracking; Asset/Liability Management; and Risk Based Loan Pricing. Also, management should pursue training or consulting services relating to partnering with the Small Business Administration. Managers also should be skilled or seek consultant services in creating MBL profitability projections and timelines. Strategic Planning skills are also a must.

Mortgage Originations and Servicing (CFPB):

The CFPB has implemented a number of rules and regulations relating to home mortgages. These include servicing-rule changes affecting notices of foreclosure. These new rules could impact those holding mortgage loans such that they could experience more foreclosures. CFPB is putting their finishing touches on "loan streamlining". These regulatory changes as well as meeting "qualified mortgage" restrictions have led or could lead to fewer loan originations and/or reduced origination fees. Many financial institutions are experiencing reduced revenues as a result of fewer mortgage loan originations.

For those credit unions looking to pursue mortgage loan originations or are already offering mortgage loans, we recommend the following management tools (especially if they are holding mortgage loans in their portfolios): Credit Migration; Delinquent Loan Tracking; Risk Based Loan Pricing; and Asset/Liability Management. Investing in mortgage loan training is also highly recommended.

Auto Loans (CFPB):

Consider these statistics: (1) auto loan originations are at their highest in a decade; (2) a third of auto loan originations have been in less-than-prime; and (3) 2015 is projected to be an even bigger year for auto loan originations than the previous three years. Not surprisingly, auto loan delinquencies are also on the rise. The hot auto loan market has not escaped the attention of the CFPB. The CFPB is considering regulations that will affect loan disclosures, borrower profile-pricing, indirect lending and debt collection.

Since auto loans are the life blood of credit unions, any changes in auto loan regulations could have lasting impacts on profitability. We recommend credit unions have in place stochastically-derived management tools including: Credit Migration; Risk Based Loan Pricing; Delinquency Tracking; and Asset/Liability Management. Managers should be proficient in auto loan regulations and debt collection regulations. They should be skilled at, or have access to consulting services specializing in, Strategic Planning.

Overdraft Fees and Overdraft Services/Loans (CFPB):

The CFPB is working toward tightening regulations relating to overdraft fees and overdraft protection services particularly overdraft "opt in/out" options. Credit unions have come to rely on fee income to assure profitability. In some cases, fee income subsidizes losses in lending programs. Changes in overdraft fee and service fee structures could seriously impact earnings.

We suggest credit unions change strategies and switch back to loan interest income as a primary source of profitability. Relying more on loan interest income will require stochastically-derived management tools including: Credit Migration; Risk Based Loan Pricing; Delinquency Tracking; Member Relationship Pricing and Asset/Liability Management. We also suggest managers become skilled at Strategic Planning as changes in fee structure pricing might well mean a dramatic shift in business models. The ability to plan and carry out those plans could have a significant impact on credit union survival.

Definition of "Small Credit Union" (NCUA):

As of this writing, NCUA has disclosed they are considering changing the definition of what they will consider as a "small credit union". These changes are in the exploratory stages but they could result in the exemption of more credit unions relating to Risk Based Capital requirements, Interest Rate Risk policy requirements and Liquidity policy requirements. These exemptions could provide significant relief for small credit unions and reduce expenses relating to compliance.

Exemption from some regulatory burdens, however, does not mean small credit unions are exempt from competitive pressures or increasing member expectations. We suggest it is especially important that small credit unions give consideration to improving their service levels and profitability by utilizing management tools including: Credit Migration; Risk Based Loan Pricing; Asset/Liability Management and Delinquency Tracking. Also, even small credit union managers need to become proficient at Strategic Planning.

The credit union industry is rapidly evolving as a result of market shifts and regulatory changes. It would be nice if we could pause a second to catch our breath. Unfortunately, regulators assure there will be no rest for the weary. But looking at the bright side: where there are great challenges, there are great opportunities for the creative and industrious.

About the author:

Dennis Child is a 40 year credit union veteran CEO (recently retired). He is a Certified Financial Planner and holds a MS in Finance. He writes for a number of industry publications. He is a strategic partner with VirtualCorps and TCT Risk Solutions, LLC. These two companies specialize in providing training, consulting and stochastically derived management tools to help credit union executives meet the challenges they face.