CU*ANSWERS
A Credit Union Service Organization

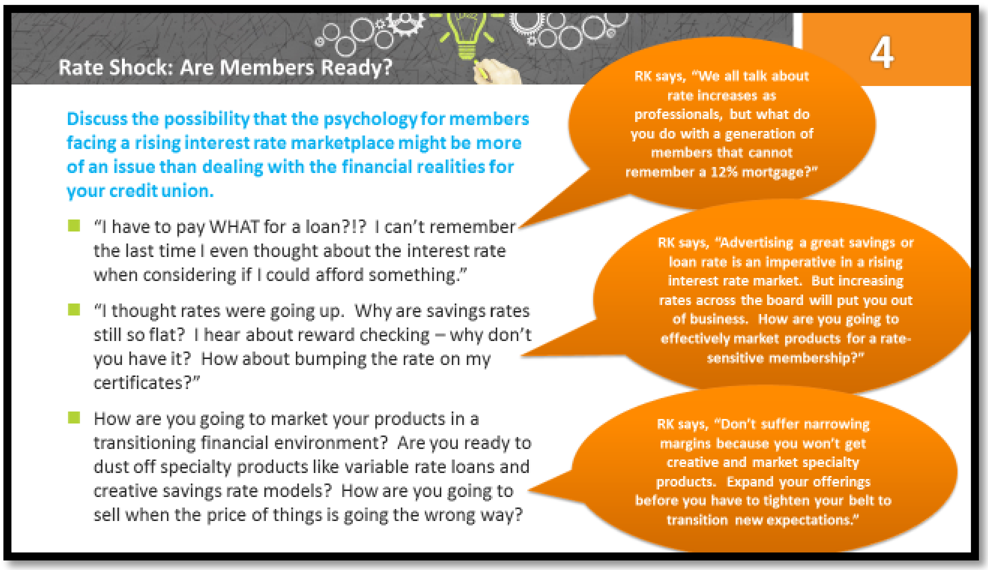
CEO Strategies Week 2015

Notes from the 2015 CEO Roundtable

At the WaterMark Country Club, November 12, 2015

Compiled From Notes Taken By the "Table Scribes"

Topic 4: Rate Shock: Are Members Ready?



Participants

Grp	Scribe	CEO Participants	Grp	Scribe	CEO Participants
1	Keegan Daniel	Peter Barnard, rkGoB1G Jim McCaw, Viriva CU Jim Dean, Oak Trust CU Ana Ordonez, Media City CU Barbara Harper, Cincinnati Ohio Police FCU	6	Marsha Sapino	Jeff Jorgensen, Sioux Empire CU April Tompkins, Services Center CU Chris Butler, Community Credit Union Don Mills, Alpena Alcona CU Jennifer Oliver, South Bay CU
2	Kristian Daniel	Kent Hartzler, Everence FCU Gene Benick, Newark Fireman's FCU Barbara Page, Kent County CU Vickie Schmitzer, Frankenmuth CU Scott McFarland, Honor CU	7	Esteban Camargo	Debie Keesee, Spokane Media FCU Janelle Franke, River Valley CU Barbara Mill, Calcite CU David Wright, Services Center FCU
3	Julie Gessner	Cathy Ellis, Meijer CU Michael Meier, SPE FCU Philip Heinlen, Northwest Consumers CU Linda Bodie, Element FCU Michael Shafer, Pathways CU	8	Karen Sorenson	Joan Moran, Department of Labor FCU Randy Gailey, Horizon Utah Kim Kniola, First Trust CU Vince Cerasuolo, Century Heritage FCU Kevin Ralofsky, Verve, a Credit Union JoAnn Sanders, Cheney FCU
4	Annalyn Hawkes	Jim Miles, MidUSA CU Dave Eyke, Safe Harbor CU Ernie Jackson, CommStar CU Janet Borer, Member1st CU Chuck Papenfus, Inland Valley FCU Greg Smith, CU*NorthWest	9	Liz Winninger	Scott Collins, Xtend Christy Leslie, Bridge CU Bryan Myers, Vacationland FCU Mark Richter, First United CU Rob Viland Fran Godfrey, United Educational

Grp	Scribe	CEO Participants	Grp	Scribe	CEO Participants
5	Peter Myers	Walt Swanson, Superior Choice Thomas Flowers, Calhoun Liberty Employees Grant Johnson, Toro Employees Carma Peters, Michigan Legacy William Burke, Day Air Tracy Miller, Kellogg Community	10	Barb Cooper	John Yeomans, Preferred CU Kris Lewis, Allegan Community Brian Vittek, Destinations CU Tom Gryp, Notre Dame FCU Steven Nazurak, Ocala Community Bret Weekes, e-Doc
			12	Janelle Krupa	Terri Maloney, Catholic United Financial CU Kim Wine, Michigan Coastal CU Laura Schell, Valley Educators CU Scott Harriman, Cumberland County Kim Hall, Tri-Cities CU Dean Wilson, FOCUS

Group Notes

The following notes are included exactly as taken by table scribes. Scribes were instructed to jot down everything that was discussed at the table, with the idea that reading the notes would be a little bit like eavesdropping on the conversations.

Discuss the possibility that the psychology for members facing a rising interest rate marketplace might be more of an issue than dealing with the financial realities for your credit union.

"I have to pay WHAT for a loan?!? I can't remember the last time I even thought about the interest rate when considering if I could afford something."

TABLE 1

- Do you have any variable rate loan products?
  - Mostly HELOC and Credit Card
- We are staying small at 96 months or less for our loan products
- We are working with members on refinance opportunities when we get a chance to talk with them
- Will the NCUA look at the lower interest rate products (mortgages) after a few cycles of rate increases?
- We have been having great success with ARM products and allowing members to pay off their homes sooner

TABLE 2

There will be a psychological thing when they read newspapers, ran a CD special and 2 members took this, and was underwhelmed by what happened. We will have multiple products with description, anyone who goes into a new rate is a different product. We offer the ability to open these online, the members have to take the lead on it and be proactive. It is going to be a slow boil, will get a lot of press and it will stop at that. They have been threatening to do it, why not just do it?

TABLE 3

Top of mind thoughts:

- Members want to know what the payment is going to be not the interest
- Members with better credit score are used to getting lower rates
- Noticed a significant change in market when rates increase - combat that by offering ARM
- People who are shopping understand the market and what is going on
- Rates can mean being a sympathetic ear
- Offer alternatives
- Seek alternatives
- Not putting ourselves in a position to have to borrow
- Offer special product attractive to members who rate shop & Creates curiosity

TABLE 4

Chuck – Here's the thing – **A certain percentage of members/money is insensitive to rates**. You could be paying 0% in a 5% market & they won't care. **Then there are the totally rate-sensitive people and in reality those are the people we might not want. Until the consumer mindset changes from a saving non-spending economy we will not have to worry about this as much as people might think**. Right now, we beg people to get a loan. The US has the highest borrowing capacity since the 70's right now but people are saving and not borrowing. An increasing rate environment, serves to slow the consumer down even more.

Janet – **I think that if wages also increase, demand for loans will be driven in spite of rates going up**. Outside political discussion of minimum wage and wages in general we see that even municipalities are starting to adopt minimum wages higher than national minimum. **So, paying 5% for a car loan just may be secondary for members compared to having more money in their pocket in the first place**.

Chuck – **Minimum wage increases actually serve to lower overall income and raise poverty limit. The reason why is that it means businesses have an incentive to figure out how to not have employees. Wage pressure can fuel inflation. However, inflation can't happen until there's demand. So if there's no demand and you raise prices, it's not going to work.**

Chuck – As to how to deal with hesitant members – CUs all price based on risk. So, **what we'll see is the borrowers who are more rate-sensitive aren't going to see the same increases as those who are insensitive to rates. I also think we'll see more variable rate products**. We only offer variable rate real estate loans.

Dave – **I say that we don't let the individual consumer take a gamble** (with their smaller balance sheets). **Keep the gamble on the credit union** (with our higher balance sheets). We saw it happen in 2008. Members need equity in their home and no variable loan. Equity will be wiped out so quickly in cases like 2008. **The way to avoid a 2008, no variable loans and a down payment. If member has their own skin in the game, they will work a lot harder to pay their loan and not default.**

Chuck – Skin in the game is HUGE.

Dave – And when you combine the credit union difference with skin in the game you get a beneficial lending relationship.

Janet – Do you care if those people who are rate-sensitive go elsewhere?

Chuck – No. Most people who are rate-sensitive are not the target of my credit union. These are low income people we're trying to get off the PayDay loans. Members will ask if we can match other rates. We say no. **You can't look to the market to set your policy. You have to run your institution based on your own internal details.**

Chuck - **I think the bigger challenge with these questions is not how are we going to sell to our employees, but how are we going to sell our boards?** Boards have the power to change rates and we have to comply with their decision.

Janet – But does that really happen?

Chuck – Yes, I had a board member come in and make a motion to raise rates to 2%. It did not pass, but it was a real consideration. So, I think this possibility is a bigger risk than anything. **Board members are out in the community hearing "so and so is giving 7% for 7 months" and they come back and say "why don't we do that".**

Janet – It is, and **we should be trying to educate our board more than we do. Board members do really have good judgement, but often they don't have very much information.**

Chuck – When you're in that ALM – you understand your credit union finances better than anyone.

Dave – **We have ALM meetings quarterly but there's nothing that mandates that timing.**

Chuck – Right, technically you can do it 1x per year if you want.

Dave – **The key thing is, where are you vs. peer.** Look at your profile of assets to liabilities for credit unions in similar size. The regulators do pay attention to it.

Chuck – I don't even care about peer at all. I look at the inside. On the flip side, I do look at the market to see what my members are exposed to.

Janet – **The peer group is just for comparison, every CU is different.**

Chuck – I would argue that if you're right at peer, you're a mediocre credit union. You're right at average**. I use this as a staff motivator. We say "This credit union is doing better than us. Are they really better than us?" And staff says "No! Of course not!" and it motivates them to step up even further.**

Janet – I don't think you can draw that conclusion (that right at peer is a mediocre CU).

Dave – What if actually all your peers are super high-performing? You could be at peer and still doing really well if all your peers are high-performing along with you.

Chuck – Then I would argue that it's no longer defined as "high-performing" If every basketball player shoots 100% then that's expected. It becomes the new normal. **The other interesting thing about peer is you can use it with your board. Tell them you're 10% above peer and ask for a raise.**

Janet – I'm interested in the 2nd question about rewards products, etc. Is anyone doing anything with those?

Chuck – We're getting a reward checking. We're doing more and more with tiered member services. We'll pay a patronage dividend. But we're happy we can say that we've paid $25,000 out to members. (Dave – If you write a press release). **Yes, Credit unions do not toot their own horn enough.**

Dave – To your (Chuck) point - my CU has always paid a dividend, but still I can't find anywhere in the news where that's documented. You give papers something for a news story and they will print it. **One thing I did is go into the juvenile detention facility and talked about financial literacy. It's talking to them as if they have a future and it totally changed their demeanor.**

Janet – I do think **sometimes we try to cast our net too far. If we just try to keep our community within our community we have much better luck.**

Chuck – On why are savings rates so flat – **benchmark CD rates by looking at what we earn and match it to members so the member takes a little haircut.** Whatever we're earning is whatever we're paying minus a small amount. It's only just to get the members into them. For the last 9 years members get CDs in the hope that rates will go up so they keep rolling over CDs but the rates never go up.

TABLE 5

- Members are going to have true shock when it happens
- Some are not going to bet on rate hikes actually happening
- Do young people understand? Do they even care?
- Should we advertise rates?
    - or could we just advertise payments?

- New checking accounts will get 2% on up to $20k
  - Using Canasa with tremendous analytics
    - Not sure about CU*BASE options being good enough

TABLE 6

- Jeff – modeling interest rates in ALM. Have you talked to your board about not raising rates.
- Don – we are going to build slowly and think that the # of members that will complain will be loan.
- Jen – use the mentality that if you want rates, play the stock market.
- Jeff- we have variable rate CD. Also, look at the early redemption clauses too.
- Chris- we have reward checking.
- Jeff – we will not raise rates
- Chris – how big of an impact will loan rates have on membership? Especially the younger generation.
- Jen- how will we compete with the non-interest generation?
- Chris - Fed is flirting with disaster when they say they will raise rates. Jeff-the market just drops every time they say it.
- Jen-will use the tier marketing tool in GOLD. Going to test different opportunities to see what works. Cyber Monday, Black Friday, etc.
- Jen – Variable savings…how can you make them exciting? Listened to a speaker once that categorized an IRA as a share product. This could be a marketplace to resurrect the IRAs.
- Jeff - Investment program? Jen – Looking into CFS.
- Jeff-Outsourcing IRAs and not charging annual fees. Jen – why outsourcing? Chris-We don't want the liability.
- Don – anyone have trust services? Jeff- actively managed trusts are good money makers.
- Chris – Anyone have CDs that you can add to? Don – you can add to ours. Jeff- now you are back to the redemption issues again when someone wants to cash out early, they pay the interest paid and it's nothing.

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Discussion

- Randy – online retailing and rate management. Character decisioning and deal decisioning. Model deal or model character.
- You could offer different loan products via the internet via across the counter

TABLE 7

Notes:

- With a lower loan-to-share ratio, we can't raise our dividends without first selling more loans.
- Rates will increase more incrementally because competition is much higher now since FIs have wider range.
- We can't afford to have more money walk in the door, we need more loans. Which means we have to keep loan rates down to be competitive.
- How do you sell the value of the credit union when rates aren't going in the direction members are hoping (i.e. loan rates up, savings rates stagnant)?
- Concentrating on loan segments to change the loan repayment is an important factor in managing this rate issue.
- With millennials able to access information easier and faster, competition with other FIs will increase dramatically.
- Never change the rate; add a new product--applies to certificates and savings accounts, not loans as much. Loans need to be relatable.
- Older members still have customer loyalty, but the younger generations don't have this same concept of customer loyalty; they're shoppers and will go out and find the best deal, be it loan or savings.
- Today's environment favors speed rather than loyalty. Fast and cheap is the way to capture members.
- ING and other internet banking organizations have an advantage since they can afford to keep their loan rates lower longer as the market shifts.

- Organizations that are better loaned out (100%+) will be better positioned to handle the changing rate environment.
- We've been in this rate environment so long, that we don't remember how to transition.

TABLE 8

No one talks about rates anymore, it's going to be tough. Jack Brick (ALM system) has advised credit unions not to raise rates right away. Cheney FCU recently started offering above rate certificates to help the certificate funds roll off more quickly. A few of the CUs are considering increasing penalties so that members won't close out certificates to get a higher rate. It's not just about retaining regular maturities, how many people are going to break their CDs?

Once rates start going up, don't think that the Feds can stop it (thinks it will happen quicker than people realize). The speed with which the rates go up will be a factor. Some of the competition has raised their rates really fast, but sometimes you just can't match competitor's rates.

The 15/15 mortgage is popular at Dept. of Labor. Also, used car loans as well as 1st mortgages do well. Auto loan rates were discussed. Indirect lending did not do Cheney much good.

Other things may need to be done to not fund loans solely from member deposits.

TABLE 9

- Concentration on the monthly payment and the B and lower grade paper. What's the payment?
- Watching where the money is moving, cd's have dropped slightly. We are creating rewards account to tier members out.
- Members are liquidity sensitive.
- Members using the money markets will be our early movers.

TABLE 10

John – education to employees and members about rate changes, especially when they rise. Shift to CD's from rate sensitive shares. Start now before the rates hit the marketplace.

Kris - Create products that are sticky – Reward checking, loan or CD rate benefits,
Use a 'match the rate' program for both CD and Loans. Allegan currently doesn't offer certificates and is considering to do so. Wants to move funds from his money market account to a less rate sensitive product.

TABLE 12

- Everyone is going to have an opinion. Trying to allow your lending rates to yield before you start moving deposit rates.
- Not something you can ease into. Need to be aware. How do you manage expectations in membership.
- A lot of people are going to stop lending because it's going to be a huge shock to them, they've been doing 2% for so long. It was a long time ago. Almost 40 years since it's been that high.
- Hoping people don't react too much because they are locked in and have heard a lot on the topic but don't see much of a change.
- Who's going to leave a 3% mortgage? Equity loans will be back in business but no one is going to refinance.

"I thought rates were going up. Why are savings rates still so flat? I hear about reward checking – why don't you have it? How about bumping the rate on my certificates?"

TABLE 2

Withdrawal penalties are a large factor, which credit unions became stricter on. Most members who were concerned about this, have pulled their money out, and the younger generations are more lending side than savings. It is cheaper to borrow as a member, and then deposit. How rates come up will be different, they are going to bucket low rate funds, and make people make a decision to move up, is this the best for the member? They have the ability to ask for the best rate. Reward checking to too expensive, and we don't understand it, possibly not the primary financial institution? We offered the bump CD rate, and members never took advantage of the bump CD rate.

TABLE 3

1. We all have reward checking
2. Saving rates are flat because we follow the market
3. Bump Rate - Great tool to give people an option so they are not walking away

TABLE 5

- "For this exercise, let's assume rates are going to rise"

TABLE 8

The CUs will make a move on rates, but with a cautious approach. Certificate rates will be raised first, then checking and money market. Cheney recently offered a promotional higher rate 36 month product. The member can bump the rate one time in a 36 month period.

An incentive another credit union offers is paying a percentage of the loan if the member is pre-qualified.

Members with most of their money in regular shares aren't really the rate jumping kind of people.

Luring members from regular checking to rewards checking was discussed. Some CUs did not realize that members can be qualified for rewards checking via online banking.

TABLE 9

- Rewards checking can get members in the door, but it feels wrong at times when you are setting the parameters around those clubs too high, it feels like a bait and switch sometimes.
- Are we being more sensitive than our members?
- The concern for many is in the next generation of borrowers, making minimum wage, unable to afford the next stage of life.

TABLE 10

Steve, Ocala - Marketing to large depositors to get information why the $ is 'stagnant' and how they could make it work from them by shifting to other products.

John, Preferred - Offer lease like alternatives, lower the repayment factor on LOC loans. Loan more on C/D & E paper. Use Risk based pricing.

TABLE 12

- Can't anticipate a change, may believe it's going to come but not a fact.
- In an area where people don't really care about rate which is good.
- Do home prices go down because rates go up to get an affordable payment? People will not be able to afford it.

How are you going to market your products in a transitioning financial environment? Are you ready to dust off specialty products like variable rate loans and creative savings rate models? How are you going to sell when the price of things is going the wrong way?

TABLE 2

Going to rename products, offer specials, example creating multiple products, possibly 6 money market products. We don't want to chase the runners, but we want them to run a mile for us. Sending communication to members, and we don't want funds to sit. Credit union is about supply and demand, we have what we have, and it is available if demanded by the consumer. Possibly 30% pay attention and will notice, and 70% stay put and do not notice. Move to our credit union and we will match for members that are not the primary financial institution. We have to spend money to make money, with rewards checking through third party options.

TABLE 3

1. Not worries about rate to market because we can't compete with other market offers. (Rewards) We can be if we understand our members activity -think of behavior when designing all of our products

2. Offering products we can control - Skip a Pay (does not work for payroll deducted loans unless we do this manually)

3. When the price of things goes the wrong way - everyone will be slow to bring the rates up. This will be a long process and will not happen in a year. Perception - we need to condition the member to react to market conditions.

TABLE 5

- Variable and Adjustable rates are attractive and successful
- Step-up CD Rates eventually may pay out

OTHER DISCUSSIONS

- How about an app that lets you pay to bump your rate either up or down
- How about an app for members that want to set up Peer to Peer payments
  - weddings
  - graduations
  - etc.

- Would CU*Answers provide some due diligence documents for the Payveris transition?
  - Carma Peters is interested

TABLE 8

The CUs are comfortable with variable rate loan products, but not variable rate savings products. They will move with a cautious approach. They discussed the need to have a "canned" response to members when rates start changing (i.e. rate is X.XX% in order to maintain the equity position of the CU). We must consider what will happen to the stock market when rates go up.

TABLE 9

- If interest rates goes up there is going to be an issue with delinquencies, tied to the prime rates.
- The risk is the members being able to pay back their bills.
- Watching people with HELOC's to make sure when the variable rates start to move they are aware that there are other options.
- Watch your balance sheets.

TABLE 10

PRESENTATION

Table 9 – Mark (First United) See A+ paper as "blood sucking members" as they use their score to rate shop. Not much loyalty. Leave the share rates low and raise MMA's. Variable rate loan products can be put to use. Interest Only and HELOCs at other FI's. Do some data mining. Make sure the Balance Sheet is ready and liquidity is ready.

Randy – did you talk about the psychology? Examiner reaction to rising rates and Interest Rate Risk?

Table 4 – Chuck, Inland Valley - Psychology of the Board – how does management set the correct view rather than matching the competition. Still have members with mortgages at 9% that don't care and have kept that rate. When the loan/share ratio is 50 – 60% we don't need to change the rate sensitive money. Should credit unions make the member take the risk by taking a variable rate loan?

Table 10 – Kris Lewis – Allegan Community – Look at extending loan terms to offset higher rates. Offer sticky products to earn more dividends. Increasing CD penalties to keep the funds.

OTHER COMMENTS:

Randy – How many CU's here think rates will still be flat in 2016? Most of the room raised their hands.

Randy – character and score – match the deal to this borrower. Indirect lending – do you want that piece of paper? It is possible to offer different rates to delivery channel – over the counter vs. online banking vs. dealership loans. CEO vs Lending Teams have different approaches when it comes to lend on character or on the deal.

CU*A will have up to three auto-decision models: We will have one where we make money on . . . (Randy did not elaborate about the other two.)

Relationship pricing vs. the science of rates.

Randy then reviewed the 15.2 Release items to wrap up the session.

TABLE 12

- People move into leases when rates go up. Leasing is done by a 3rd party but that could play into the marketplace is rates do go up.
- Unfulfilling prophecy not in institutions best interest but kind of have to.
- Continues the delay of younger people buying homes.
- Change is over so long of a period, people will evolve
- Create pay interest only.
- We've had these rates before, don't think they are going to be a tough sell.
- People will have to adjust to economy as always. We've done it before in the past.
- Millennials are not educated in finances, used to have to take classes on looking at what it would cost in the end, but they care about monthly costs.
- Rates go up, lending demand go down a little bit. Money Market sitting in our shares. Competing again with money market mutual funds. Anticipating growth and assets to slow down and even stop for a year or two as rates go up.
- Do whatever it takes to get loans, shave off money to sell loans if they need to.
    - Will re-address revenue.

NOTES AFTER TABLE DISCUSSION:

Rates sensitivity factors. Opportunities in variable rate products, steal members from banks lock them into products to come over to the credit union. Raise CD rates as a whole or just raise it on specials. A lot of us pay above market rates anyways. Going to have to work with members and employees when they are coming in looking for those rates.

Members don’t look at rates. How much does the cu want to chase the rate market? How do we keep that member even if their money might go somewhere else?