

**CORNERSTONE**  
ADVISORS

# 2017 Regulatory Impact Study

---

PRESENTED BY: Vincent Hui, Senior Director  
Ryan Myers, Director  
Kaleb Seymour, Analyst

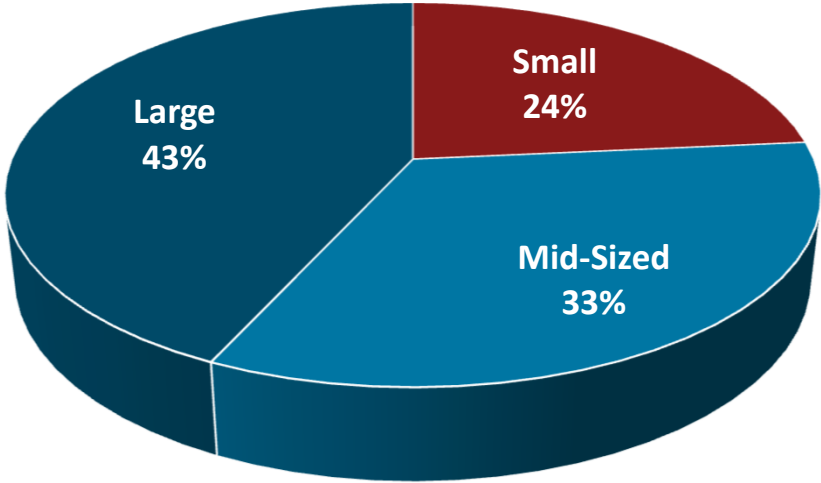


# Our 2017 Participant Profile

- 51 credit unions across 27\* states
- Volunteers were categorized into three asset ranges, consistent with our previous study

Response Distribution by Asset Size

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



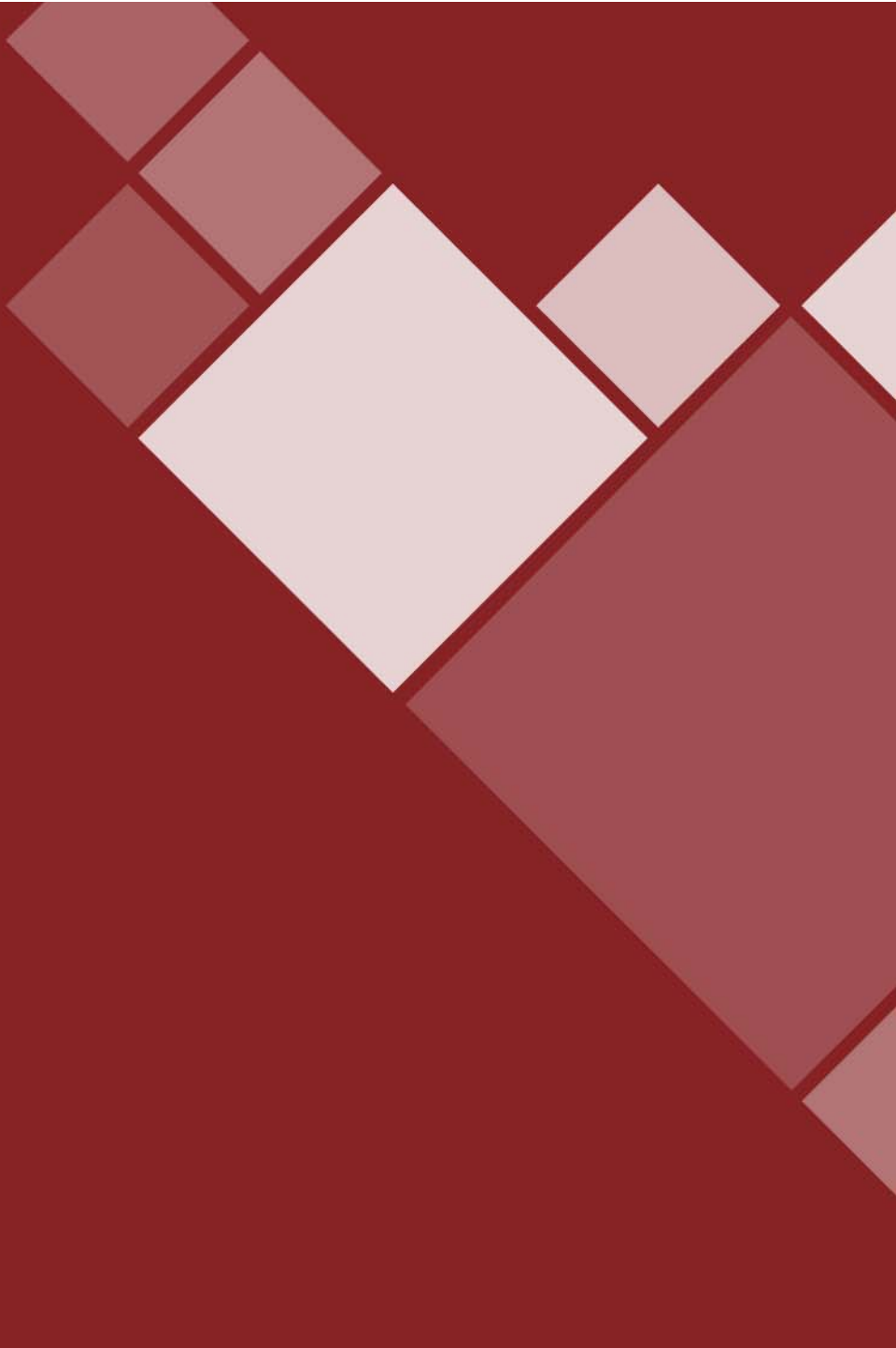
\*Does not include one credit union based out of Puerto Rico

# Type of Impacts Reviews

Impact Type	Description
<b>Cost</b>	Regulatory-related Staff and 3 <sup>rd</sup> party expenses incurred throughout the major functional areas of the credit unions.
<b>Specific Regulations</b>	Staff spent on major regulations and quantified into a dollar cost impact
<b>Strategic Impacts</b>	Impacts to the credit union through the viewpoint of the CEOs. Insight on how resources would have been allocated if not for regulatory cost.

Revenue impacts (including interchange) were excluded from the study. This decision was made to remain conservative in light of challenges with data collection, dollar estimates, and potential variation due to market conditions rather than regulations.

# Overall Impacts



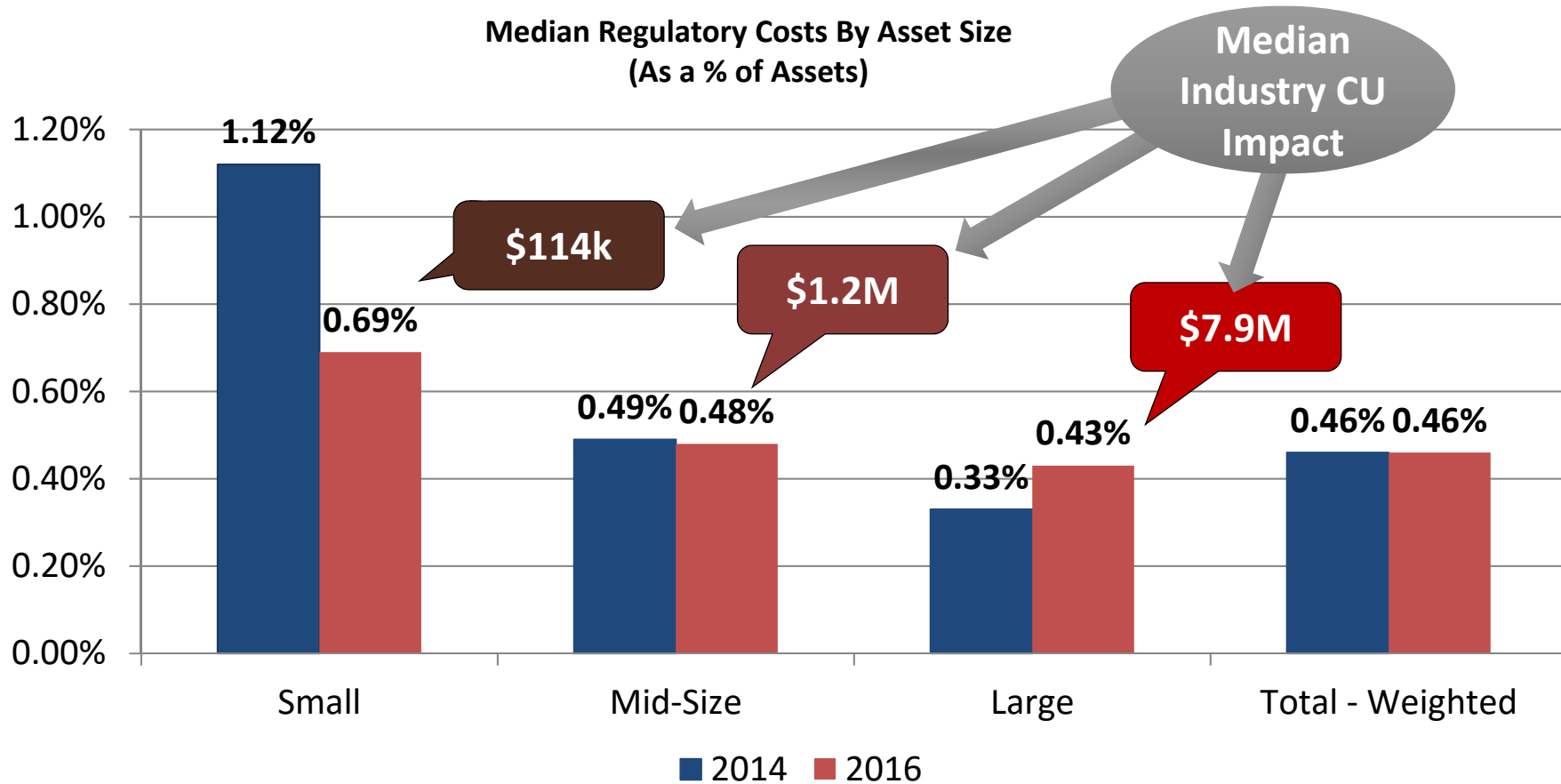
# Overall Regulatory Cost Impact – New Elevated “Normal”

	2014		2016		Change: 2014 to 2016	
	Unweighted	Weighted	Unweighted	Weighted	Unweighted	Weighted
<b>As a Percent of Credit Union Assets</b>	0.54%	0.46%	0.48%	0.46%	-0.08%	0.0%
<b>In Billions of Dollars</b>	\$6.1 billion	\$5.3 billion	\$6.3 billion	\$6.1 billion	+\$0.2 billion	+\$0.8 billion

- As context, the annual financial impact is:
  - 61% of 2016 industry earnings
  - 4.3% of 2016 industry new worth
- The cost impact is 15% of 2016 industry operating expenses

Weighted information reflects the extrapolation of the results based on the asset distribution of the industry vs the distribution of the respondents where the median asset size of respondents increased from \$293 million in the 2015 study to \$734 million in the current study.

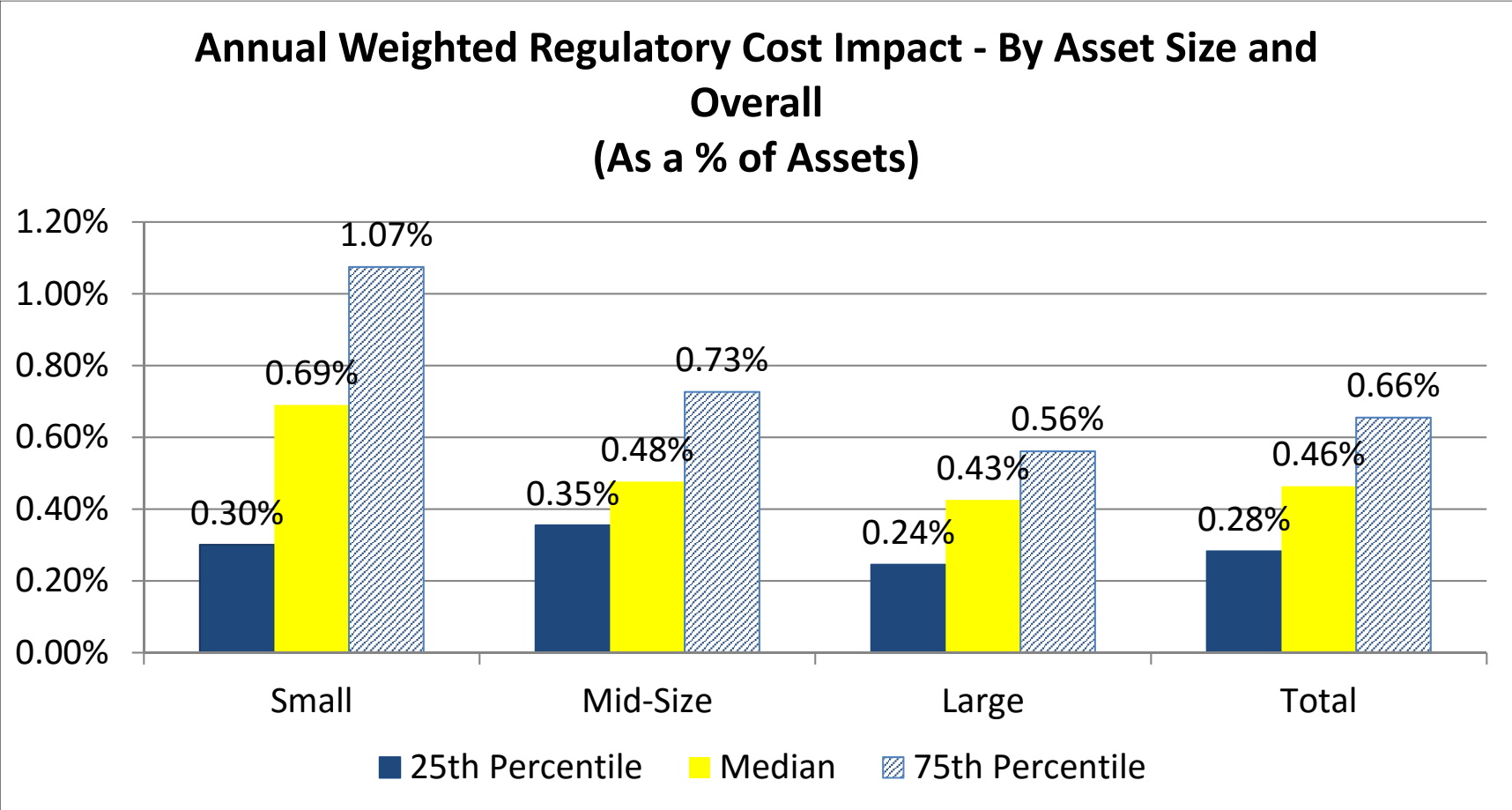
# Scale Still Matters



# Cost Impacts



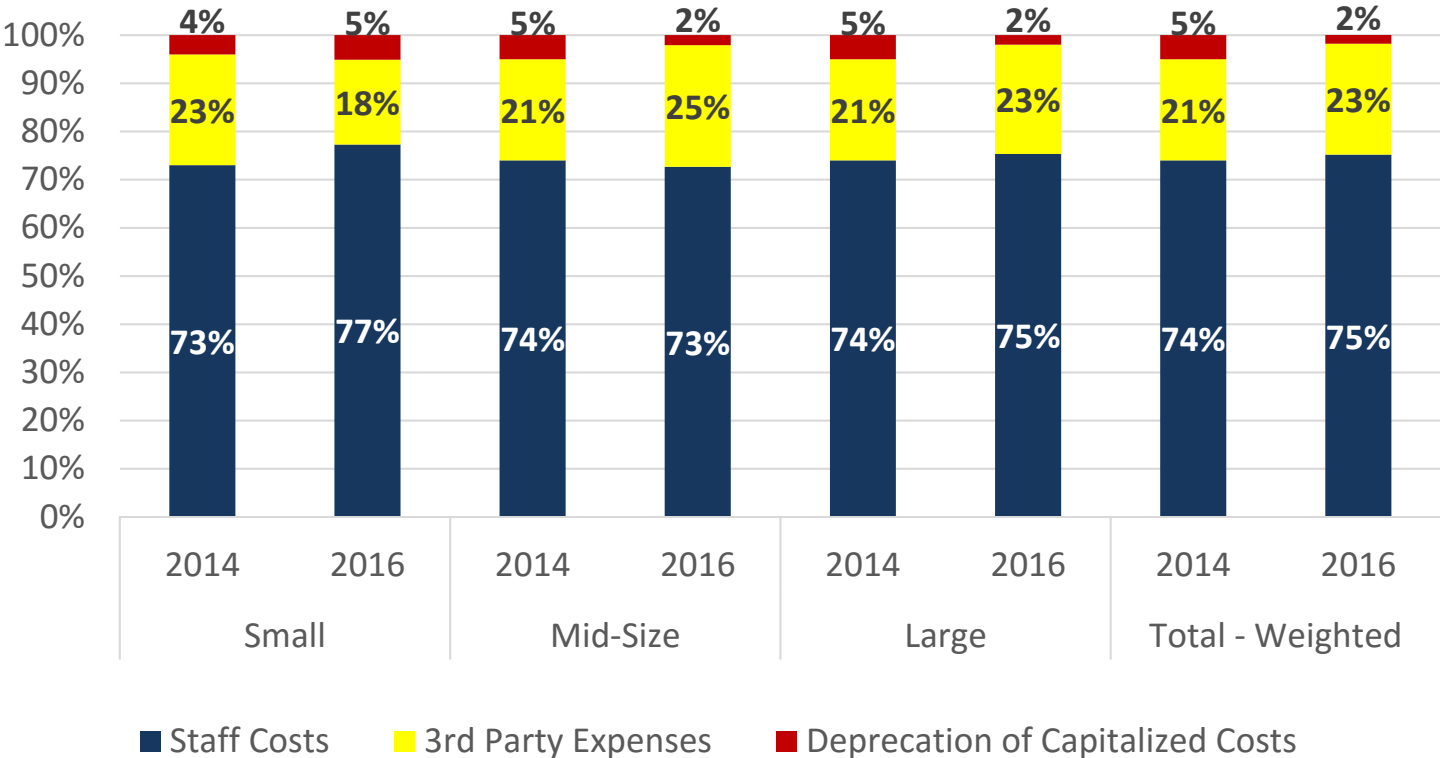
# Changes in Regulation Have Outsized Impacts for Smaller Credit Unions





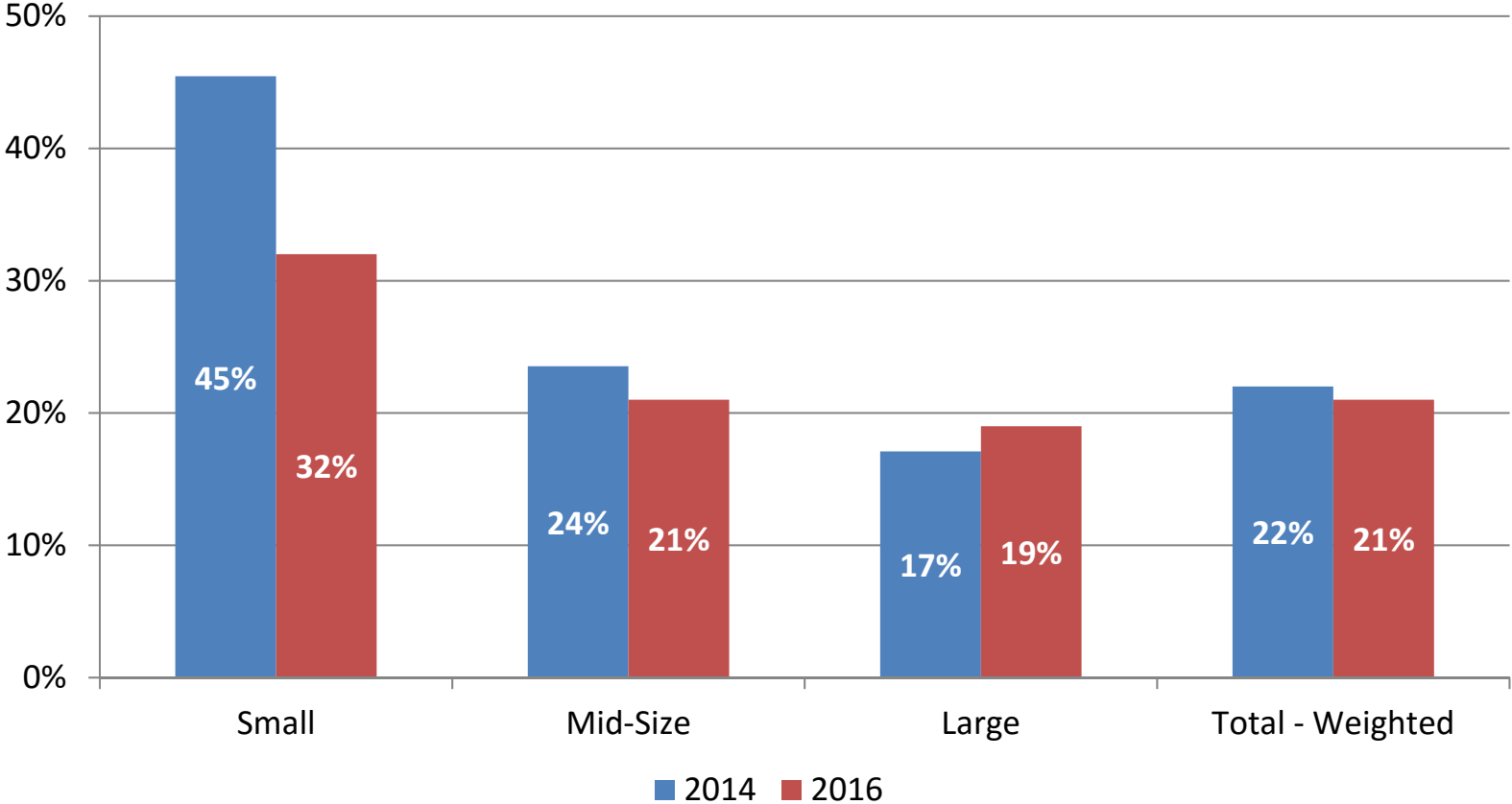
# While The Mix of Costs Are Similar Across Asset Groups, One-Time Investments Appear Complete

Regulatory Costs by Expense Type - By Asset Size and Overall



# The Investments Have Freed Up Some Time But the Level of Effort is Still Substantial

Proportion of Total Staff Devoted to Regulatory Activities



# Staff Impact In All Areas of the Credit Union



## **Risk**

Back office functions often 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, Online Banking



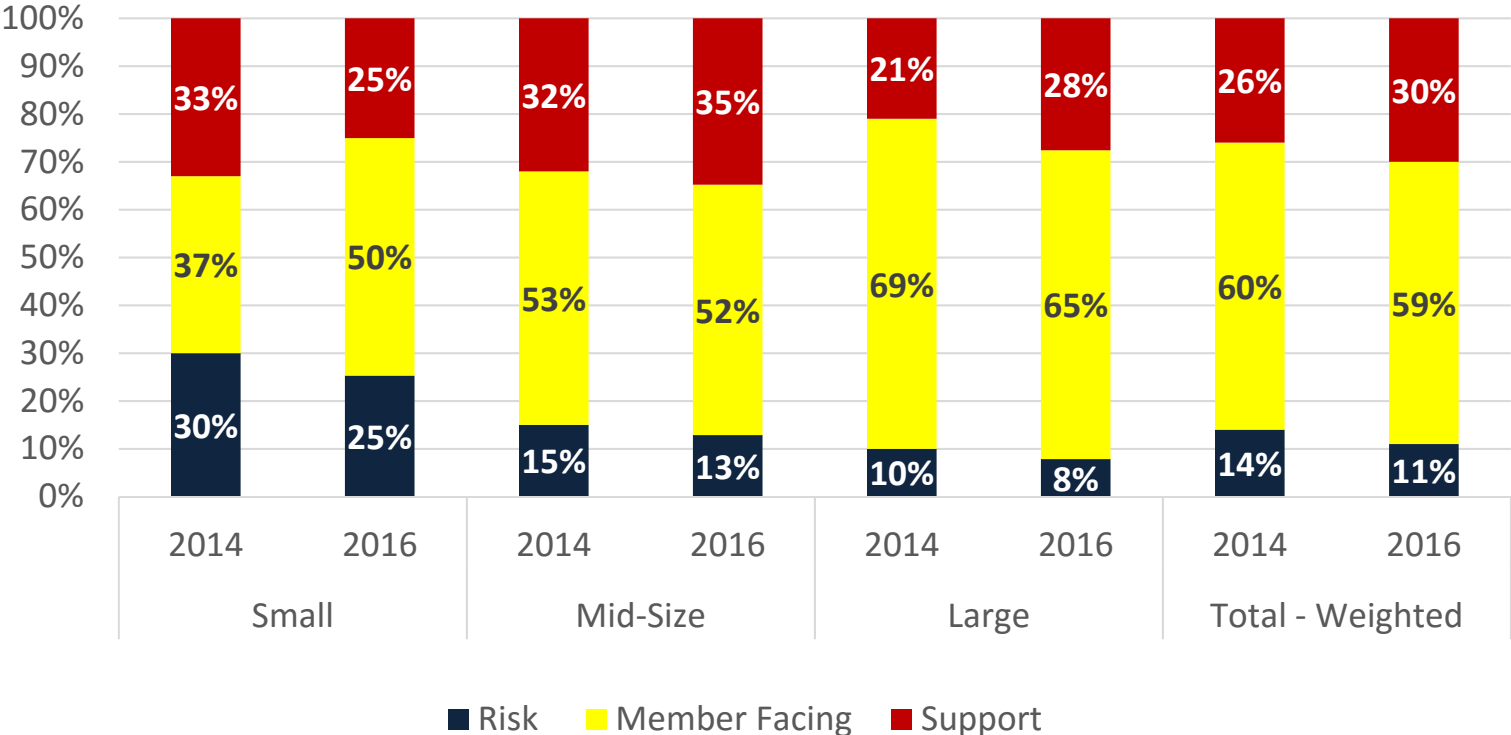
## **Support**

All other back office functions

E.g., Finance, IT, HR

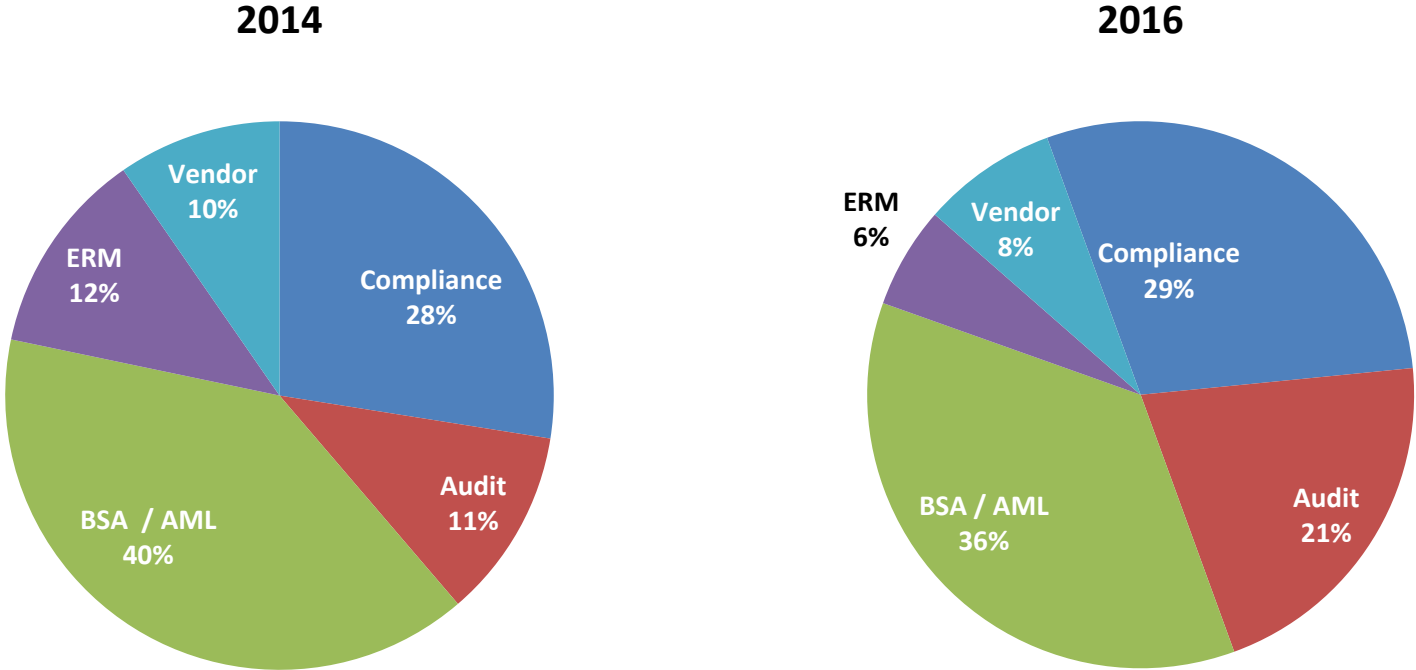
# Member-Facing Staff Continues to Bear the Brunt of the Regulatory Requirements

REGULATORY STAFF COST DISTRIBUTION BY STAFF TYPE - OVERALL AND BY ASSET SIZE



# Audit Had a Big Jump as Credit Unions Focus on the 3rd Line of Defense

Distribution of Regulatory Direct Staff Expense By Risk Management Function

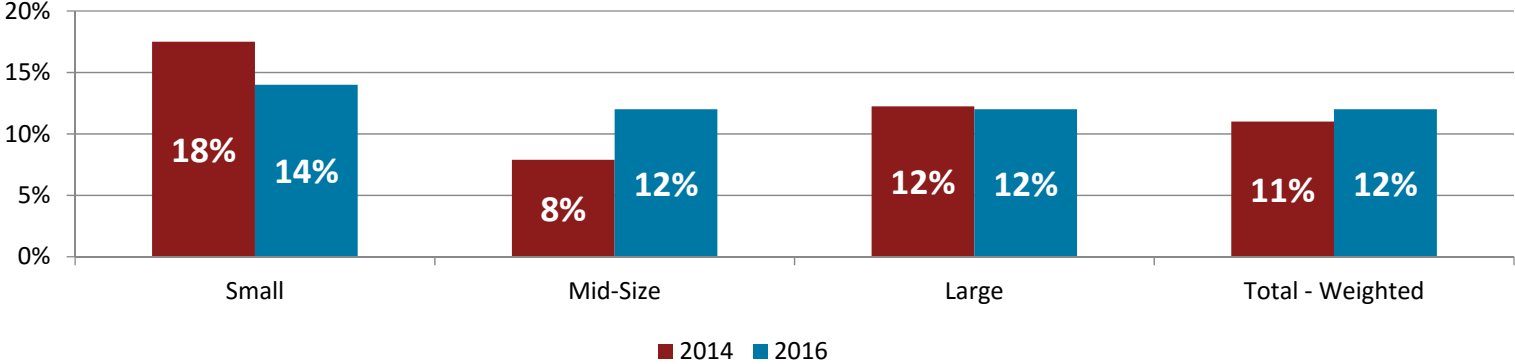


# Mix of Regulatory Member-Facing Staff Skews More Toward Lending

Member-Facing Regulatory Staff by Function



Member-Facing Regulatory Staff as a % of Credit Union Staff - By Asset Size and Overall

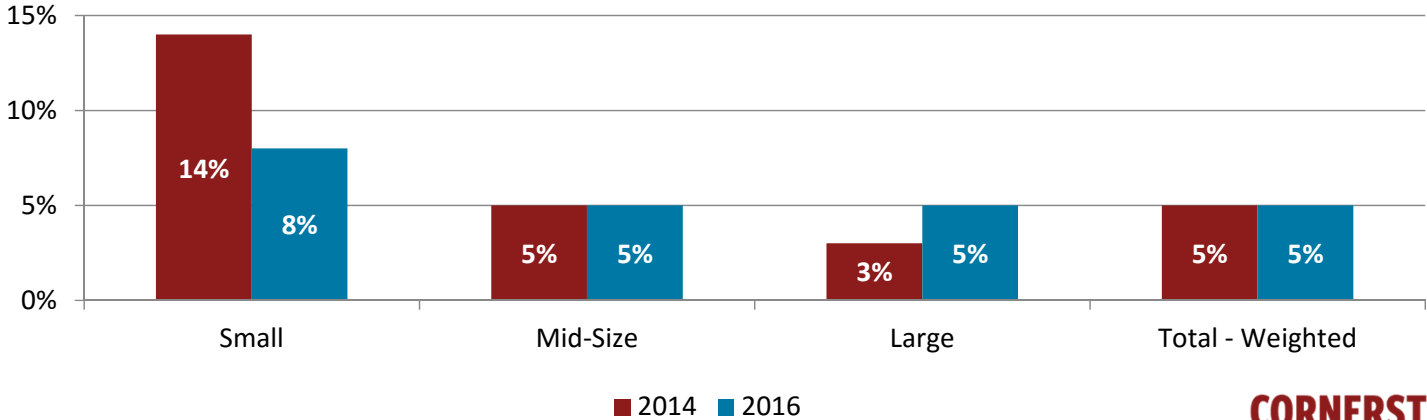


# Loan Operations Increase Align with Lending Increase, While Lower IT Reflects Past Investment

Support Regulatory Staff by Function

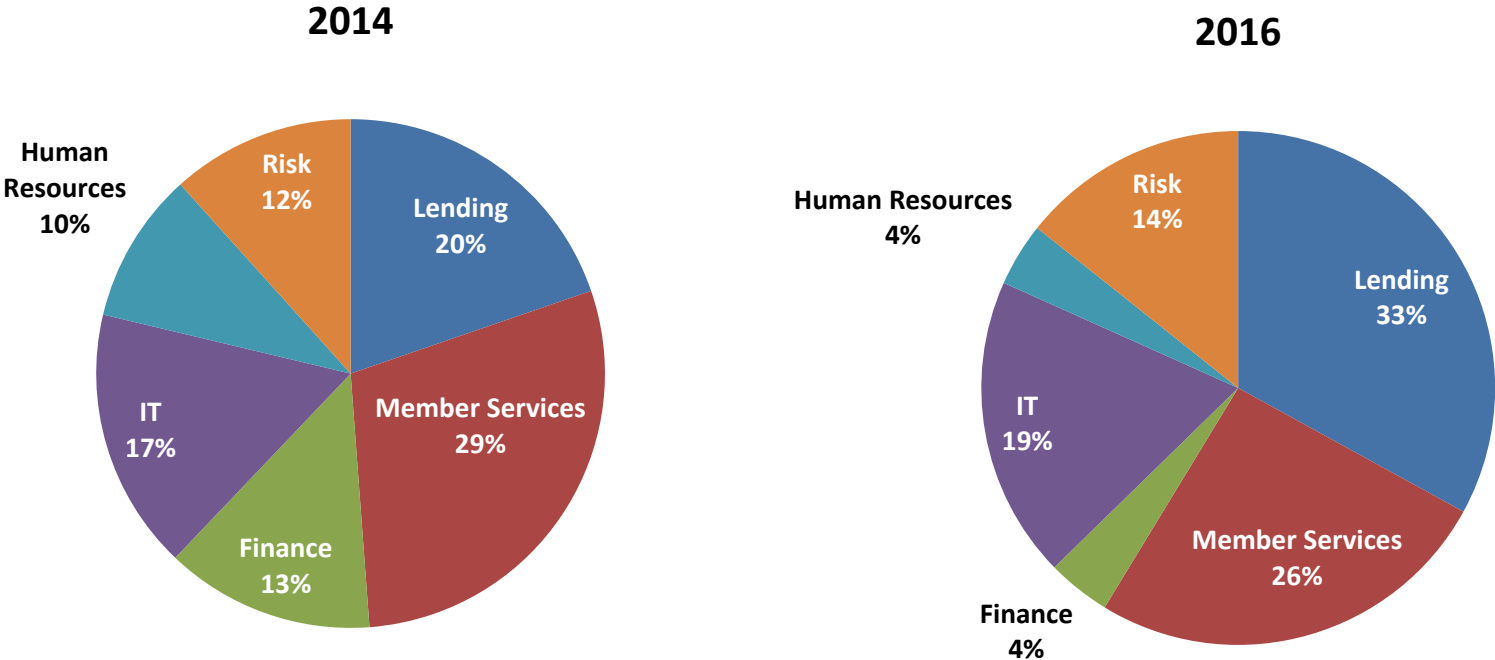


Support Regulatory Staff as a % of Total Credit Union Staff



# More External Assistance for Lending Aligns with Relative Increase in Other Cost Types

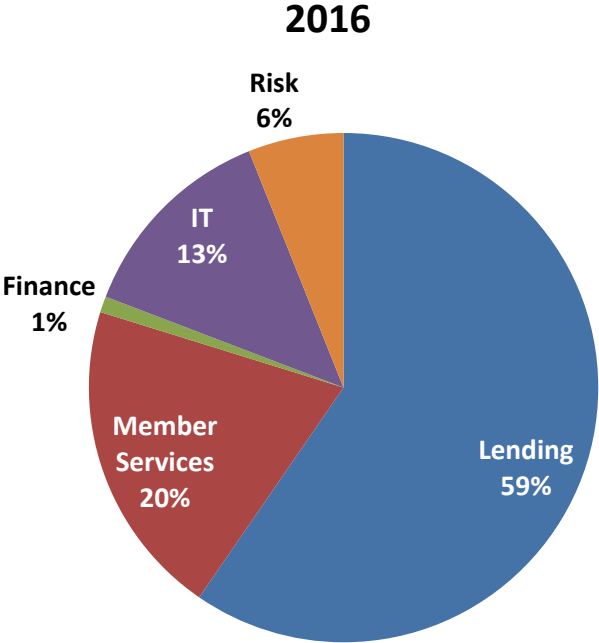
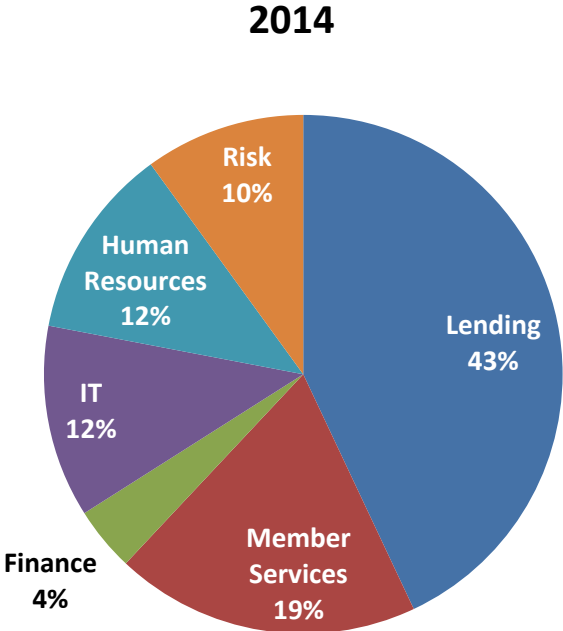
Distribution of Regulatory 3rd Party Expenses by Function





# Go-Forward Regulatory Investments Focus On Lending

Distribution of Capitalized Costs by Function





# Impact of Specific Regulations

# Top 3 Costliest Regulations Are Long-Standing, While Most of Lending-Related

## ESTIMATED COSTS OF SPECIFIC REGULATIONS (Millions of Dollars)

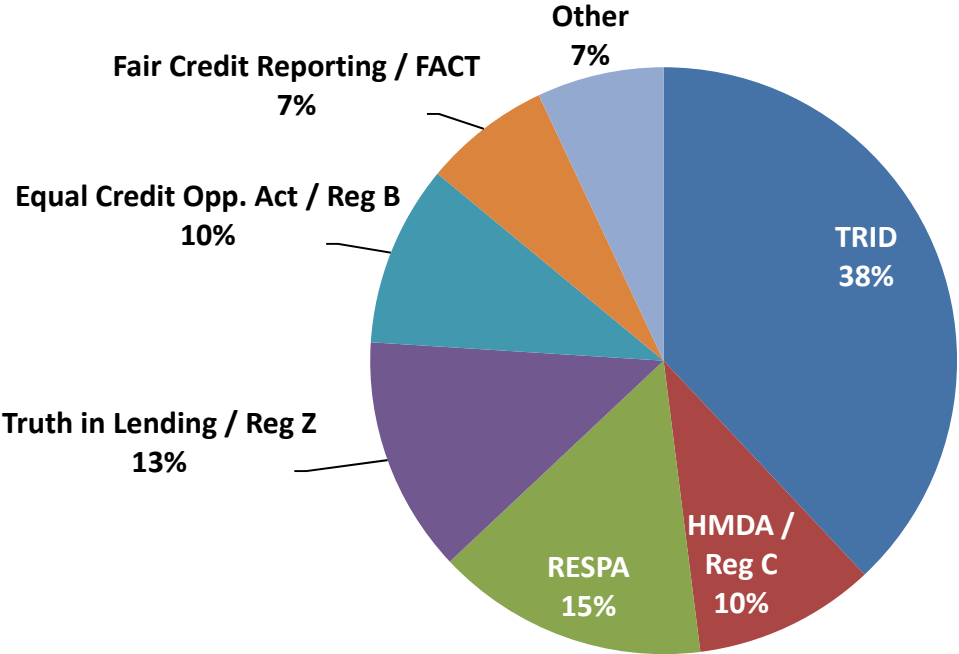
Regulation	Area/Function	Reg Costs	Percent
Electronic Funds Transfers (Reg E)	Mem Services/Deposit Ops	\$589	9.6%
Expedited Funds Availability/Check 21 (Reg CC)	Mem Services/Deposit Ops	\$545	8.9%
Bank Secrecy Act/ AML	Mem Services/Deposit Ops	\$530	8.6%
Prudential Regulation	All areas	\$501	8.1%
TILA/RESPA Integrated Disclosure	Residential (RE) Lending	\$497	8.1%
Truth in Lending/Regulation Z	Consumer, RE Lending	\$490	8.0%
Equal Credit Opportunity Act/Reg B	All lending	\$408	6.6%
Truth in Savings/Regulation DD	Mem Services/Deposit Ops	\$396	6.4%
Fair Credit Reporting Act & FACT Act	Consumer, RE Lending	\$320	5.2%
Military Lending Act	Consumer Lending	\$227	3.7%
IRS Reporting	Mem Services/Deposit Ops	\$198	3.2%
Real Estate Settlement Procedures Act/ (RESPA)	Residential Lending	\$196	3.2%
Home Mortgage Disclosure / Reg C (HMDA)	Residential Lending	\$155	2.5%
Privacy (Reg P)	Mem Services/Deposit Ops	\$153	2.5%
UDAAP (unfair, deceptive, abusive acts/practices)	Consumer Lending	\$148	2.4%
Service Members Civil Relief Act	Consumer Lending	\$75	1.2%
SBA Rules	Business Lending	\$20	0.3%
Other	All Areas	\$698	11.4%
<b>Total</b>		<b>\$6,144</b>	<b>100.0%</b>

# Other Regulations Sited By Respondents With Greatest Burden

Area / Function	Top Regulatory Impacts
Risk and Compliance	<ul style="list-style-type: none"> <li>• Burden and resources required during regulatory examinations</li> <li>• Telephone Consumer Protections Act (TCPA)</li> </ul>
Residential Lending	<ul style="list-style-type: none"> <li>• Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act)</li> <li>• Telephone Consumer Protections Act (TCPA)</li> </ul>
Consumer Lending	<ul style="list-style-type: none"> <li>• Consumer Collections</li> <li>• Credit Card Act</li> <li>• Telephone Consumer Protections Act (TCPA)</li> </ul>
Deposit Operations	<ul style="list-style-type: none"> <li>• Automated Clearing House (ACH)</li> <li>• Customer Identification Program (CIP)</li> </ul>
Member Services	<ul style="list-style-type: none"> <li>• Office of Foreign Assets Control (OFAC)</li> <li>• Overdraft Protection</li> </ul>
Finance	<ul style="list-style-type: none"> <li>• Current Expected Credit Loss (CECL)</li> <li>• Call Reporting</li> <li>• IRS Reporting</li> </ul>
IT	<ul style="list-style-type: none"> <li>• Cybersecurity (Reg 748)</li> <li>• Federal Financial Institutions Examination Council (FFIEC) Guidelines</li> <li>• Vendor Management</li> </ul>
Legal	<ul style="list-style-type: none"> <li>• Collections</li> <li>• Lending Disclosures</li> <li>• Review of new regulations including CFPB rules</li> </ul>

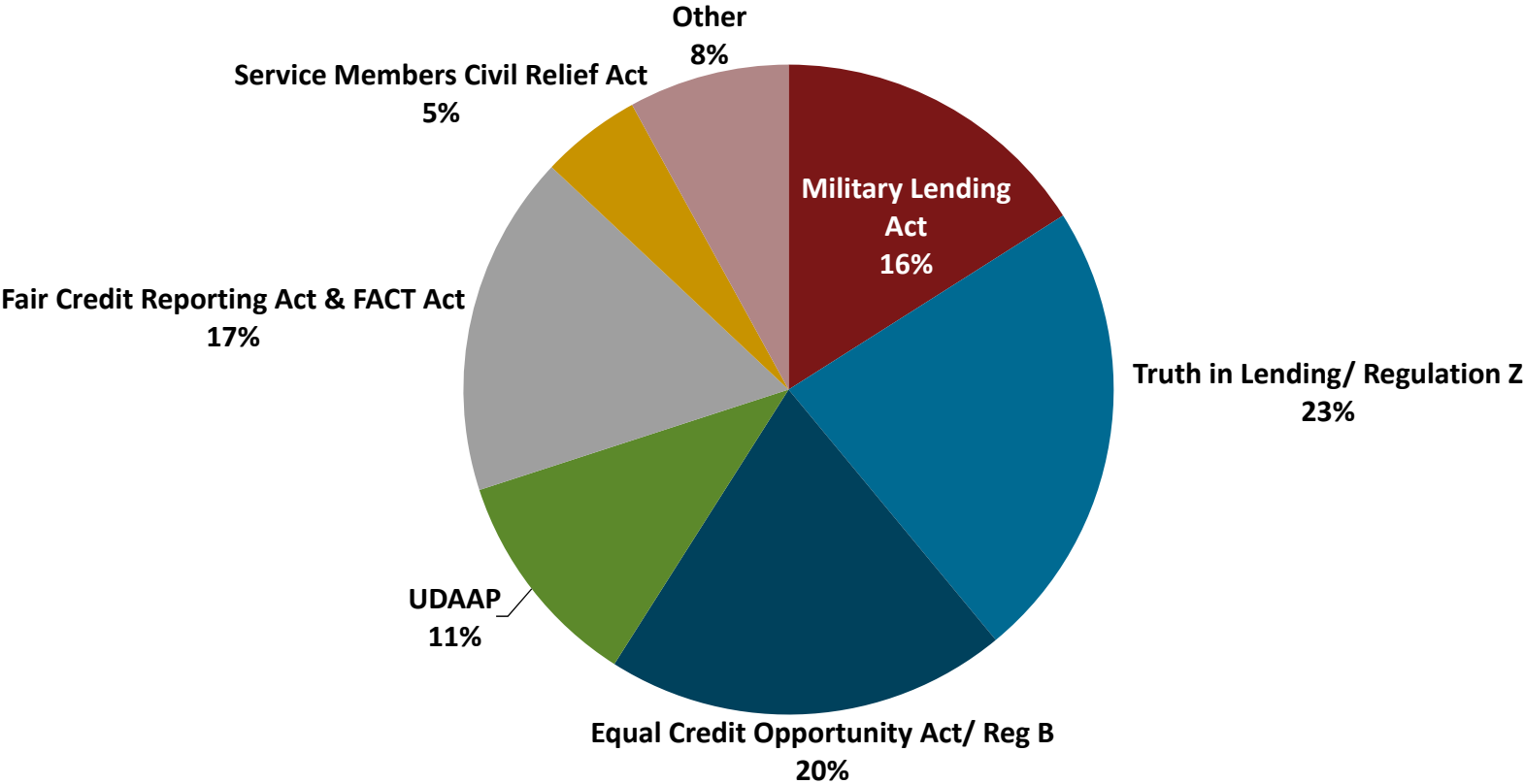
# TRID Takes Up Over One-Third of Regulatory Time for Residential Lenders

Allocation of Regulatory Costs - Residential Lending



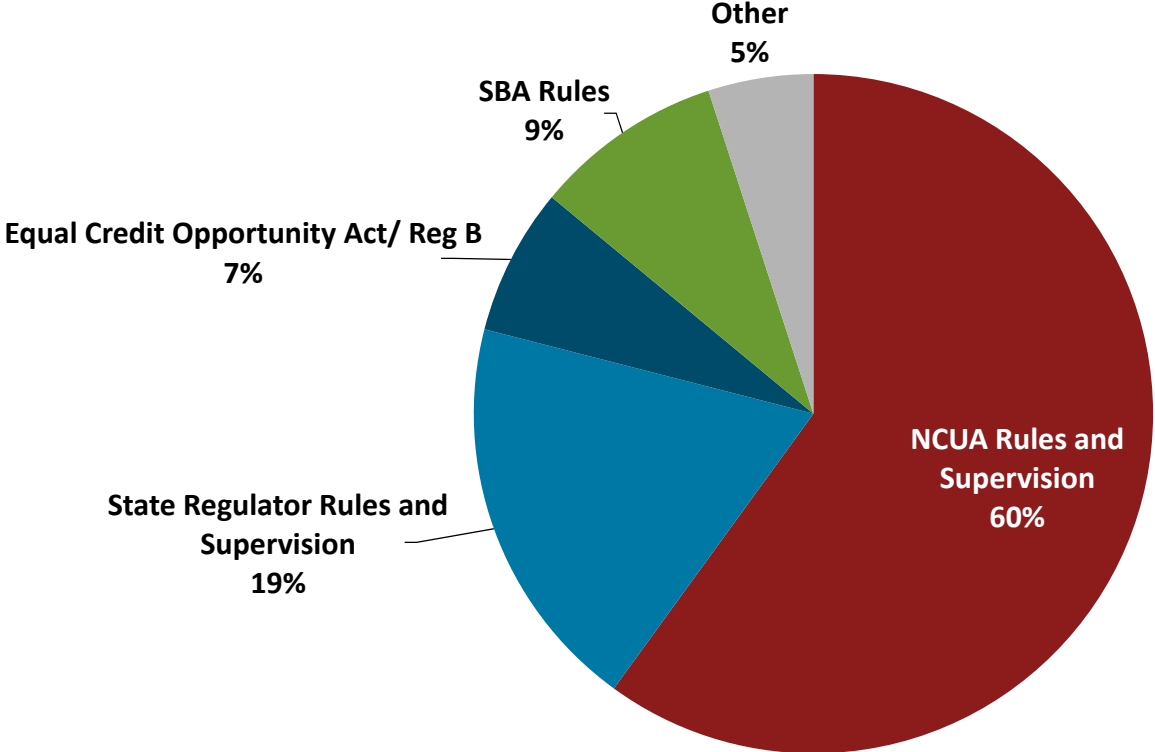
# Consumer Lending Impact Was Similar Across Multiple Regulations

Allocation of Regulatory Costs - Consumer Lending



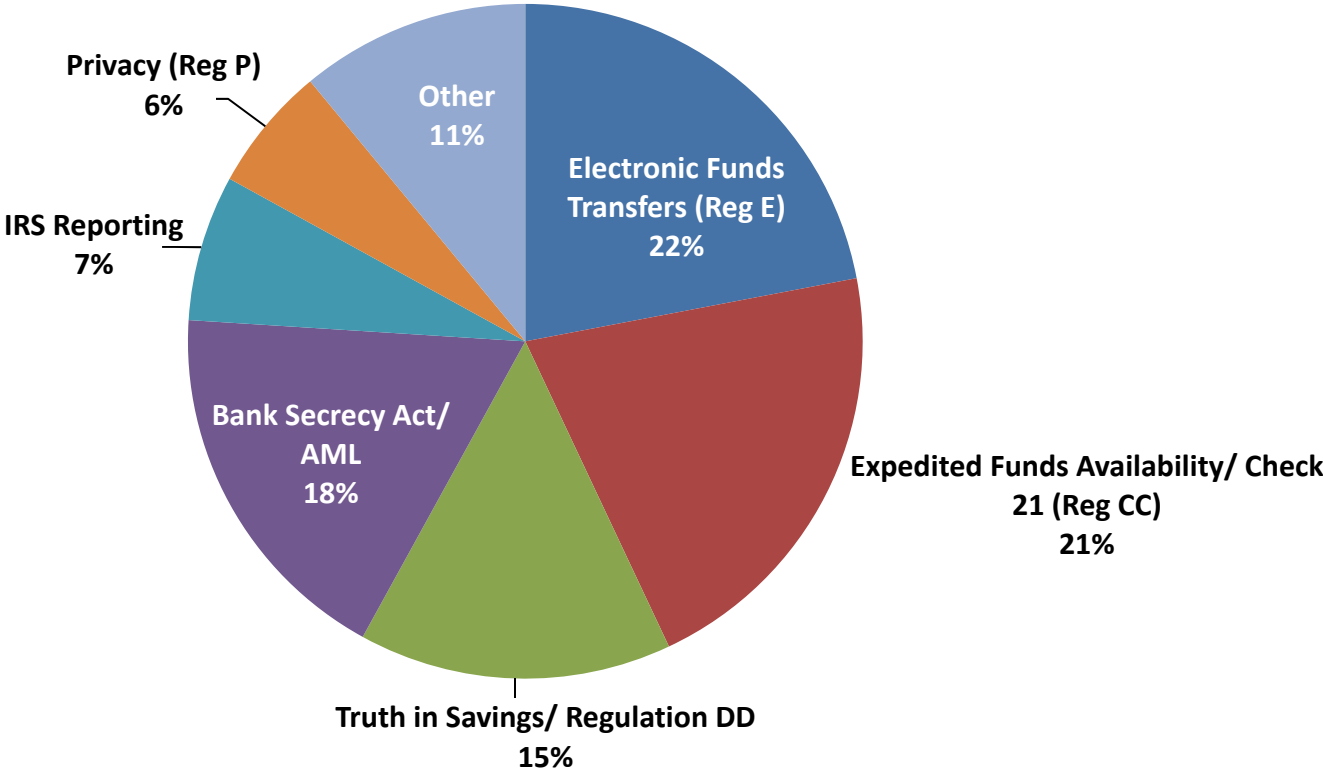
# Few Regulations on Business Lending Which Impacted Mainly Larger Credit Unions

Allocation of Regulatory Costs - Business Lending



# Regulatory Impact for Member Services Covered Transactions and New Accounts

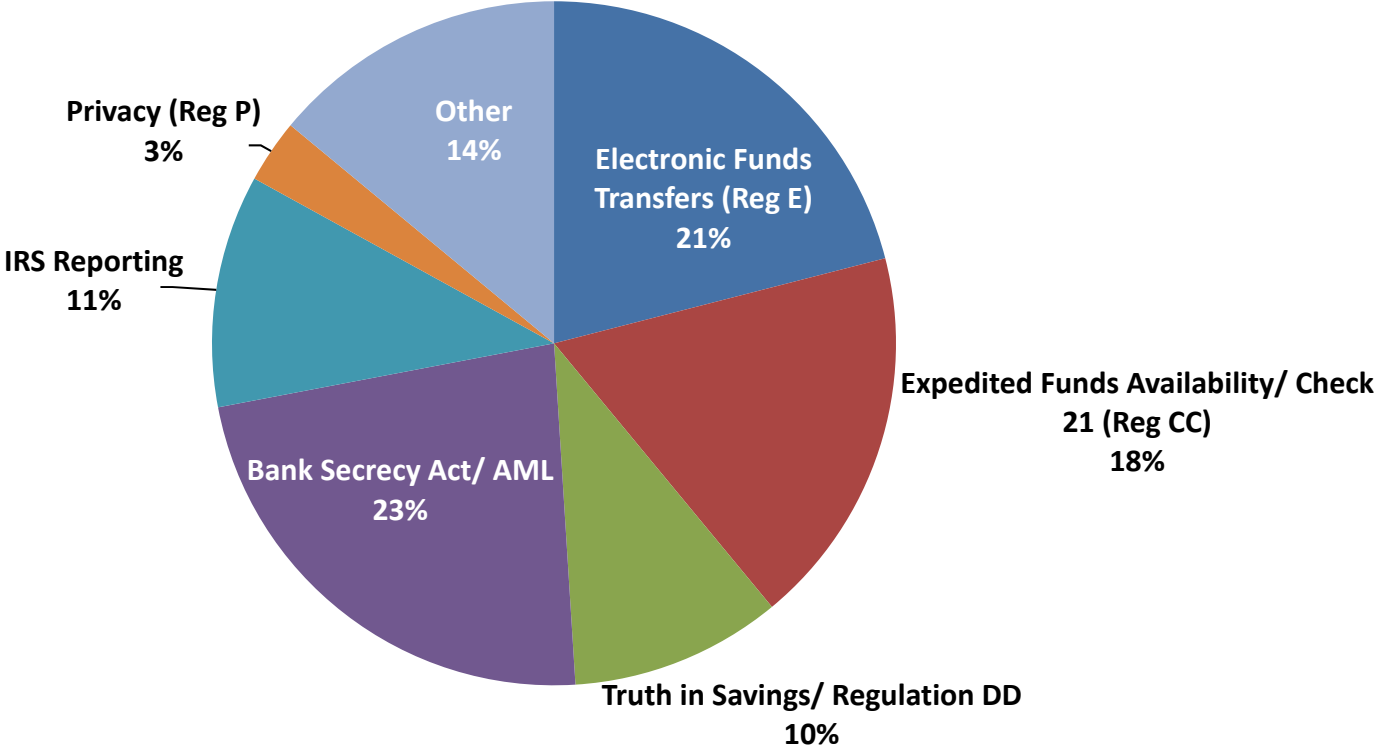
Allocation of Regulatory Costs - Member Services





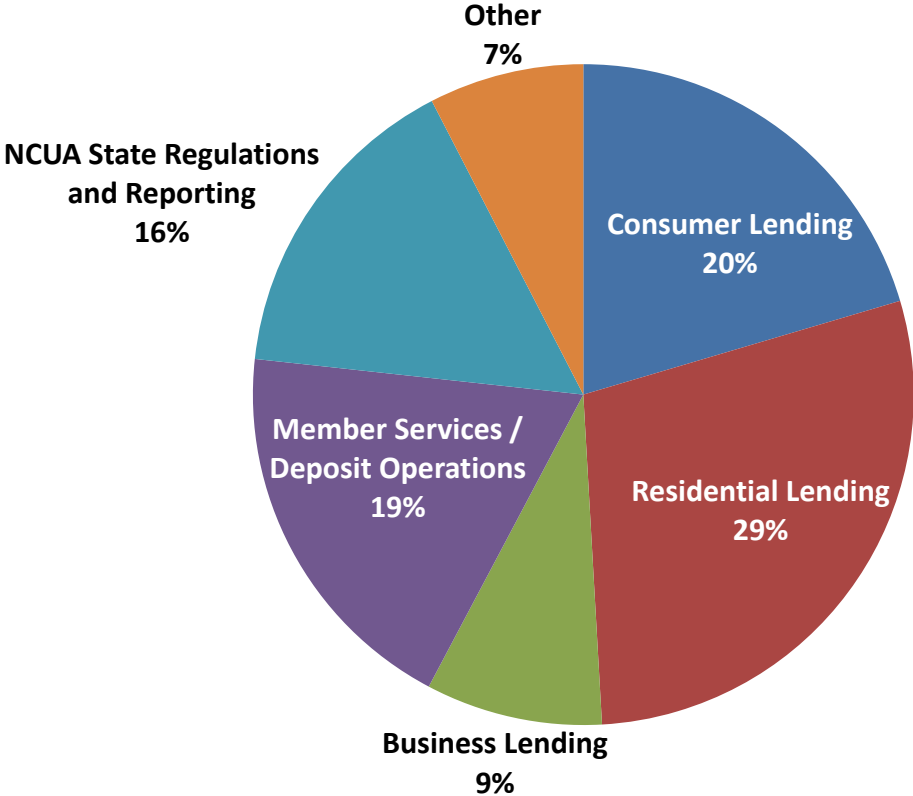
# Deposit Operations Regulatory Impacts Aligns with Member Services Where Requests Are Initiated

Allocation of Regulatory Costs - Deposit Operations



# The Risk Areas Spent Most of Their Time on Lending-Related Regulations

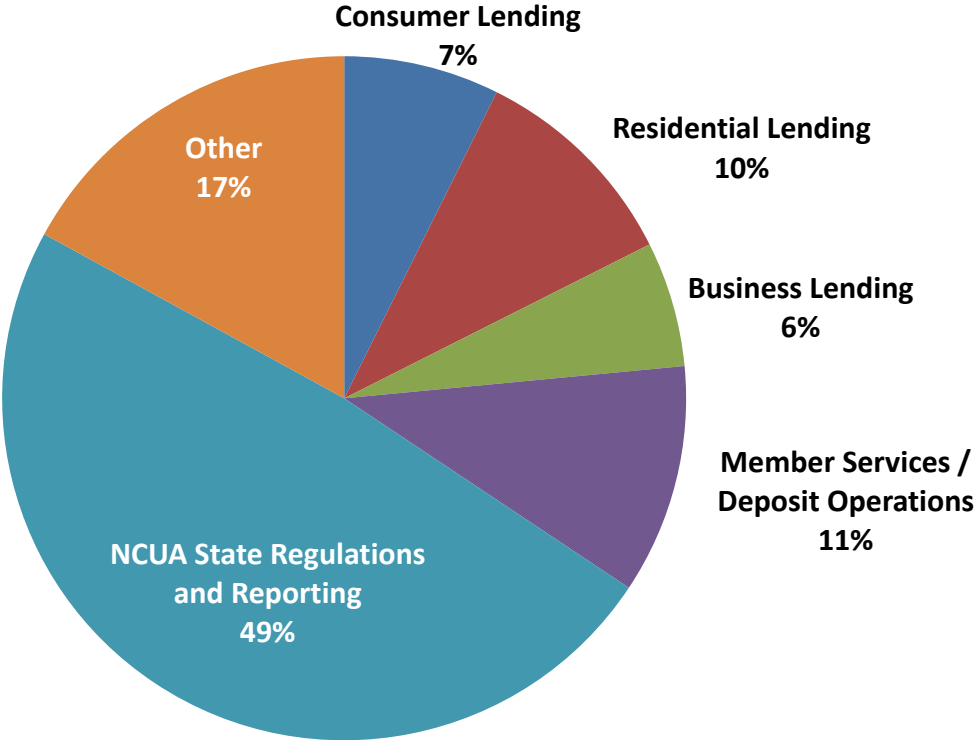
Allocation of Regulatory Costs - Risk



# Finance Focused Their Efforts on Reporting Requirements

---

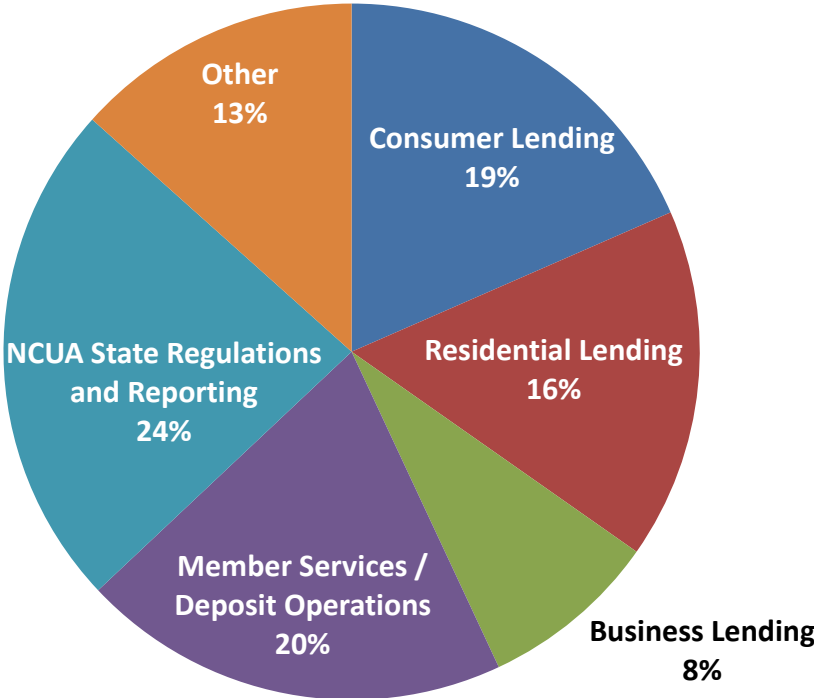
Allocation of Regulatory Costs - Finance



# IT Efforts Were Very Well Spread Out Across the Credit Union

---

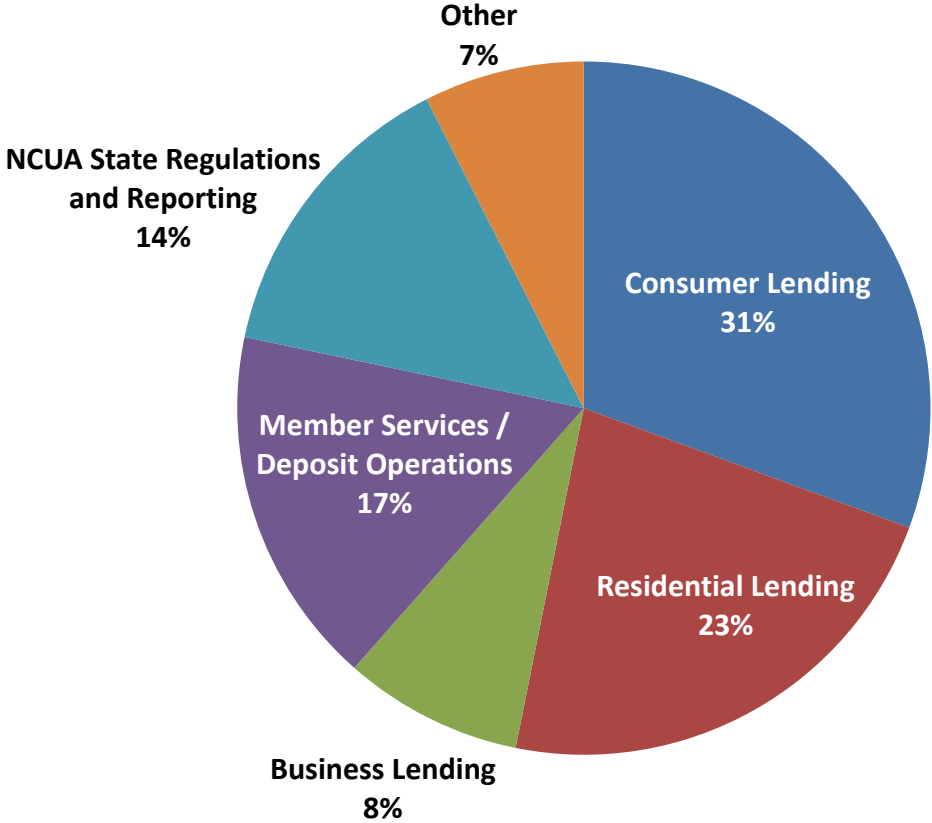
Allocation of Regulatory Costs - IT



# Legal's Time Was Spent Mainly in Supporting the Lending Functions

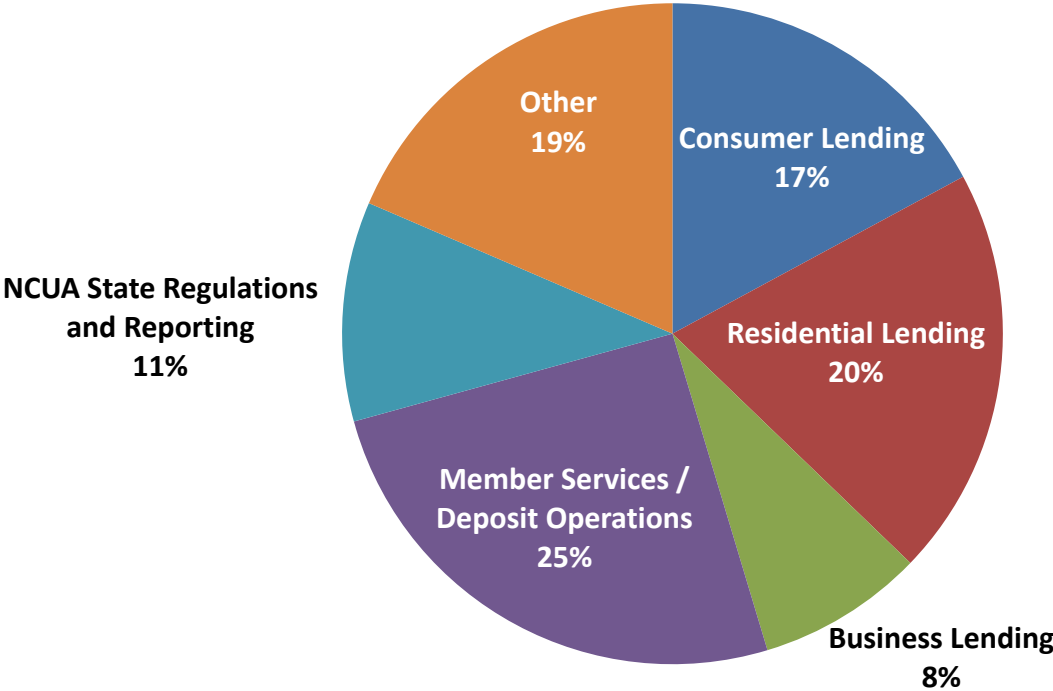
---

Allocation of Regulatory Costs - Legal



# HR Spent More Time on Member Services Given the Training and Support Required of Branch Staff

Allocation of Regulatory Costs - HR

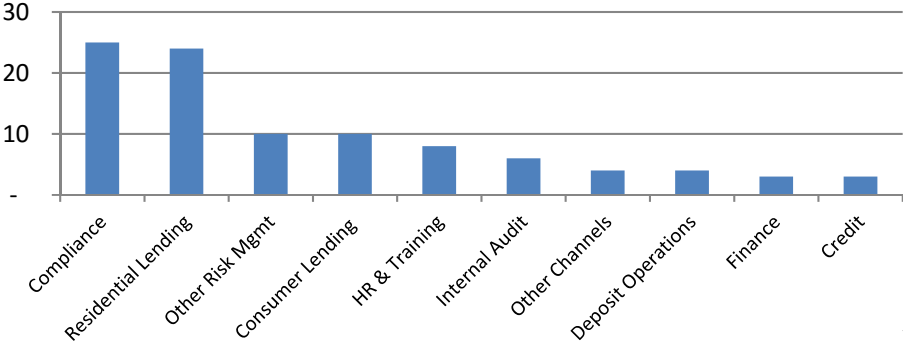




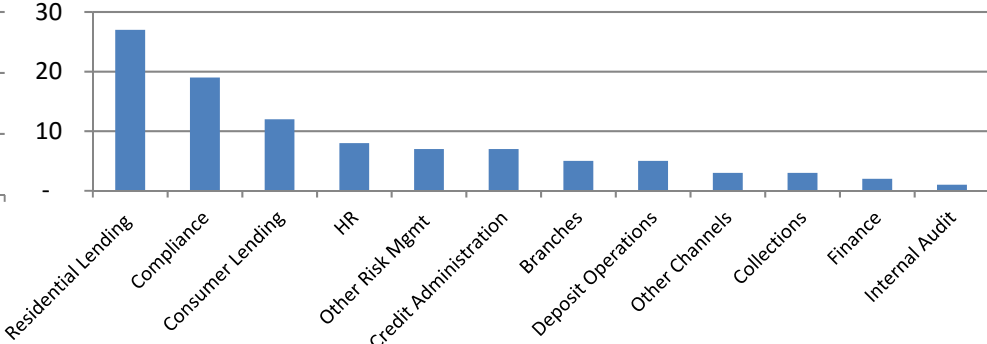
# Strategic Impacts

# CEO Perception of Regulatory Impact Continues To Be in Mortgage and Compliance

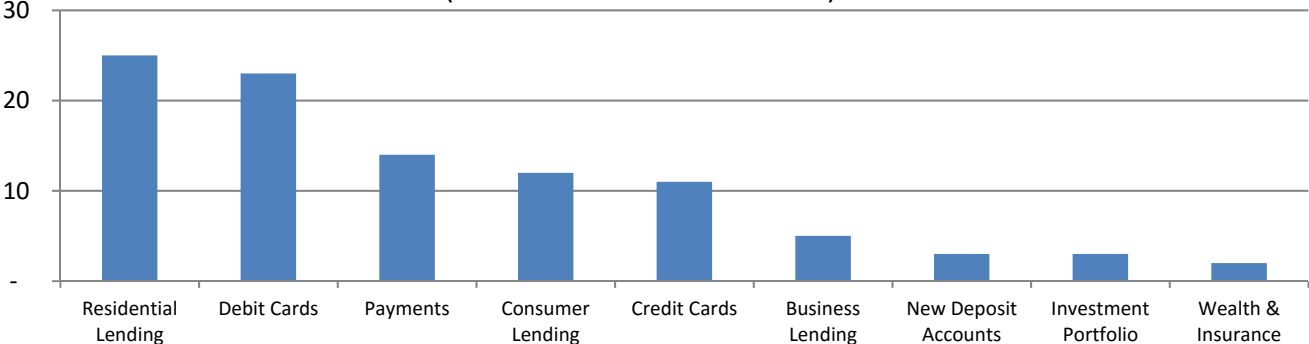
**Areas With Highest Regulatory Expenses**  
(Based on # of CEO selections)



**Areas With Greatest Productivity Impact**  
(Based on # of CEO selections)



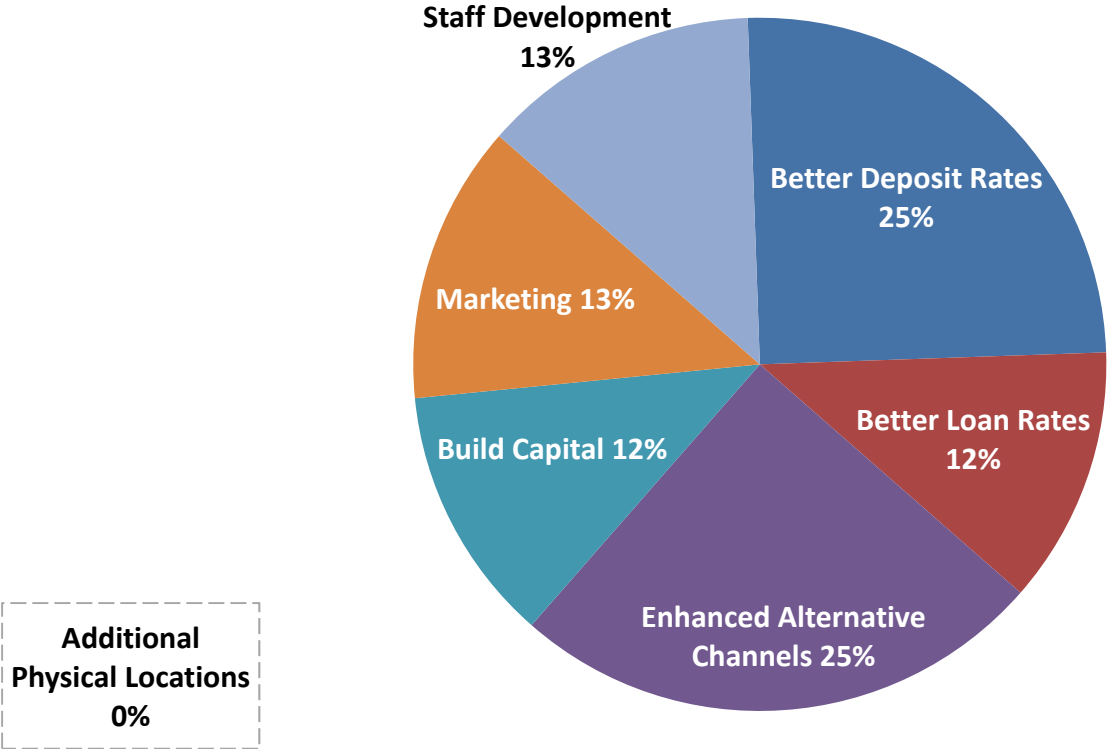
**Areas With Most Lost Revenues**  
(Based on # of CEO selections)





# The Majority of Regulatory Cost (76%) Would Be Used to Benefit Members and Member Growth

Reallocation of Regulatory Costs - All CEOs

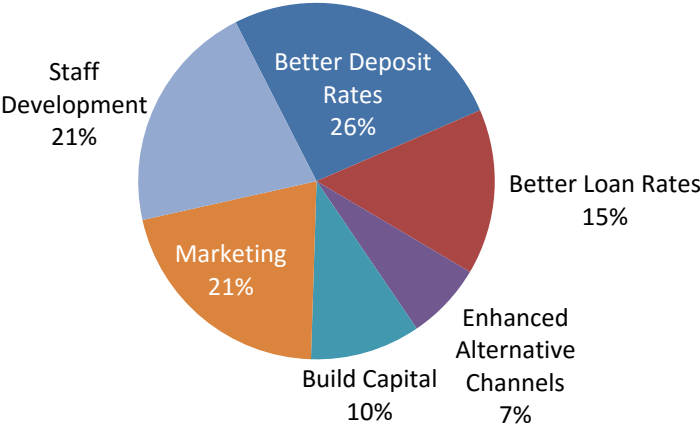


Based on median allocations of all CEO responses

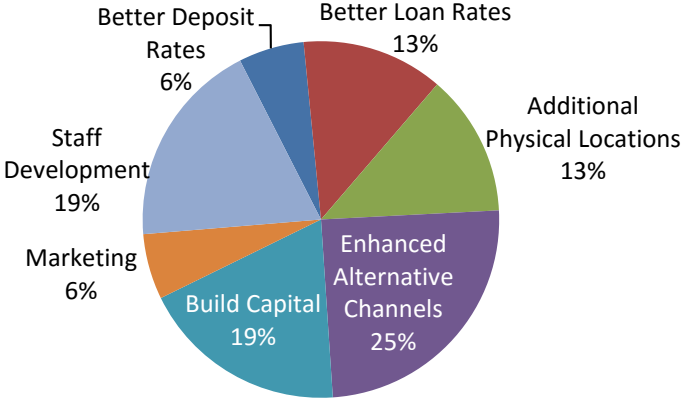
# Alternative Channels to Meet Member Needs Was the Top Focus for Larger Credit Unions

## Reallocation of Regulatory Costs By Respondent Credit Union CEOs

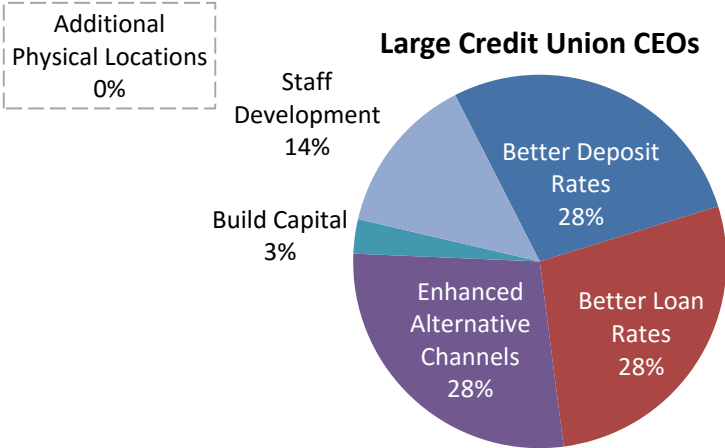
Small Credit Union CEOs



Mid-Sized Credit Union CEOs



Large Credit Union CEOs



Based on median responses for each asset category

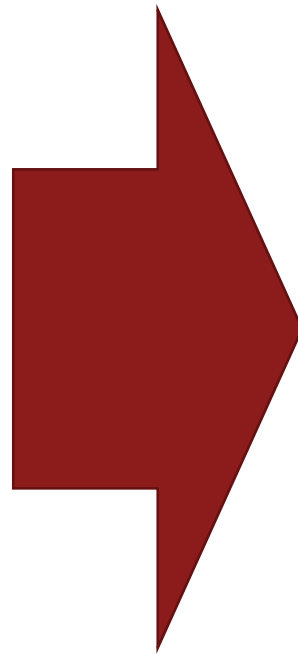


# Themes & Conclusions

# The Level of Strategic Risk Is Higher

## Four Key Themes

1. New Elevated "Normal"
2. Lending and Member / Staff Experience
3. Incremental Changes Make Big Difference to Smaller Credit Unions
4. Regulatory Exams Becoming More Onerous Without A Corresponding Increase In Value



## Increased Strategic Risk

- Higher level of fixed costs that needs to be funded to drive net worth growth to fund loans
- Loss of staff due to less satisfying work experiences
- Loss of members to other industry players like Fintech who are not burdened by all regulations, especially in Lending
- Unknowns about future regulations / exams make planning more difficult -- requiring more use of expensive 3<sup>rd</sup> parties



# Participant Scorecards

# Regulatory Impact Participant Scorecard: Overview of Total Costs

	Example Credit Union	Large Peer Group			All Participants
<b>Total Regulatory Costs as % of Assets</b>	<b>2016</b>	<b>Median</b>	<b>25th Percentile</b>	<b>75th Percentile</b>	<b>Total Weighted</b>
Total Regulatory Costs as % of Assets	0.50%	0.43%	0.24%	0.56%	0.46%
Regulatory Staff Costs as % of Assets	0.40%	0.29%	0.19%	0.48%	0.34%
3rd Party Regulatory Costs as % of Assets	0.09%	0.06%	0.03%	0.12%	0.08%
Depreciation of Capitalized Total Regulatory Costs as % of Assets	0.01%	0.01%	0.00%	0.02%	0.01%

	Example Credit Union	Large Peer Group	All Participants
<b>Composition of Total Regulatory Expenses</b>	<b>2016</b>	<b>Average</b>	<b>Total Weighted</b>
Staff Costs	80%	75%	75%
3rd Party Expenses	18%	23%	23%
Depreciation of Capitalized Expenses	2%	2%	2%

<b>Staff Cost Impact</b>	<b>2016</b>	<b>Average</b>	<b>Total Weighted</b>
Regulatory FTE as % of Total FTE	24%	19%	21%

# Regulatory Impact Participant Scorecard: Specific Regulation Allocations

<b>Regulations</b>	<b>2016</b>	<b>All Participants</b>
Electronic Funds Transfers (Reg E)	11.0%	9.6%
Expedited Funds Availability/Check 21 (Reg CC)	6.6%	8.9%
Bank Secrecy Act/ AML	15.8%	8.6%
Prudential Regulation	5.5%	8.1%
TILA/RESPA Integrated Disclosure	11.4%	8.1%
Truth in Lending/Regulation Z	3.5%	8.0%
Equal Credit Opportunity Act/Reg B	10.5%	6.6%
Truth in Savings/Regulation DD	10.1%	6.4%
Fair Credit Reporting Act & FACT Act	3.3%	5.2%
Military Lending Act	0.5%	3.7%
IRS Reporting	1.2%	3.2%
Real Estate Settlement Procedures Act/ (RESPA)	3.6%	3.2%
Home Mortgage Disclosure / Reg C (HMDA)	1.8%	2.5%
Privacy (Reg P)	4.0%	2.5%
UDAAP (unfair, deceptive, abusive acts/practices)	1.0%	2.4%
Service Members Civil Relief Act	0.5%	1.2%
SBA Rules	0.4%	0.3%
Other	9.3%	11.4%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>

\*Regulatory costs for Risk & Compliance and Support (Finance, IT, Legal, and HR) functions were allocated to specific regulations based on line of business allocations. For example, assume 20% of Finance's time was allocated to Residential Lending. That 20% was dispersed based on allocations provided in the Residential Lending section (e.g., 40% TRID, 20% HMDA).



Q&A