

Executive intelligence on credit union exams, enforcement and risk management

Technology Gap Hamstrings CUs

The events surrounding “Bank Transfer Day” (BTD) gave credit unions a rare chance to showcase themselves. But despite the tens of thousands of new accounts picked up from customers fleeing the big banks, it may also be a time to reflect on opportunities lost, at least when it comes to using technology as a tool to gain market share.

New research indicates that credit unions remain far behind banks, large and small, when it comes to recruiting new account holders online. The competitive disadvantage, experts say, likely slowed the gains that CUs achieved at banks’ expense over the last month or so. It could also hurt the ability of CUs to continue the momentum and fully exploit consumer dissatisfaction with bank fees and other practices in the future.

“Here was a great opportunity for community banks and credit unions. The question in my mind is whether consumers were able to get through that door to the virtual branch or whether it was jammed,” says Mark Schwanhausser, an analyst at Javelin Strategy and Research, a Pleasanton, Calif., financial institution consultant.

This past spring, Javelin studied the experiences of more than 5,100 bank and CU customers trying to open accounts online. That was before a decision, later reversed, by Bank of America to raise debit-card fees touched off a frenzied push by CUs to lure disaffected bank customers to the non-profit financial world. But the results of the study suggest that customers looking to switch from big banks to CUs likely encountered many problems.

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Don’t Forget Your Current Members, Experts Say

CUs have been pulling out all the stops lately to win new customers from the banks. They’ve offered free debit cards for life. They’ve offered cash on the barrelhead for opening a checking account. The offers are all designed to be attractive. Many of them have another feature in common: Existing members aren’t eligible.

That’s a big mistake, some experts say. It sends the wrong signal to your loyal customer base. You risk alienating them – to the point of even losing them – given the glut of special

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ERM, Jr. - How to Design a Scaled-Down ERM Program and How to Know If It’s Right for You

Enterprise Risk Management (ERM), particularly as it’s practiced in the largest banks, can be extremely complicated, involved and expensive. As the industry – and industry regulators – discuss the need for ERM, CUs are asking if a simplified, scaled-down ERM program can meet their needs, both regulatory and strategic, or if they need to swallow a Bank-of-America-sized program whole.

Is ERM scalable? Can less involved ERM programs work well for smaller financial institutions? Yes, experts say, but design matters. Some elements of a functional ERM program can be left out. Others can’t. And just as important, CUs need to know if a scaled-down program still allows them to manage their risk effectively.

A smaller, less sophisticated, more affordable program may be a smart idea for a smaller financial institutions

as long as it’s done right, says Dan Borge, a director and risk consultant with LECG in New York, N.Y.

“It’s important to prioritize,” he says. “Smaller financial institutions have people coming in, saying, ‘We’ll sell you ERM packages with bells and whistles.’ But that may be too complicated and it might not fit their business. Yes, there’s a burden on management and the board to make

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In the Javelin study, nearly half the people who applied to open a checking account online with a CU abandoned the process, apparently frustrated by technical and other glitches. Only about a third succeeded in actually opening and funding an account online. The remaining CU applicants were either rejected or forced to visit a branch to complete the application process.

The findings of multiple problems are striking because consumers have come to expect online banking to be relatively hassle-free, at least compared with the time-consuming process of making the trek to a brick-and-mortar branch and fitting into the schedule of a multi-tasking account officer.

It is also problematic because the application process is considered crucial in setting consumers' first impressions about an institution or system. "Doing it right can open the door for a new customer to begin an enduring self-service relationship" Javelin observed in the study. "Doing it wrong can leave applicants with a sense of lasting frustration and a financial institution with a stack of incomplete or unused accounts."

Interest in opening accounts online continues to rise. Some 23.2 million U.S. adults attempted to open a checking account online in the 12-month period that ended in March 2011, up 8% from 20.2 million in 2010.

To be sure, many CUs are justifiably basking in the after-glow. Thousands of consumers decided to shred their bank cards since Bank of America tried to push through a \$60 a year debit card fee increase in September. The big bank's decision to rescind the increase earlier this month seemed to do little to immediately quell the consumer unrest.

CUNA estimates that some 690,000 consumers have moved their accounts

to CUs since Bank of America's original announcement, reflecting a populist revolt against higher fees and the social-media inspired BTD on Nov. 5.

While CUs remain challenged to develop profitable relationships with those new customers, the surge was a shot in the arm for the movement, eclipsing the total number of net members that CUs added in all of 2010.

CUNA did not break out how many of the new members opened their accounts online, although a spokesman said anecdotal evidence indicated that both online and branch applications were higher.

Andera Inc., a leading provider of online customer acquisition services, said the CUs it serves more than doubled the number of online applications processed the weekend of Nov. 5-6 compared with the previous weekend. Big CUs gained the most with \$5 billion-plus-asset institutions adding an average of 55 accounts, the Providence, R.I., firm said.

A few large CUs have been challenging the big banks when it comes to developing technology to grab new customers. Workers' CU (\$811 million), Fitchburg, Mass., has allowed consumers to open accounts on their smart phones since July, drawing dozens of applications.

"I have had a lot of people say to me, 'Why would you want to do that on your phone?'" says Chris Saari, assistant vice president and head of Internet banking for the CU. "For the 22-year-old, they are doing everything on their phone. Why wouldn't they open an account?" The service is currently only available for existing members, although Saari says the CU is talking about extending the concept to new ones. He says the online branch is the CU's fastest growing.

Nonetheless, Javelin's study points up

banks' enduring technological advantage based in part on size and resources. A growing number of CUs are more aggressively seeking new business online, although many, particularly smaller institutions, have not taken the leap.

Aside from the cost, many remain concerned about the potential for fraud in online systems, as well as the perceived threat that online systems will make it harder for employees in branches to reach performance goals.

Others have held back in a belief that online services are less important to CU members than to bank customers, and that in-person service remains a core advantage.

The Javelin report – "2011 Online Account Opening: Faulty Process Hobbles FIs in the Battle for Customer Acquisition, Profitability and Retention" – is based on data collected online from 5,102 consumers who were primary or shared financial managers in March 2011. The survey covered the nation's ten largest banks, and a group of smaller institutions with a technology focus, including Navy Federal CU (\$45.5 billion), Vienna, Va., and Desert Schools FCU (\$2.8 billion), Phoenix.

Among all institutions surveyed, 53% of consumers who applied online to open a checking account succeeded in opening and funding the account. The remaining applicants met with frustration. About 17% were able to open an account but were unable to fund it; 25% abandoned the process; and 5% of applicants said their applications were rejected.

The experience of online applicants at credit unions was significantly worse. Just 34% of applicants succeeded in opening and funding accounts; 12% opened but could not fund the account; 48% abandoned the process and 7% were rejected.

The high overall abandonment rate meant that as many as 5.8 million applicants walked away from the bank or CU, took their business to a rival or attempted to complete the application through more costly channels. Using what it said was a conservative \$150 value for each account, Javelin put the lost opportunity cost for the industry at \$873 million.

Javelin's analysis detailed a raft of frustrations that stem from limited application menus, unfriendly user interfaces, web glitches, human intervention in a supposedly automated process, and other shortcomings.

Financial institutions are under pressure to use online banking to broaden their footprint. Some institutions see online channels as having the potential to be their biggest "branch."

Online success elusive

At least in theory, online banking can alleviate various nuisances consumers associate with opening accounts in person, including limited hours of operation, sales pressures, and lack of proximity to physical branches.

In reality, Javelin said, the data indicates that success remained an elusive goal for banks and CUs of all sizes.

"The primary goal of an effective online account-opening process should be to approve and fund all qualified, legitimate applicants in an efficient, automated single session, with minimal risk of fraud," the firm said. "As simple as that sounds, there is no perfect system yet."

In practice, the process is often clunky and time-consuming. With consumers already pressed for time, and little patience, the slightest glitch can disrupt or sidetrack the experience.

The methods of verifying the identities of applicants and funding their


new accounts are flawed. CUs are having trouble knitting together the infrastructure in a user-friendly way. Consumers are prone to abandoning the process from the moment of the first technical breakdown or unexpected requirement.

Broken online links at one large institution left applicants unable to initiate an application. A supposedly online-focused operator failed to inform applicants that only existing customers were eligible to open accounts online. Another institution regularly phoned people who appeared on the verge of abandoning their applications, a practice Javelin said could be disconcerting to applicants who prefer anonymity.

Frontline employees were found ill-equipped to handle questions about online applications and sometimes referred customers who visited a branch to phone a call center instead.

The firm said CUs and banks need to focus more on designing online processes that are intuitive and quick. They need to streamline the experience for existing customers, while providing tech-anxious applicants with lots of hand-holding, such as simplified forms that have some information filled in automatically.

Making systems more useable and simple should reduce abandonment rates. Banks and CUs also need to upgrade verification screening for identifying and funding purposes to reduce rejection rates. Firms should also make a point of stressing how applicant information is protected.

Applicants should be able to resume incomplete applications in branches. Frontline bankers should be armed with tools to assist them. Incentives for branch and call center employees should be revamped as online application volumes grow. 

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The Safety & Soundness Report, the independent eyes and ears of the credit-union movement, provides executive intelligence on CU exams, enforcement and risk management.

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sure that someone's watching [risk]. They just need to know that they have the bases covered."

For many CUs, enterprise-wide risk isn't particularly knotty or large. "A smaller financial institution just doesn't need a highly complex system," he adds. "They need to prioritize the risk they're actually taking and that's mostly credit risk in some form or another. Having a good credit risk discipline is 80% of the battle."

Asset Size and ERM

If you're considering a smaller-scale ERM program, keep your eyes on the right metrics, cautions Marcus Faust, an SVP and ERM consultant with RP Financial, Arlington, Va. CUs with smaller asset sizes and tiny staffs may be inclined to think that they should use a small-scale ERM program, too, but asset size isn't a particularly relevant metric when it comes to calibrating an ERM program, Faust argues. CUs that want to make sure they're using an ERM program that makes sense for them should look to complexity rather than asset size.

"You can have a \$1.5 billion plain vanilla slow growing financial institution with a balance sheet that's not particularly diverse," says Faust. "I'd describe that as relatively simple. For the purposes of ERM it could be considered small. On the other hand, you have a \$500 million dollar financial institution that's growing rapidly, opening branches rapidly and doing things; that's a much more complex operation and, from an ERM perspective, it should have a more sophisticated program."

How can financial institutions gauge complexity? It all comes down to two factors, says Orlando Hanselman, the education programs director for Fiserv Risk & Compliance in Johnstown, Pa.

1. Balance sheet complexity. Rather than getting hung up on metrics, like asset size or staff size, Hanselman counsels CUs to assess the balance sheet. Look at the term structure of the investments and deposits, he says. Are durations short, intermediate or long? Is there a significant mismatch between assets and liabilities? Does the portfolio lean towards fixed rate or variable rate loans? How much optionality does your CU have embedded in the balance sheet?

Questions like this can help a financial institution determine the general level of complexity in the balance sheet, he says. The more complexity there is, the more consideration a CU should give to a thorough, more involved ERM program.

2. Capital philosophy. If your CU follows a relatively conservative business model and holds a lot of additional capital, a smaller ERM program can be fine, Hanselman says. CUs with daring business plans – i.e., those that want to deploy as much capital as they can and hug regulatory capital minimums – just can't rely on a simple ERM program, he adds.

"If you want a [simple] ERM program, you have to approach capital with an abundance of caution," Hanselman says. "You have to have a clearly excessive capital position."

The reason, Hanselman says, is that a simple, beginners' ERM program won't help a CU quantify risk and without that information, the CU can't anticipate and plan for changes in environmental effects. Those with less sophisticated ERM programs can save money on staff, analytical costs and tech costs, but they'll be hard pressed to track their capital-at-risk. They can't afford to run on lower capital levels and that, whether they realize it or not, is the hidden cost in going simple with ERM, he adds.

With simple ERM programs, CUs will need to "over-insure" by maintaining capital levels well in excess of regulatory minimums, he says. Those that plan to keep capital high can get away with using a more basic ERM program.

"[CUs] do have the choice about how much effort they want to put into ERM to a degree," he says. "It's continuum of choice."

Base-Level ERM

If you are a smaller plain vanilla institution and want a smaller scale, less-involved ERM program, you can design one that can be useful. It doesn't need to be expensive and it doesn't need to involve complicated analytics, either, says Faust.

"In its smallest form, ERM doesn't take much in the way of effort or resources," Faust says.

Here, according to Faust, is what a bare-bones, small-institution ERM program should look like at the outset:

1. A formal reporting structure. Collect a small group of C-level executives – typically the chief lending officer, the chief credit officer, the compliance officer, the internal audit head and the heads of the various lines of business – and establish an ERM management committee. This group should hold regular meetings to talk about risk as it impacts the entire organization, Faust adds.

2. A risk committee charter. Establish the objectives for risk mitigation, says Faust. Look at it from a portfolio perspective. The idea is to look for risk factors that impact the entire organization, grade the risk as low moderate or high and determine the direction of the risk (stable, increasing, or decreasing).

3. A risk policy. This can be simple and short – only around four pages,

Faust says. The document should include simple objectives for the committee and should set a meeting schedule. Make sure to keep minutes for the meetings, he adds.

For a lot of CUs, getting started on these three elements can be “a giant step forward,” Faust says. When executives get together regularly and talk about risk, they’re no longer thinking about risk in silos, he adds. They are now looking at the entire portfolio of risk.

Should you appoint a chief risk officer, too? Even with a basic program, it makes sense to do so, Faust says. Typically, CUs in this scenario will tap the chief credit officer (CCO) to take on the role. “If that CCO is separate from the chief lending officer, which would have to be the case for this to make sense, then the CCO is the most objective executive in the group,” Faust says. “The CCO is, almost by definition, independent.”

But don’t forget the need to have some independent look at the effectiveness of your ERM program, Faust adds. That’s what the regulators will be looking for regardless of the CU’s asset size.

What’s Next?

For CUs interested in a slightly more sophisticated ERM program, the next step is an independent assessment, Faust says. Consultants providing third-party ERM assessments devote all their time to evaluating risk profiles and they’ve been through a lot of different financial institutions. That expertise can be invaluable to risk committees, particularly inexperienced ones. “The purpose is to guide [a nascent ERM program], to point out the risks” that CUs should focus on, he says.

Has the CU’s risk committee missed anything considerable? Is the CU’s informal ERM process func-

tioning? These are the questions an independent assessment can answer, he says.

These reviews can give an ERM committee an objective look at the CU’s enterprise risk profile and how well the risk is managed, says Faust. The more reviews a CU has, the more the committee learns about the way it functions, the evolving risk profile of the CU, and the mistakes the CU may have made in looking at its risks. “It’s a learning process,” Faust says.

How often should a CU hold an independent risk assessment? There’s no prescription, but in general, the frequency of assessments should depend on the profile of the CU, Faust says. A faster growing company should have independent reviews more often, since its risk profile could be changing quickly. A CU like this may want a yearly assessment. CUs on a less dynamic path will probably be fine with an independent assessment once every two years. ▲

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deals and offers available only to non-members these days.

Also, those same experts add, you could be missing an opportunity to build goodwill with those customers and, subsequently, leverage that relationship into other products and services.

Indeed, while the focus of the “Bank Transfer Day” (BTD) happening has been on luring disaffected customers from banks, existing CU members are also likely considering their own options.

“One segment of the target market that many community financial institutions have a tendency to overlook is that of existing customers. Small FIs know all too well that a great number of their customers use only one or may-

be a small handful of the services available, choosing to place the majority of their business with national banks. But many of these customers may right now be reevaluating their decision to compartmentalize their financial services,” according to TJ Riha, chief executive of PayFusion, an Omaha, Neb., debit-card consulting firm, and Andrea Stritzke, vice president, regulatory compliance, of Policy Works, a Des Moines, Iowa, firm that advises CUs on legislative and legal issues.

“Organic growth has a tendency to give development efforts invaluable momentum. FIs should evaluate how many of their current customers are not taking advantage of their most competitive programs – like free checking – and go after them with sales

gusto,” Riha and Stritzke write, in a recent white paper, “Use Caution When Wooing Angry Bank Customers.”

“You don’t want to disappoint existing members because they may find a better offer right down the street,” Riha adds in an interview.

Some CUs already seem to have gotten the message. Some \$90 million in loans that CUs made on BTD went to existing as well as new customers, CUNA says.

Individual CUs are also offering special promotions that have the dual purpose of luring new members and pleasing old ones, offering up enhanced debit card rewards to all comers, and finder’s fees to existing members who can encourage friends

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or relatives to make a switch.

Giving a new relationship a better deal than a current loyal customer may work in the short term but is ultimately counterproductive.

“How can a bank say, with a straight face, that they value their customers and build real relationships with them when they’re willing to give a better deal to someone they’ve just met?” asks Lauren O’Connell, president of O’Connell Consulting Group, a Littleton, Colo., financial marketing firm.

Tweaking Bank of America for its failed \$5 monthly charge on debit cards, Mission Federal Credit Union, (\$2.1 billion), San Diego, is offering to pay customers, new and old, up to \$5 a month to use their debit cards in November and December.

Similarly, Randolph-Brooks Federal Credit Union, (\$4.5 billion), Live Oak, Tex., is rewarding all its members with 15 cents cash back on debit

card purchases – an increase from 10 cents – through year-end. “Giving this additional reward makes RBFCU membership even more valuable because of the decisions other financial institutions are currently making,” the CU says in promotional materials. “At RBFCU, your account is free and you’ll actually be paid to use it.”

Building Loyalty

Such an even-handed approach may be central to CUs keeping the momentum going to gain share in coming weeks and months.

“Those community FIs that take the time to first craft a strategy for which customers they want to bring into the fold, how they will win them over and how they can earn their trust and loyalty over time have the best chance at success,” Riha and Stritzke say.

To that end, the authors say, CUs should:

- Complete a competitive analysis of products and services likely to be of the highest values to members;
- Identify qualification standards to better understand the type of customer it hopes to attract;
- Carefully define the messages for attracting new customers; and
- Train personnel to be prepared to help customers make the switch.

Aside from the thousands of new accounts CUs have opened of late, the experience gained in developing strategies to win those new customers may be the most enduring legacy of the BTB event. “It has given CUs the opportunity to identify how they can compete against the larger financial institutions,” Riha says. “They have really learned how to walk someone through switching banks and having the tool kits available if you have the opportunity to attract a new member.” 📌

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