2017 Regulatory Burden Financial Impact Study: An Elevated New Normal

EXECUTIVE SUMMARY

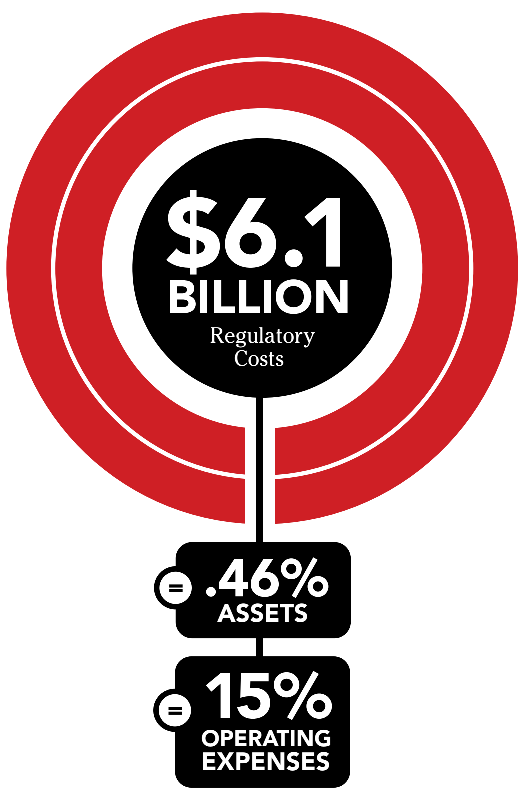
Credit unions recognize that they operate in a regulated industry and must bear reasonable costs of regulation. However, the total financial impact of regulation on credit unions and their members is high and has increased dramatically since the financial crisis.

With the support of state credit union Leagues, CUNA commissioned Cornerstone Advisors to perform a new, rigorous analysis of the current financial impact of regulation on credit unions and the specific regulations that are most burdensome.

Cornerstone Advisors conducted a two-phased study to gain an in-depth examination and quantify the impact of regulation at small, medium and large credit unions. The study gathered data in terms of increased costs, including staffing, third-party expenses and capitalized expenses.

These financial impacts are considerable in terms of the scale of credit union operations.

Cost of Regulatory Burden to Credit Unions



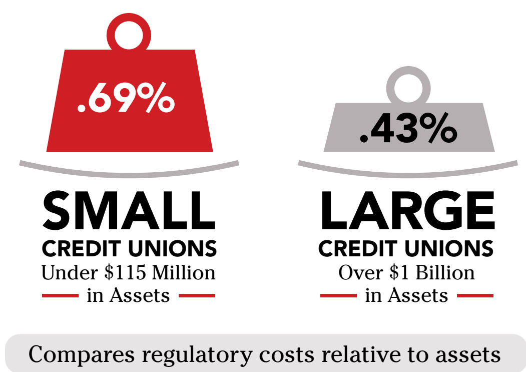
SUBSTANTIAL INCREASES IN REGULATORY COSTS

The regulatory cost of 46 basis points of assets translates to an elevated new normal, totalling an estimated $6.1 billion overall. The $6.1 billion dollar total represents an $800 million dollar increase in just two years.

In percentage terms, credit union regulatory burden dollar costs grew 15.1%, far exceeding the 2.8% inflation rate over the two-year period. Total credit union regulatory burden costs translate to $115 per credit union household.

Substantial Regulatory Cost Increases

Small Credit Unions Bear the Brunt of Regulatory Burden



REGULATORY IMPACTS AND CREDIT UNION SIZE

The study found dramatic evidence of differential impacts by credit union size. Cost impacts were much stronger at smaller versus larger credit unions. There are basic fixed costs associated with complying with regulations and, at larger credit unions, these costs can be spread over a larger asset base. In contrast, adverse revenue impacts were stronger at larger than smaller credit unions. This is because members of larger credit unions are more likely to generate interchange income by using a debit card from their credit union.

TYPES OF REGULATORY COST

The largest component of regulatory expense was for staff, at 75% of the total. This is not surprising, as compensation typically accounts for about half of total credit union operation expenses.

Of the staff costs driven by regulation, the largest component came in member-facing staff. This suggests that credit unions have to employ more such staff than otherwise, and/or that member-facing staff have to divert much of their attention from serving members to complying with regulations.

COLLECTED DATA

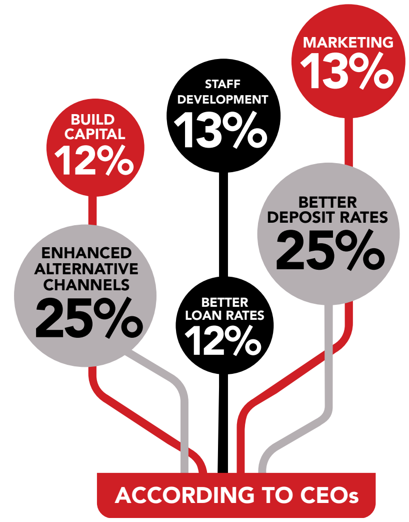
The study collected data on three types of costs related to regulation: staff costs, third-party expenses and depreciation of capitalized costs. For each cost category, care was taken to include only that portion of the costs that are driven by regulatory requirements.

For example, for compliance staff, time spent on compliance with internal policies not required by regulation was not included as a regulatory expense.

STRATEGIC IMPACTS

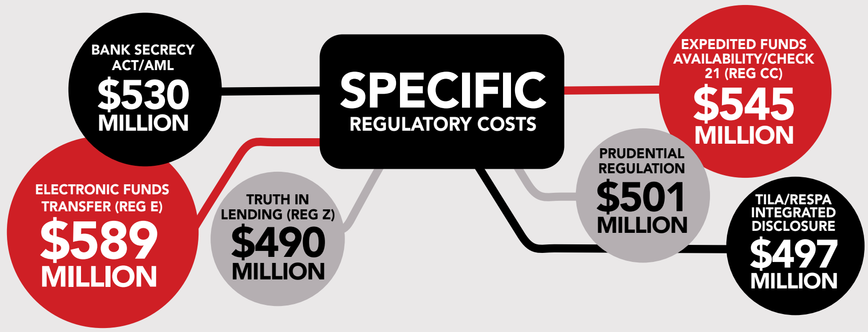
The study solicited credit union CEOs' views on how the funds devoted to regulation would have been reallocated within the credit union had they not been drained by regulation. Better member pricing, better service delivery and institutional strengthening topped the CEOs' lists.

In addition to extensive data collection, the study solicited participating CEOs' viewpoints of where they had seen the greatest increase in regulatory impact in the areas of greater costs, reduced productivity and reduced revenues. The greatest cost and productivity impacts occurred in compliance, mortgage and consumer lending, and internal audit. The greatest revenue impacts were in mortgage lending, debit interchange and payments.



THE MOST COSTLY REGULATIONS

Specific regulations with the biggest impacts include:



KEY THEMES

As a result of engaging with credit union executives over several months while conducting the study, Cornerstone Advisors' analysts catalogued four key features of how credit unions view the impact of regulation:

AN ELEVATED NEW NORMAL
imposing high fixed costs that inhibit growth.

DETERIORATING MEMBER EXPERIENCE & STAFF MORALE
constraining loan growth and increasing staff turnover.

SMALL CHANGES HAVE BIG IMPACTS
loss of members and loan relationships to other industry players not burdened by the same regulations.

MORE ONEROUS REGULATORY EXAMS
with no corresponding increase in value.

CONCLUSION

The study found that the costs that credit unions bear as a result of regulation, even when conservatively measured, are very high, and have increased substantially since the Great Recession. Those substantial increases remain obvious even over the last two years. The burden is particularly egregious for smaller institutions – for many of them, threatening their ability to remain viable in the marketplace.

This summary was prepared by CUNA. Readers are encouraged to visit cuna.org/regburden for additional resources.