April 2023

Changing Regulatory Landscape Brings Member Focus to Credit Unions

Credit Union Tracker® Series

Read the previous edition

MARCH 2023

Credit Union Tracker® Series

What's Inside

PYMNTS | PSCU

Acknowledgment

The Credit Union Tracker® Series is produced in collaboration with PSCU, and PYMNTS is grateful for the company's support and insight. PYMNTS retains full editorial control over the following findings, methodology and data analysis.

Need to Know

Banking Shakeup Means Regulatory Changes Likely

The Silicon Valley Bank (SVB) collapse shocked the venture capital and technology communities with its suddenness. When the bank's massive investment losses caused a huge swath of depositors to withdraw their money, regulators moved in fast to shut down the bank to protect its customers. Now federal regulators are scrambling to address the situation, and financial institutions (FIs) are bracing for change.

In the meantime, SVB's collapse has forced banks, credit unions and FinTechs to reexamine their regulatory posture as fears of wider shock waves across the financial services sector persist. Several major issues related to SVB's failure have come under scrutiny, such as how the bank was without a chief risk officer for almost eight months last year and why its chief executive sold $3.6 million in stock just weeks before the crisis.

SVB's collapse raises regulatory compliance issues, including questions about the following:

- **Adequacy of risk management**
- **Cryptocurrency connection**
- **Possible insider sales of stock**
- **Need for regulatory clawbacks of executive compensation**
- **Overemphasis on environmental, social and governance (ESG) policies relative to financial risk management**

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Need to Know

Regulatory and compliance burdens are a major challenge for credit unions.

CUs differentiate themselves from other FIs by being member-focused and transparent, but 41% admit to being weighed down by regulatory compliance as they look to move digital initiatives forward. The National Credit Union Administration (NCUA) recently cited a number of CU violations in fair lending, for example, due to weaknesses in compliance management systems.

The NCUA noted violations at 29 federal CUs, impacting 64,000 members. Analytics can be a useful tool for CUs to uncover potential fair lending issues regarding loan data, complaints and fee waivers. Enabling this kind of visibility helps CUs adjust when necessary and can offer better protection against violations. Without it, CUs leave it to chance whether examiners will identify a problem.

The NCUA is tasked with helping CUs uncover and prevent regulatory compliance failures.

15% — **Share of federal credit unions found to have violated consumer compliance regulations**

64K — **Number of federal CU members found to have been subjected to unfair lending practices**

Need to Know

The cost of regulatory compliance is enormous for FIs.

The price tag is typically high for new technologies that drive improved compliance, as well as the appropriate talent to integrate and operate it. As CUs embark on their digital transformations, they have an opportunity to match a next-generation core banking platform with a customizable, scalable framework for compliance.

While planned compliance investments can often get sidetracked by other priorities, the consequences of noncompliance can be incredibly costly, including fines and reputation. When U.S. Bank was cited last year for illegally pulling customer credit reports to open accounts without their knowledge, it was hit with a $37.5 million penalty and instructed to create a plan to repay impacted consumers.

Compliance failures come at great cost to organizations.

$1.2B

Expenses Bank of America incurred in regulatory penalties and settlements in 2022

$3.7B

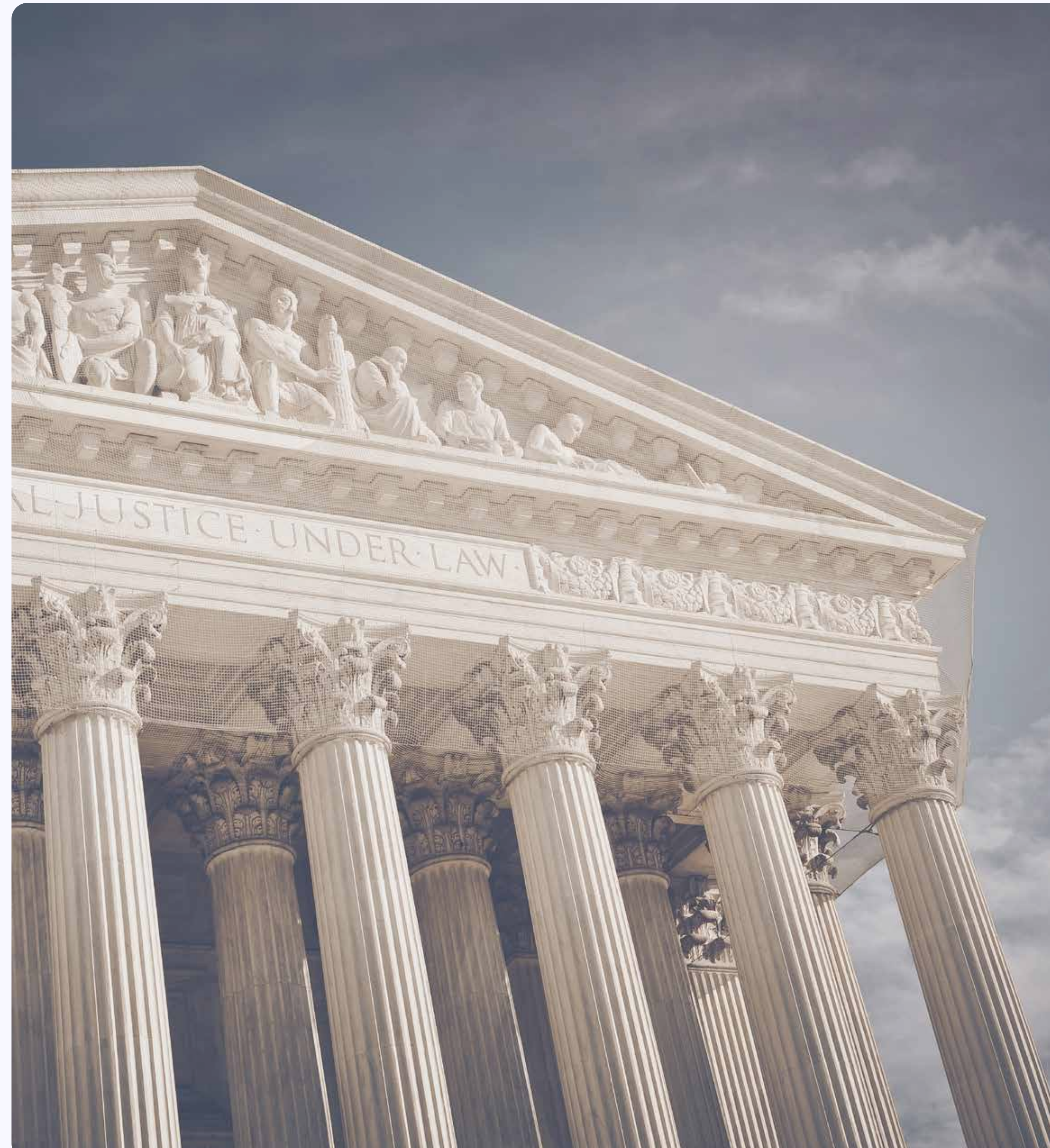
Amount of Wells Fargo's settlement related to charges of gross mismanagement of car loans, mortgages and bank accounts

News and Trends

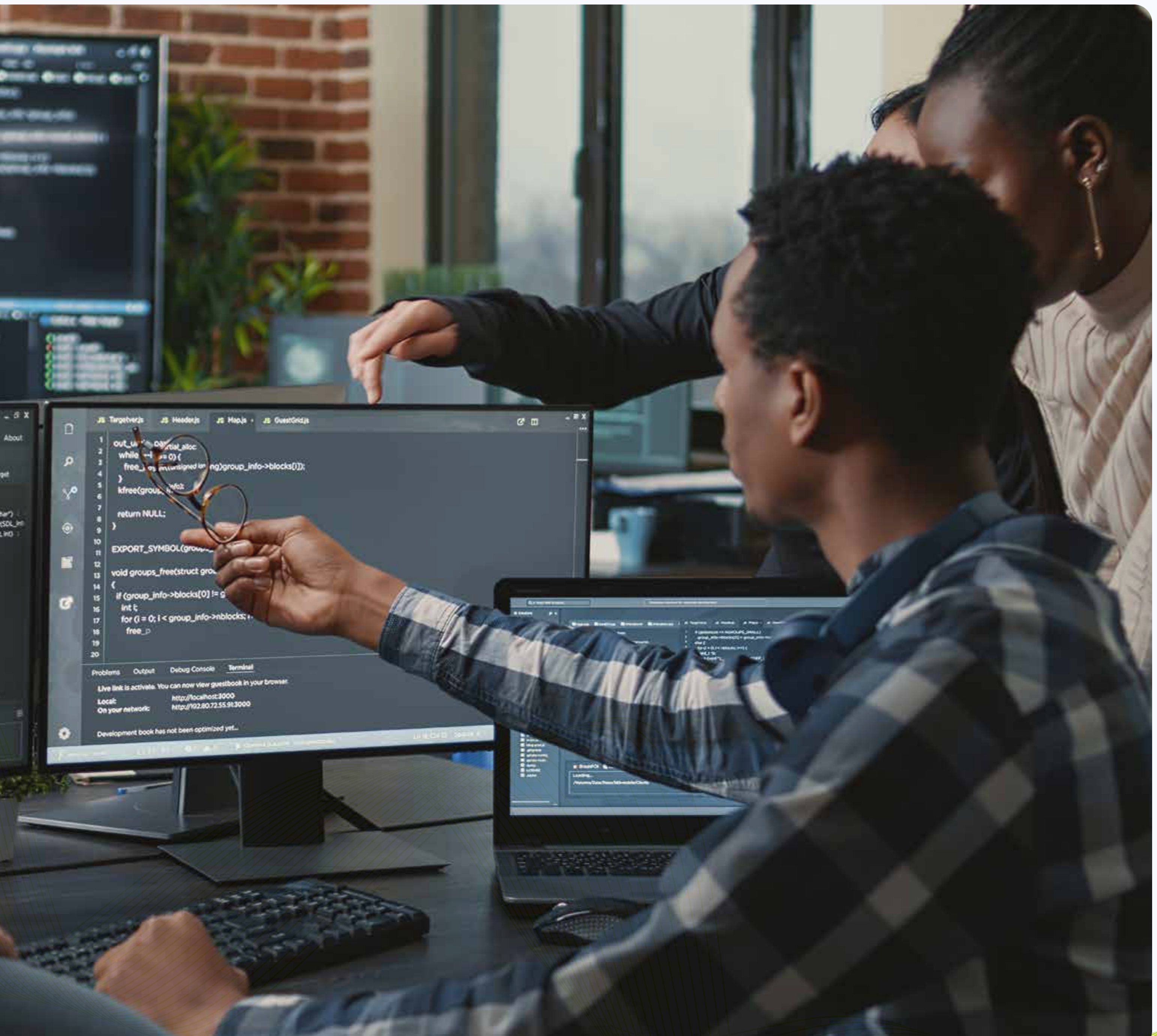
CUs' Lending Rules at Risk With Supreme Court's Scrutiny of CFPB

The Consumer Financial Protection Bureau (CFPB) was established by Congress in 2010 to address the abuses that contributed to the Great Recession. With the Supreme Court set to investigate and potentially dismantle the CFPB, credit union leaders, though longtime critics of the bureau, are nevertheless concerned about the ramifications.

For one, a dismantling of the CFPB could "put the consumer financial services industry into chaos," according to Ann Petros, vice president of regulatory affairs at the National Association of Federally Insured Credit Unions (NAFCU). Beyond that, the potential unconstitutionality of the CFPB could erode the legality of many existing lending regulations, with which CUs have spent substantial time and resources on building systems to comply.



News and Trends



Credit unions prepare for new 72-hour cyberincident reporting rule

The NCUA has approved a new rule requiring federally insured credit unions to notify the association within 72 hours of a reportable cyberincident. Such incidents are defined as those resulting from sensitive data exposure that involves a significant loss of confidentiality, integrity or availability of a network or information system. The incidents must also involve disruption of business caused by the compromising of a CU, cloud service or third-party data hosting provider. The NCUA's new rule also broadens the definition of sensitive data.

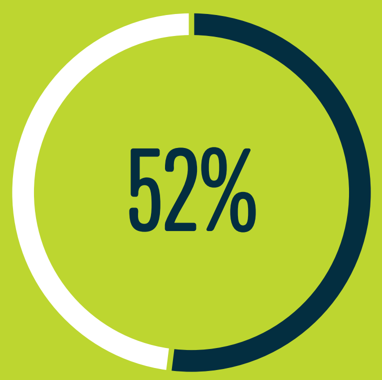
The rule takes effect on Sept. 1, giving credit unions only a short time frame to prepare. It is recommended that federally insured CUs update their incident response plans accordingly and be sure they have clarity on the types of incidents that could trigger a reporting requirement. A data flow diagram or sensitive information audit can also help CUs better identify and retain sensitive member information or data.

News and Trends

CFPB probes data brokers to understand consumer impact

Data brokers have taken on an outsized role in the daily lives of consumers but have done so mostly out of the public eye. As more companies track and collect consumer data, the introduction of the Data Privacy Act of 2023 aims to provide more control to consumers related to their personal information.

The bill would notify consumers on how their data is collected and used while enabling them to stop collection when they choose. Recent PYMNTS research found that consumers are increasingly aware of their personal data's value, with nearly all consumers attaching some level of importance to their data's security when sharing personal information online.



Share of consumers who said data security is extremely important when sharing their personal information online

Share of consumers who said data security is unimportant when sharing their personal information online

PYMNTS Intelligence

Protecting Members Is at the Heart of Compliance

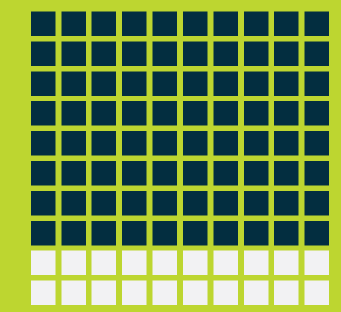
Credit unions are regulated by a number of federal agencies, including the NCUA, the Federal Reserve, the CFPB and the Federal Deposit Insurance Corporation, as well as a host of state agencies. The NCUA regulates, charters and supervises federal credit unions and insures deposits for some 135 million members nationwide, playing a substantial part in the industry's competitive and regulatory landscape while protecting member interests.

The agency's supervisory guidance is nonbinding, but it sets the agenda for what credit unions can expect in terms of regulatory compliance. Among the NCUA's 2023 priorities are consumer financial protection, information security and fraud prevention and detection. These priorities are shared across agencies and represent the many regulatory shifts coming toward CUs.

PYMNTS Intelligence

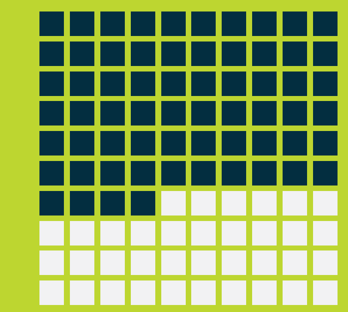
Junk fees are a regulatory priority

One of the CFPB's key areas of focus has been illegal junk fees and their impact on consumers, with a recent report revealing many types of violations by FIs in this area. These violations include unfair fees for bank overdrafts or insufficient funds and overly aggressive late charges on auto and student loans and mortgages. Some of the violations involved vehicles that were illegally repossessed even though customers had already made payment agreements.



80%

Share of consumers who do not trust companies to provide honest and transparent pricing



64%

Share of consumers who refuse to purchase a service or product if a junk fee is levied

Many offending organizations have already addressed the issues, while those that refused will face further CFPB investigation and possible enforcement actions. The report comes at a time when President Biden called for a junk-fee crackdown during his recent State of the Union address. When the CFPB issued guidance on surprise bank overdraft fees, 20 of the largest banks in the U.S. eliminated the charges. Some $30 million was refunded to 170,000 fee-stricken account holders, CFPB found.

PYMNTS Intelligence

Planned CFPB regulation would move industry closer to open banking

The CFPB has also worked to move financial services toward open banking, or providing access to consumer banking data by third-party financial services firms to develop new products and services. When implemented, its Open Banking Rule could be one of the most important data privacy laws issued by a federal agency. The proposed rule would enable consumers to control and share their financial data with banks and nonbank FIs via application programming interfaces (APIs).

The rule would require "data providers" — including banks, credit unions, card issuers and other entities — to "make available" consumer financial information in six different categories, from periodic statement and transaction information to consumer identity information. FIs, meanwhile, are not granted any discretion to refuse consumer information requests. The CFPB is considering proposals that address third-party data collection and security. After additional input from small businesses, the CFPB will finalize and implement rules next year.

Under the Open Banking Rule, an authorized third-party financial service provider would be required to do the following:

Provide an authorization disclosure informing the consumer of important terms of access

Obtain the consumer's informed, express consent to terms of access within an authorization disclosure

Certify to consumers that it will operate according to obligations related to collection, use and retention of their information

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Open Banking Rule could work against CUs

The proposed Open Banking Rule is meant to stimulate market competition by enabling consumers to leave their FIs and take their financial data to new providers. The NAFCU, however, believes the rule could have the opposite impact. Because API adoption has been cost-prohibitive for many smaller organizations, the NAFCU contends that the proposed Open Banking Rule rewards larger and more technologically advanced FIs at the expense of CUs and community banks.

Further, CUs would face major expenditures and operational challenges under the CFPB's proposed requirement that data providers fund and construct a portal to their core banking systems for access by third parties such as FinTechs. In addition, a provision to eliminate screen scraping would put CUs and small banks at a competitive disadvantage during their transition to APIs. Industry groups are favoring an incremental approach to open banking that would strike more of a competitive balance. These kinds of details regarding the CFPB's proposed rule are sure to create compliance challenges. Those CUs that are proactive in their response will be best prepared for change.

Financial services industry advocates are critical of the CFPB Open Banking Rule along multiple fronts:

- **The Bank Policy Institute** wants FIs' liability for data to end when the data leaves the portal, or for them to be indemnified by the responsible party related to any consumer loss, pushing third parties to improve data security and privacy.
- **The Consumer Bankers Association** believes the party responsible for consumer data loss should be whoever was in control of the data when the breach occurred.
- **The Consumer Data Industry Association** wants to exclude credit report information.

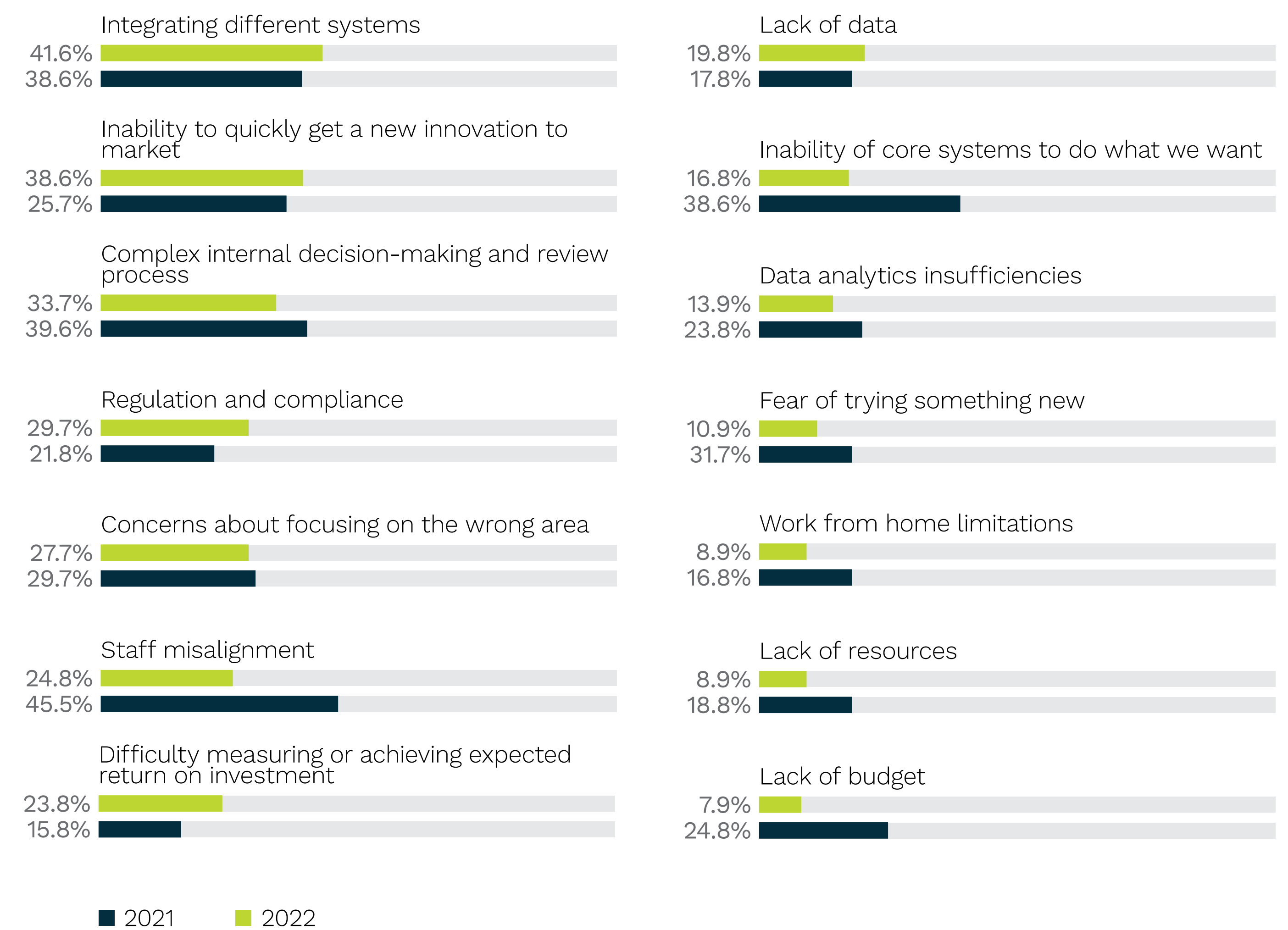
Chart of the Month

Regulatory Compliance Is the Fastest-Growing Challenge to CU Innovation

When introducing new products and services, FIs often run into snags that can delay or even eliminate altogether the rollout of new technology. A recent PYMNTS study found that regulation and compliance comprise the fastest-growing challenge for credit unions aiming for innovation. About 30% of CUs cited regulation and compliance as a challenge in 2022, while roughly 22% did so the previous year. The acceleration of technology adoption across the industry has driven new regulatory concerns, prompting rule changes and an increased workload for FIs' compliance teams.

Challenges in innovation

Share of CU executives citing select challenges when bringing products to market



Source: PYMNTS
Credit Union Innovation: The Race to Meet Consumer Demand, July 2022
N = 101: Complete responses, fielded April 4, 2022 – April 20, 2022

Insider POV

An Insider on Staying Ahead of Regulation with Proactive Measures

Junk fees and interchange are two regulatory concerns credit unions can prepare for by providing CU-specific context that may elude many regulators.

TODD LANE
President and CEO

> “We are always looking for ways to protect consumers and members, to [stay] ahead of [regulation]. We’re staying ahead of things because we know the issue before it comes down and impacts us.”

When Todd Lane of California Coast Credit Union says his organization tries to stay ahead of regulatory changes, he means it. Lane noted how he keeps in close contact with legislators involved in regulating the industry and that he is not shy about sharing CUs’ collective point of view when the time is right.

“Those relationships can make a difference,” he said.

As banks and credit unions brace for likely regulatory changes on the heels of the recent SVB collapse, Lane said it is vital for CUs to contribute proactively to the conversation. He said many CUs rely too much on trade associations to do the heavy lifting in terms of advocacy, and the more that credit unions can develop relationships with legislators and regulatory agencies, the better positioned they will be when it comes to compliance.

Insider POV

One area that Lane is following closely is junk fees, a clear priority of the Biden Administration as well as the Consumer Financial Protection Bureau. In California, legislation went into effect this year requiring CUs to report certain fees, such as overdraft and nonsufficient funds, and the state recently issued its first report of aggregated data that measures the levied fees as a percentage of FIs' total income.

Lane believes the data being collected does not paint an adequate picture of how the different types of fees are applied, however. California Coast Credit Union is among those FIs that use guardrails for members when charging fees, limiting the number and total cost of fees in certain situations. Fundamentally, he said, consumers want their purchases to be protected if their balances cannot cover them, and reasonable fees enable that. Lane said the data California collects cannot factor in those situations.

"Our concern was that they asked for very specific data, and they didn't ask for anything that perhaps would round out the picture of those fees," Lane said.

Another area Lane is following is interchange. With Senator Dick Durbin likely to reintroduce legislation that failed to advance last year, the Credit Card Competition Act, CUs' interchange income from credit card charges would take a big hit. Credit unions, however, must bear the cost of defending against fraud and protecting transactions, which eats into revenue over time and makes a reduction in fees a potential headache.

"Interchange fees income is important to credit unions as card issuers, and merchants would like nothing more than those [fees] to be significantly reduced," said Lane. "I don't believe that those making our laws understand the expense related to these programs and the risks related to [them]."

In addition to staying in front of regulators, Lane says CUs can be proactive by addressing regulatory impacts internally before they start. For example, California Coast Credit Union has spent the last few years diversifying its revenue base through investment services, broker or dealer services and insurance.

Lane said CUs should always try to get ahead of regulatory priorities, such as with additional fraud controls to prevent losses or marketing and education that helps members better protect themselves.

Above all, he implored other CUs to prioritize advocacy as much as possible as these issues take shape.

"Getting involved and telling your story, for us, is top of the list," Lane said.

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Companies to Watch

New Tech Adoption Helps CUs Improve Compliance

One of the nation's largest CUs announced it has chosen compliance solutions provider AML RightSource to improve its anti-money laundering (AML) compliance with artificial intelligence. AML RightSource will automate Golden 1 Credit Union's transactions, investigations and reporting, delivering an estimated 50% increase in efficiency for member risk reviews and transaction monitoring systems alert investigations.

Frontwave Credit Union, a CU serving military and civilian communities in Southern California, implemented Black Knight's Empower loan origination system (LOS) to drive its expanding lending operations. The high-performance LOS will help Frontwave win new mortgage business with a full suite of data and analytics solutions as well as compliance validation testing.

Encapture, a high-growth software-as-a-service platform for banks, credit unions and FinTechs, launched a new data validation solution that will enhance compliance automation for regulatory reporting. The solution eliminates the need for manual data scrubbing, enabling the bandwidth to address anticipated regulatory expansion across the financial services sector.

What's Next

Biden Looks to Reverse Trump's Weakening of Safeguards for Regional FIs

Another area of emphasis that could impact many CUs, signaled with a recent fact sheet by the Biden Administration, is how Trump Administration regulators weakened "commonsense bank safeguards and supervision" for large regional banks. President Biden is urging federal banking agencies to consider reforms that would better regulate FIs with assets between $100 and $250 billion, avoid factors that contributed to the SVB collapse and strengthen the entire banking system. Among the Biden Administration's recommendations are restoring liquidity requirements, enhanced liquidity stress testing and annual supervisory capital stress tests, along with comprehensive resolution plans.

"Trust is the real opportunity that is going to come out of today's situation. [The aftermath of the SVB crisis offers] a great opportunity for credit unions, which in a lot of ways are the pillars of their local communities, to reach out to their client bases and see [how] those relationships can be strengthened."

BRIAN CALDARELLI
Executive vice president and CFO

PSCU

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About

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PSCU

PSCU, the nation's premier payments CUSO and an integrated financial technology solutions provider, supports the success of more than 2,400 financial institutions and processes nearly 7.7 billion transactions annually. Committed to service excellence and focused on continuous innovation, PSCU's payment processing, fraud and risk management, data and analytics, digital banking, strategic consulting and real-time payments platforms, along with 24/7/365 member support via its contact centers, help deliver personalized, connected experiences. The origin of PSCU's model is collaboration and scale, and the company has leveraged its influence on behalf of credit unions and their members for more than 45 years. Today, PSCU provides an end-to-end, competitive advantage that enables credit unions to securely grow and meet evolving consumer demands. For more information, visit pscu.com.

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