Credit Union Guide to Crossing the $10 Billion Asset Threshold

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The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was signed into law in July 2010 and was aimed at implementing go-forward corrections following the financial crisis and recession over the preceding three years.

Under the far reaches of the Dodd-Frank, an asset threshold of $10 billion was established as a trigger to invoke heightened risk management, regulatory oversight and scrutiny, including direct supervision from the newly created Consumer Financial Protection Bureau (CFPB). Furthermore, surpassing the $10 billion threshold would unlock aspects of certain regulations that impact credit union revenue generation, such as debit card interchange fees under Regulation II.

Reaching and surpassing the $10 billion threshold (and thus becoming a "covered" credit union) brings about very significant implications for credit unions in terms of complexity, increased costs and pressures on revenue, which impact the entire organization, from the Board to front-line staff.

Preparing for the implications of the $10 billion threshold is a very complex undertaking and requires multiple years of commitment. This guide is intended to provide an overview of what to expect, as well as considerations and recommendations as your credit union approaches this significant event.

$10 Billion CU Definitions and Requirements

According to the June 2021 Call Report data, a total of 19 credit unions in the U.S. had surpassed the $10 billion asset threshold, with another 18 credit unions in the $7.0-$9.9 billion range, poised to reach the $10 billion mark within the next few years.

It is important to note and acknowledge the impact that policy response driven by the COVID-19 pandemic (e.g. multiple stimulus payments, low interest rates, etc.) has made on credit union balance sheets. Given government and consumer reaction to the resulting economic recession, credit unions have generally been injected with high l evels of deposits and have seen balance sheets grow substantially over the past 18+ months. As noted previously, the industry had 19 CUs above the $10 billion mark as of June 2021. Looking back to December 2019, there were a total of 10. Essentially, the number of $10 billion credit unions in the U.S. has nearly doubled since the onset of the pandemic.

As a result of this unintended balance sheet expansion, two interim rules have been adopted by regulators to temporarily ease the burden of increased compliance costs and revenue impacts for credit unions reaching the threshold to become covered financial institutions ahead of plan:

- In December 2020, a temporary interim final rule was issued by the Federal Reserve that changed the asset measurement date for Regulation II (Debit Card Interchange Fees and Routing). As a result, if a debit card issuer reached $10 billion in assets after December 31, 2019, that issuer would not be considered a covered issuer subject to interchange fee limitations until assets are measured by the Federal Reserve in 2022.

- In March 2021, another temporary interim final rule was issued by the NCUA that changed the asset measurement date for capital planning and stress testing requirements, with direct oversight from the NCUA's Office of National Examinations and Supervision (ONES). As a result, if a credit union surpassed $10 billion in assets after March 31, 2020, then the CU would not be considered as covered until January 2023.

Key Implications of Becoming a $10 Billion Credit Union

Once a financial institution surpasses the $10 billion threshold, the primary impact is a new realm of risk management and capital planning requirements, as well as more rigorous regulatory oversight, all of which entail significant impacts to the cost structure of a covered credit union.

For example, covered credit unions are required to initially develop and maintain an annual capital plan and related policy by December 31 of each year. The capital plan must be based on financial information from either of the two quarters preceding the quarter in which the plan is approved by the board of directors (or designated committee). Credit unions can expect a heightened level of regulatory scrutiny and examination of impacts from NCUA ONES, as well as the CFPB as an additional bureau of oversight and examination, primarily through the consumer protection lens.

Directly related to these requirements, there will be a need to invest significantly in technology, infrastructure and talent needed to support the new regulatory demands of a $10 billion institution. To that end, credit unions plan for higher levels of operating expenses.

Becoming a $10 billion credit union brings an end to the small issuer exemption that is afforded through Regulation II, which governs debit card interchange fees and routing. More specifically, credit unions can expect to have debit card interchange fees capped, with the current level at 21 cents, plus five basis points of the transaction amount and a one-cent fraud adjustment, regardless of POS transaction type (e.g. signature vs. PIN-based).
This regulated level of interchange fee represents roughly a 50% reduction from the current level of non-regulated interchange.

Furthermore, debit card issuers over $10 billion are subject to rules around

net compensation from a payment card network, which have been established to avoid issuers and networks evading the interchange fee caps. As a result, a covered issuer may not receive financial compensation from a payment card network that exceeds the total amount of fees paid by the issuer to the network in a calendar year.

Recommended High-Level Approach

Becoming a $10 billion credit union is a very large undertaking and requires ample preparation. The key to success is to start the process early, at least two to three years prior to the anticipated crossing of that threshold.

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The following are some key activities and milestones in the multi-year preparation process:

- **Network often with your large credit union peers, NCUA contacts and other industry partners, incorporating their best practices into your particular approach and planning process.**
- **Enlist assistance from an advisor with expertise and experience in risk management, capital planning and NCUA/CFPB regulatory oversight for credit unions transitioning to the $10 billion+ asset range, well in advance of the event.**
- **Conduct a full current-state and future-state assessment of technology, infrastructure and talent that will be required in order to manage risk and achieve compliance.**
- **Effectively plan out your timing in reaching the $10 billion threshold. During this process, credit unions will have a choice of either actively managing their balance sheets below the threshold for a period of time or accelerating through the finish line.**

- **Create an initial inancial analysis to quantify expected impacts to revenue, cost structure and ROA, based on the current and future state assessments. Remember that debit card interchange revenue impacts will be signi icant, with regulated rates being at a level of around 50% of unregulated rates.**
- **Begin addressing talent needs for the future at all levels of the organization, including the board.**
  - Recruit board members and senior leaders with large financial institution experience. While you do that, be mindful as to not cause disruption of your mission and culture.
  - Consider appointing a Chief Risk Officer and Chief Compliance Officer, if you have not done so already.
  - Examine new or expanded roles, such as data analysts, in-house compliance personnel and technical writers.
- **Determine an optimal organizational structure.**
  - Do you need a formal risk organization, including a risk committee of the board (inclusive of the credit committee)?
  - Does your credit union have the right data warehouse, data governance, analytics and modeling resources in place?
  - Is an expanded compliance organization needed?
  - Where does it all fit within the credit union?

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- **What technology investments will be required?**
  - Data warehouse and analytics / modeling systems
  - Risk management system
  - Capital management / ALM modeling systems
  - Information / data security upgrades
  - Other
- **Work proactively with the NCUA to start building the necessary infrastructure to achieve $10 billion requirements.**
- **In anticipation of CFPB oversight, enhance your current member complaint review process to a more formalized tracking system.**
- **Develop a plan to mitigate revenue pressure and added costs that will occur as your credit union surpasses $10 billion in assets, including:**
  - Ensure optimal performance of credit and debit programs, which is even more critical as you cross the threshold. PSCU's team of of Advisors Plus consulting experts can assist you in addressing important questions, including:
    - Has your credit union forecasted the expected financial impact of Durbin / Regulation II on non-interest income?
    - What are the impacts of a reduction in debit interchange to checking profitability? Should your credit union consider migration from free checking to fee-based checking products, commensurate with overall member strategies? Are there other alternatives?
    - Does your credit union offer a compelling credit card product lineup and features, given your membership profile and your unique competitive environment? The same question is just as appropriate for the checking products that drive your debit card program.
    - Are your credit card products priced appropriately, considering the balance of risk, increased operating costs as well as the intense competitive environment?
    - Do you make it easy and logical for your members to understand, apply for, use and receive service for your payments products, particularly through your digital channels? Is your operating model in alignment with that approach?
  - Consider expansion into new verticals, such as wealth management, commercial services, etc.
  - Evaluate growth opportunities as to quickly leverage scale, such as expanding membership and /or geographic footprint. M&A opportunities could also be explored.
  - Actively manage your operating costs across the credit union.

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