SOUTHEAST CUNA MANAGEMENT SCHOOL

Athens, Georgia

Third-Year White Paper

For the 2023-2024 School Year

How Credit Unions Can Navigate the Changing Landscape for Account Fees and Interchange

Johanna Gillispie | Go Energy CU | Tucker, GA | johanna.gillispie@goenergyfin.com

Jennifer Webb | SAFE FCU | Sumter, SC | jwebb@safefed.org

Joseph Staff | The Health and Education FCU | Lexington, KY | jstaff@thefcu.com

Justin Cousins | Peoples Advantage FCU | Petersburg, VA | jcousins@peoplesadvfcu.org

Julie Irvin | Georgia's Own CU | Atlanta, GA | jsirvin@georgiasown.org

Tori Shoemaker | 1st Mississippi FCU | Meridian, Mississippi | tshoemaker@1stms.com

Table of Contents

Introduction 3

Statement of Issue..3

Research.. 4

Fee Income Sources Subject to Regulatory Scrutiny... 4

Consumer Financial Protection Bureau's Initiative to Eliminate Excessive Fees............5

Consumer Financial Protection Bureau's Regulatory Scope.. 6

National Credit Union Administration's Plans for Change...7

Federal Reserve System's Proposal to Lower Debit Card Interchange Fees..................7

Rising Threats of Litigation.. 8

The Reduction of Overdraft/NSF and Debit Card Interchange Fees...............................8

What are Competitors Doing to Offset the Potential Loss of Income?...................... 10

Recommendations and Solutions.. 11

Diversification of Lending Products for Increased Interest and Non-Interest Income 12

Credit Union Service Organizations (CUSO's), Fintech Firms, and Automation........... 13

Summary and Conclusions.. 15

Johanna Gillispie: Go Energy Credit Union.. 16

Jennifer Webb: SAFE Federal Credit Union.. 16

Joseph Staff: The Health and Education Federal Credit Union..................................... 16

Justin Cousins: Peoples Advantage Federal Credit Union... 16

Julie Irvin: Georgia's Own Credit Union.. 17

Tori Shoemaker: 1st Mississippi Federal Credit Union... 17

References.. 18

Appendix A.. 23

Introduction

Increased challenges driven by uncertainty are nothing new in the financial services industry. Today's credit unions are faced with increased regulatory scrutiny, changing consumer expectations, economic uncertainty, and energized competitors (Healy, 2022). Credit unions have shown the ability to be resilient after becoming a major movement during the Great Depression in 1934. During this time, the Federal Credit Union Act was passed, and the growth of credit unions accelerated as alternatives for saving and borrowing were provided to the every-day consumer in the United States (Institute for Local Self-Reliance, 2010). The time to test the resiliency of the credit union movement appears to be reaching a very pivotal point.

Proposed regulations from government agencies, pressure from other financial institutions, and changes to normal consumer behavior are items which could be currently or are actively appearing on credit union strategic plans. A large factor influencing decisions in all credit unions, regardless of asset size, is the reshaping of the landscape for account fees and debit card interchange income (Packer, 2020).

Statement of Issue

In January 2022, the Consumer Financial Protection Bureau (CFPB) launched an initiative aimed at providing guidance, scrutiny, and potential policy implementation around the category of 'junk fees.' On October 26, 2022, the CFPB issued formal guidance on what they feel are unlawful and unfair practices (CFPB, 2022a). Junk fees are an array of fees consumers do not anticipate nor are they typically explained. In the financial industry, these may include surprise overdraft fees and surprise depositor fees (Bennett, 2023). This guidance has led many larger financial institutions to remove insufficient funds (NSF) fees entirely. To keep up with this growing trend, many smaller institutions also followed suit (Borne' and Zirkle, 2022).

In addition to the perceived upcoming removal or reduction in overdraft, NSF, and depositor fees, there is also a proposal to reduce interchange income on debit card transactions. Interchange income from debit card transactions helps offset daily occurrences such as fraud, offering rewards, and issuing physical cards for point-of-sale transactions. There is a proposed rule drafted by the Federal Reserve Board to amend Regulation II, a standing provision of the Dodd-Frank Act. The proposal drafted aims to reduce the base component of debit card interchange from 21.0 cents to 14.4 cents, and the ad valorem component would decrease from 5.0 basis points to 4.0 basis points. Adjustments to these calculations would also be likely to occur every year according to the proposed rule (Larson, 2024).

During a ten-year review of call report data from 2008 through 2018, it was reported non-interest income as a percentage of gross income increased from 19% in 2008 to 27% in 2018. This review also noted credit unions attributed this increase in non-interest income because this income source was not tied to the changing interest rate markets (Dearing, 2019). Based on the above guidance from the CFPB and the Federal Reserve, the period of non-cyclical changes in non-interest income appears to be ending.

While it is true many of the proposed changes highlighted above are only intended to impact institutions with asset sizes $850 Million or more (American Bankers Association, 2024), or with more than one million credit card consumers (CFPB, 2024), we must weigh the feasibility of the ability of credit unions to continue to operate under the status quo. When the larger institutions with a more sizable consumer base update their fee structure, it can and most likely will shift the entire industry to develop new industry norms. As a result of this transformation, credit unions, regardless of asset size, will be required to also pivot to make similar changes as the larger institutions' changes will drive consumers to expect this behavior.

Based on the changes, either already in force or what will potentially become a part of regulations, all credit unions must be prepared to adapt (Offices of Consumer Populations and Markets, 2023). By remaining on the sidelines, we will not be doing good for the members whom we are helping each day. We need to think of alternative ways of producing continued sound financial stability without the continued assistance of penalty fees and interchange income as we know it today. Honestly, in our opinion, by promoting the philosophy of 'People Helping People,' we should agree with any change which will help retain more money for our membership. This just seems like the right thing to do.

This paper will dive into the increased regulatory landscape and what this means for the credit union industry. In addition, we will explore how these traditional fees, which are now labeled as 'junk fees' by the CFPB, have been historically heavily relied upon. We will also discuss alternative ways to increase non-interest income for other credit unions to help supplement the expected losses of traditional sources of fee and interchange income.

Research

Credit unions have relied on non-interest income, which consists of income generated primarily by services and transaction fees, as a means to assist in maintaining their bottom lines (Packer, 2020). Traditionally, fee income derived from programs, such as overdraft, fraud protection services, loyalty programs, and ATM marketing, have been significant contributors to this effort (Packer, 2020). However, with the changing economic landscape, credit unions' reliance on income from these programs and services is in jeopardy (Fritz, 2023).

Fee Income Sources Subject to Regulatory Scrutiny

Overdraft programs have proven to be an income generator for credit unions for several years. However, the intent behind establishing overdraft programs was to provide credit union members peace of mind when conducting transactions (Deschaine, 2023). In its 2005 Letter to Credit Unions, the National Credit Union Administration (NCUA) recognized overdraft programs benefit credit union members and credit unions (NCUA, 2005). The letter stated while credit unions could receive a fee income, credit union members could avoid the inconvenience and subsequent fees associated with returned checks. As a condition for the NCUA's support for the programs, the NCUA outlined credit unions were required to implement clear guidelines on the program and adequately educate its members on alternatives (NCUA, 2005).

To clarify its oversight of overdraft programs, the NCUA issued a separate letter to credit unions in 2005, *Overdraft Courtesy Pay Programs,* which detailed the expectation for additional disclosures on member statements as required by the *Truth in Savings Act* (NCUA, 2005). Concurrently, the NCUA also included a questionnaire with the letter outlining its expectation for an overdraft examination. The questionnaire covered policies on the program, disclosures, communication to members, reporting requirements, vendor responsibilities, compliance considerations, and reputation expectations (NCUA, 2005).

As part of its examination, the CFPB also reviews overdraft services (CFPB, 2023a). Additionally, to raise awareness of overdrafts, the CFPB offers an educational handout for consumers (CFPB, 2021). The CFPB handout explains options to consider to assist in reducing or eliminating overdraft fees. The options include opting out of debit and ATM overdraft coverage, linking accounts to cover overdrafts, or considering a line of credit. In addition, the handout provides tips for consumers to avoid overdrafts, including tracking balance, prescheduling electronic transfers, and receiving email or text alerts.

Credit unions have also relied upon debit card interchange fees as another lane of revenue. The 2011 Dodd-Frank Act required the Federal Reserve Board to set interchange limits at a reasonable and proportional level to the cost incurred by the issuer concerning the transaction (Schwarz, 2023). For over a decade, the Federal Reserve Board maintained the cap on these fees at 21 cents plus .05% of a debit transaction amount with a 1-cent fraud adjustment for qualified issuers (Schwarz, 2023). Interestingly, when the Federal Reserve Board implemented the change, the average debit card interchange fees dropped substantially and have not fluctuated since then (Marek, 2023).

Despite the long-standing history of fee-generating programs and the prior regulatory oversight, scrutiny of these programs has recently increased due to the concern these practices are unfair, deceptive, or abusive for consumers (Deschaine, 2023). In response to regulatory attention, competitors in the financial industry are transitioning away from charging these types of fees. With the mounting pressure to adjust fee practices, credit unions must rethink their current strategy and explore new revenue-generating streams.

Consumer Financial Protection Bureau's Initiative to Eliminate Excessive Fees

In recent years, the CFPB has been laser-focused on its strategy for financial institutions to eliminate charging consumers so-called junk fees (CFPB, 2022b). Within the financial industry, the CFPB asserts fees charged for overdrafts and non-sufficient funds (NSF) have significantly impacted consumers monetarily (CFPB, 2022a). Per the CFPB's position, the fees charged for these services primarily benefit the financial institution and provide little to no value to the consumer (CFPB, 2022b). According to the CFPB, assessing overdraft fees a consumer would not reasonably anticipate is likely unfair. (CFPB, 2022c). The CFPB imposed enforcement actions against financial institutions under its authority to bolster its initiative.

In 2022, the CFPB issued a Consent Order concerning Regions Bank's overdraft fee practices (*In the Matter of Regions Bank*, 2022). The CFPB identified Regions Bank committed unfair and abusive acts and practices when it charged overdraft fees on transactions with a sufficient balance when the Bank authorized the transaction but later settled with an insufficient balance, known as Authorized-Positive Overdraft Fees. Similarly, the CFPB ordered Wells Fargo Bank, NA, to abstain from charging Authorized-Positive Overdraft Fees for consumer debit card purchases and ATM withdrawals, asserting the practice was unfair (*In the Matter of Wells Fargo Bank, NA*, 2022).

Moreover, the CFPB identified Atlantic Union Bank violated federal law when it failed to obtain consumers' affirmative consent to enroll in opt-in overdraft services and subsequently charged fees for the service (*In the Matter of Atlantic Union Bank*, 2023). The CFPB further identified Atlantic Union Bank committed deceptive acts or practices when it failed to sufficiently explain transactions covered by the overdraft services, including the fees associated with the service.

Notwithstanding the CFPB's mission to eliminate fees related to overdraft services, the reluctance to implement this change has been gradual. The CFPB has reported only four credit unions under its scope had stopped charging fees for non-sufficient funds (CFPB, 2023b). Additionally, many financial institutions have been slow adopters due to the CFPB's limited regulatory reach (Neal, 2023).

Consumer Financial Protection Bureau's Regulatory Scope

According to statutory law, the CFPB's scope of coverage applies to insured depository institutions and credit unions with total assets of more than $10 billion and any affiliate (Wall Street Reform and Consumer Protection Act, 53 USC § 5481 *et seq*., 2010). As of September 30, 2023, 176 financial institutions fell within the CFPB's purview (CFPB, 2023b). The number of credit unions included in the count was limited to twenty-one. In comparison, in a review of the National Credit Union Association's (NCUA's) data during the same time frame, the number of federally insured credit unions totaled 4,645 (NCUA, 2023c). The comparison illustrates the overwhelming number of credit unions falling outside the CFPB's umbrella.

Another reason some financial institutions lack the urgency to stop charging overdrafts and non-sufficient fund fees may be due to the constitutional challenges facing the CFPB (Neal, 2023). In a recent decision, the United States Fifth Circuit Court of Appeals held the funding of the CFPB violated the Appropriations Clause and the Constitution's underlying structural separation of powers (SCOTUSblog, 2023). The case has been appealed to the United States Supreme Court to determine whether the funding of the CFPB is constitutional (SCOTUSblog, 2023).

National Credit Union Administration's Plans for Change

Despite the lack of impulse to follow the CFPB's lead, credit unions may be forced to acquiesce due to the NCUA's position. The NCUA has heavily forecasted credit unions should be moving toward eliminating overdraft and NSF fees (NCUA, 2023b). NCUA Chairman, Todd Harper, has stated, "Banks have worked in recent years to restructure their overdraft and NSF fee programs. The time has come for credit unions to do the same, if they want to remain competitive and live up to the statutory mission of credit unions of meeting the credit and savings needs of members, especially those of modest means (para. 12)." Harper cited a critical concern with overdraft and NSF fees is due to falling disproportionately on underserved communities (NCUA, 2023b).

Adding support to this position, the NCUA outlined in its January 2024 letter to federally insured credit unions it will focus on overdraft programs (NCUA, 2024a). In particular, for federal credit unions, there will be an expanded review of a credit union's overdraft programs, including website advertising, balance calculation methods, and settlement processes. Furthermore, the NCUA planned to evaluate credit unions' adjustments to their overdraft programs to address consumer compliance risk and potential consumer harm from unexpected overdraft fees. To add additional support to its charge, the NCUA changed the Call Report form, requiring credit unions with over $1 billion in assets to begin reporting fee income for overdraft fees and non-sufficient funds (NCUA, 2024b).

Federal Reserve System's Proposal to Lower Debit Card Interchange Fees

In a separate but related manner, credit unions may face a change in fee income related to debit card interchange fees. The Federal Reserve Board has requested comment concerning a proposal to lower the maximum interchange fee a large debit card issuer can receive for a debit card transaction (Federal Reserve, 2024).

In addition, the proposal would establish a regular process for updating the maximum amount every other year going forward. This proposed change would impact all three components of the interchange fee cap (Larson, 2024). The base component would decrease from 21 cents to 14.4 cents, the ad valorem component would decrease from 5.0 basis points (multiplied by the value of the transaction) to 4.0 basis points (multiplied by the value of the transaction), and the fraud-prevention adjustment would increase from 1.0 cents to 1.3 cents for debit card transactions subject to the interchange fee cap.

In response, credit unions have raised concerns, citing the current interchange caps as having already caused significant harm to credit unions and their members (America's Credit Unions, 2024). This proposal could prove to be even more harmful.

Rising Threats of Litigation

Another eminent concern for overdraft programs stems from the risk of class action litigation. Even credit unions with a small membership base and remote locations are not immune from lawsuits (Sickels & Vilker, 2022). The basis behind the litigation can revolve around how transactions are processed, calculation of available balance, charging multiple overdraft fees for a single transaction, or charging fees for transactions authorized with a positive account balance (Sickels & Vilker, 2022). Consumer advocates often mention the majority of consumers do not utilize overdraft protection nor are impacted by fees. Rather, it is often the most financially vulnerable who have the highest fees and charges (The Credit Union Connection, 2021).

A common theme in the overdraft lawsuits centers around the failure to accurately disclose the precise method in which overdraft fees will be charged (Sickels & Vilker, 2022). Communications and disclosures for overdraft programs should be consistent, clear, and unambiguous. While credit unions cannot prevent potential litigation surrounding the overdraft and NSF fees, credit unions can attempt to manage the risks accompanying these practices (Sickels & Vilker, 2022). However, new claims and theories for these lawsuits are constantly advancing requiring credit unions to stay focused and vigilant as to the exposure these practices may impose (Sickels & Vilker, 2022).

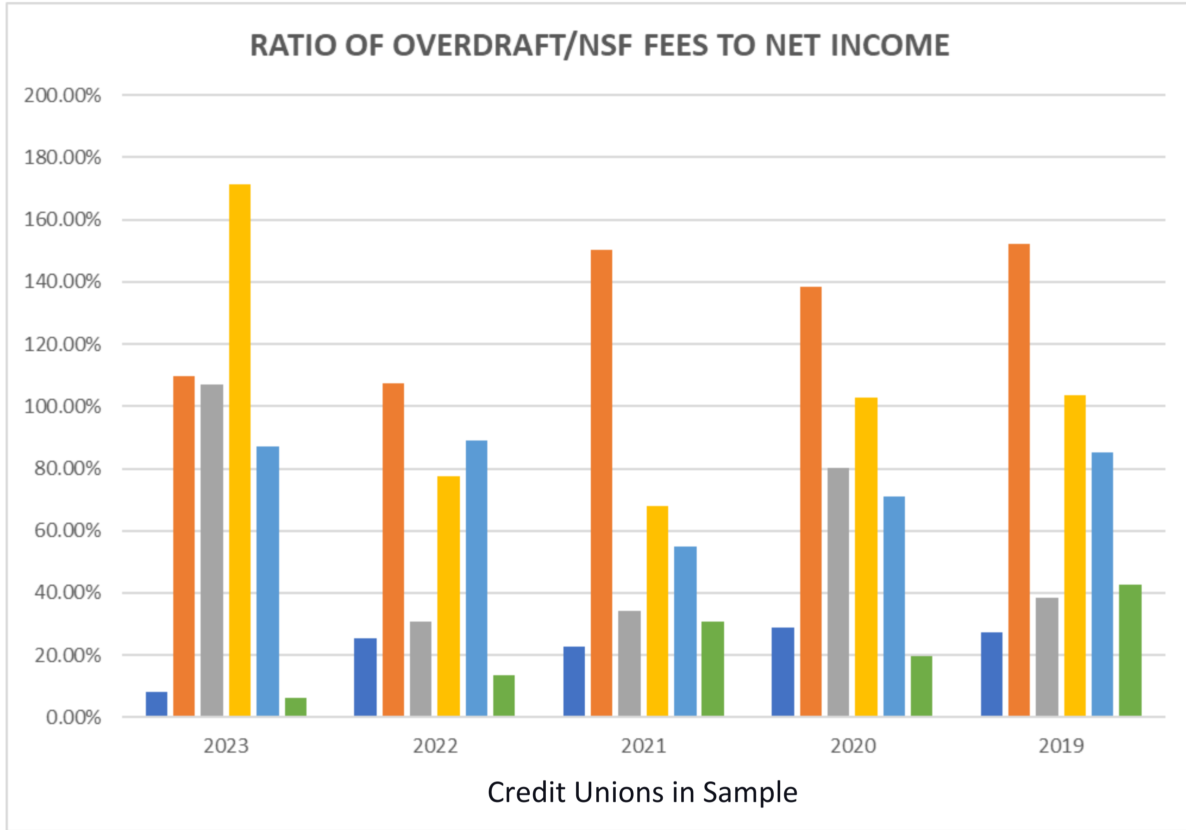
The Reduction of Overdraft/NSF and Debit Card Interchange Fees

In review of the 2023 Q3 data from the NCUA's Summary of Federally Insured Credit Unions Call Report, we can see fee income made up $9.7 billion of credit union's $16.6 billion in net income (NCUA, 2023c). In turn, the removal of overdraft fees could reduce credit unions' net income by up to 50% more or less, depending on the credit union. This could be detrimental, especially for small to midsize credit unions relying on this fee income to keep their head above water.

Rob Johnson, President of C. Myers, advises credit union leaders to take steps to prepare for their exposure to legislative changes, rising inflation and the possibility of the federal government offering digital currency. "For the last decade, we've run long-term simulations of what could happen if non-interest income got materially reduced," Johnson says. "How do we diversify our reliance away from this?" (Fritz, 2022).

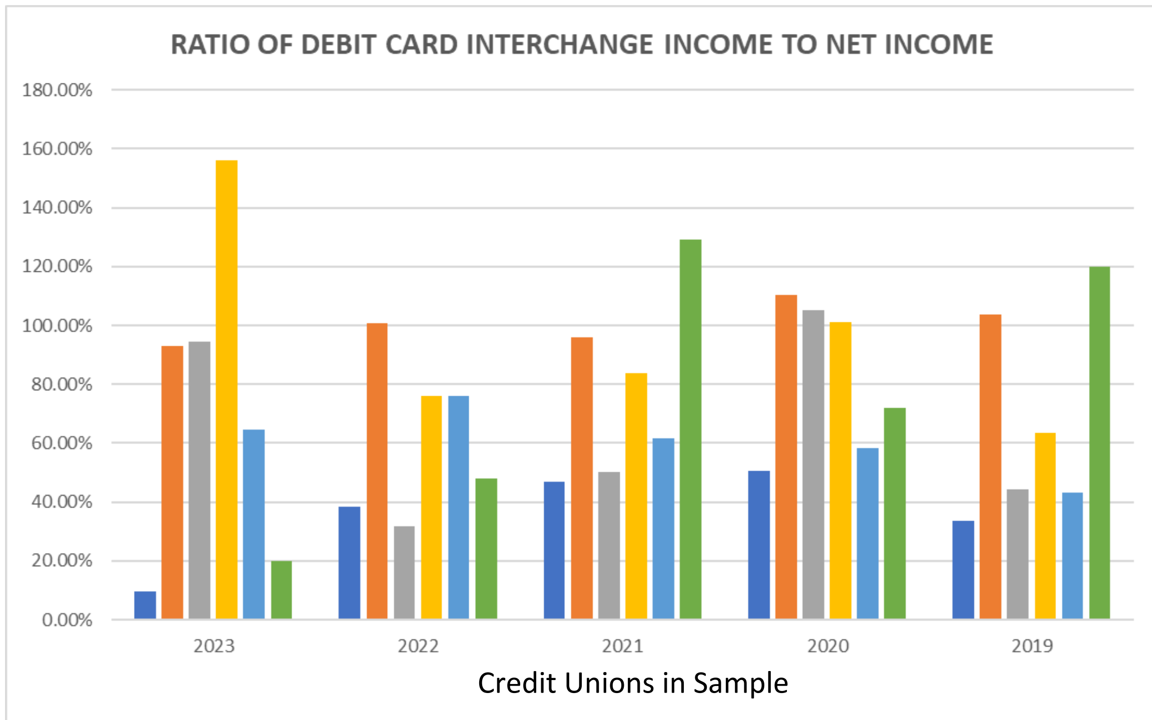
According to CUNA, 32% of credit union revenue is from non-interest income (Fritz, 2022). To compare this statistic to the credit unions in a sample group, we reviewed the percentage of overdraft Income/NSF fee income to net income to determine how much it would impact income. Sample credit unions range from $78 Million to $4.2 Billion in total assets. We looked at the income each credit union received from overdraft/NSF fees to find the percentage of income as it pertains to each credit union's overall net income. The average percentage of overdraft/NSF fees to net income ranges anywhere from 6% all the way up to 171%. Based on our review, the loss of income from this source could be detrimental.

RATIO OF OVERDRAFT/NSF FEES TO NET INCOME



We also looked at the impact of the potential reduction of income from debit card interchange income and how it would affect the credit unions represented in this group project. We looked at the ratio of debit card interchange income to net income. Interestingly, the results were similar to the overdraft/NSF fees to net income figures listed above. The income percentage ranged from 9% to 156%. With the potential loss of debit card interchange income combined with the potential loss for overdraft/NSF fee income, all financial institutions will show balance sheets impacted by the proposed changes.

RATIO OF DEBIT CARD INTERCHANGE TO NET INCOME



What are Competitors Doing to Offset the Potential Loss of Income?

With the increased pressure to change current strategies on overdraft/NSF fee income and debit card interchange income, we reviewed what key competitors are doing to replace the potential loss of revenue. Fintech enterprises and national banks are the biggest threat to small and mid-size credit unions. Eighty percent of Chase customers prefer to bank using their digital offerings (Healy, 2022). These mega banks can offer a much higher rate of return on their savings and money market products.

The biggest assets of credit unions are the relationship they build with their membership (Packer, 2022). Staying engaged with our members increases the possibility to cross-sell products and increase loan relationships. Some credit unions are offering rewards to get their members more connected, therefore increasing usage of the member's accounts. Improving our member experience by using member surveys to uncover our members' needs and offering products which would increase revenue like credit report monitoring or loan products such as Guaranteed Asset Protection (GAP) and Mechanical Repair Coverage plans. Some banks and credit unions are offering lines of credit implementing an annual fee to help members establish credit along with having access to the line of credit to help avoid overdraft fees. Using data driven marketing and analytics helps determine the best ways to advertise to your membership base.

Recommendations and Solutions

NCUA Chairman, Todd Harper (2024), articulated it most effectively in his article for Credit Union Times on why Credit Unions should rethink their overreliance on overdraft and NSF Fees:

> With markets changing, it is time for credit unions of all sizes and charter types to reevaluate their overdraft and NSF fee programs. These programs can harm consumers, and they are also unsustainable in the long run. This is because the failure to adjust to market changes and diversify income streams can eventually lead to safety-and-soundness problems. (para. 6)
>
> A well-structured, diversified balance sheet includes an assortment of revenue sources. To enhance revenue streams, credit unions can build their member base and make prudent adjustments to investment portfolios. They can also originate a greater number of safe, fair, and affordable mortgages. And they can underwrite new loans by using alternative ways to identify the creditworthiness of their members. (para. 11)
>
> The hard truth is as more banks decrease overdraft fees or drop them altogether, consumers will expect their credit unions to follow. Those credit unions which fail to recognize the evolving market and regulatory landscape, their not-for-profit mission and their members' well-being will find themselves behind the curve. (para. 13

As regulatory pressure continues to mount on interchange income along with overdraft fee and non-sufficient funds income, credit unions must begin to shift their focus to revenue diversification and rethink non-interest income strategies to ensure alignment with the overall credit union membership. History has proven the credit union industry is resilient and there are a multitude of opportunities for credit unions to diversify and find solutions which fit the uniqueness of each institution. In the words of credit union pioneer, Edward Filene, the threat to non-interest income should be seen as a catalyst for progress by way of replacing the current best with something even better for our members and communities. (Kucera, 2023-2024)

Evaluating your credit union's product and services offerings is vital in identifying any opportunities for change or enhancement which will positively impact your business overall. Identifying the opportunities for change can put your credit union in a better position to increase income and shows flexibility in meeting member needs in general. There are numerous options which exist within lending alone which will possibly allow your credit union to increase both interest and non-interest income. There is also increased opportunity for automation and simplification of frequently used services for deposit and loan products. Finally, options exist in partnerships with Credit Union Service Organizations (CUSO's) which could generate increased income to offset the reliance on fee income.

Diversification of Lending Products for Increased Interest and Non-Interest Income

Abundant options exist in the lending arena allowing credit unions to diversify product offerings and allow for the potential increase of both interest and non-interest income. A few of those options include but are not limited to:

Personal Line of Credit with an annual fee- Instead of offering only overdraft protection or courtesy pay which could lead to numerous charges, a credit union could open a line of credit for a member. The member could borrow against the line of credit as needed to cover any shortfall. There are numerous income options here including an annual fee to keep the line of credit available, a nominal fee for each transfer to cover an overdraft, and a higher interest rate associated with this line which will allow for increased interest income.

Payday Alternative Loans- These would be smaller dollar loans ranging from approximately $200 to $1,000 with terms from one to six months or from $200 to $2,000 with terms up to twelve months. Having a credit union offer a payday alternative loan keeps members from relying on payday lenders and paying an even higher interest rate with short terms. It benefits the membership with lower interest rate alternatives versus normal payday lenders and aids the credit union with increased interest income.

Ancillary Products- Offering Guaranteed Asset Protection (GAP), GAP Advantage, Extended Warranty, Auto Deductible Reimbursement not only benefits the member when they need car repairs or face an unexpected automobile accident but is also increases non-interest income for credit unions overall based off the sale of these products.

Loan Protection Products- Credit Unions can choose to offer credit life insurance, credit disability insurance, or debt protection insurance alternatives to help protect loan balances as well as members overall. These insurance options exist to protect loan balances and assist with payments if a member is unable to work due to illness, injury, and in some cases overall unemployment (Fritz, 2023). These insurance policies also exist to payoff loan balances in the event of a member's untimely death leaving the member's family with an asset rather than a financial burden. It offers an incomparable peace of mind for members and their families and in turn reduces collections, strengthens the loan portfolio, and increases non-interest income for a credit union. Many credit unions even chose to participate in Lender Development Programs to keep lenders trained, motivated, and institute monthly goals to drive the overall sale of these products.

Credit Cards-Credit Unions can offer credit cards to members for a lower APR and enhanced advantages such as lower balance transfer fees and lower late charges than most major credit card companies can provide. This increases interest income for the credit union and grows overall loan volume while again offering an unmatched product to the membership.

Business Account Services and Business Lending- Options exist within many credit unions to serve the small businesses which are underserved by the larger banks and financial institutions. Not only can credit unions lend to the business members increasing overall interest income, but

there are also a multitude of options for business account services to generate fee income such as treasury and merchant services which can produce additional revenue streams for credit unions (NCUA, 2023a). Credit Unions are positioned to offer these services at a lower cost to what business members are accustomed to paying at larger banks.

Increased Indirect Lending Documentation Fee- This is a fee short-funded from loan proceeds and paid by the dealership rather than the member thereby not affecting the membership in a negative way. Truity Credit Union increased their documentation fee on indirect loans and increased their overall fees collected from this service in 2022 by $1,070,048 (Meyer, 2023).

Home Equity Line of Credit- Credit Unions can always look at offering a home equity line of credit if they do not do so already. Home Equity lines are a fantastic way to allow a member to access the equity of their home at typically a lower rate than a personal loan or credit card without refinancing their first mortgage. Members can borrow money when the need arises over time not only aiding the membership, but also increasing interest income and growing a credit union's overall loan portfolio.

Wealth Management- Credit Unions have the capability to offer wealth management services in conjunction with tax and investment advisory resources to boost non-interest income and in turn increase member loyalty. (Kucera, 2023-2024)

Payments-Many credit unions have explored faster payment options for person-to-person or bill payment at a low cost to the member. Members benefit from added convenience and faster service while credit unions benefit from additional streams of revenue and income. (Kucera, 2023-2024)

Cryptocurrency Investments-There is obvious disagreement on whether this is a sound investment or not; however, some credit unions playing in this space have generated a new source of noninterest income. The most successful credit unions in this arena took a different approach and coupled cryptocurrency offerings with an educational platform to guide members in making sound investment decisions into cryptocurrency. (Kucera, 2023-2024)

Cannabis Banking- Another delicate area and unique service some credit unions have chosen to offer their membership in certain market areas with corresponding risk appetites. When backed with the appropriate resources and due diligence, this can result in a significant boost in non-interest income while offering services to a very underserved market. (Kucera, 2023-2024)

Credit Union Service Organizations (CUSO's), Fintech Firms, and Automation

A Credit Union Service Organization (CUSO) is an organization owned by credit unions in whole or in part which provides financial and/or operational services (Messick, 2018). However, CUSOs are separate entities which are not governed by the NCUA thus they can be limited liability companies, corporations, or limited partnerships which could be non-profit or for-profit entities. They are normally run by a board of directors and are nominated by the credit unions who have an ownership interest in the company, and they can be owned by one or multiple

credit unions. Employees or directors of the credit union are not allowed to be co-owners in the CUSO. In most cases, CUSOs providing financial services are owned by a single credit union whereas CUSOs providing operational services are owned by multiple credit unions. CUSOs were originally formed to provide operational services at lower costs (Messick, 2018).

CUSO's provide numerous services such as mortgage loan origination and servicing, small business and commercial loan origination and underwriting, financial and investment services, ATM/ITM servicing, and Information Technology services. They offer an immense potential to increase revenue while providing additional services to members by leveraging economies of scale and allowing credit unions to expand their offerings to members and the communities they serve. They create cost savings by sharing expenses with participating credit unions. CUSO's also foster innovative solutions industry wide and provide recurring revenue streams for credit unions all while fostering partnerships and collaboration with other credit unions, which is the foundation of the credit union philosophy of "people helping people" (Olney, 2018).

Fintech is a shortened term for "Financial Technology" and is used to describe innovative technologies seeking to improve and automate the delivery of use of financial services (Healy, 2022). Many credit unions have partnered with fintech firms either through CUSO ownership or some other means. These partnerships allow credit unions to bring to market products and services to retain and attract new members providing much needed non-interest income which is otherwise lost and creating new revenue streams. The catalyst behind fintech and credit union relationships is often attributed to the fact fintech organizations excel in and have mastered certain markets, particularly those relating to technology, where credit unions have yet to even broach the subject. (Kucera, 2023-2024)

Two examples of partnerships with CUSOs and Fintech firms are listed below:

QCash Financial- SAFE Federal Credit Union and People's Advantage Federal Credit Union utilize QCash Financial as a CUSO offering an alternative to payday lending in which cash is deposited in the member account within 60 seconds of completing the application. The lending decisions are credit union relationship based and not tied to the traditional credit scoring model. As referenced on the QCash Financial website, $227 million small dollar loans were issued in 2022, growing by 30% since 2019 (QCash Financial, 2023). With faster turnaround times and increased efficiencies, CUSOs such as this are gaining traction throughout the industry.

In September 2022, SAFE Federal Credit Union introduced a program powered by QCash called CashQuick. After one year of being live with this added feature, we decided to halt the program until we could get a firmer grip on increased delinquency on these loans. For SAFE FCU, the program was breakeven at best. Fee income far outweighed the interest income generated from the program; however, the cumulative charge off ratio of these loans was 12.50% causing us to rethink our marketing and funding strategy of these loans. We do have plans to revisit this lending alternative again in the future. Peoples Advantage Federal Credit

Union utilizes QCash for a payday alternative loan product, named PAFCU Fast Cash and net yields 14% of a portfolio of nearly $2 Million, so there is obvious success in this alternative.

Zest AI- Zest AI uses powerful artificial intelligence to generate more approvals while accepting less risk overall. It essentially analyzes recent payment history of members and can answer if an 800-credit score member has recently been paying like a 600-credit score member. SAFE Federal Credit Union invested in this technology and at first rolled it out side by side with our loan officers' decisions to see where there was room for enhancement. What we learned in the first 90 days is 84% of the time our loan officer and Zest AI came to the same decision, thereby allowing us to comfortably turn automated decisioning over to the Zest AI without compromising our risk appetite which creating overall efficiencies for the credit union in time saved for members and employees waiting on lending decisions.

There are obvious advantages to partnering with CUSOs and Fintechs for increased non-interest income and interest income. The important thing to remember is to weigh the risk with the reward. There are risks associated with using a CUSO. The National Credit Union Association (NCUA) has been concerned and warned credit unions about the possibility of cyber-attacks and the potential vulnerability of CUSOs as they are not governed by the rules and regulation of the NCUA. On November 26, 2023, there was a ransomware attack targeting a Fintech firm, owned by Trellance Cooperative Holdings, which affected nearly sixty credit unions where member account accessibility was affected. Members were unable to access funds which left many credit unions scrambling to put systems in place for members to have access to their ATM and debit cards (Ogden, 2023).

Summary and Conclusions

When initially discussing this topic, our team knew there would be a large amount of relevance in today's regulatory environment when authoring this paper. We all come from credit unions which are mission-based and hold a variety of roles within our organizations. Our team members consist of a Chief Risk Officer, an AVP of Member Experience, an SVP of Administration, a VP of Branch Operations, a Regional VP of Enterprise Risk Management, and a VP of Lending and Collections.

The diversity in our professional backgrounds led us to have many different angles of pursuit and opinion initially. Being made up of both risk-averse and retail-minded professionals, we initially figured our interpretations may be vastly different on how we would perceive the current regulatory landscape as they pertain to 'Junk Fees' and interchange income. What we came to realize is the credit union movement is much bigger than our individual thought processes. After all, we are 'People Helping People.' This movement was developed out of a necessity to battle uncertainty. We are now faced with a new kind of regulatory uncertainty which will certainly limit traditional revenue streams. We will weather this storm the same way we have always done, by helping our members.

Our individual summaries below pinpoint our key takeaways from this project.

Johanna Gillispie: Go Energy Credit Union

This topic is even more ebb and flow in 2024 than it was when we started the project in 2023. The legislative heat around “junk fees” is only ramping up. Credit Unions, and all financial institutions, must be nimble and flexible in this ever-changing landscape. While researching this topic, articles from 10 years ago were already hinting at these changes. However, most entities have continued with the same practice until the hand is now being forced to change. At our credit union, we budgeted less income in fees for 2024 to ramp up efforts to temper the negative effects. Not only will credit unions see long-term impacts in lowering fees, but members will also. Financial institutions will shift account structures and lending fees to minimize the declining income streams.

Jennifer Webb: SAFE Federal Credit Union

Given the ever-changing regulatory landscape credit unions face daily, we all must look to alternative sources of income to replace so-called junk fees as well as overdraft and insufficient funds fee income. It was eye-opening for me to look and realize for three of the last five years, my credit union was over 100% when comparing overdraft fees to net income. We have actively made changes over the last several years to reduce these fees overall including limiting the number of charges per member per day and not charging a fee on transactions under a ten-dollar threshold. Even with these changes, there is more we need to work hard to improve. Banks and even larger financial institutions will make changes and the expectation will be all financial institutions will do the same. We need to continue to diversify our income sources to prepare for a world which exists beyond overdraft and NSF fees.

Joseph Staff: The Health and Education Federal Credit Union

Reflecting through the process of this group research paper, I have learned a lot about the current issue affecting all financial institutions throughout our nation. At our credit union, we have already been impacted by some reductions in overdraft fees. We no longer charge overdraft fees on checks or ACH items which have been represented. We have allowed for a 25% decrease in overdraft income when calculating our 2024 budget. If we were to remove overdraft fees for our members, it may not have a significant impact on our budget this year. However, if we had lost this income during Covid, we probably would have suffered losses through those years.

Justin Cousins: Peoples Advantage Federal Credit Union

Regulatory change and monitoring have always been a part of my job as Chief Risk Officer. The largest takeaway for me from going through this exercise was about unintended consequences. Government bodies such as the Consumer Financial Protection Bureau (CFPB) and the Federal Reserve want to protect consumers, while also showing understanding towards smaller, community-driven financial institutions. However, it is believed these entities may have underestimated how their policies towards larger institutions will force smaller institutions to make the same changes due to the influence the larger entities possess.

Another key takeaway for me was the fact many credit unions in the movement relied so heavily upon fee income, which does take some of the sting out of the purpose of the credit union movement. While we understand how this non-interest income allows us to offer more services to help members, we need to be mindful of the missions of credit unions, which are aimed to help protect the financially vulnerable. As much as it may pain us to lose substantial portions of solid revenue streams, we need to aim to find better ways to serve our communities while also providing value and a willingness to participate in revenue-generating products willingly.

Julie Irvin: Georgia's Own Credit Union

Due to the increasing threats of litigation and regulatory scrutiny, changes to overdraft programs are inevitable. While credit unions may be able to weather the storm for a while by enhancing disclosures or making changes to current practices, the litigation surrounding overdraft and NSF demonstrates the claims are unpredictable and ever-changing.

Based on the data from our credit unions, a loss of fee income generated from the overdraft programs and debit card interchange fees will likely be a major hit to the bottom line. In turn, members could be negatively impacted by the loss of services as cost-saving measures must be implemented. To stay competitive, credit unions will need to be creative in absorbing the loss of income without incurring too much harm to their membership. Process improvements within the credit union to help with efficiency and save on costs may be one angle to explore, but alternate streams of revenue will need to be a focal point as well. With the uncertain times, credit unions must remain nimble and ready to adapt.

Tori Shoemaker: 1st Mississippi Federal Credit Union

As the VP of Lending, my focus has never been on account fees and the weight they carry. This project has opened my eyes to how much revenue is driven by overdraft, non-sufficient funds, and interchange fees. The upcoming changes, if ignored, will carry the potential to lose smaller credit unions. The CFPB proposed rule would only apply to financial institutions with more than $10 billion in assets; however, this will not stop the negative impact on smaller institutions. The larger institutions may shift these fees into programs or services not available at smaller institutions, causing a runoff of current membership.

My key takeaway is finding a solution. We were the first credit union in Mississippi to offer Cannabis Banking. This has helped increase our non-interest income and we are researching the loan side to be prepared when it is allowed. 1st Mississippi plans to implement some of the fees and services currently not available. Our strategic plans include home equity lines of credit, business services and business lending. We are currently researching lending CUSOs, such as Q-Cash Financial.

References

American Bankers Association. (2024, January 3). *Projected rulemakings on non-sufficient funds (NSF) fees and overdraft Fees*. Retrieved from: https://www.aba.com/-/media/documents/letters-to-congress-and-regulators/01032024-aba-jointtrades-letter-to-bureau-anticipating-overdraft-nsf-rulemakings.pdf?rev=58d7305778c6473ca60cd0d13036d7bb

America's Credit Unions. (2024, March 5). *Debit interchange proposal fails to account for potential impact.* Retrieved from: https://www.americascreditunions.org/news/debit-interchange-proposal-fails-to-account-for-potential-impact/?utm_campaign=debit-interchange-proposal-fails-to-account-for-potential-impact%3Futm_source%3DHS%20Daily%20News&utm_campaign=daily%20news%3Butm_content%3Dfeb24-daily news%3B&utm_medium=rss&utm_medium=Email&_hsmi=296866399&_hsenc=p2ANqtz-9UWbA2c1ZlS56a8tAQGxnq0U6V5mlSVAY0L30mE69cqVx2KtxcmQguHxcHrE80aOGHuxXSSfPO4ung0rAF4XUHeeBQqw&utm_source=rss

Atlantic Union Bank. (2023, December 7). *United States of America consumer financial protection bureau administrative proceeding*. Retrieved from: https://files.consumerfinance.gov/f/documents/cfpb_atlantic-union-bank_consent-order_2023-12.pdf

Bennett, K. (2023, April 4). *What are junk fees?* Bankrate. Retrieved from: https://www.bankrate.com/banking/junk-fees/#:~:text=If%20you've%20ever%20purchased,referred%20to%20as%20junk%20fees

Borne', R. and Zirkle, A. (2022, February 10). *Comparing overdraft fees and policies across banks.* Consumer Financial Protection Bureau. Retrieved from: https://www.consumerfinance.gov/about-us/blog/comparing-overdraft-fees-and-policies-across-banks/

Consumer Financial Protection Bureau. (2023a, February 7). *Banks' overdraft/NSF fee revenue declines significantly compared to pre-pandemic levels*. Retrieved from: https://www.consumerfinance.gov/data-research/research-reports/banks-overdraft-nsf-fee-revenue-declines-significantly-compared-to-pre-pandemic-levels/

Consumer Financial Protection Bureau. (2022a, October 26). *CFPB issues guidance to help banks avoid charging illegal junk fees on deposit accounts*. Retrieved from: https://www.consumerfinance.gov/about-us/newsroom/cfpb-issues-guidance-to-h p-banks-avoid-charging-illegal-junk-fees-on-deposit-accounts/

Consumer Financial Protection Bureau. (2024, January 24). *CFPB proposes rule to stop new junk fees on bank accounts.* Retrieved from: CFPB Proposes Rule to Stop New Junk Fees on Bank Accounts | Consumer Financial Protection Bureau (consumerfinance.gov)

Consumer Financial Protection Bureau. (2022b, Jan 26). *Consumer Financial Protection Bureau launches initiative to save Americans billions in junk fees.* Retrieved from: Consumer Financial Protection Bureau Launches Initiative to Save Americans Billions in Junk Fees | Consumer Financial Protection Bureau (consumerfinance.gov)

Consumer Financial Protection Bureau. (2021, March). *Know your overdraft options*. Retrieved from: https://files.consumerfinance.gov/f/documents/cfpb_know_your_overdraft_options-handout.pdf

Consumer Financial Protection Bureau. (2023b, December). *List of depository institutions*. Retrieved from: https://files.consumerfinance.gov/f/documents/cfpb_depository-institutions_2023-12.pdf

Consumer Financial Protection Bureau. (2022c, October 26). Unanticipated overdraft fee assessment practices. *Consumer Financial Protection Circular 2022-06.* Retrieved from: https://files.consumerfinance.gov/f/documents/cfpb_unanticipated-overdraft-fee-assessment-practices_circular_2022-10.pdf

Dearing, J. (2019, April 11). CFO focus: How to boost your credit union's non-interest income. *CU Management*. Retrieved from: https://www.cumanagement.com/articles/2019/04/cfo-focus-how-boost-your-credit-unions-non-interest-income

Deschaine, C. (2023, June 20). *Credit unions: Key questions for overdrafts and lending programs.* Wipfli. Retrieved from: https://www.wipfli.com/insights/articles/fi-ra-credit-unions-should-review-overdraft-fees-and-fair-lending-programs

Federal Reserve. (2024, January 22). *Federal Reserve Board announces it will extend the comment period on its interchange fee proposal until May 12, 2024 and published additional related data.* Retrieved from: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20240122a.htm#:~:text=In%20October%202023%2C%20the%20Board,every%20other%20year%20going%20forward

Fritz, B. (2022, January 25). Replacing noninterest income: Use long-term planning to find ways to create new revenue streams. *Credit Union National Association Magazine*. Retrieved from: https://news.cuna.org/articles/120415-replacing-noninterest-income

Fritz, B. (2023, April 24). Unlock noninterest income alternatives. Credit unions examine fee structures amid new pressures on NII. *Credit Union National Association Magazine*. Retrieved from: https://news.cuna.org/articles/121961-unlock-noninterest-income-alternatives

Harper, T. (2024, March 4). Credit unions should rethink their overreliance on overdraft and NSF fees. *Credit Union Times.* Retrieved from: Credit Unions Should Rethink Their Overreliance on Overdraft & NSF Fees (cutimes.com)

Healy, M. (2022). *Ten growth strategies for banks and credit unions.* The Element Group. Retrieved from: https://www.everybitmatters.com/bank-credit-union-growth-strategy/

Institute for Local Self-Reliance. (2010). *Credit Unions.* Retrieved from: https://www.google.com/url?q=https://ilsr.org/rule/credit-unions/%23:~:text%3DIn%25201934%252C%2520Congress%2520passed%2520the,options%2520for%2520saving%2520and%2520borrowing&sa=D&source=docs&ust=1711400641397093&usg=AOvVaw0ocSaxJ3taofr0XbxnEAVr

Kucera, C. (2023-2024) *CUNA environmental scan trend 5: Diversifying revenue sources.* Cuna Councils. Retrieved from: Environmental Scan (E-Scan) (cuna.org)

Larson, K. (2024, January 24*). Federal Reserve extends comment period for debit card interchange fee rulemaking.* Consumer Finance Monitor. Retrieved from: https://www.consumerfinancemonitor.com/2024/01/24/federal-reserve-extends-comment-period-for-debit-card-interchange-fee-rulemaking/

Marek, L. (2023, October 20). *Fed to review debit card fee cap.* Payments dive. Retrieved from: https://www.paymentsdive.com/news/federal-reserve-debit-card-transaction-fee-cap/697244/#:~:text=The%202010%20Dodd%2DFrank%20Wall,%2Dcent%20fraud%2Dprevention%20adjustment

Messick, G. (2018, February 7). *Credit Union Service Organizations ("CUSOs").* NACUSO. Retrieved from: https://www.nacuso.org/wp-content/uploads/2018/02/History-of-CUSOs-2-7-18.pdf

Meyer, Steven. (2023, November 13). Common types of non-interest income on consumer loans. Lending Council Breakout Session at Cuna Councils. Retrieved from: file:///C:/Users/ujxg095/AppData/Local/Microsoft/Windows/INetCache/Content.Outlook/TJEWC3EY/015c%20Best%20Practices%20to%20Increase%20Non-Interest%20Income%20Through%20Consumer%20Lending%20-%20Liesener%20Meyer.pdf

National Credit Union Administration. (2023a, February 6). *Guidance statement – Expansion of permissible CUSO activities and associated risks*. Retrieved from: https://ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/expansion-permissible-cuso-activities-and-associated-risks/guidance-statement

National Credit Union Administration. (2023b, October 24). *NCUA Chairman Todd M. Harper's remarks at the 2023 REACH Conference.* Retrieved from: NCUA Chairman Todd M. Harper's Remarks at the 2023 REACH Conference | NCUA

National Credit Union Administration. (2024a, January). *NCUA's 2024 Supervisory priorities.* Retrieved from: NCUA's 2024 Supervisory Priorities | NCUA

National Credit Union Administration. (2005, February). *NCUA letter to credit unions.* Retrieved from: https://ncua.gov/files/letters-credit-unions/LCU2005-03.pdf

National Credit Union Administration. (2023c) *Quarterly credit union data summary 2023 Q3*. Retrieved from: https://ncua.gov/files/publications/analysis/quarterly-data-summary-2023-Q3.pdf

National Credit Union Administration. (2024b, March). *What's new? Call report changes for March 2024.* Retrieved from: https://ncua.gov/regulation-supervision/regulatory-reporting/cuonline/whats-new#:~:text=In%20the%20March%202024%20Call,Funds%20Fee%20Income%20(IS0049)

Neal, J. (2023, September 29). *Consumer Financial Protection Bureau on trial*. Harvard Law Today. Retrieved from: https://hls.harvard.edu/today/supreme-court-preview-consumer-financial-protection-bureau-v-community-financial-services-association-of-america/#:~:text=But%20somewhat%20surprisingly%20and%20in,lending%20rule%20was%20itself%20unlawful

Offices of Consumer Populations and Markets. (2023, October 11). *Vast majority of NSF fees have been eliminated, saving consumers nearly $2 billion annually.* Consumer Financial Protection Bureau. Retrieved from: https://www.consumerfinance.gov/data-research/research-reports/vast-majority-of-nsf-fees-have-been-eliminated-saving-consumers-nearly-2-billion-annually/

Ogden, M. (2023, December 4). Days into ransomware attack, many CUs remain 'non-operational'. *Credit Union Times.* Retrieved from: https://www.cutimes.com/2023/12/04/days-into-ransomware-attack-many-cus-remain-non-operational/?slreturn=20240006181344

Olney, T.. (2018, May 8). *The true meaning of people helping people.* CUToday. Retrieved from: https://www.cutoday.info/THE-tude/The-True-Meaning-of-People-Helping-People

Packer, P. (2020, December 23). *Non-interest income for credit unions: Planning and understanding.* FlexCuTech. Retrieved from: https://blog.flexcutech.com/blog/non-interest-income-for-credit-unions-planning-and-understanding

Packer, P. (2022, September 7). *Optimizing revenue streams for credit unions.* FlexCuTech. Retrieved from: https://blog.flexcutech.com/blog/optimizing-revenue-streams-for-credit-unions

Qcash Financial. (2023, May 16). *Credit union liquidity fears give CUSOs the stage to shine.* Retrieved from: https://qcashfinancial.com/credit-union-liquidity-fears-give-cusos-the-state-to-shine/

Regions Bank. (2022, September 28). United States of America Consumer Financial Protection Bureau Administrative Proceeding. Retrieved from: https://files.consumerfinance.gov/f/documents/cfpb_Regions_Bank-_Consent-Order_2022-09.pdf

Schwarcz, M. (2023, December 15). Lowering debit card interchange fees to challenge all financial institutions. *CU Management*. Retrieved from: https://www.cumanagement.com/blogs/2023/12/15/lower-debit-card-interchange-fees-challenge-all-financial-institutions

SCOTUSblog. (2023, October 3). *Consumer Financial Protection Bureau v. Community Financial Services Association of America, Limited.* Retrieved from: Consumer Financial Protection Bureau v. Community Financial Services Association of America, Limited - SCOTUSblog

Silkels P. and Vilker J. (2022, February 23). Overdraft class actions: What credit unions need to know in 2022. *CUSO Magazine.* Retrieved from: Overdraft Class Actions: What Credit Unions Need to Know in 2022 - CUSO Magazine ®

The Credit Union Connection. (2021, December 10). *The death of overdraft and NSF fees – But NOT your noninterest income*. Retrieved from: https://www.thecreditunionconnection.com/blog/the-death-of-overdraft-and-nsf-fees-but-not-your-noninterest-income

Wall Street Reform And Consumer Protection. 12 U. S. Code 5515 Chapter 53 (July 21, 2010). Retrieved from: 12 USC CHAPTER 53, SUBCHAPTER V: BUREAU OF CONSUMER FINANCIAL PROTECTION (house.gov)

Wells Fargo, NA. (2022, December 20). United States of America Consumer Financial Protection Bureau Administrative Proceeding. Retrieved from: https://files.consumerfinance.gov/f/documents/cfpb_wells-fargo-na-2022_consent-order_2022-12.pdf

Appendix A

RATIO OF OVERDRAFT/NSF FEES TO NET INCOME

CREDIT UNION	2023	2022	2021	2020	2019
Credit Union A	**8%**	**25%**	**23%**	**29%**	**27%**
Credit Union B	**110%**	**107%**	**150%**	**138%**	**152%**
Credit Union C	**107%**	**31%**	**34%**	**80%**	**39%**
Credit Union D	**171%**	**78%**	**68%**	**103%**	**104%**
Credit Union E	**87%**	**89%**	**55%**	**71%**	**85%**
Credit Union F	**6%**	**14%**	**31%**	**20%**	**43%**

RATIO OF DEBIT CARD INTERCHANGE TO NET INCOME

CREDIT UNION	2023	2022	2021	2020	2019
Credit Union A	9%	38%	47%	50%	33%
Credit Union B	93%	101%	96%	110%	104%
Credit Union C	94%	32%	50%	105%	44%
Credit Union D	156%	76%	84%	101%	64%
Credit Union E	65%	76%	62%	58%	43%
Credit Union F	20%	48%	129%	72%	120%