

# STATE OF CREDIT UNION INDUSTRY: *WHAT 6 MONTHS OF COVID HAS TAUGHT US & A GLIMPSE INTO THE FUTURE*

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# COVID-19 – The Impact

- Agenda for today
  - ✓ Introductions
  - ✓ Talk about our path to today
  - ✓ Moving forward, what events may change that data
  - ✓ Review risk topics currently impacting credit unions
  - ✓ Visit on what is, or could be, coming
  - ✓ Support internal audits role as a trusted business advisor

# Your Presenters



**Chad Garber, CPA**  
Partner | BKD  
Indianapolis, Indiana

A member of BKD National Financial Services Group, Chad serves as the chair & head of the firm's credit union committee. He has more than 16 years of audit & attestation experience, focusing on providing audit & advisory solutions to financial institutions. He has worked with public & closely held financial institutions of wide-ranging size throughout his career. Chad has experience analyzing loan loss reserves & assisting with mergers & acquisitions, SEC reporting requirements, & integrated audits.

He is a graduate of Ball State University, Muncie, Indiana, with a B.S. degree in accounting. He attended the AICPA National Banking School at the University of Virginia, Charlottesville, & is a graduate of the Graduate School of Banking at the University of Wisconsin–Madison.



**Bud Hollenkamp, CPA**  
Partner | BKD  
Denver, Colorado

A member of BKD National Financial Services Group & the Colorado/Utah financial services team lead, Bud provides external & internal audit & consulting services for single & multibank holding companies, credit unions, & other financial service entities ranging in asset size from start-up organizations &/or de novo banks to multibillion-dollar SEC & non-SEC institutions.

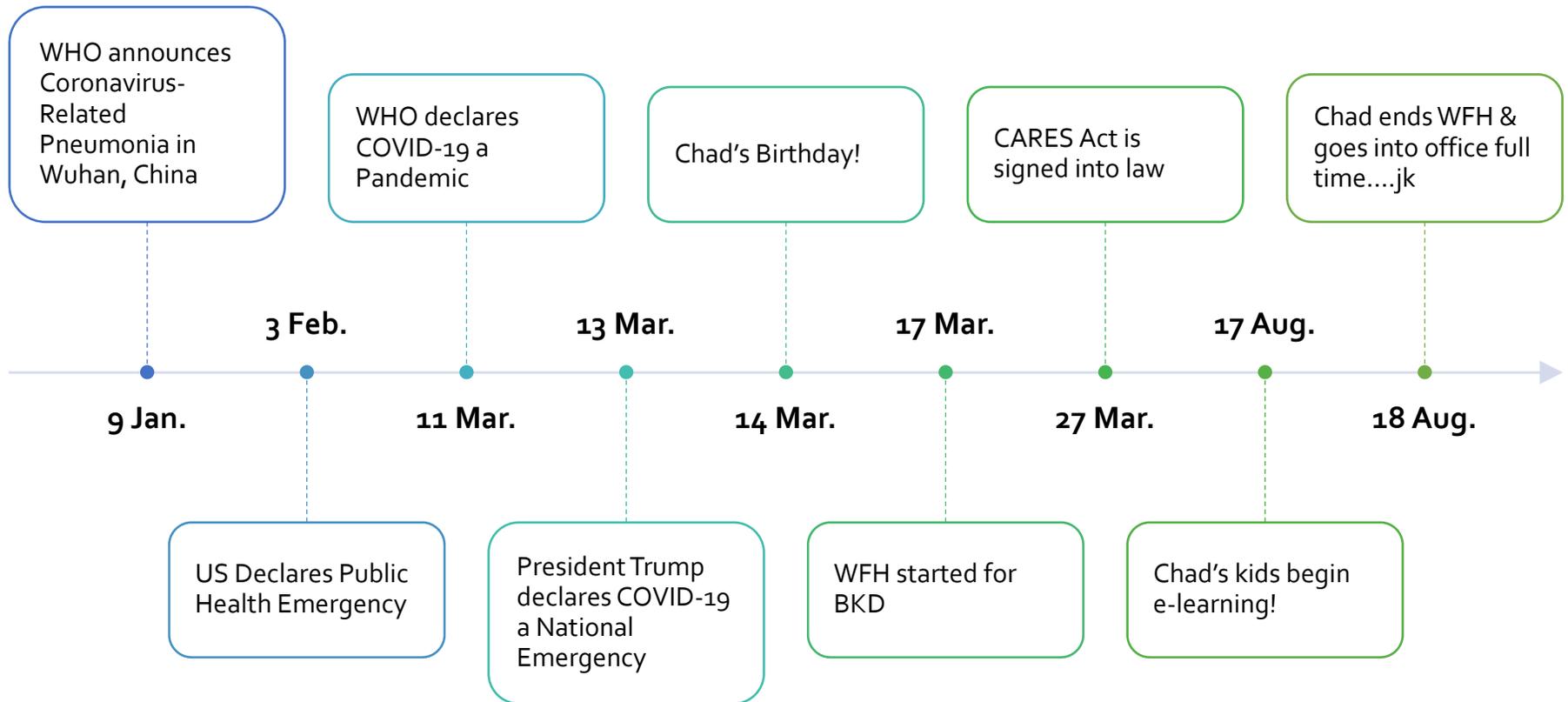
Bud is a member of the American Institute of CPAs & Colorado Society of CPAs. He also serves on the board of Young Americans Bank & volunteers with several community organizations in the Denver metropolitan area. He is active in various state & national Banking associations & the Financial Managers Society, Inc. He has participated in several presentations on accounting issues related to executive compensation plans, other real estate owned, troubled debt restructurings, Basel III & CECL & has written articles for BKD publications. Bud is a 2000 graduate of Southern Illinois University, Edwardsville, with a B.S. degree in accounting.



# COVID-19 – The Impact

- Caveat on slides
  - ✓ NCUA, FASB, SEC, regulators, depository institutions expert panel & others are debating/discussing many of the things we are about to go over, & certain of the items discussed in the next slides could be further clarified or modified
    - Therefore, please continue to pay attention to new developments

# COVID -19 – Timeline





# CARES Act Considerations

- Passage of the Coronavirus Aid, Relief, and Economic Security (CARES) Act on March 27, 2020 - \$2.2 trillion economic stimulus
  - ✓ Economic impact payments
    - \$1,200 per adult & \$500 per child, up to \$3,400
  - ✓ Creation of the Payment Protection Program (PPP)
    - \$350 billion later increase to \$669 billion
  - ✓ Unemployment benefits
    - \$600 per week in addition to amount allocated by state
  - ✓ Foreclose & eviction moratorium



# CARES Act Considerations

## Section 4013 of the CARES Act – Temporary Relief From Troubled Debt Restructurings

- Provides financial institutions the option to temporarily suspend certain requirements under U.S. GAAP related to troubled debt restructurings (TDR) for a limited period of time to account for the effects of COVID-19

**March 27, 2020**

**April 7, 2020**

REVISED - Interagency Statement on Loan Modifications & Reporting for Financial Institutions Working with financial institutions to work prudently with borrowers Customers Affected by Coronavirus

- To & to describe the agencies' interpretation of how accounting rules under ASC 310-40 apply to certain COVID-19 related modifications



# Current Environment

Slight increase in allowance levels in Q1 & Q2

Most institutions not seeing increases in charge-offs

Most institutions not seeing increases in delinquencies

New deferrals & modifications seem to be slowing down

Loan volume up (most in residential)

- Low rates

Consumers/Members in good cash position

Net interest margin compression

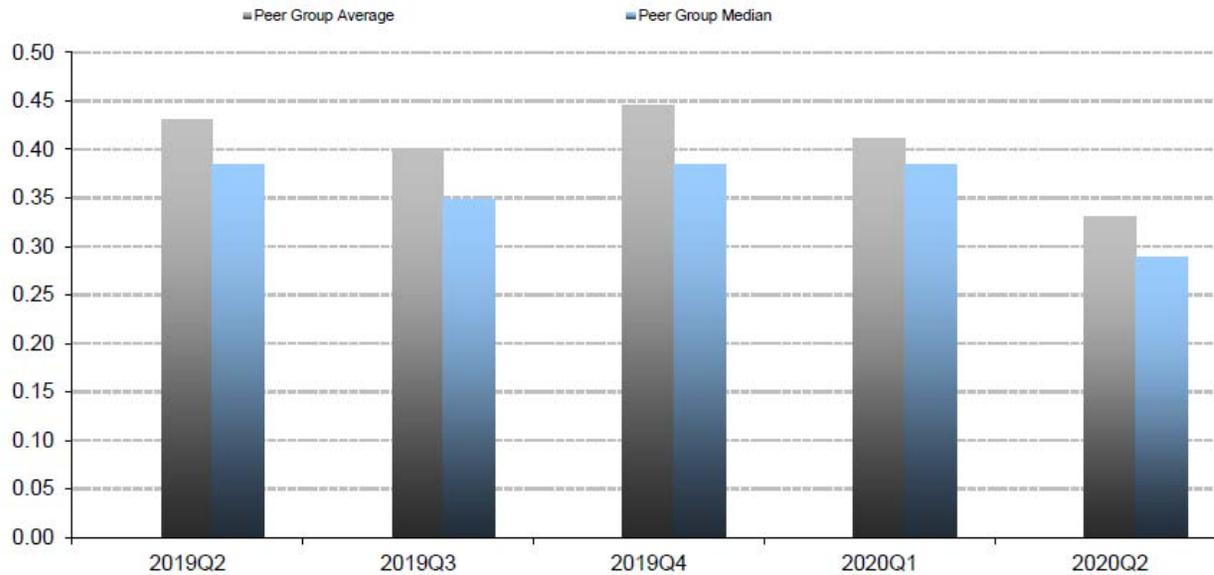
Excess liquidity – no good answers

# Current Environment – Net Charge-offs



Q2 2020 Credit Union Allowance for Loan Loss Trends

## NCOs/Avg Loans (%)



## NCOs/Avg Loans (%)

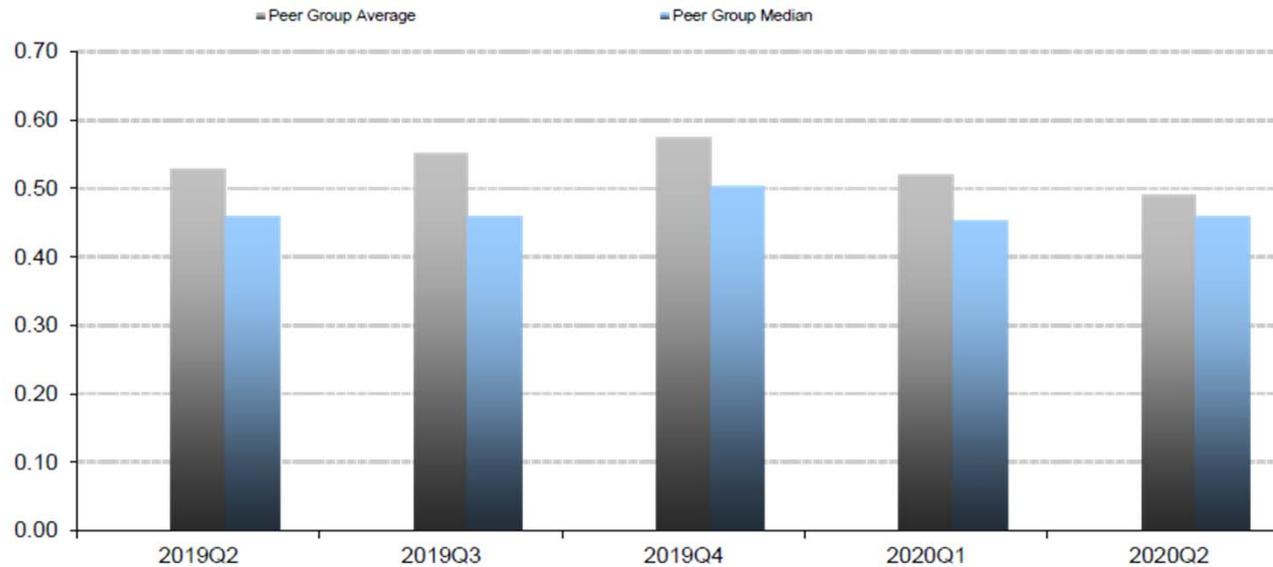
	2019Q2	2019Q3	2019Q4	2020Q1	2020Q2
Peer Group Average	0.43	0.40	0.45	0.41	0.33
Peer Group Median	0.39	0.35	0.39	0.39	0.29

# Current Environment – Nonperforming Loans



Q2 2020 Credit Union Allowance for Loan Loss Trends

## Nonperforming Loans (NPLs)/ Loans

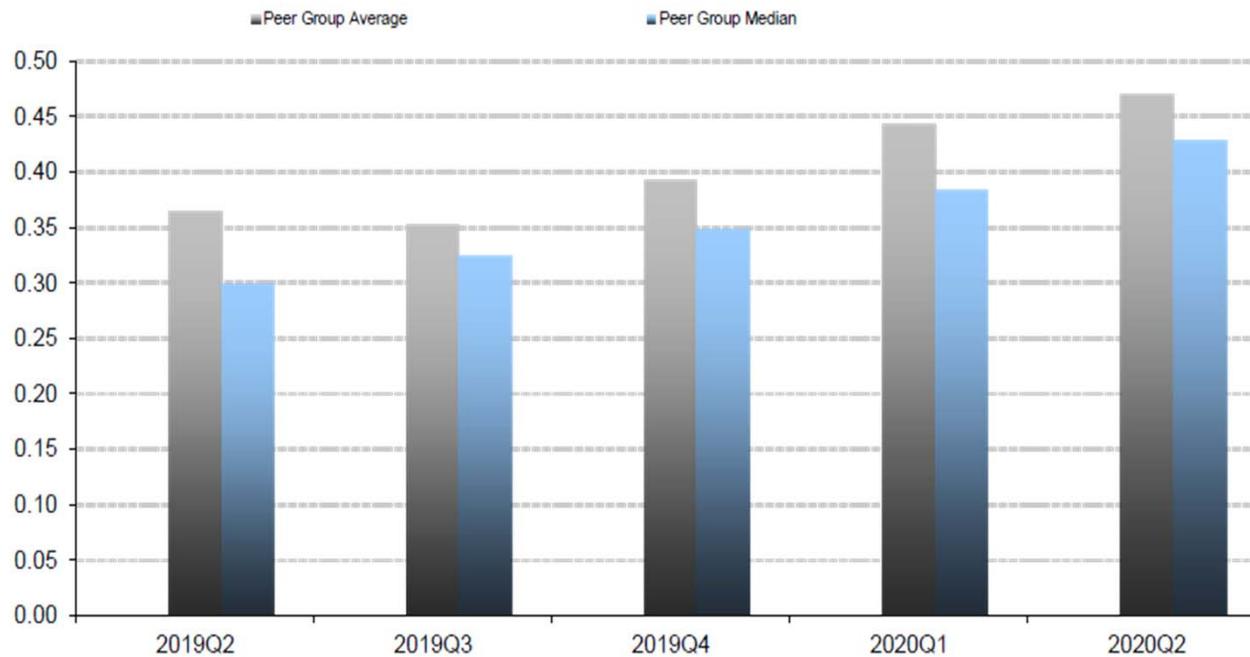


## NPLs/ Loans

	2019Q2	2019Q3	2019Q4	2020Q1	2020Q2
Peer Group Average	0.53	0.55	0.58	0.52	0.49
Peer Group Median	0.46	0.46	0.51	0.46	0.46

# Current Environment – Provision Expense

Provision for Loan Losses/ Avg Assets



Provision for Loan Losses/ Avg Assets

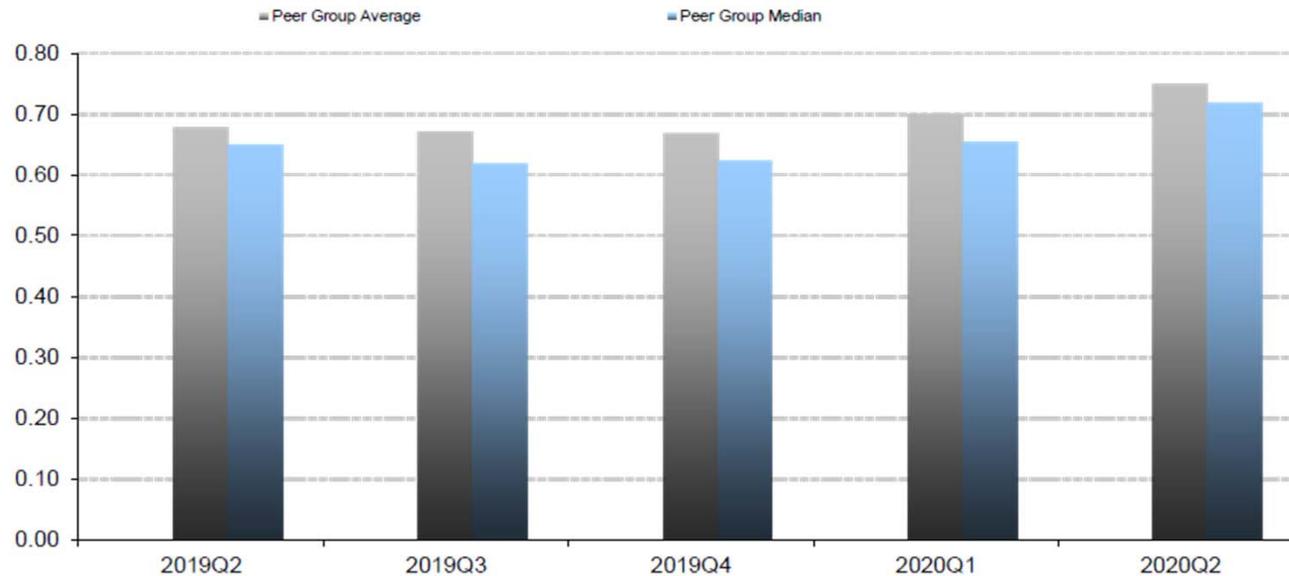
	2019Q2	2019Q3	2019Q4	2020Q1	2020Q2
Peer Group Average	0.37	0.35	0.39	0.44	0.47
Peer Group Median	0.30	0.33	0.35	0.39	0.43

# Current Environment – ALLL to Loans



Q2 2020 Credit Union Allowance for Loan Loss Trends

## Loan Loss Reserves/ Gross Loans



## Loan Loss Reserves/ Gross Loans

	2019Q2	2019Q3	2019Q4	2020Q1	2020Q2
Peer Group Average	0.68	0.67	0.67	0.70	0.75
Peer Group Median	0.65	0.62	0.63	0.66	0.72



## CUNA Economic Outlook – August 2020

- Loan loss provisions will double to 0.80% of average assets, significantly above the historical average of 0.35%-0.45%
- Significant increase in unemployment & an increase in underemployment expected
- Economic contraction, increased uncertainty, & heightened consumer caution expected
- Expect charge-off rates to increase, peaking in the third & fourth quarters at 1.25% (quarterly annualized) & settling at 1.5% for 2021



# CUNA Economic Outlook – August 2020

- Highlights – Credit Union Issues for 2020 and 2021
  1. Record low net interest margins will lead to expense containment
  2. High unemployment rates will lead to larger collections departments & higher provisions for loan losses
  3. Monitor employee stress & moral during pandemic
  4. Invest in better technology for employees working at home
  5. Update business activity expectations & reallocate staff
  6. The new economic environment will create new path for profitability
  7. Opportunities for prime real estate purchases & future branching
  8. Adopt COVID-19 related design changes for old & new buildings
  9. Excess liquidity will intensify search for higher yielding assets
  10. Monitor closely the drop in capital-to-asset ratios
  11. Focus on serving financially stressed members will build brand loyalty
  12. Plan for post recession opportunities

# Internal Auditors

- What is an internal auditors role?
  - ✓ Provide insights into efficiency & effectiveness
  - ✓ Reveals existing & emerging risks
  - ✓ Increase communication across the organization
  - ✓ Provide operational feedback
  - ✓ Provide compliance feedback
  - ✓ Find potential revenue enhancements





# Internal Audit Plans – COVID-19 Impact

- Risk assessment
- Internal audit plan developed
- March 2020

## Now what?



# Internal Audit Plans – COVID-19 Impact

- COVID-19 focus areas
  - ✓ Good news, most already in plan!
    - Credit administration/risk grading
    - ALLL – losses likely have been incurred
    - Liquidity risk management
    - Accounting – change in processes
    - Information technology
    - Information security
  - ✓ But, not all, or not enough, focus?
    - SBA lending – PPP loans
    - Secondary market or mortgage banking
    - Corporate governance
    - Impairment of intangibles
  - ✓ **KEEP THE PLAN GOING!**



# Internal Audit Plans – COVID-19 Impact

- Fraud risks
  - ✓ Incentive
  - ✓ Opportunity
  - ✓ Rationalization
- We are seeing an uptick!
  - ✓ Kiting
  - ✓ Fictitious loans
  - ✓ External attacks on members
  - ✓ Cybersecurity....stay tuned for Cy's presentation next

# What is, or Might be, Coming?



## PPP loans

Recognition of income into yield  
Forgiveness testing & validation



## Loan deferrals

Regulator scrutiny on monitoring  
Recognition of accrued interest income  
Deferred loans can be  
substandard/impaired loans  
Tracking of this portion of the portfolio



# What is, or Might be, Coming?

- Continuation of credit unions buying banks
- Impairment monitoring
  - ✓ Goodwill
  - ✓ Core deposit intangible
  - ✓ Mortgage servicing rights
- Delay of CECL & Lease ASUs
- Employee benefit plans
  - ✓ SECURE Act
  - ✓ CARES Act



# Exam Expectations

What can we or should we expect out of exams?

# Questions?

The background of the slide features a row of chess pieces (king, queen, knight, and pawns) silhouetted against a bright, hazy sunset or sunrise. The pieces are arranged in a line, receding into the distance. The overall mood is contemplative and strategic.

## FOR MORE INFORMATION

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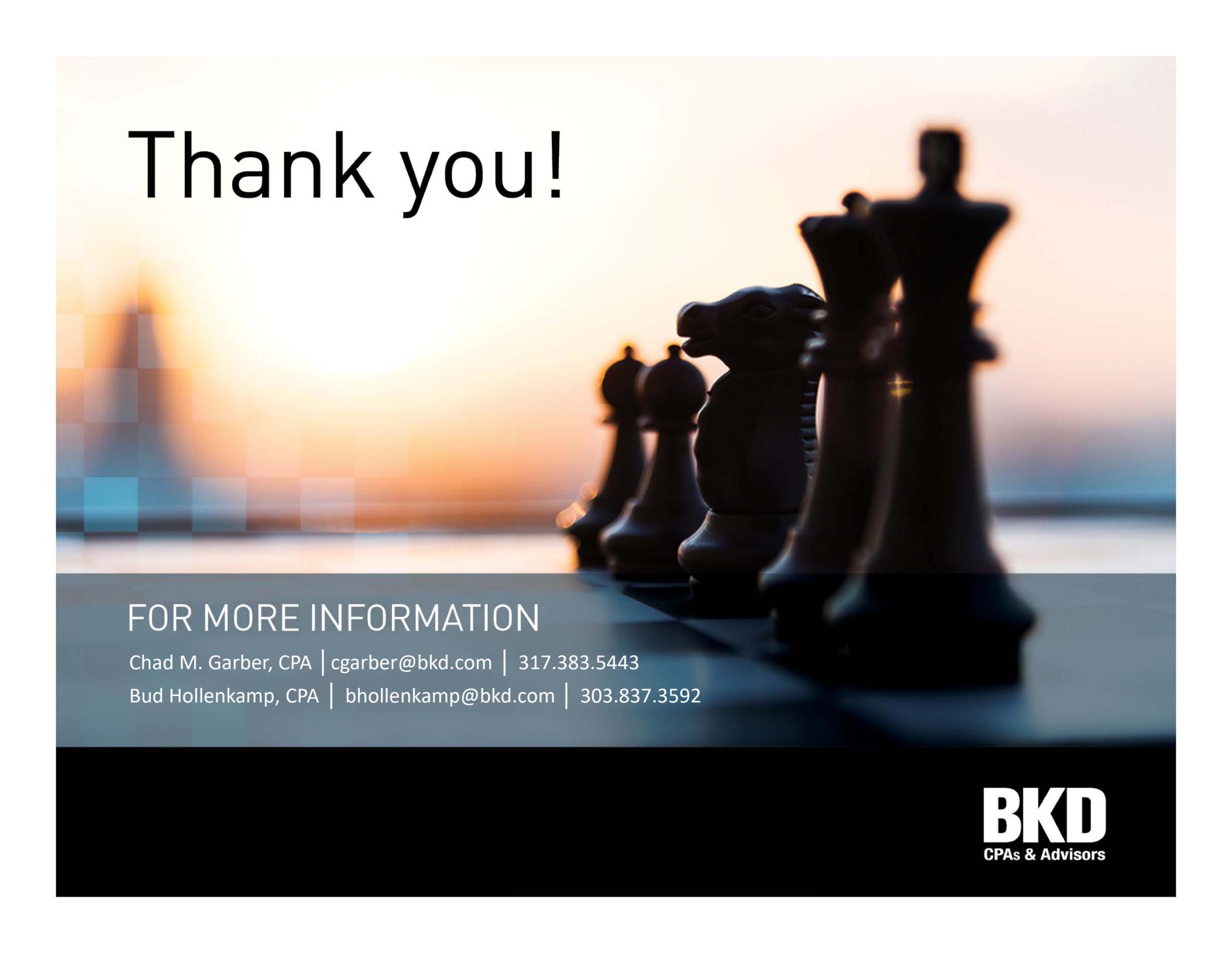
# BKD Financial Services Group Profile

BKD provides audit, tax, regulatory compliance, loan review, cybersecurity, internal audit, strategic planning, valuation services & more to over 1,400 financial institutions nationwide.

With one of the largest community banking practices in the country, our advisors possess the experience & expertise needed to help guide financial institutions through uncertain times.

For additional guidance on this evolving issue, check out our [COVID-19 Resource Center](#).

# Thank you!

The background of the slide features a row of chess pieces (king, queen, knight, and pawns) silhouetted against a bright, low sun on a horizon, creating a warm, golden glow. The pieces are arranged in a line, receding into the distance.

## FOR MORE INFORMATION

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