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Hot topics

Takeaways from the 2022 AICPA & CIMA Conference on Credit Unions

Nov. 28, 2022

Contents

Conference overview

The annual American Institute of Certified Public Accountants (AICPA) and Chartered Institute of Management Accountants (CIMA) Conference on Credit Unions was held from Oct. 24 through 26, 2022, at the MGM Grand in Las Vegas. Conference topics focused on the current economic environment and risks in the credit union system.

The economist and credit union leaders discussed the continued unusual nature of the current environment and the risks credit unions are facing. Liquidity concerns, net interest margin compression, and talent retention were common themes throughout the conference.

Current projects and rules published by the Financial Accounting Standards Board (FASB) were discussed, including but not limited to the upcoming lease standard and the current expected credit loss (CECL) model. One session covered the AICPA Audit and Accounting Guide: Credit Losses (AICPA CECL A&A Guide). In addition, a panel of credit union employees provided input and insights learned as they have prepared for CECL adoption.

Conference panelists also highlighted the ever-changing landscape of the credit union industry, including digital assets and the acceleration of technology. In addition, conference speakers discussed attracting, retaining, and leading talent; regulatory and compliance updates; and other credit union hot topics.

The 2023 conference is slated for Oct. 23 through 25, 2023, online and on-site, at the Grand Hyatt Denver in Denver.

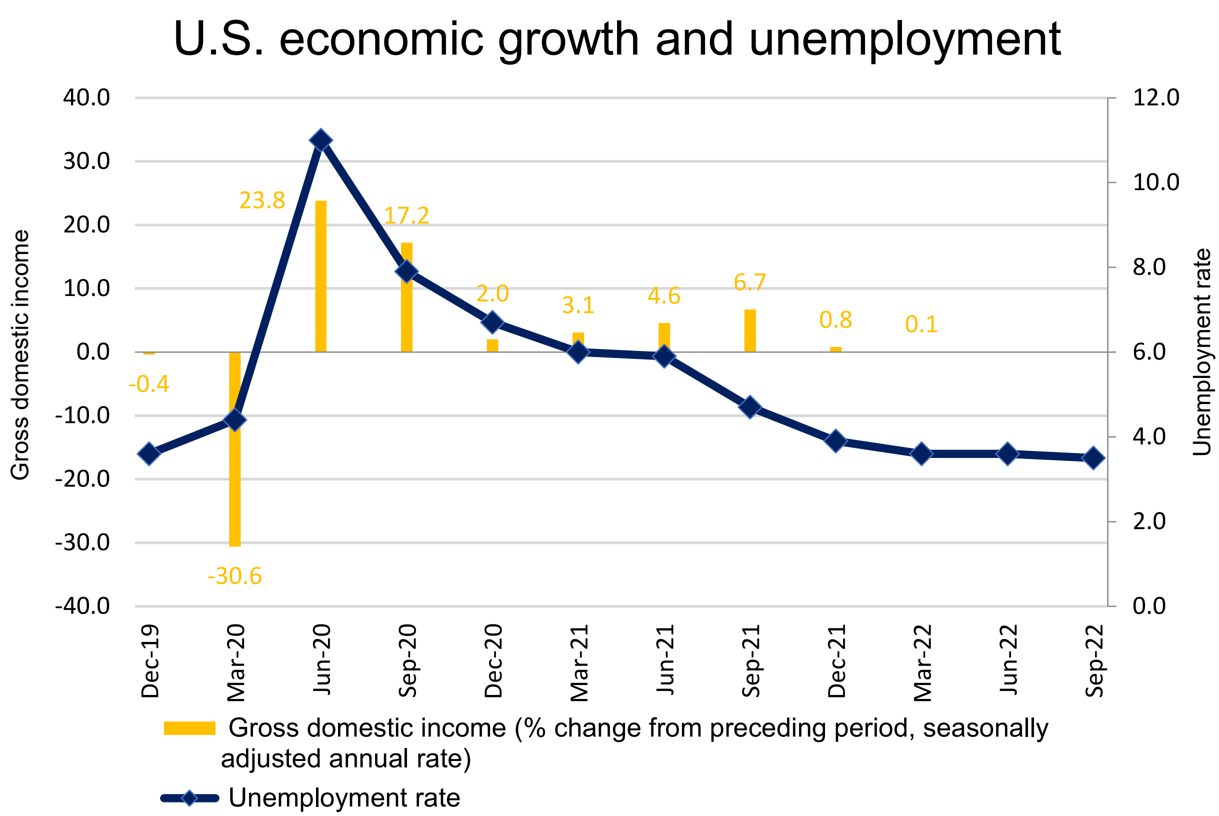
We hope you find this summary useful.

Economic updates

Ligia Vado, a Credit Union National Association (CUNA) senior economist, kicked off the 2022 conference with an economic update. Vado provided her perspective on both economic trends and consumer trends. Vado indicated that a recession includes both economic decline and unemployment rate increases. While the latter has yet to happen, it is forecasted to occur by the end of the year, and the United States has already experienced a downward trend in gross domestic product (GDP) for the past two quarters. Fortunately, the job market is still strong at near pre-pandemic levels, and consumers are stronger financially than in the most recent recession.

Unemployment and labor

The COVID-19 recession was unlike any other recession, given the amount of government relief provided, and that uniqueness likely will carry forward into the next recession. As of September 2022, unemployment was 3.5%, the same rate it was in February 2020, just before the start of the COVID-19 pandemic.[1] Unlike the drop in labor force seen at the start of the pandemic, labor force participation in September 2022 of 62.3% has rebounded to nearly a pre-pandemic level of 63.4% in February 2020.[2] However, Vado warned that the unemployment rate is expected to increase in 2023 and economic growth is expected to remain stagnant.

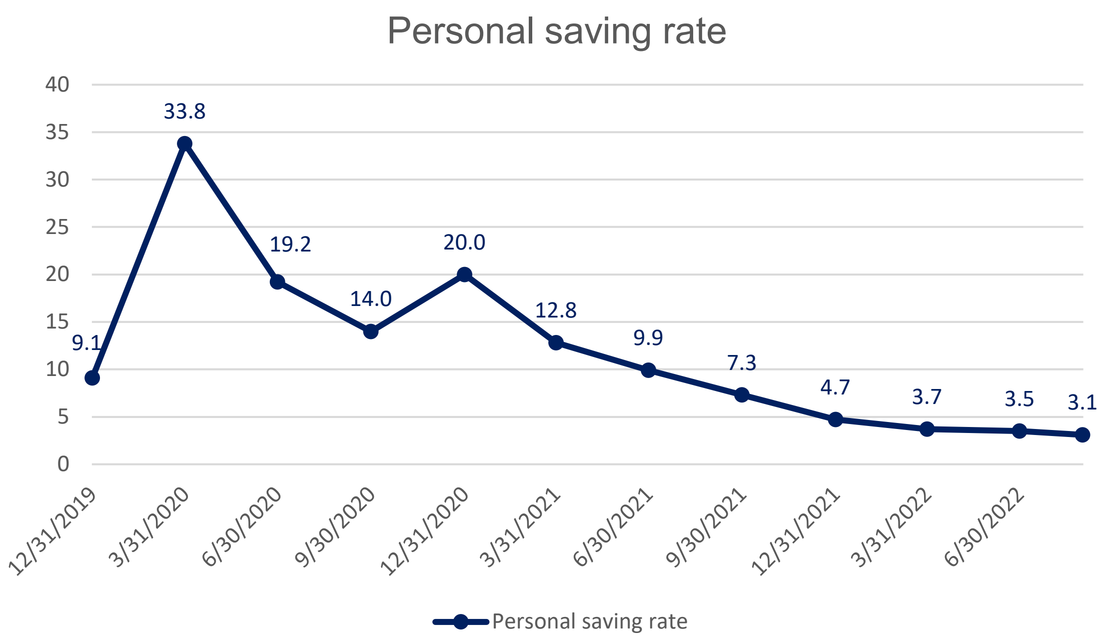


Source: St. Louis Fed.[3]

[1] https://fred.stlouisfed.org/series/UNRATE
[2] https://www.bls.gov/charts/employment-situation/civilian-labor-force-participation-rate.htm
[3] https://fred.stlouisfed.org/series/UNRATE; https://fred.stlouisfed.org/series/A261RL1Q225SBEA

Real estate
While record demand for mortgage loans has slowed, according to the S&P CoreLogic Case-Shiller 20-City Composite Home Price NSA Index, home prices have risen over 13% from August 2021 to August 2022.[4] Home prices continued to rise through June 2022 and then began a slow decline in July 2022 and August 2022.[5] According to June 2022 National Credit Union Administration (NCUA) call report data, however, mortgage loan growth year over year continues to increase. Mortgage loan growth from Q4 2020 to Q4 2021 was 9.2%, while loan growth from Q4 2021 to Q2 2022 was 16.4%.[6]

Saving rates
Consumers continue to have lower levels of debt, but consumer saving rates have continued to decline significantly from the peak experienced during the pandemic. The personal saving rate in February 2020 was 9.3%, spiked in April 2020 at 33.8%, and was reported at 3.1% as of September 2022.[7] According to Vado, the personal saving rate is expected to increase in 2023 to levels seen in mid- to late 2021.



Source: St. Louis Fed.[8]

<u>Conference takeaway</u>: A CUNA senior economist, Ligia Vado, noted that the loan growth experienced by credit unions in 2022 is likely to reduce in 2023. Loan-to-share ratios likely will be higher in 2022 and 2023 due to less liquidity.

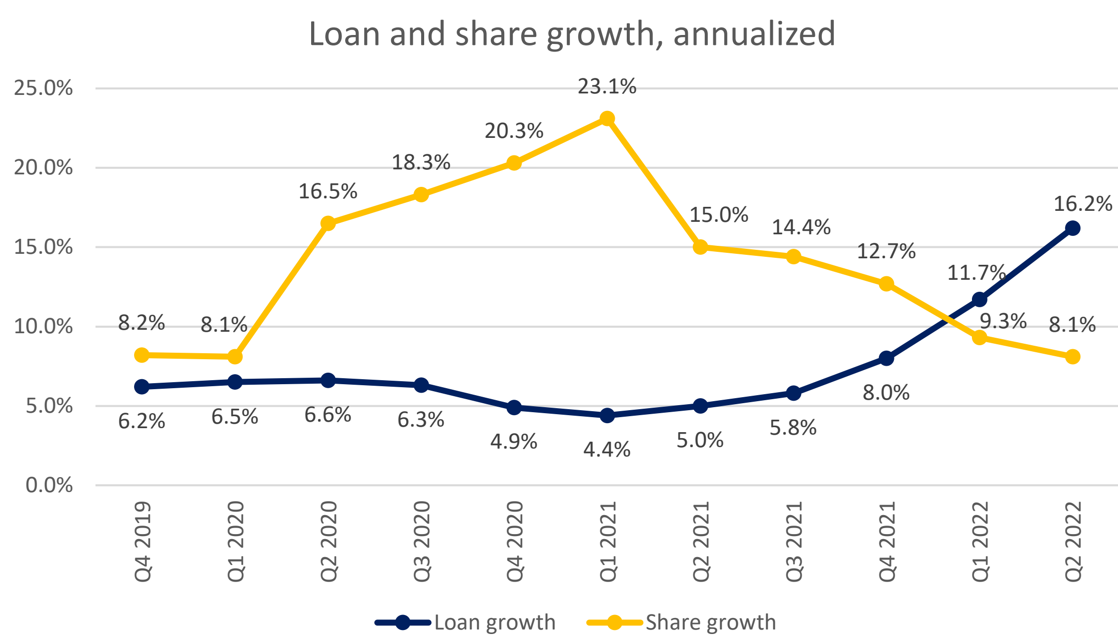
[4] https://www.spglobal.com/spdji/en/indices/indicators/sp-corelogic-case-shiller-20-city-composite-home-price-nsa-index/#overview
[5] https://fred.stlouisfed.org/series/CSUSHPINSA
[6] https://www.ncua.gov/analysis/credit-union-corporate-call-report-data/financial-trends-federally-insured-credit-unions
[7] https://fred.stlouisfed.org/series/PSAVERT
[8] Ibid.

Outlook
Increasing Federal Reserve (Fed) rates and increasing inflation were on the minds of many conference participants. After Fed funds rates were below 0.10% from April 2020 through February 2022, the market saw significant increases. The Fed rate in October 2022 of 3.08% is the highest since January 2008.[9] Inflation remains elevated despite the rate hikes from the Fed, so there are certainly still unknowns going into 2023.

Credit union industry

Vado also spoke on credit union operating results with takeaways in three key areas: fast loan growth and lower savings growth, focus on internal rate of return (IRR), and more obvious bottom-line pressures. A panel of credit union employees discussed the current risks facing the credit union industry, including but not limited to risks associated with the current economic environment, cybersecurity threats, vendor risk, and new products.

Kelly Lay, director of the NCUA Office of Examination and Insurance, also highlighted the loan growth that the credit union industry has seen. Share growth has steadily declined since the end of 2020.



Source: NCUA call report financial trends in federally insured credit unions.[10]

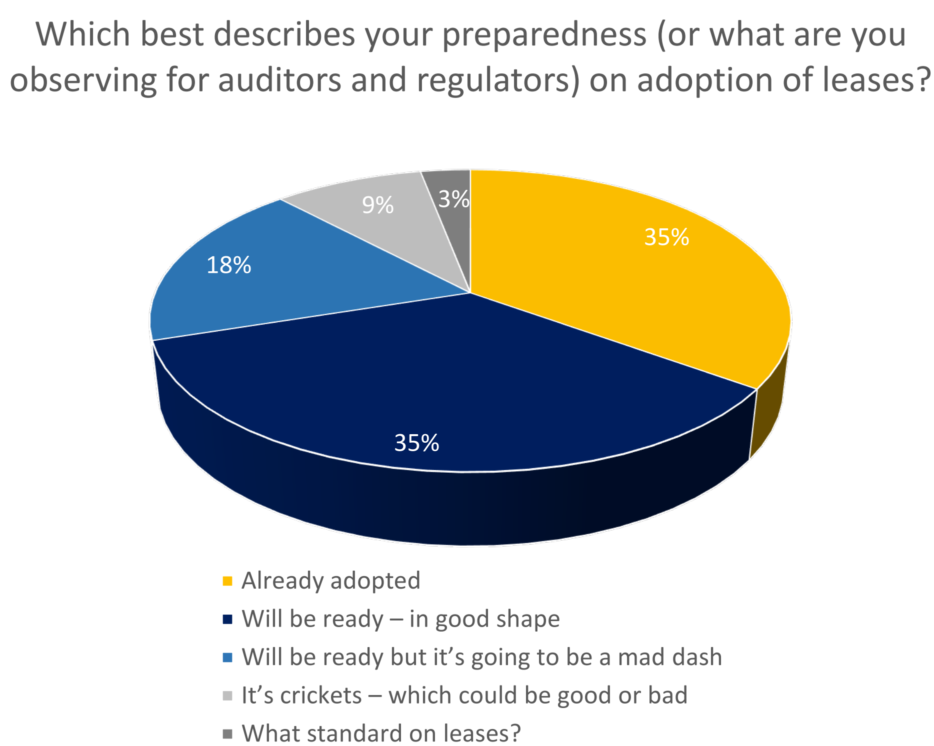
[9] https://fred.stlouisfed.org/series/FEDFUNDS
[10] https://www.ncua.gov/analysis/credit-union-corporate-call-report-data/financial-trends-federally-insured-credit-unions

Accounting Standards Updates

Representatives from the FASB, the NCUA, and Crowe discussed accounting standards on leases and CECL and highlighted other practice matters. In November 2019, the FASB issued an Accounting Standards Update (ASU) to delay the adoption date of leases to Jan. 1, 2021, and CECL to Jan. 1, 2023, for calendar year-end credit unions. In response to the pandemic, in June 2020, the FASB issued an ASU to further delay the adoption date of leases to Jan. 1, 2022, for calendar year-end credit unions. NCUA acting Chief Accountant Chris McGrath reminded attendees of the clarifying letter sent out by the NCUA addressing that accounting standard adoption should align with the credit unions' reporting year-end (for example, a credit union with a financial statement reporting year-end of March 31, 2023, would adopt CECL on April 1, 2023).

Leases

ASU 2016-02, "Leases (Topic 842)," is effective Jan. 1, 2022, for calendar year-end credit unions. As a friendly reminder, this standard requires the recording of a right-of-use asset and lease liability for leases with an original term of more than 12 months. At adoption, the cumulative effect adjustment (if any) is recorded through equity, and if the transaction practical expedient is elected, credit unions do not need to adjust prior periods for comparability. A poll of the audience asked which best describes credit unions' preparedness (or observations for auditors and regulators) on adoption of leases. Of those who responded, a majority had either already adopted or will be ready to adopt prior to the end of their fiscal year.



Source: Audience poll results during the conference.

Jeffrey Mechanick of the FASB reminded attendees that with the issuance of ASU 2021-09, an accounting policy election can be made to use a risk-free discount rate when the rate implicit in the lease is not readily determinable. Mechanick also commented on two issues being addressed by the FASB on common control arrangements: 1) what terms and conditions an entity should consider for determining whether a lease exists and the classification and accounting for that lease and 2) accounting for leasehold improvements. On the first issue, tentative decisions for the FASB's September 2022 meeting indicate that a practical expedient will be provided to use written terms and conditions on an arrangement-by-arrangement basis. Unwritten arrangements remain subject to Topic 842's legally enforceable terms and conditions. For the second issue, at its September 2022 meeting, the board indicated that a lessee will amortize leasehold improvements over the economic life of the improvements as long as the lessee continues to use the underlying asset.

CECL

The FASB has continued its post-implementation review (PIR) by monitoring preparation for initial implementation, analyzing financial reporting data, monitoring earnings calls and investor presentations, and hosting public roundtables. PIR feedback has resulted in the board adding two projects to its technical agenda: accounting for troubled debt restructurings (TDRs) by creditors and accounting for acquired financial assets.

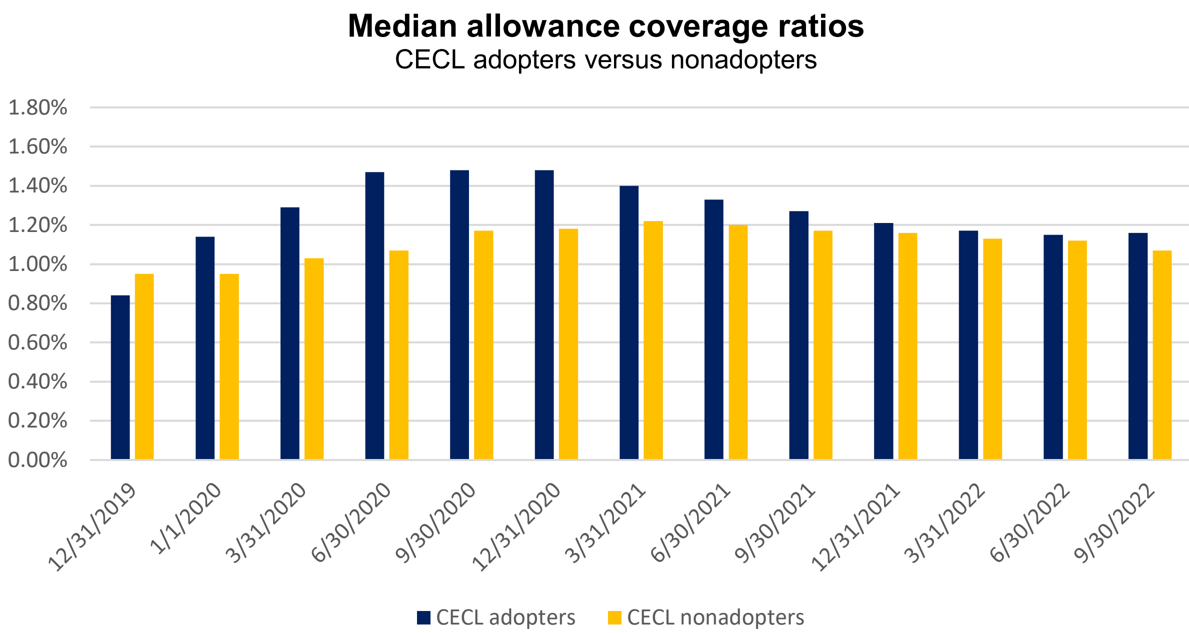
In response to the PIRs conducted prior to 2022, the FASB issued ASU 2022-02 on March 31, 2022, which removes TDR accounting and enhances disclosures. The ASU also changes the vintage disclosure requirements, which apply only to public business entities. The FASB also added a project to expand the scope of the purchase credit deteriorated (PCD) model.

Instead of evaluating modifications for TDRs, a credit union should evaluate whether the modification meets the criteria for disclosure of a borrower experiencing financial difficulty and whether it is a new loan or not. If disclosure is required, the credit union should disclose information about modifications (for example, types, financial effect, and outcome) and modifications that defaulted within the previous 12 months. While disclosures might sound similar, the underlying accounting for TDRs (such as classified as an impaired loan) is removed.

For more information, see the Crowe article "FASB Tweaks CECL: TDR Accounting and Vintage Disclosures," https://www.crowe.com/insights/fasb-tweaks-cecl-tdr-accounting-and-vintage-disclosures.

For PCD assets, FASB added a project to consider expanding the "gross-up" approach, which would eliminate the prior issue of "double-counting" allowance amounts booked for both day one acquisition and life of loan under the CECL methodology.

Crowe observation: To provide perspective on the day one impact of CECL adoption, the following chart presents median allowance coverage ratios for public company banks, bifurcated by CECL adopters and nonadopters.



Source: Crowe analysis of press releases filed with the SEC through Nov. 8, 2022.

McGrath reminded the audience that the transition to CECL for regulatory capital will occur as a phase-in over three years. After a one-time entry on the call report of the CECL amount and the credit union's financial statement reporting year-end, the call report automatically will calculate the phase-in over the three-year period. There will be a 100% add back for the first three quarters of 2023. The phase-in is not optional unless a credit union early adopts CECL.

McGrath also demonstrated the Simplified CECL Tool developed by the NCUA, which was released on Sept. 14, 2022.[11] The Simplified CECL Tool uses the weighted average remaining maturity methodology. While the tool is designed to assist credit unions with less than $100 million in assets in determining their allowance under CECL, it can be used by any credit union. However, the model might not be appropriate for credit unions with complex lending portfolios.

The AICPA CECL A&A Guide was highlighted in its own session. Sydney Garmong, Michael Lundberg, and Jason Brodmerkel, all members of the AICPA's Credit Losses Task Force, highlighted the preface of the A&A Guide, which outlines implementation observations from the nearly 150 financial institution SEC registrants that already have adopted. Key observations include:

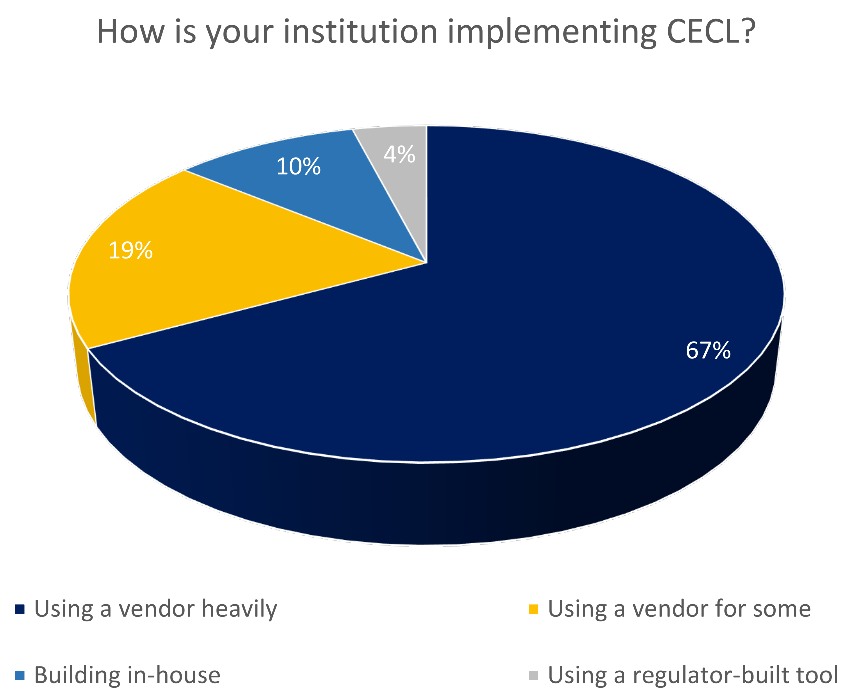
- CECL might not be comparable among institutions, even those with similar size and/or geography.
- When using a third party, calibration and customization are necessary.
- Model validation is a key component.
- Parallel runs in advance of adoption are vital to success.

[11] https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/simplified-cecl-tool-credit-unions

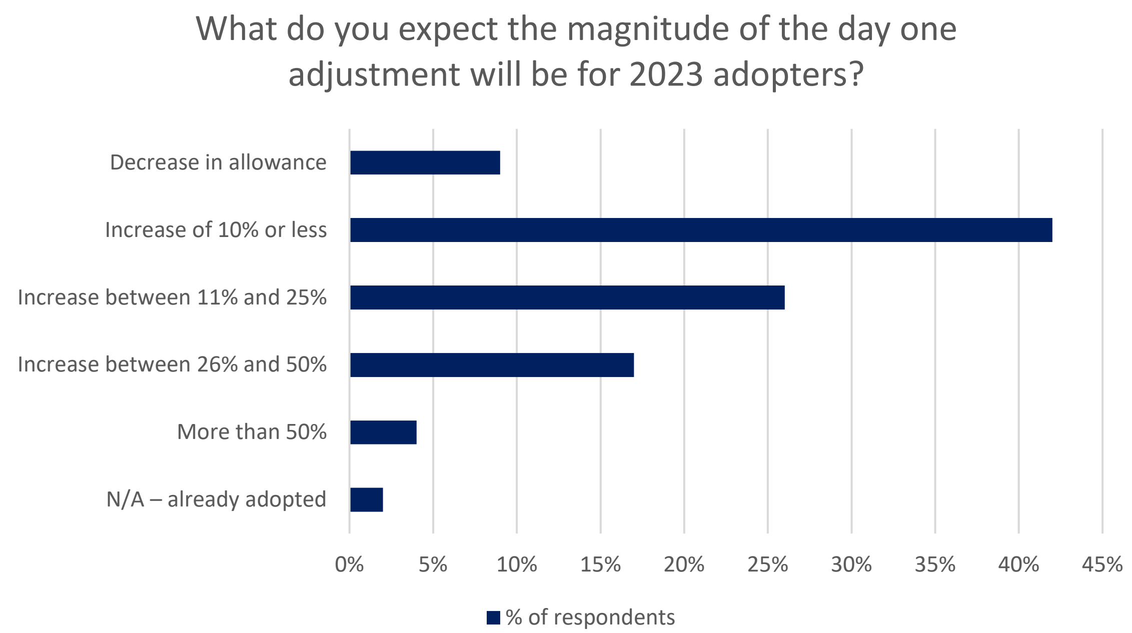
The remaining chapters of the A&A Guide outline:

- Background information, management's responsibility, and audit/supervisory committee's role in oversight
- Internal controls and governance
- Audit objectives and procedures and sources of risks of material misstatements
- Common accounting issues, including reasonable and supportable forecasting, reversion methods, and zero expected credit losses, among others
- Presentation and disclosure
- Communications with those charged with governance, regulators, and others

During this session, attendee polls provided insight regarding how credit unions are implementing CECL, as well as the expected magnitude of the day one adjustment for CECL adoption in 2023.



Source: Audience poll results during the conference.



Source: Audience poll results during the conference.

Conference takeaway: The magnitude of the day one adjustment of CECL will vary by credit union. The audience poll indicated that a majority of respondents expected an increase of 0% to 25% upon adoption, which is in line with those institutions that already have adopted CECL.

Other practice matters

Other practice matters highlighted by panelists included:

- Grants from the Community Development Financial Institutions (CDFI) Fund and Emergency Capital Investment Program (ECIP) – reported in other noninterest income
- Reference rate reform – final ASU to be issued by year-end
- Accounting for and disclosure of digital assets – added to the FASB's technical agenda
- Accounting for and disclosure of software costs – added to the FASB's technical agenda

Technology, fintech, and digital assets

Bryan Clagett, chief revenue officer and chief strategy officer at Moven, noted the vast changes the branch structure has undergone over the years. Branches are now just one of many different channels to conduct transactions. Members seek experiences that are efficient, informative, and engaging in the current digital society. Technology continues to evolve, but credit unions should ensure that technology creates value and is relevant to their members.

Clagett spoke about challenger banks and the top reasons consumers adopt challenger bank solutions: largely, because they are easy to set up, have more attractive fees and rates, have access to different products and services, and provide a better experience. These challenger banks remain competitive, and credit unions should focus on rich and personal experiences both offline and online.

Lou Grilli of Payment Systems for Credit Unions (PSCU) provided his perspective on digital assets, blockchain, and non-fungible tokens (NFTs). Grilli said that technology has evolved significantly over the past 10 years, and he expects current technologies will be obsolete in 10 years. For example, projects currently are in place to create a central bank digital currency, which will be disruptive to the credit union industry in the future.

Clagett and Grilli both noted that digital transformation is occurring all around us and is embedded in what credit unions already are doing. Grilli provided recommendations related to digital assets to ensure credit unions are ready for the future:

- Educate credit union members.
- Understand what current credit union members are doing with digital assets.
- Develop policies to address what the credit union will and will not allow its members and itself to be involved in.
- Educate the board of directors.
- Understand what the competition is doing with digital assets. Competition is not just other credit unions.

Conference takeaway: Credit unions should seek to understand what is relevant and important to their members in this technology-driven world. Digital assets are going to continue to evolve, and understanding what members currently are doing with digital assets is key to understanding future impacts and next steps.

Other industry and conference hot topics

Collateral-assigned split-dollar policies
Regulators and auditors provided insight into collateral-assigned split-dollar policies. Current accounting requires that if a loan to an executive is nonrecourse and the cash surrender value (CSV) is less than the loan amount, the loan is written down to CSV. If the loan to the executive is with recourse, credit unions need to consider the underlying collateral, if any; the ability of the executive to repay; and the credit union's intent to seek collection.

Other than temporary impairment
With the rising interest rates, available-for-sale security portfolios are showing meaningful unrealized losses, resulting in a reduction of capital due to other accumulated comprehensive losses. While the significant decline might be the result primarily of general market conditions of the economy rather than because of specific information, regulators and auditors reminded attendees of the factors to consider when determining whether other than temporary impairment exists:

- Length of time and extent to which the market value has been less than amortized cost
- Financial condition and near-term prospects of the issuer
- Intent and ability of the holder to retain its investment for a time sufficient to allow for any anticipated recovery in market value

Regulatory update
The NCUA's Lay discussed the state of the industry and changes experienced since the beginning of 2022. The economic environment has changed due to supply shortages, increased inflation, Fed funds rate increase, weakened housing demand, and continued low unemployment levels. Due to this environment, Lay said, interest-rate risk remains a supervisory priority and rising interest rates might affect net interest margins. Credit risk also remains a supervisory priority. Lay stated that in late 2022 or early 2023, the NCUA board might consider the following rules:

- Financial technology
- Chartering and field of membership
- Emergency Capital Investment Program
- Cyber incident reporting (final rule)
- Credit union member expulsion
- Loan interest-rate ceiling extension

Other topics
A panel of CFOs discussed the current challenges facing the credit union industry. Common themes were liquidity issues, margin pressure, digital transformation, the current labor market, and CECL.

Other conference sessions included these topics:

- Accounting and auditing issues
- Auditing and assurance updates
- Balance sheet management
- Derivatives
- Mergers and acquisitions
- Supervisory Committee Audit Guide
- Regulatory compliance

Learn more

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