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Cooperative Leadership In 2012

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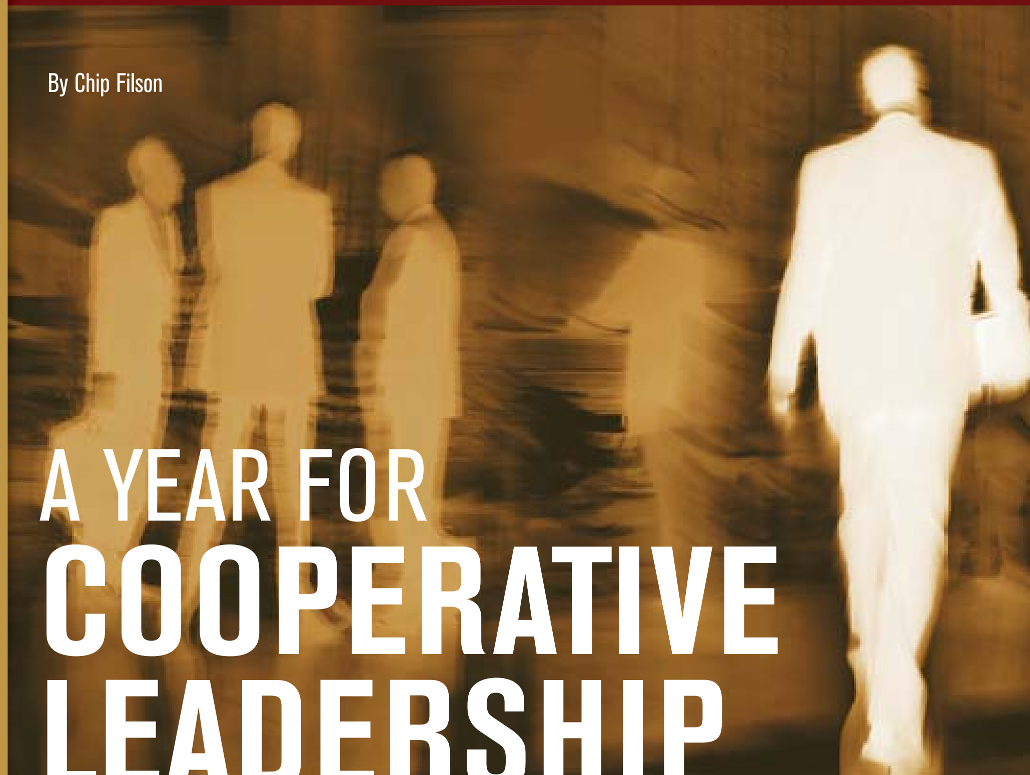
Callahan's
CREDIT UNION REPORT
At the Leading Edge of Credit Unions



By Chip Filson

A YEAR FOR COOPERATIVE LEADERSHIP

Why credit unions can be at the center of financial "Climate Change"

The credit union system is poised to report the most successful total bottom line in its history, topping the $5.9 billion of capital added in 2005. Liquidity is over abundant, with loan demand slowly emerging across all sectors. There is pent up energy among leaders to move forward on new business efforts.

More important, many "tectonic" social and market forces are moving in credit unions' direction. Consumers are seeking transparent, trusted, and locally vested financial providers. The financial sector of the economy is undergoing a massive makeover — mega-financial institutions are still trying to shed the legacy of past decisions, and there is growing concern that some firms have become too big to succeed.

The GSEs are in conservatorship with trillions of dollars in real estate-secured loans under their management. The FHLBs are rethinking their structure as borrowings have been hitting 10-year lows. Even the Federal Reserve with its nearly $3 trillion balance sheet is creating a new role in the economy and becoming the default destination for thousands of financial institutions' short-term funds.

The regulatory approach is torn between traditional overseers' hyper-ventilating from prior financial crises on the one hand and serving up more regulation on the other. The new kids on the block (Consumer Financial

OUR **COMMON BOND** HERITAGE TRANSLATES READILY IN THE **FACEBOOK SOCIAL ERA.**

Protection Bureau) are trying to design a better balance between consumers and institutional providers. Congress continues to examine past failures (GAO reports) while Dodd-Frank implementation is only partially done.

Made in America – The Product of Human Ingenuity and Character

The credit union system, like the American story from which it emerged, was begun with an act of imagination. Cooperatives are a vital way of promoting the country's ambitions of life, liberty, and human happiness. They provide a unique financial model that depends on an ongoing challenge for cooperative democracy: Will this critical inventive spirit be sustained by the current generation of leaders?

Credit unions were created by energetic and iconic thinkers. They seeded a century of innovation, building an interwoven system of bountiful assets that nonetheless held the open-ended question: How will such inspiration-reliant institutions further enhance their member-owners' well-being?

This stewardship now falls during a much more complex environment in which global, not just local, forces impact future possibilities. We are heirs of an incredibly successful experiment built on common purpose. Even when some efforts occasionally go awry, credit unions are a continuing expression of the transformative power of American inventiveness. The credit union movement is a vision not yet, if it will ever be, fully realized. What must we do to refresh this effort in 2012?

Why Cooperatives Can Lead Change

Six factors can contribute now to credit unions' unique action capability:

1. Our common bond heritage translates readily in the Facebook social era. As Gary Oakland, BECU CEO, says, "The common bond is just another form of social networking."
2. The contemporary generation's values of altruism, self-help, and community awareness align with the cooperative culture. Their political expressions often echo the progressive intentions of credit unions.
3. Ever expanding technical networks combine credit unions' local advantage with national reach via cooperative solutions.
4. Growth based on a "long view" of investment return uniquely favors the cooperative financial model. Quarterly earnings expectations do not inhibit strategic investing commitments.
5. The singular focus on what will benefit the member means that for credit union strategy, strength is always being applied to opportunity.
6. Today's networked business solutions rely on cooperation and technical interfaces, both credit union core capabilities.

Cooperatives uniquely combine these elements to create alternatives to traditional business growth strategies such as mergers, asset acquisitions, or capital intensive expansion. Scale is always accessible whether a credit union's assets are large or small; members can have local contact but also national, 24/7 access; capital is always available in prepositioned resources; learning from new ventures is accelerated and risk-diffused at the same time; success by one institution adds to every credit union's brand of trust and member service.

Cooperative approaches overcome many of the paradoxes analysts pose for strategic choice such as whether an institution will be a low-cost or high-service competitor. Credit unions' cooperative structure enables accomplishment of both objectives.

A New Paradigm: Public Banking

2012 is an election year. Political leaders have intensified the debate over how American society should respond to our common needs and citizens' "pursuit of happiness." One view is that government must have an activist role in providing safety nets for essential needs: retirement security, affordable health care, and market place oversight for fair dealing. The alternate view is that only "free-markets" can result in productive wealth creation and that consumers alone are best at making their economic and life choices.

Cooperatives overcome this seeming division. Market-facing cooperatives must provide value or go out of business. Cooperatively owned means that market demands for performance are muted by

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the goal of creating member value.

A new approach being touted in this era of fractured financial services is "public banking." The most prominent example is the state-owned, 92-year-old Bank of North Dakota. This $4 billion institution is state-chartered, has $325 million in capital, and has seven consecutive years of record earnings. Deposits are not insured by the FDIC (but backed by the state) and all state agencies are required to deposit their funds with it. The bank provides loans for economic development, student education, and — with community banks — small business and farms. The core value of this state-owned example is the same that cooperatives deliver — locally generated funds are consolidated and used to stimulate local economic projects.

Other signs of this "public" approach to financial services are the announcements by several religious and nonprofit groups of moving funds from banks to credit unions because credit union values more closely parallel their own.

An extension of this "public banking" concept is the Democratic National Committee's announcement of a $2 million short-term deposit in Latino Community Credit Union of Durham, N.C., from funds to be used for the Democratic National Convention that will be held in Charlotte in September. Similar "public" moves are being considered by political party organizations in other states.

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THE CONTEMPORARY GENERATION'S VALUES OF **ALTRUISM, SELF-HELP,** AND **COMMUNITY AWARENESS** ALIGN WITH THE **COOPERATIVE CULTURE**.

Credit unions' democratic and cooperative character is an increasingly visible model that publicly funded and socially conscious organizations, not just consumers, are attracted to. These organizations want their short-term funds used as an extension of their purpose, not be an asset merely in want of a parking place.

The Opportunity: Without Cooperation, Everyone Pays More

In this era of market makeovers, credit unions are well positioned for seeing needs and responding faster, because they are closer to the consumer. Opportunities abound in housing loan modifications, rising auto sales, and consumer refinance.

But the credit union position is only an advantage if we act on it. Better solutions often lie less in price than in value – which flows from innovation, and depends on resources and management leadership.

In many areas of society still under financial stress — education, public finance, and secondary market and correspondent relationships — new designs are needed. These offer opportunities whose scale and solutions require joint efforts.

To succeed in 2012 and beyond, credit unions that invest in both individual and cooperative initiatives will become leaders. Cooperative effort means credit unions have a stake in helping members of other credit unions become better off. Credit unions care about all members, not just their own. By solving needs and sharing solutions, every member pays less or earns more.

The cooperative system lives in the tradition of inspired innovation lying at the heart of both American and credit union progress. The writer Charles Handy observes that, "Change comes from small institutions which, when imitated, become the fashion." Credit unions are indeed small, but we are increasingly becoming in fashion. That's a good place to be — though it requires work. Let's get to it! •

2011'S TWELVE ISSUES OF THOUGHT LEADERSHIP

Ideas to prod and propel the credit union movement forward

Time didn't stand still in 2011, and neither did we. Each month last year we published a **Callahan Report** that addressed critical issues for credit unions. Better use of the cooperative spirit, restructuring NCUA, creating a secondary market in credit union mortgages, fighting the nation's unemployment, and converting strategy into effectiveness are just five of the topics we took up and debated. A month-by-month summary follows:

JANUARY

NCUA's Public Accountability

In January we worked to peel back the shield NCUA had been erecting and that was allowing it to operate with increasing disengagement from the people and institutions the agency was meant to serve. The regulatory agency had vastly increased its estimates of the assessments needed from credit unions to resolve the corporate crisis, had conserved credit unions using questionable logic, and had maintained a stance of cloaking its budget from the credit union community.

These actions required push-back and scrutiny. Chip Filson called for a more open and participatory discussion of NCUA actions, noting with alarm as well that in some quarters credit union leaders were reluctant to speak out for fear of NCUA retribution. Filson urged greater accountability of and transparency from an agency increasingly acting like an "unelected fourth branch of government."

In addition, Maurice Smith of Local Government FCU criticized NCUA's attempt to require demonstrated financial acumen of board members as infringing on rights of members to elect whom they favor. And Randy Karnes of CU*Answers worried that attacks against his online petition for restructuring NCUA were attacks on the credit union cooperative spirit of redesign.

FEBRUARY

The Credit Union System's Message To Congress

In this month of the GAC we laid out a prescription for an ailing America. Rather than asking Congress what it could do for credit unions, we urged credit unions to ask their Representatives how credit unions could make lives in their districts better. Credit unions could "pay it forward," that is, give to the community as a return for their own success. Credit unions can astonish Representatives by offering to step up for fairer housing finance, fairer credit card policies, and other community-helping actions that are the heart of the Federal Credit Union Act enacted during the Depression.

Randy Karnes of CU*Answers again presented his petition suggestions for reconstructing the regulatory nature of the credit union industry and noted that the industry needed dialogue and unorthodox thinking. Dennis Pierce – of CommunityAmerica as well as the CUNA Board – discussed working within rather than outside the system noting that change ultimately arrives when the "system" comes to embrace once radical ideas and that this most often happens after debate and reasoned advocacy.

MARCH

Living Up To Cooperative Principles

In March we pulled back the curtain on cooperatives' intangibles. All too often it's easy to believe that cooperatives have one objective: work to keep hard-earned money in members' pockets. But that is only one of their goals. Cooperatives arose in hard times, when people could not see advancement from established ways of doing things and when they felt they could help one another if they pitched in with a community effort.

Chip Filson emphasized the intangibles – and not just how the intangibles helped individuals but also helped communities by lifting households that otherwise would be left behind.

Patricia Smith at Unitus Credit Union discussed how her credit union imbued its membership with the spirit of member-owner awareness and voter participation. And Elizabeth Archerd related how the Seven Cooperative Principles infused the membership, management, and operation of her food coop in Minneapolis – it gets up to 300 persons at the annual meeting – and when asked if growth diminished the co-op's principles, she replied, "HA! No! The larger we get, the more inseparable we are from our founding principles!"

APRIL

A Reform Agenda For The Cooperative System's Future Design

In April we proposed the following reforms: Divide NCUA into three separate bodies: 1) one for chartering, rule-making, and examining; 2) one for cooperative insurance supervised by a Board comprising both regulatory and industry representatives; and 3) one for a cooperatively owned Central Liquidity Facility governed by the industry via an elected Board modeled on the FHLB. The reason: NCUA worked well enough until the crisis of 2008, when its Depression-era conception was too severely strained. No other U. S. government body encompasses legislative, executive, and judicial functions, and this has given rise to crippling conflicts of interest.

The best ideas bubble up and checks-and-balances impose restraints when rule-making, enforcement, and penalties are not compressed into a single body. A model for the chartering agency is the OCC within the Treasury Department. The NCUSIF has not been run well and requires cooperative governance. And the CLF did not meet industry needs during the credit crisis of 2008; it requires new structure and new governance.

MAY

Supporting America's Job Growth Priority

In the spring, the nation's #1 concern was jobs. We devoted this issue to how credit unions were supporting job creation and retention. We suggested that credit unions set a goal of supporting one million U. S. jobs and widely publicize the effort. In this way credit unions would receive tremendous good will and publicity. We showed how we were actually not far from the one-million job goal. We demonstrated how credit unions already supported 909,000 jobs by 1) directly employing 255,000 full and part-time persons; 2) spending $7.8 billion at third-parties thus supporting another 128,000 jobs; and 3) writing home mortgages and auto loans that can be shown to support 526,000 jobs in the home construction and auto industries.

In addition, we ran a story from WestStar CU, which organized successful Job Fairs in Nevada – at no cost to itself but which presented more than 30 companies to more than 6,000 persons. And we presented ideas credit unions can effect to help employment, some of which were: start a Job Board; hold networking sessions; post jobs available at SEGs; and use refinancing to help people hold onto the jobs they already have.

JUNE
Creating A Credit Union Secondary Mortgage Market

We presented the case for creating a secondary market exclusively handling credit union mortgages. Our case followed these lines: 1) Credit unions have sufficient mortgage origination, now about 10% of all mortgage originations in the country; 2) Credit unions have consistent cash flow to remain active in the market during all cycles; 3) Credit unions have significantly higher asset quality than at FDIC-insured institutions (owing in large part to being member organizations and to focusing on local underwriting; and 4) Credit unions have traditionally held on to the servicing in order to grow the member relationship.

Chip Filson and Barry Strickland of Tower FCU laid out the process for a secondary market maker developed on a cooperative model: 1) Assemble a team of credit union leaders; 2) Identify vendor partners; 3) Develop options for the Master Server; and 4) Approach investors.

JULY
The Cooperative Spirit Of A Community

Credit unions not only ***sprang from community*** (think SEGs), but in a time of increasingly large credit unions and community charters they are also ***"creating community,"*** the theme of this issue. Community (SEGs again) ushered forth credit unions, and now the best of credit unions are "paying forward" by strengthening community in two senses: 1) strengthening the well-being of members; and 2) strengthening the communities in which the credit unions operate. Chip Filson wrote, "Building communities within and around a cooperative organization is not merely exercising the principle of each getting along with another; it is about a creative set of design elements to get ahead and share success."

We noted Canada's largest credit union, VanCity, which, it says, "is guided by a commitment to corporate social responsibility and to improving the quality of life in our communities. Here you can change the way your money works." The July issue also noted Everence FCU, which organizes around a principle of good stewardship of Earth's resources, strengthening those who share its values as well as their communities around the world. And we ran a story from Southern Chautauqua FCU, which dedicates itself in interesting ways to uplifting a low-income section of New York State.

AUGUST
Planning Effectiveness In A Cooperative

In this issue we looked at the tender area between strategy and execution, specifically how strategy is translated into successful operations. The investigation examined the difference between a strategic plan and a business plan. Our finding was that the specific strategic model was less important than the recommitment of purpose and passion unique to credit unions and their cooperative structure; these would drive business priorities that would lead to success.

Debbie Connors of MoneyOne FCU in Largo, MD., laid out how after two rough years, her credit union had settled on a strategy of growth and the tactics to reach its goals. David Sprague at Hanscom FCU described how his credit union moves from strategy to implementation, mainly by means of forging a tight Board-management team.

SEPTEMBER
Regulatory Evolution - Let's Work Together More

In this issue we looked at NCUA and what some people considered its heavy-handed and arbitrary actions in 2010-2011. We questioned NCUA's proposed regulation of CUSOs. And we laid out a prescription for improving NCUA as well as the NCUA-credit union relationship.

We also invited the views of others. Jerrie Jay, a credit union regulator in North Carolina, discussed ways of improving NCUA's relationship with the states. Henry Wirz of SAFE CU concentrated on the CUSO debate, championing CUSOs and saying NCUA already has sufficient examination power to ensure credit union safety without prying into CUSO businesses. And Gary Oakland of BECU felt NCUA could be a better listener to credit unions while listening less to Wall Street experts, Congressional inquisitors, and its own senior staff. Oakland suggested NCUA learn from state regulators, who seem more open to diversity and variety – of opinion as well as operation. These changes, Oakland believes, will restore a healthy regulator-regulated relationship.

OCTOBER
Leveraging Unique Cooperative Capabilities

People have become angry at banks, but they seem to be more repelled by banks than attracted to credit unions. We asked ourselves if credit unions could take advantage of consumer bank disenchantment to swell credit union use and membership. We noted headwinds – some credit union leaders are reluctant to build assets in a time of low loan demand, for example – but we urged concerted consideration of seizing this time to tell the credit union story and argued that how we set our course now will define our success – or lack of it – for a generation.

We asked Ted Malone, in charge of financial aid at Purdue University, how cooperatives were faring in helping student he dealt with. He gave good marks to credit unions, noting rates and options.

We also suggested a "cooperative score," by which a credit union and its members would be better able to judge how the credit union is incorporating cooperative principles to its business operation. Some metrics might be: percentage of members voting in elections; payment of a dividend clearly marked as an "ownership dividend;" and cooperation with other cooperatives.

NOVEMBER
The Cooperative Way - Debt Management

In this issue we looked at the important role of debt and how it is handled in credit unions compared to other kinds of institutions. Credit unions do better at extending credit during all economic cycles while controlling delinquencies in main part because they establish relationships meant to last not merely for a term of a contract but for a lifetime. If members are meant to be the beneficiaries of credit union action, then a loan is not an us-versus-them contract for profit but rather a "here is how we can help and we have faith in you to repay in kind" agreement. That said, credit unions need to rebuild their credit/liquidity structure from the wreckage of the corporate system.

We ran two other stories. One by Danny Delarosa of United FCU demonstrated the unique credit union approach to lending – United refinanced a member family's debt saving it $67,000 over 20 years – by working at relationship and value rather than profit. The other describes the growing work of credit unions in providing loans to students, again not for profit but to afford a student the best way to finance a higher degree.

DECEMBER
Good News For Credit Unions And From Credit Unions

In this issue we looked at some recent good news: consumer confidence up, as well as consumer spending for the holidays and better employment figures. In some respects these were surprises, just as pleasant surprises are often what credit union members experience when dealing with their credit unions. We reported examples of extraordinary service by three credit unions, not just saving members money but also saving some members from a great deal of trouble and grief: Credit unions deliver extraordinary service because they are organized to do that.

We added two stories: one of Jeffrey Farver's long and extraordinary service to SECU and its community of San Antonio. At Jeff's retirement party, his community surprised him with the announcement of a SECU scholarship in his name to help San Antonio community college students – what goes around comes around. The other story recorded a real estate agent's reflections on how credit unions – Desert Schools FCU in particular – have been leading the way to dig greater Phoenix out of its housing foreclosure problems. T'was a season of goodness and light. •

By Gary Oakland, Pres/CEO of BECU, Washington

A FUTURE WITH TREMENDOUS POTENTIAL

But we can't brand ourselves or let others brand us in the old fashioned way

BECU under Gary Oakland: When Gary arrived at BECU it was a single-branch single-sponsor (Boeing), state-chartered credit union of $170 million and about 65,000 members. At that time, about any member who left Boeing had to surrender their credit union account. By 1986, when Gary took over as CEO, membership was allowed for life, assets had grown to $770 million and membership to 109,000. As Gary retires, BECU holds a state community charter allowing membership to residents or workers throughout Washington, as well as to Boeing employees and family wherever they live. Assets are just shy of $10 billion and membership is 744,000. Callahan's talked to Gary about his tenure at BECU and his thoughts for the credit union movement going forward.

Name some things BECU held onto over these past 31 years.

GO: Our guiding principle and dominant focus has always been what is good for the member. The basic form this took over all these years was remote access, with convenience being defined by the members. In 1980, remote access meant stations in Boeing plants that had forms and envelopes for delivery by intra-company mail or U. S. Mail, as well as telephone. Delivery tactics have changed dramatically since then but the focus on remote access has remained. I resisted branches for years but ultimately we did partner with Safeway for in-store locations; we discovered that people had a need for face-to-face contact, at least when establishing a relationship. As a result, the vast majority of branches do not have traditional tellers. Our staff in our branches are focused on relationship building and educating members on how to use our remote services. We've kept these views for years. Basically we think of ourselves as a small credit union with a very large membership.

How did you move from a credit union based on a single sponsor to one oriented toward community?

GO: This was a challenging transition. We worried over how we would get more involved in the community. We broke through with our BECU Foundation, which awarded scholarships to BECU employees' children; we found we could contribute to the community this way and then expanded on it. This was a turning point in our perception of ourselves and the perception of us by others. Today, we focus our community efforts in four areas: affordable housing, financial well-being, education, and the credit union movement.

SOCIAL NETWORKING IS JUST **"COMMON BOND"** BY ANOTHER NAME.

How did you manage navigating through all the regulatory, economic, and technological change of the last 30 years?

GO: By never taking our eye off of the "member" ball. Our decision-making starts by asking "what is in the best interest of the membership?" I believe the coop model is a competitive advantage and it doesn't always make sense to follow how banks approach their challenges or measure their success. I also believe strategic discipline has helped. By staying true to the credit union philosophy, anticipating where the "puck" is going to be, and realizing that we can't be all things to all people has helped us navigate through all of the changes over the past 30 years.

Discuss how you defined value.

GO: Early on, we defined value as the loan and savings rates we offered members. Then we realized that we were also delivering an exceptional experience and service as well. We began to define ourselves in a new and broader way. We understood the prevailing wisdom was that you could deliver on price or service but not both; we believe the coop model allows you the ability to deliver on both. We adopted what is sometimes called

WE ARE GOING TO MOVE INCREASINGLY AWAY FROM A **"TRANSACTION"** BUSINESS TO AN **"EXPERIENCE"** BUSINESS.

FACE, which stands for Fast-Accurate-Cheap-Easy. We believed that if we could deliver Fast-Accurate-Cheap-Easy to members we could do very well and compete on both price and service.

You had an opportunity to "go national" as Boeing spread and expanded, but you stayed close to western Washington. Why?

GO: We wanted to concentrate on community; we wanted to hold to our roots. We had a strong brand in the Puget Sound area. It's not that we didn't want to expand, it's more that we felt we didn't want to commence any action that would diminish the value we were providing the persons already being served.

Nevertheless BECU has been a big player in cooperation among credit unions.

GO: That's true, and we still feel that the broader movement can experience tremendous improvement. What as a movement we don't seem to be doing well at present is turning conversation into transaction. Many people agree on an idea (e.g. a national brand, shared services, etc.) but on a political, delivery, or product level we become fragmented and fail at the transaction.

What do you see for credit unions in the future?

GO: We are at a very important cusp. The really good news is that more consumers are seeing credit unions as a true and beneficial alternative to large commercial banks. What seems to be holding us back is — except in certain locales — the lack of a strong branding presence. Consumers don't know us well enough yet. I hasten to add that it's very important that we are not branded as what financial institutions do but rather as *what we are* – cooperatives organized to help persons and communities – and *what we will become*, which is even better cooperatives.

We have to leverage the cooperative model much more than we have done so far, because – as I just said another way – this is how consumers are aligning. People want local, community, and social. Social networking is just "common bond" by another name. We are facing a tremendous opportunity – especially with younger people.

A big danger is remaining in "present thinking." We should never define ourselves or let others define us as a banking model. We should never try to conform our message to *what people expect* rather than *what experience they deserve.* We can't think about "what is" or we will dig a hole for ourselves in "what is." We need to think it terms of "what if…" We should be thinking about and defining ourselves in what we will become.

We should be emphasizing the cooperative model, democratic principles, and helping one another. Then we can deliver on what is going to be a different sort of financial institution. Do you know what currency they used in *Star Trek*? It wasn't money; it was only transactions, almost a kind of bartering. That could be a piece of our future – we have to leverage what we could turn into. I think we are going to move increasingly away from a "transaction" business to an "experience" business. Think of it this way: Behind every transaction there is a "why" — we need to understand that "why" and then we can be a part of spreading the experience through the community.

We have to stop letting the status quo overwhelm us. This ties in with letting others define us. We shouldn't let constraints and historical perspectives get in the way. We need to understand that we are undergoing a tremendous change in financial services. Are we going to fight it and be overwhelmed or learn how to ride the wave and be energized by it?

We should be putting aside things that are irrelevant to our success, or consider the costs of fighting certain battles. For example, we might consider giving up on the tax exemption issue if by doing so we could win access to supplemental capital, which would propel us far more in the future than taxes would constrain us. Think anew. Think unbounded. A world of possibilities awaits. •

Gary Oakland joined BECU in 1980 and became CEO in 1986. He is retiring this year. As well as building BECU into a giant of the industry, Gary has chaired the National Credit Union Foundation and served the boards of the Washington League, NASCUS, the Filene Institute and others.

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