



## TRENDWATCH 1Q22



May 18, 2022

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# Today's Lineup

## **Market Update**

*Jason Haley, Chief Investment Officer, Investment Management Group, ALM First*

## **1Q 2022 Credit Union Results**

*Jay Johnson, Chief Collaboration Officer, Callahan & Associates*  
*Will Hunt, Industry Analyst III, Callahan & Associates*

## **The Business Case for Fee-Free**

*Kendall Garrison, CEO, Amplify Credit Union*





Callahan Quarterly Trendwatch | May 18, 2022

# ALM First Market Update

- **Uncertainty and Volatility**

- Financial asset volatility surged higher in April after a brief pause in the second half of March
  - Volatility has been particularly elevated in the aftermath of the 5/4 FOMC meeting
- Following the worst quarter since early 1980, broad fixed income did not rebound in April
  - YTD return through April is -9.5% for ICE BofA Broad Market Index (2<sup>nd</sup> worst was -3.57% in 1994)
  - April was worst 1-month return since September 1980
  - S&P 500 -8.72% in April (-12.9% YTD)
- Sources of uncertainty largely the same
  - Somewhat better picture of the Fed's near-term plans, but still high uncertainty regarding how the economy and inflation will respond to Fed rate hikes and balance sheet reduction
  - Russia/Ukraine and China Covid lockdowns also fueling uncertainty

- **Inflation still running hot**

- Employment Cost Index (ECI) sets record high in Q1
- April CPI higher than expected, with core prices up 0.6% m/m
  - Prices particularly firm in services sector, including a 18.6% m/m increase in airfares
- April producer price index (PPI) showed some signs that CPI could soften in coming months
- Some housing market data softening amid sharp rise in HPA and mortgage rates
  - Fed's Senior Loan Officer Opinion survey revealed a drop in mortgage demand as well as less easing of lending standards

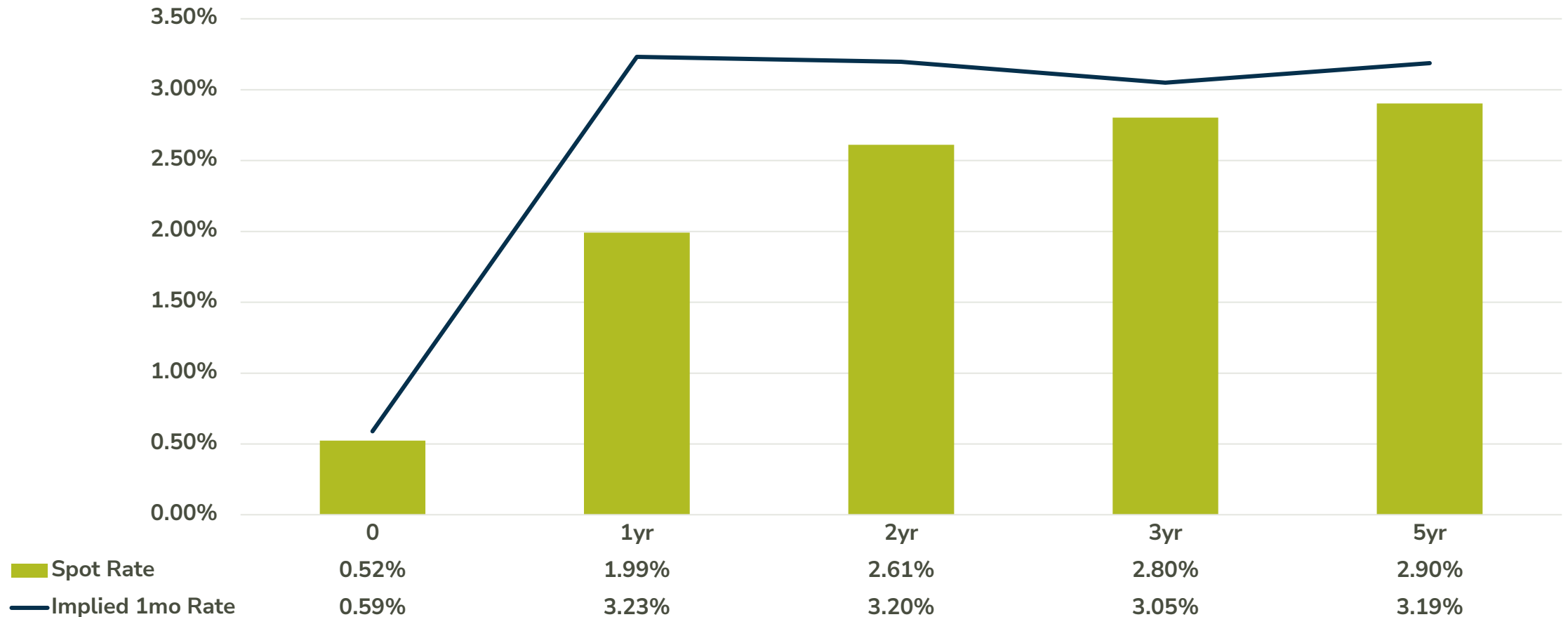
- **FOMC raised funds rate 50 bps on May 4 & announced balance sheet plans**
  - Market was fully prepared for 50 bps hike, but there was some concern of a more hawkish move leading up to the 5/4 meeting
  - Powell effectively ruled out a 75 bps hike, which Bullard (St. Louis Fed) had suggested should be a consideration in April (Fed leaders have since adopted a more uniform voice)
  - Balance sheet reduction plans were largely in line with expectations
  - Market now pricing for 50 bps rate hikes at next 2-3 FOMC meetings and a fed funds rate of 2.7% by year end
  - Job openings to total unemployed ratio now close to 2:1
    - Powell highlighted this ratio as “unhealthy” in March when it was at 1.7:1
- **How will consumers weather inflation & the Fed?**
  - Household balance sheets entered this inflation cycle with relative high levels of liquid assets and wealth, allowing companies to more easily pass long higher input costs and further aggravating the Fed’s inflation battle
  - In recent *Wall Street Journal* article, some corporate executives have suggested that signs of “inflation fatigue” are emerging based on reduced demand for high ticket items and increased demand for discount brands
  - Gas prices now back at all-time highs this week
  - Powell and his colleagues have made clear that getting inflation under control is more critical than soft landing



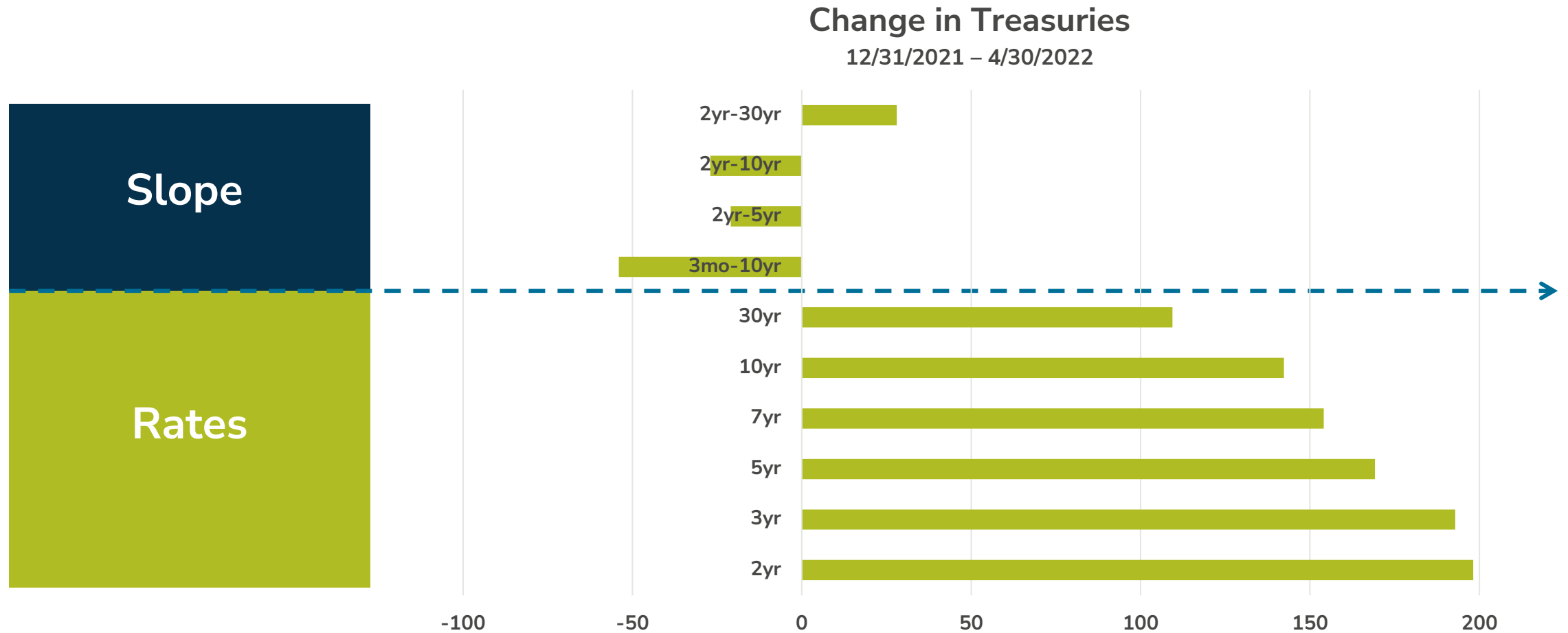
# What's Priced In?

## Front-End Treasury Yields: What's Currently Priced In?

As of 5/10/22

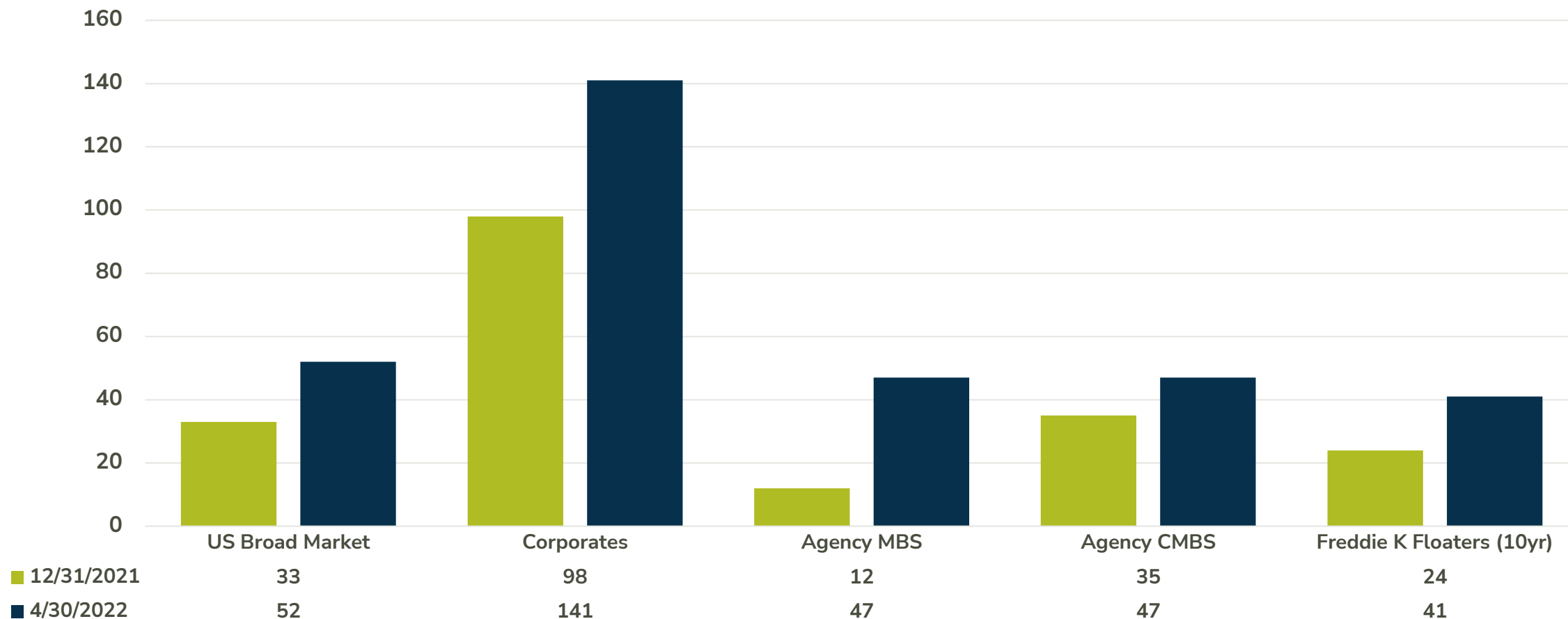


# Rates & Curve Slope YTD



# Fixed Income Spread Widening

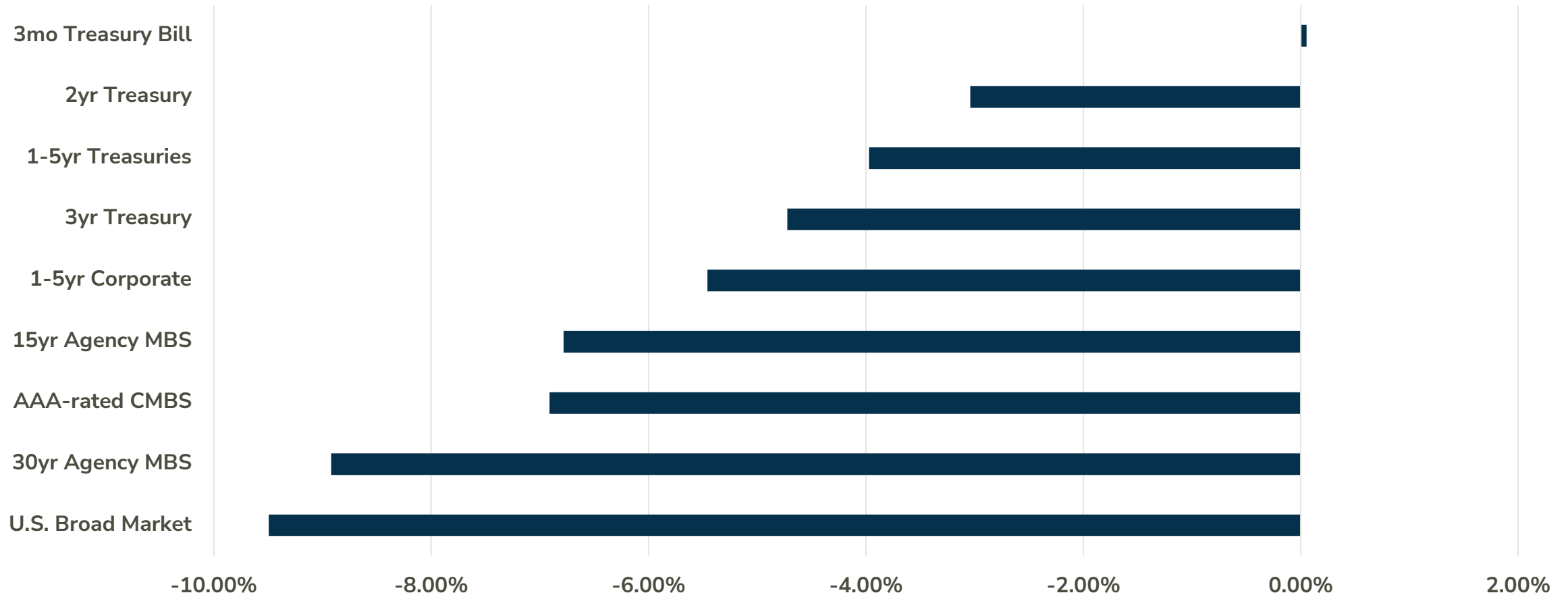
**YTD Sector Spread Changes**  
Option Adjusted Spread Vs. Treasuries (bps)



# Historically Bad Year For Bonds

## 2022 YTD Fixed Income Total Returns

As of 4/30/2022





# Impact of Rising Rates

- Higher rates → higher unrealized losses for core AFS bond portfolios
- Higher rates → higher deposit franchise value
- Higher rates → higher net-interest margins
- These longer-term trends should be more important to stakeholders than short term accounting measures
- Unrealized losses go away with time
- Having a sound investment process and managing reinvestment needs produces long-term success in the securities portfolio

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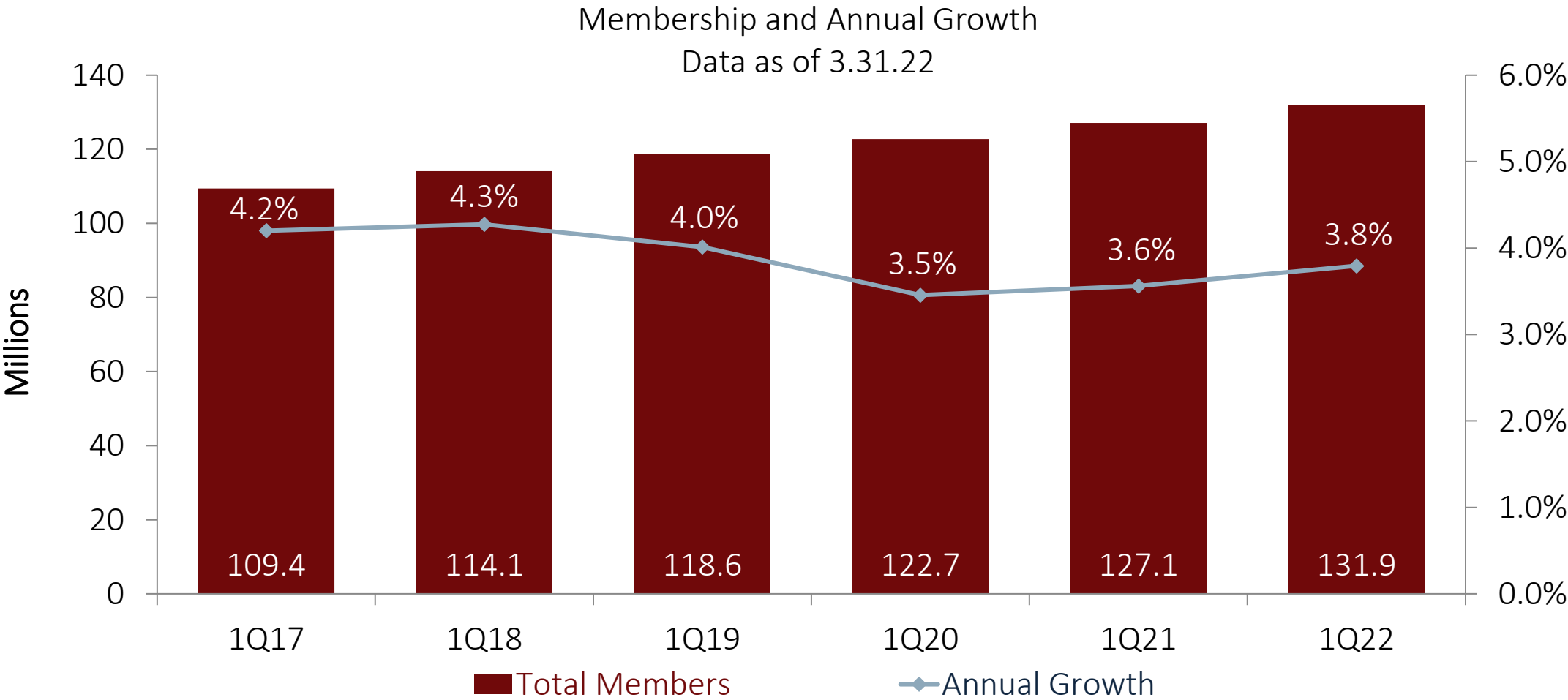
# ALM First Market Update

## Loan growth exceeds share growth for the first time since 2019

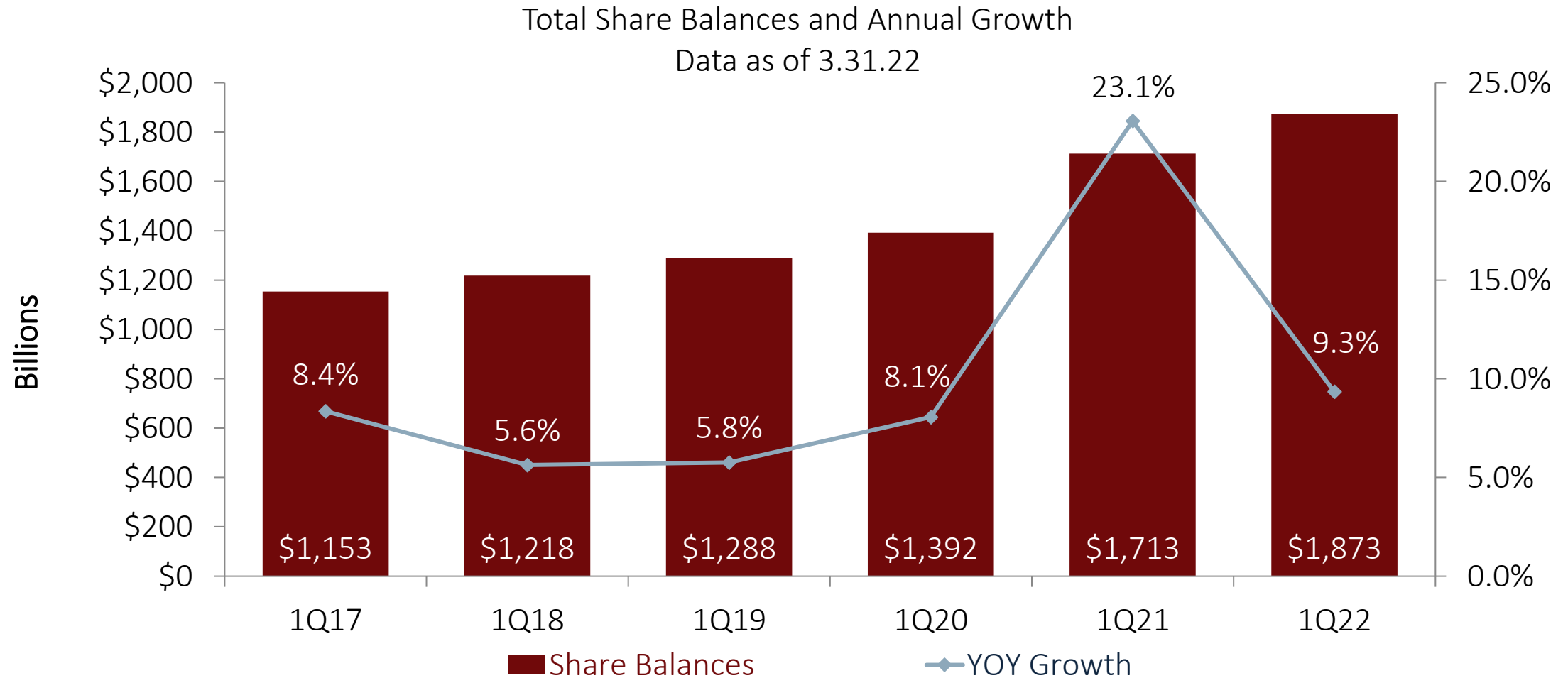
	3/31/2022	12-Mo. Growth	3/31/2021	12-Mo. Growth
Assets	\$2,142.4B	8.7%	\$1,971.5B	19.0%
Loans	\$1,315.1B	11.7%	\$1,177.7B	4.3%
Shares	\$1,873.3B	9.3%	\$1,713.2B	23.1%
Investments	\$724.8B	3.1%	\$702.9B	57.3%
Capital	\$209.6B	1.1%	\$207.3B	7.4%
Members	131.9M	3.8%	127.1M	3.6%



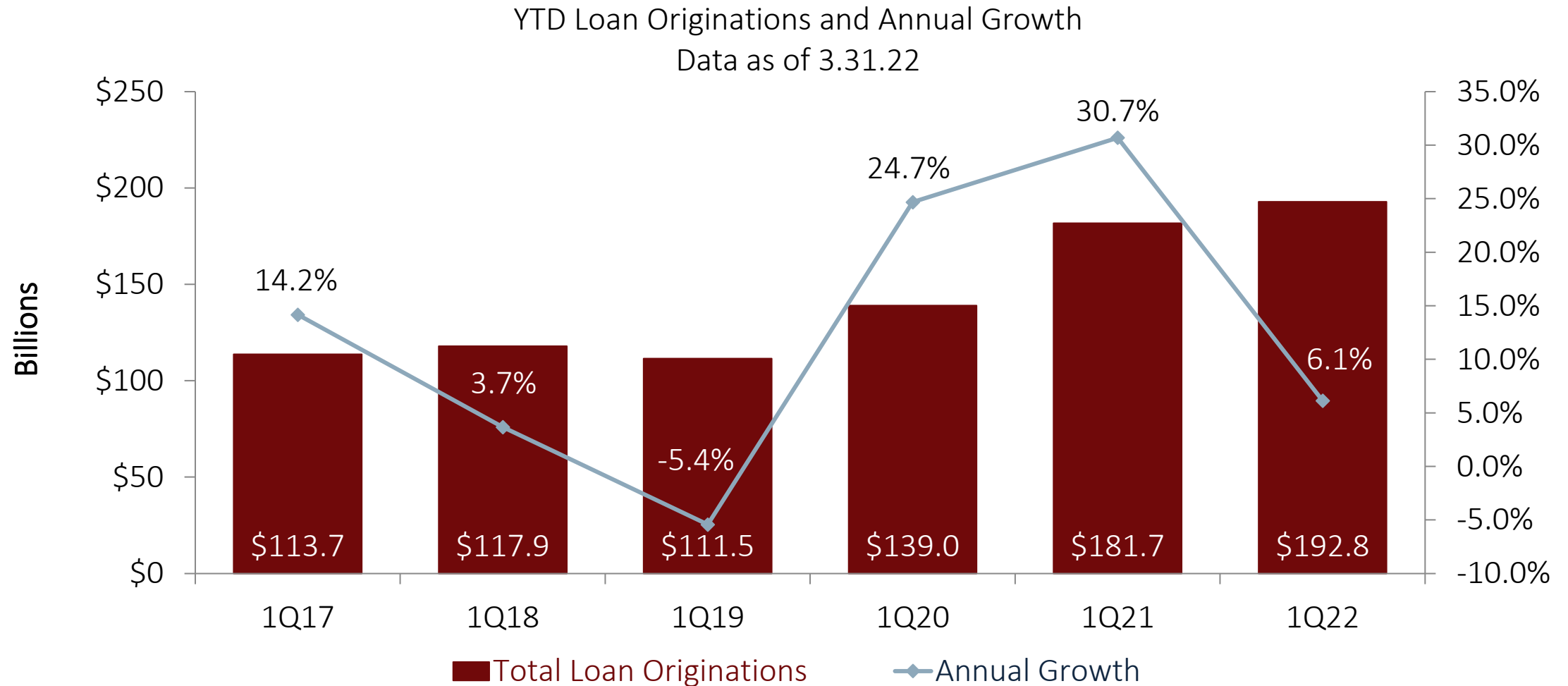
# Over 4.8 million U.S. consumers open a credit union membership in the past 12 months



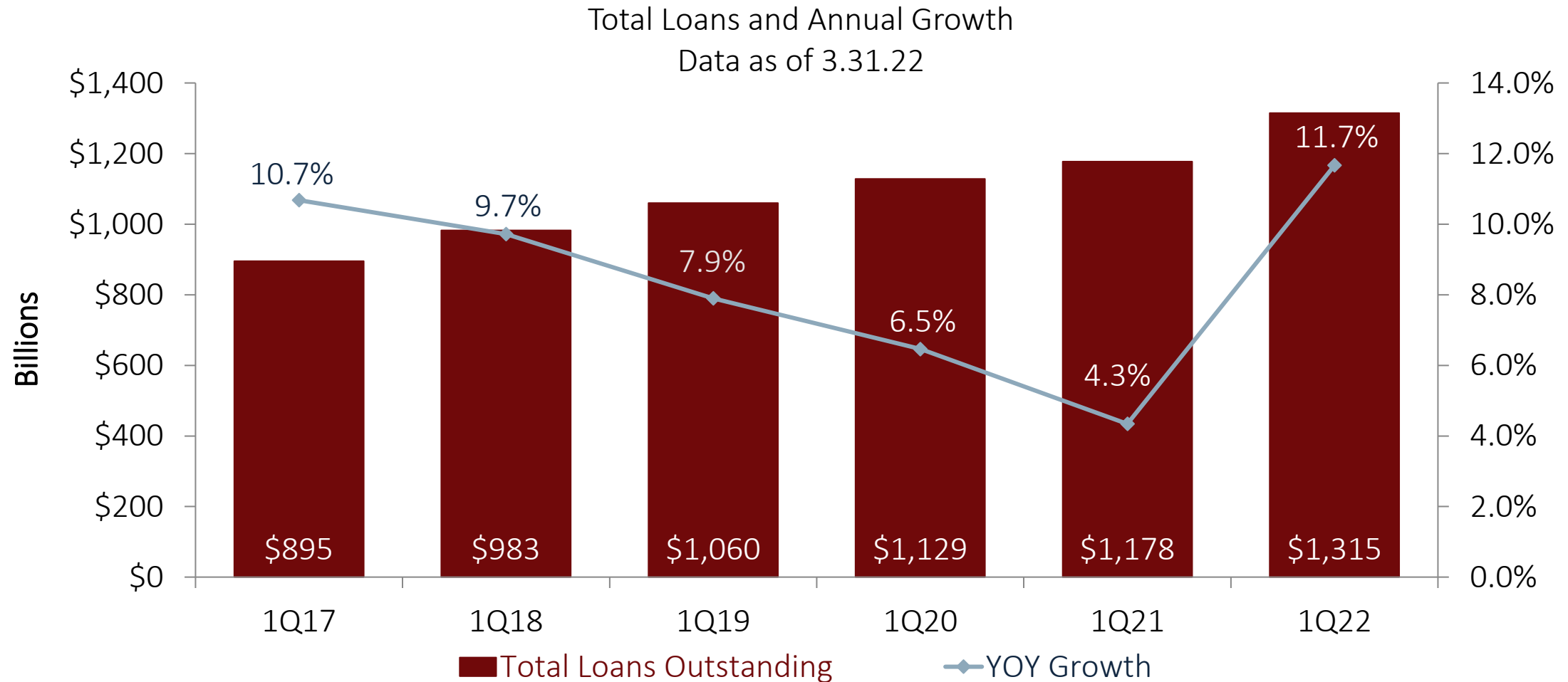
# Share growth is returning to a “normal” level as 2022 begins



# Loan originations start the year on another record pace

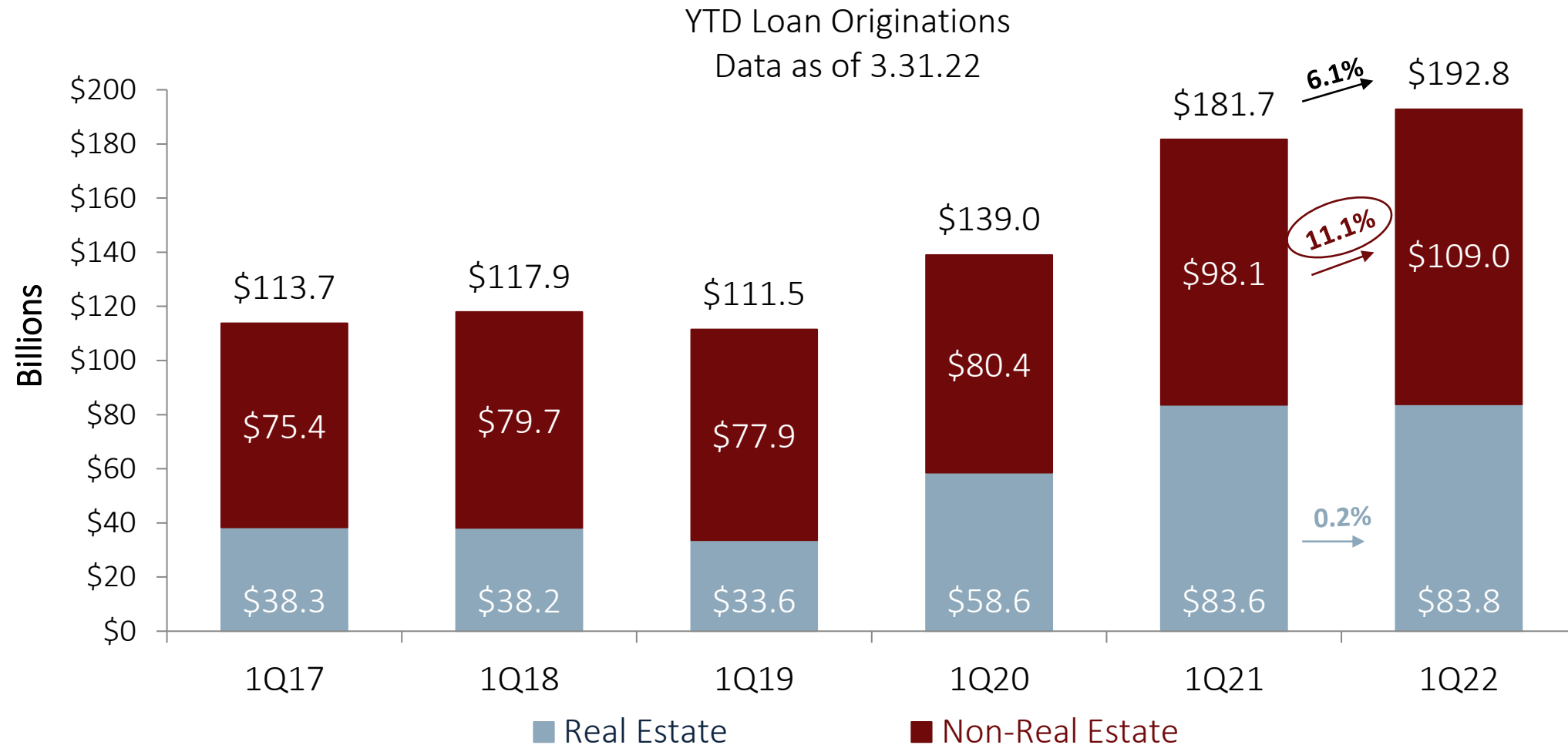


# The loan portfolio is growing at the fastest annual rate since 2005



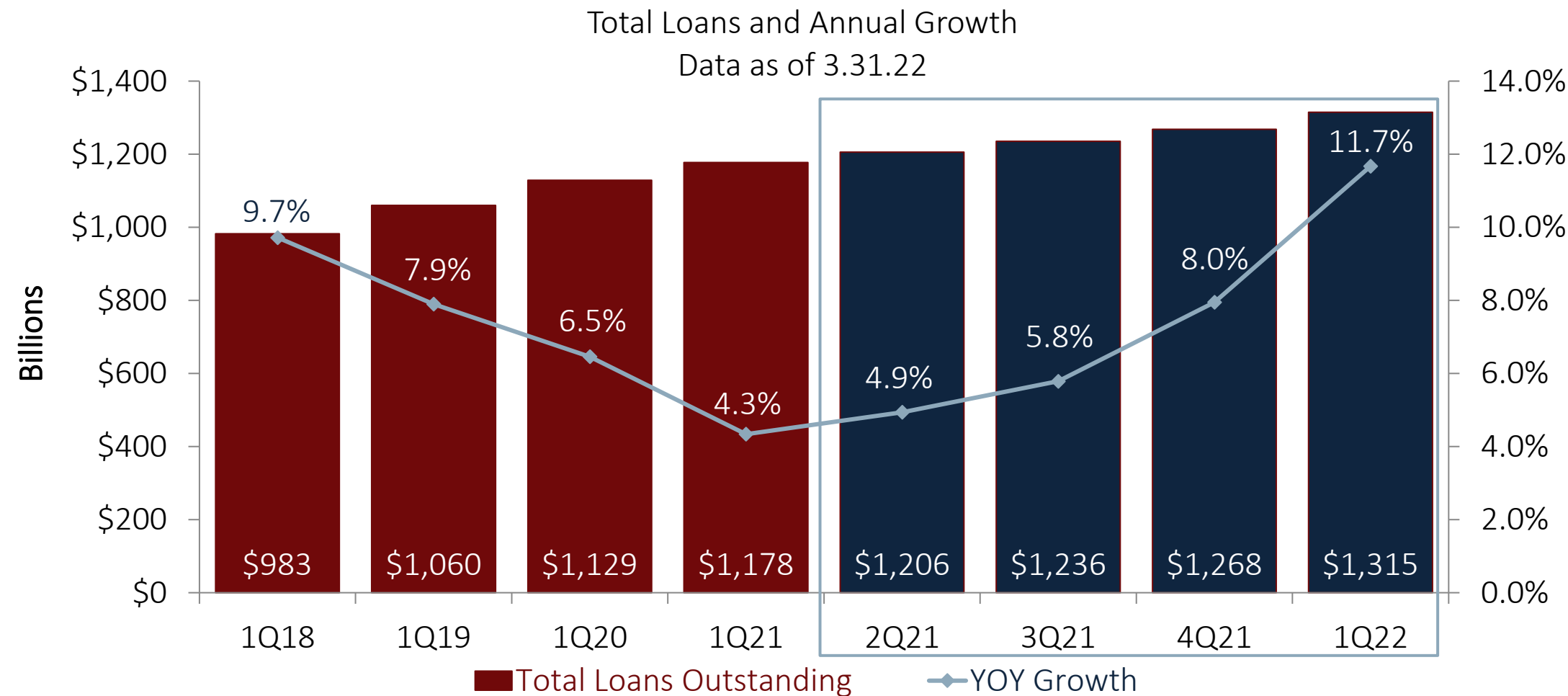
# Lending

# Consumer lending drives growth in originations

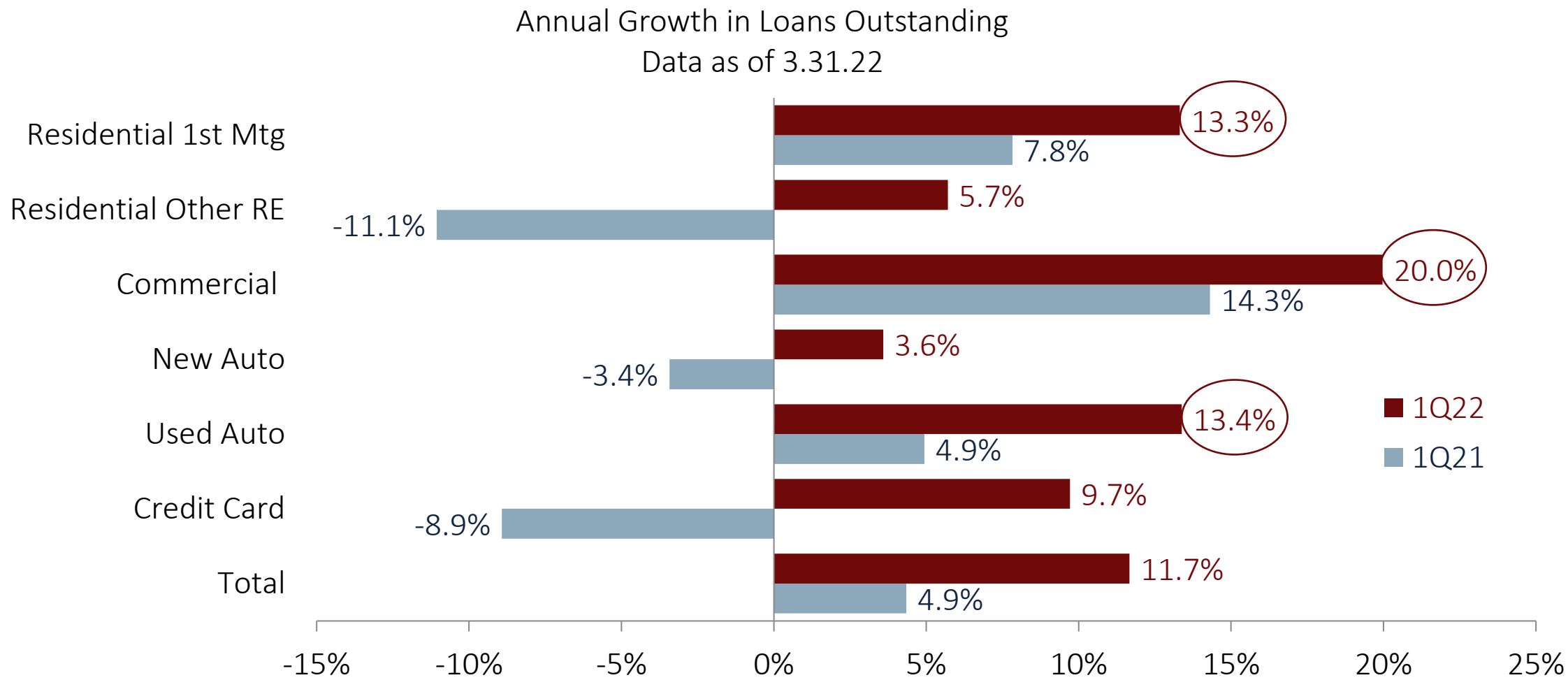




# Annual loan growth is accelerating over the past four quarters



# Growth is picking up across the loan portfolio



# Credit unions are investing in their local communities

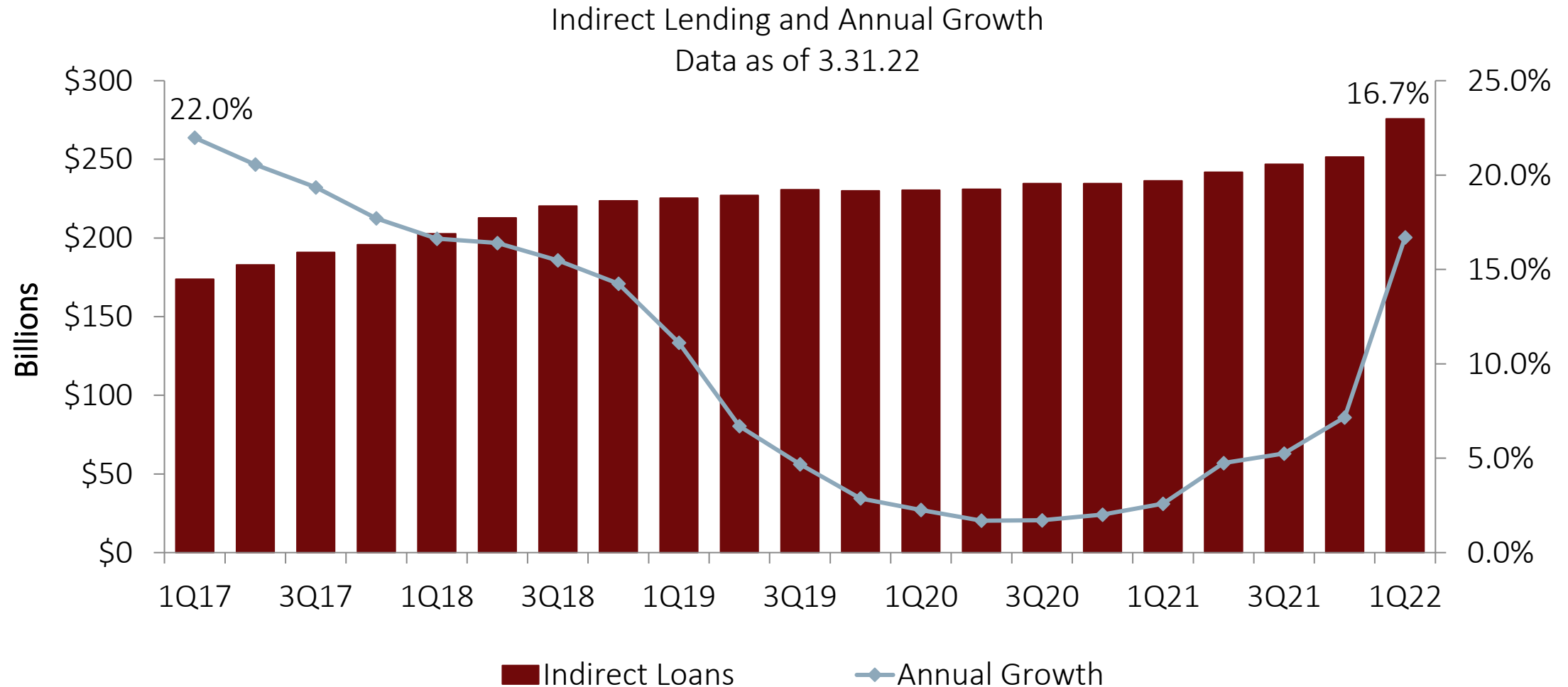
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## There's power in a dream.

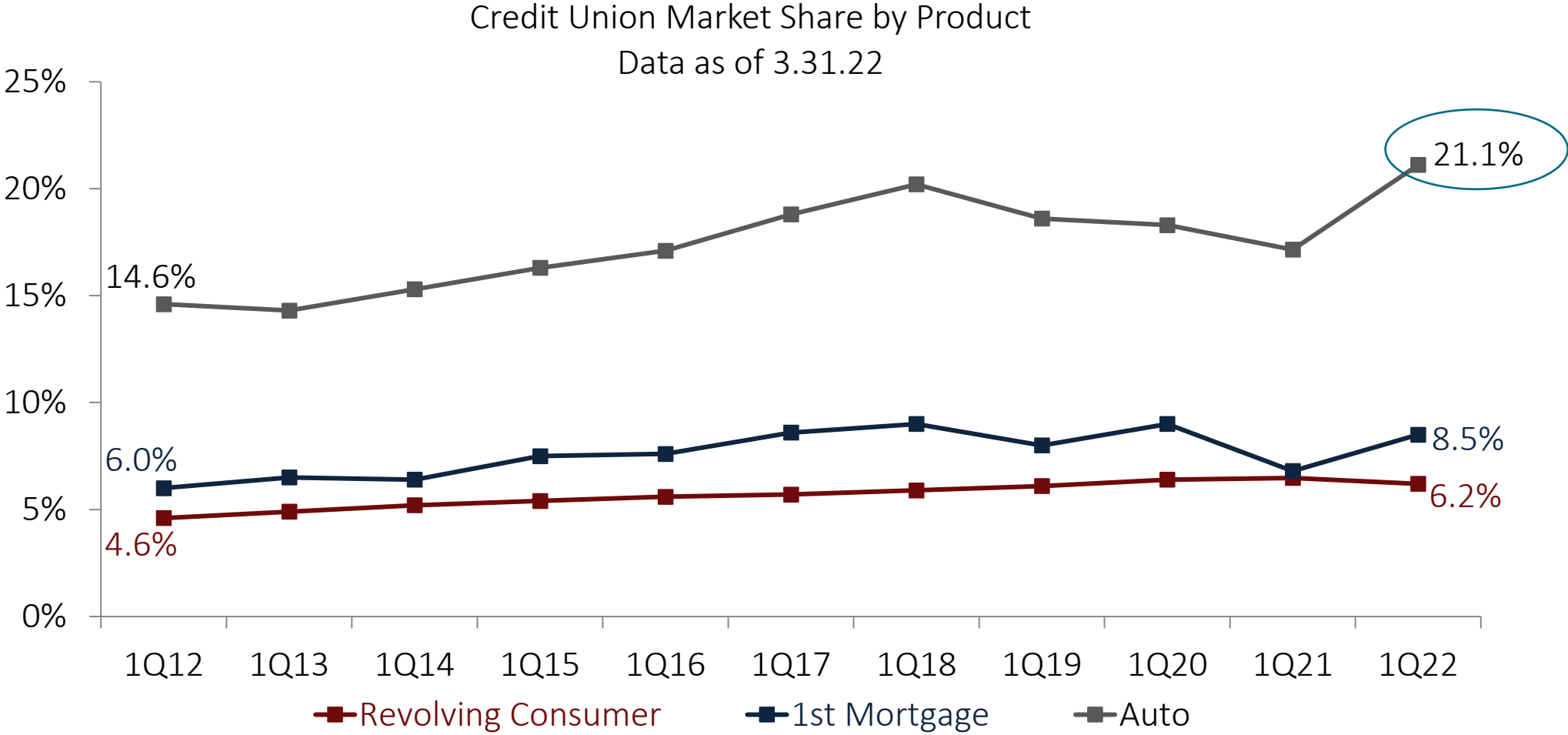
Ne'Gyle's business story started with a bow tie. At Bleu Bowtique in Detroit, he helps people express their unique style, and find a new sense of confidence.

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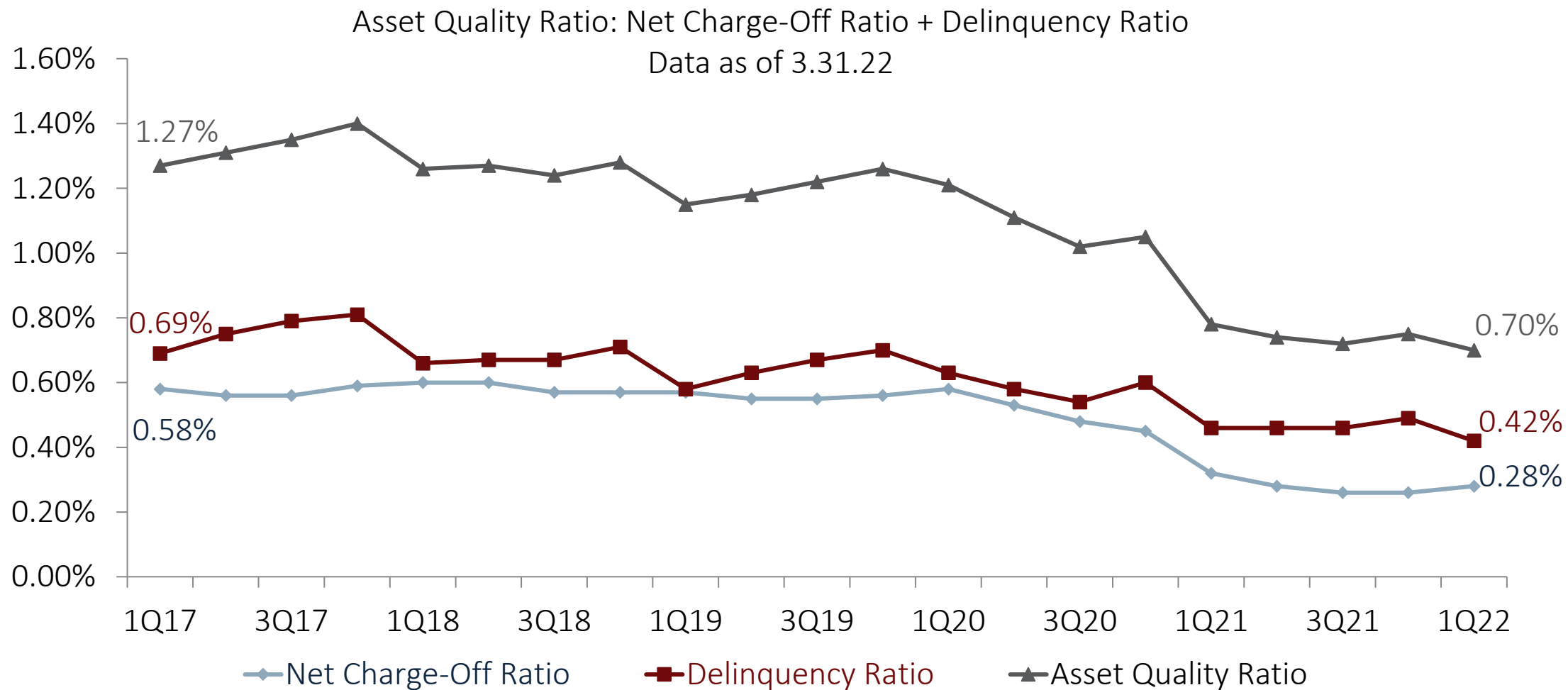
# Indirect lending is growing at the fastest annual rate since 2017



# Credit union auto lending market share hits its highest first quarter level ever

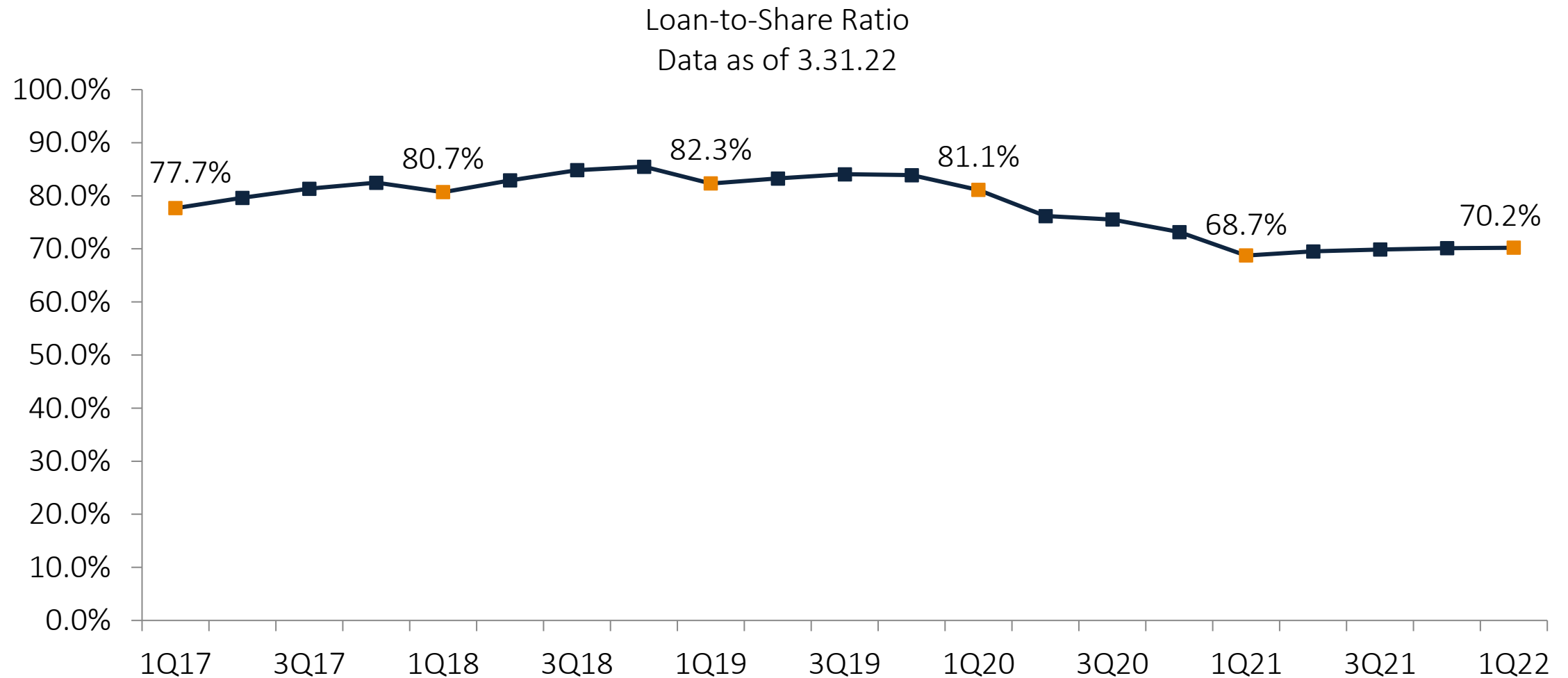


# Delinquency his record low as asset quality remains historically strong



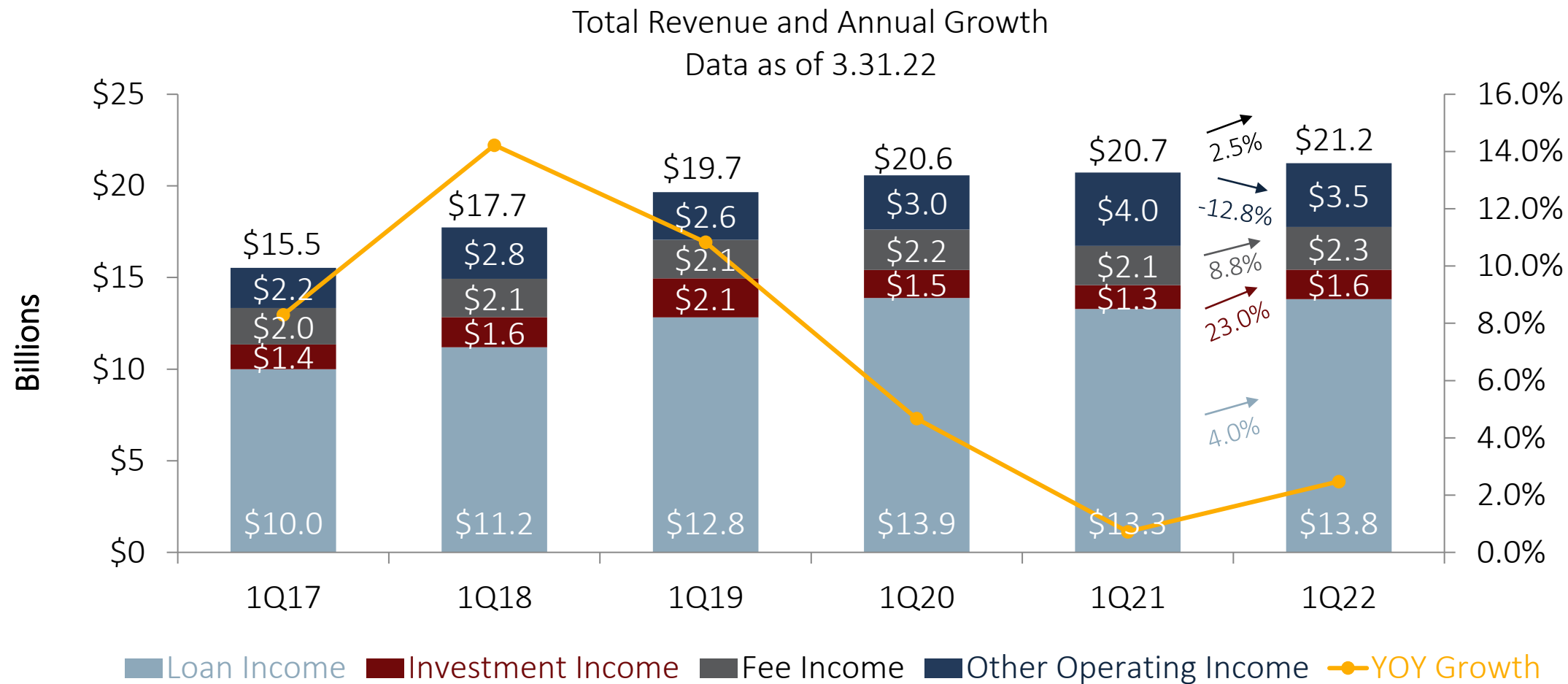


# The loan-to-share ratio is slowly rising

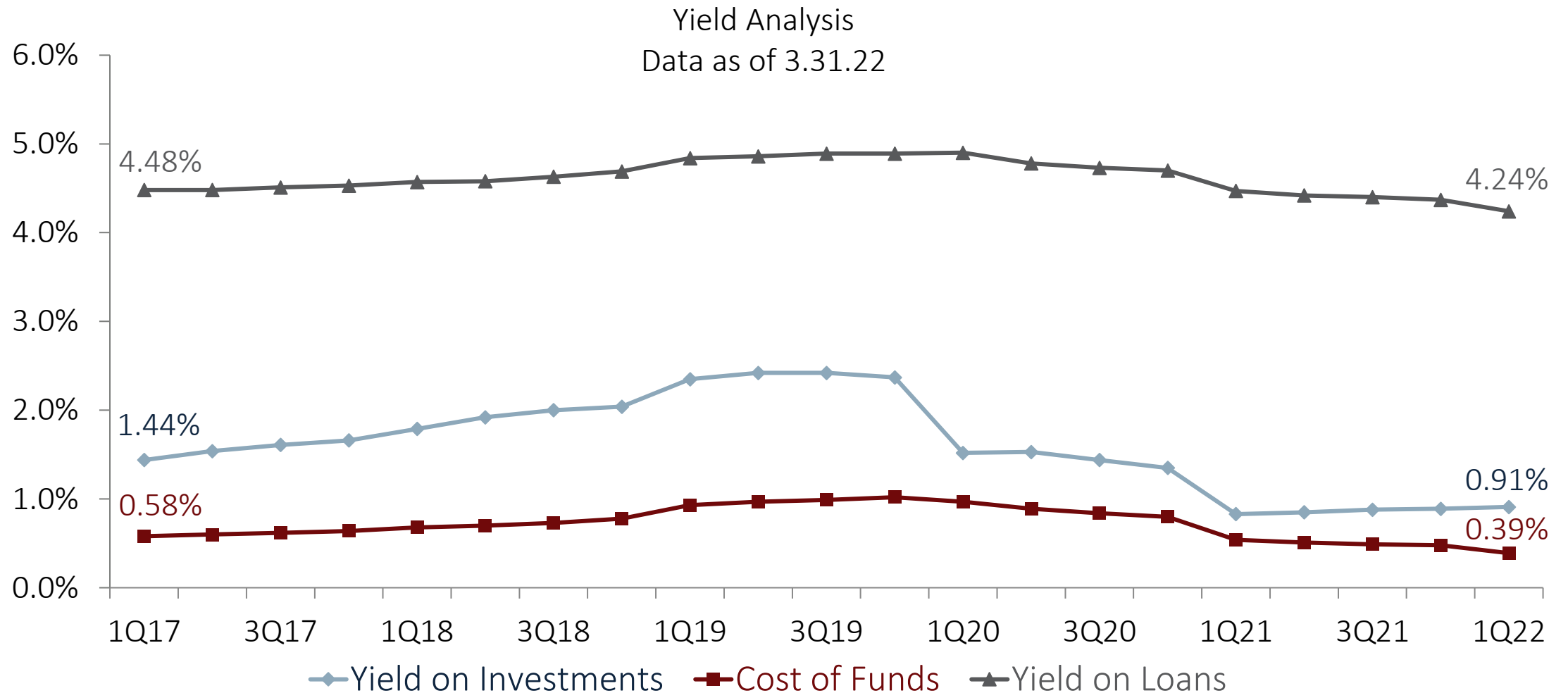


# Earnings

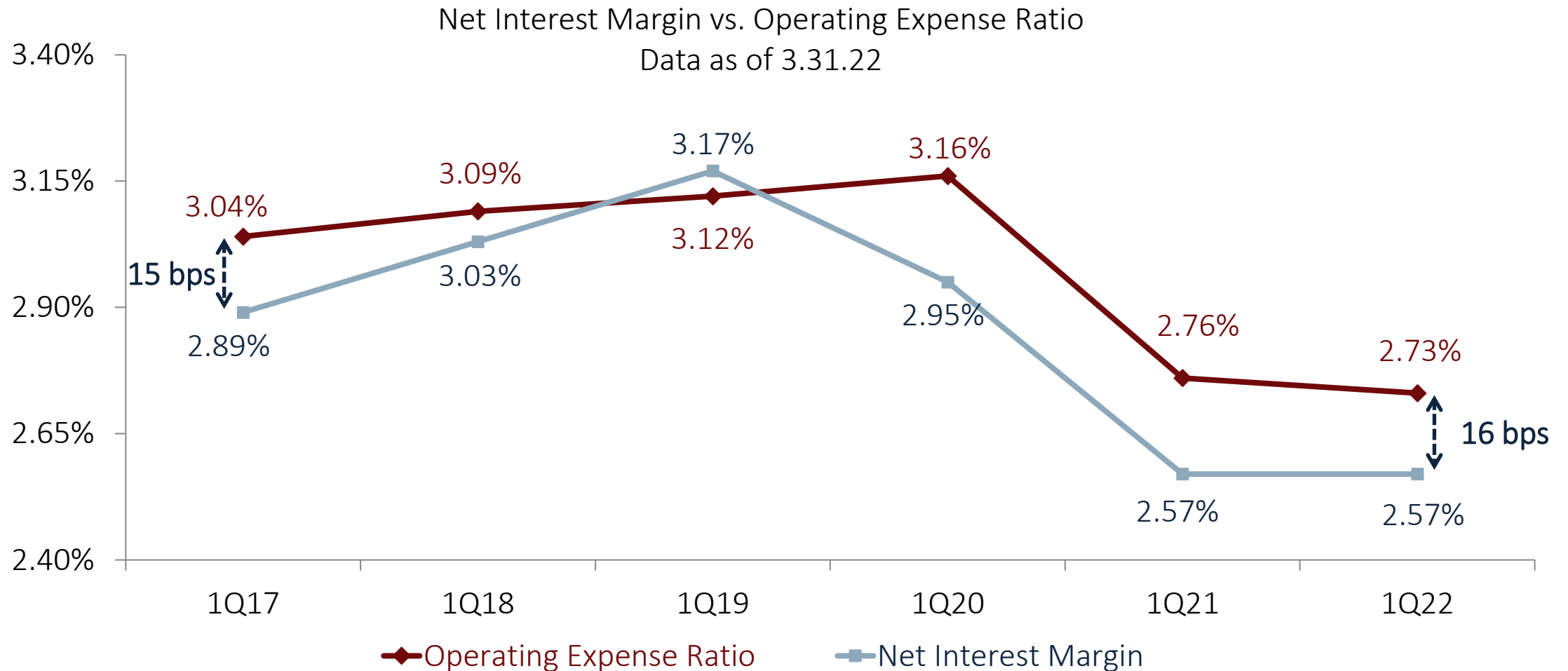
# Revenue rises versus 1Q21 driven by loan portfolio growth



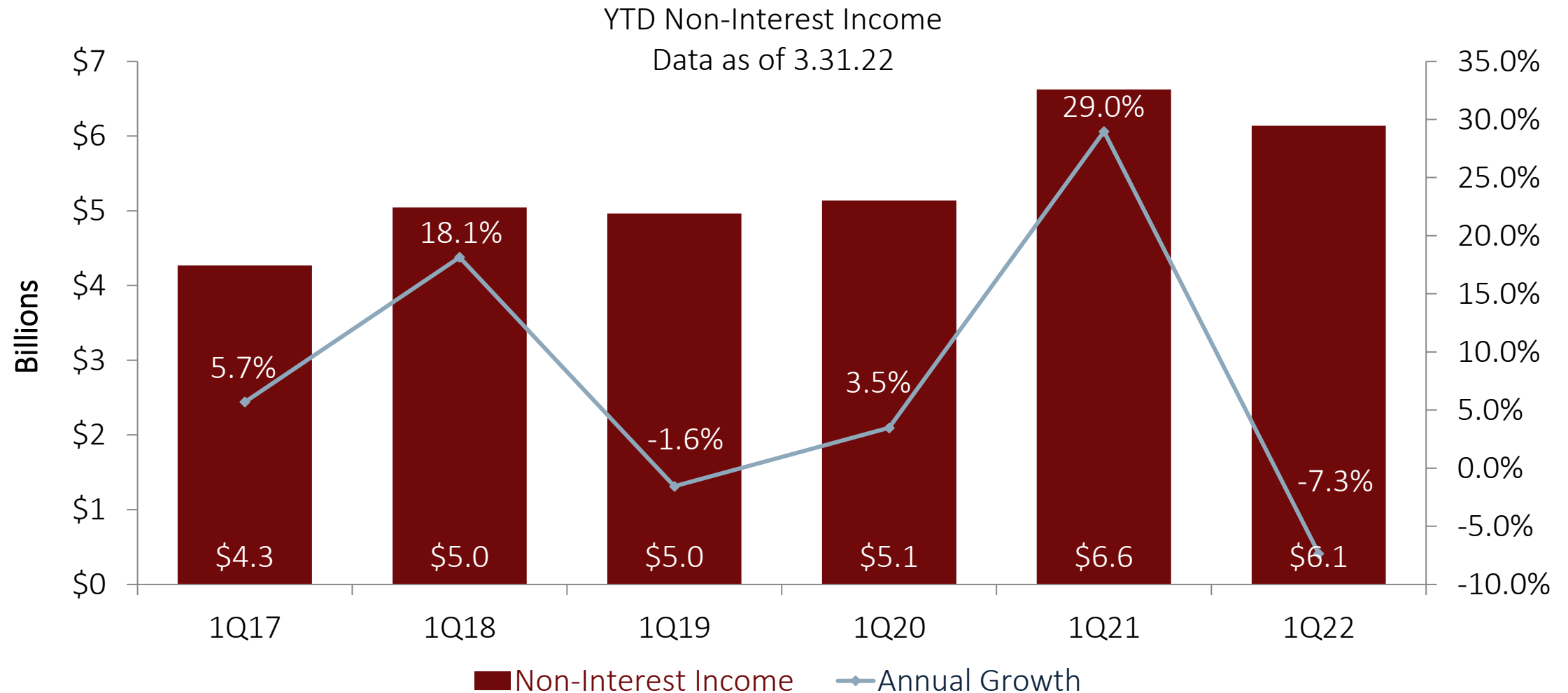
# Loan yield and cost of funds continue to trend lower but investment yield rises as credit unions reduce cash balances



Net interest margin is steady year-over-year as interest rates begin to rise; Operating expense ratio falls due to strong asset growth

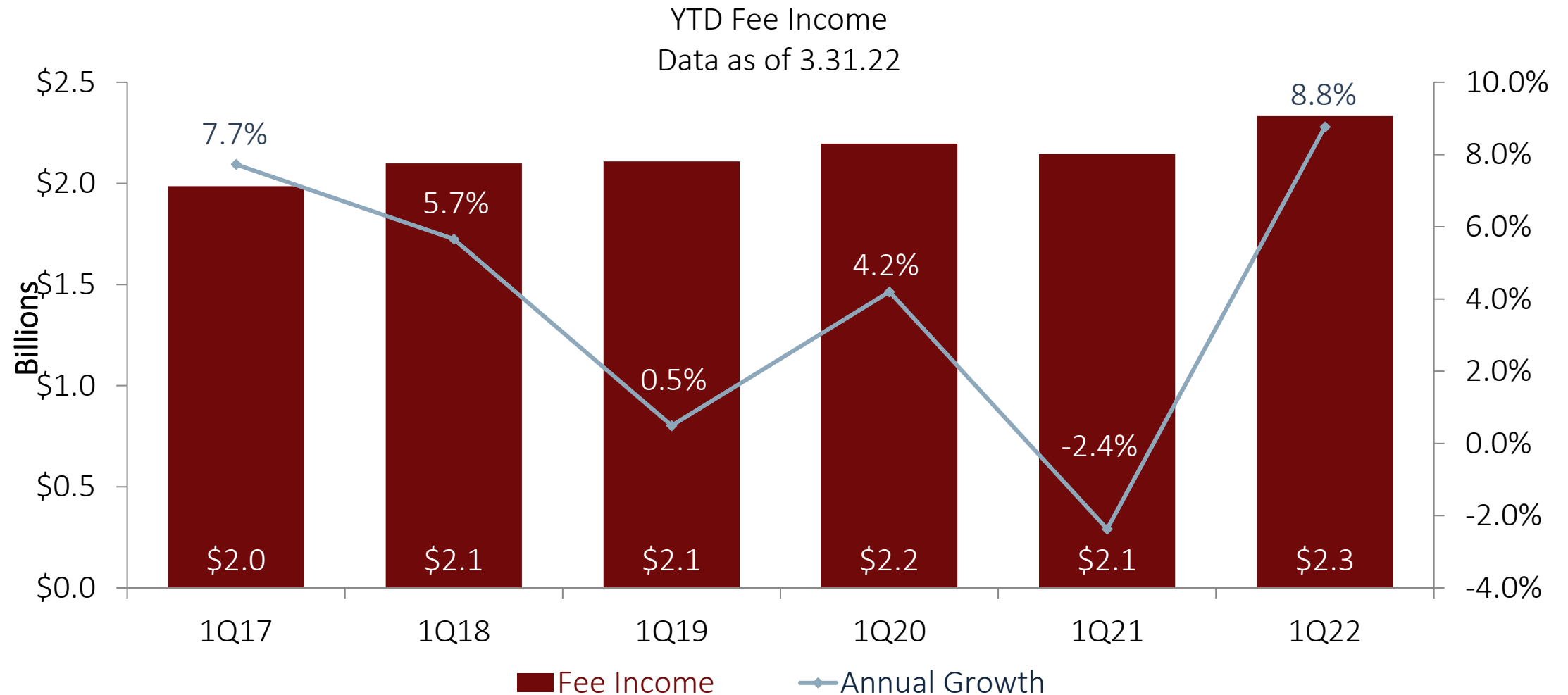


# Non-interest income declines versus 1Q21

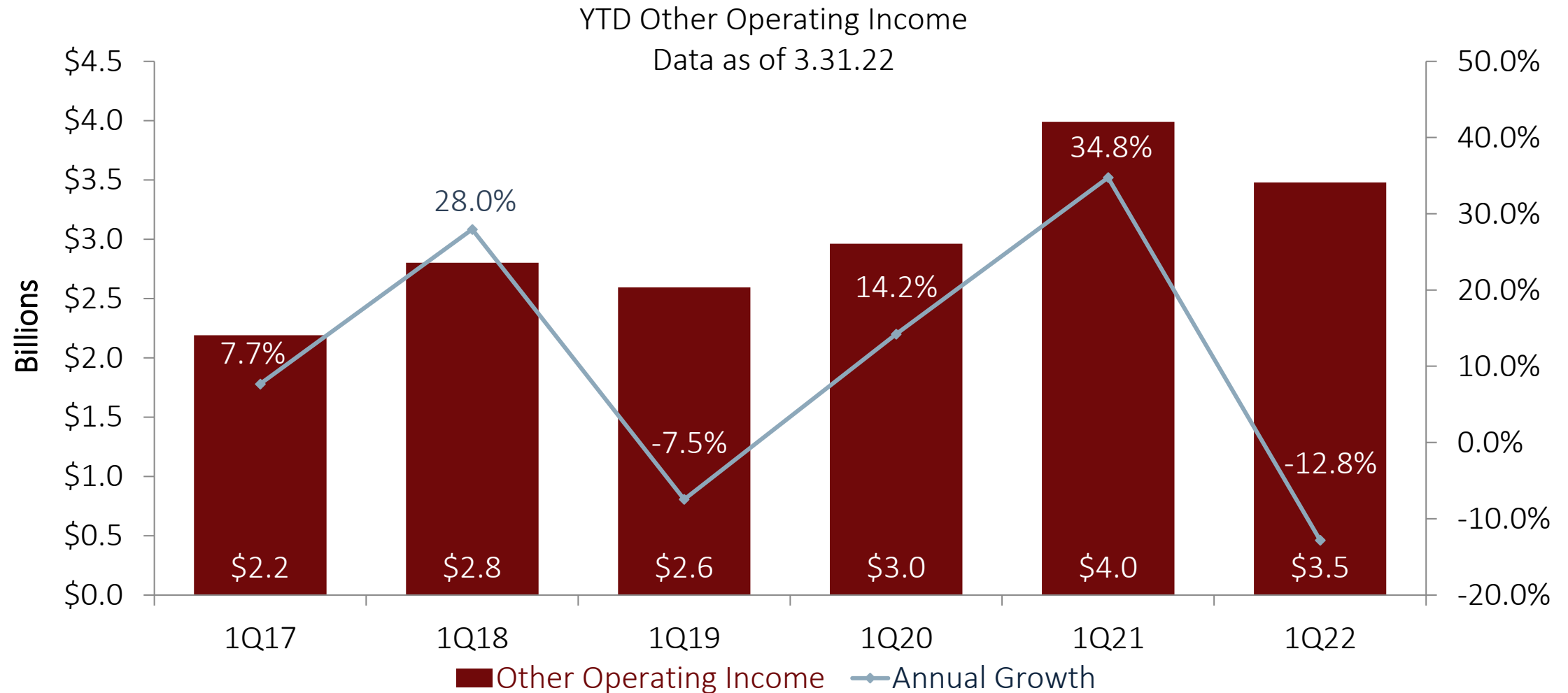




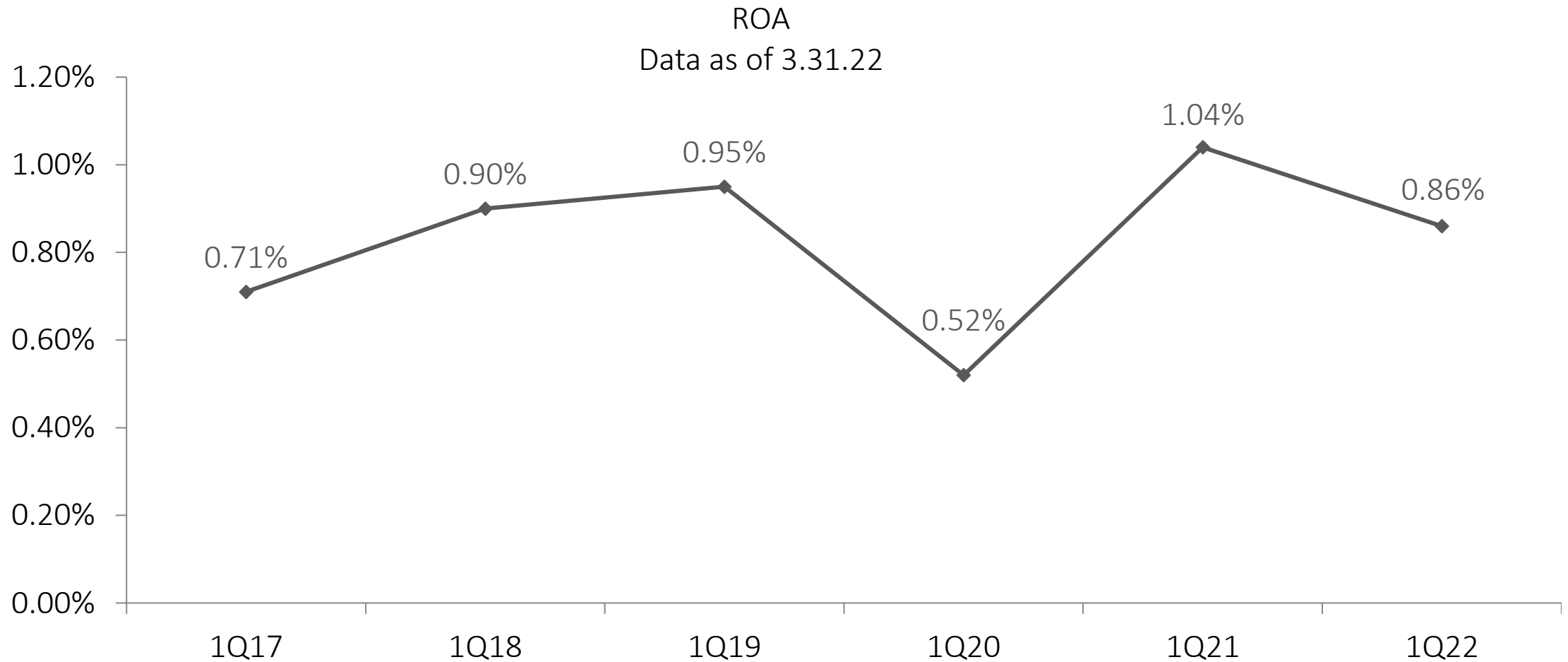
# Fee income rises...



# While other operating income contracts as secondary market sales slow



## ROA declines 18 basis points from 2021 peak







# The case for fee-free consumer deposits



Kendall Garrison

*Chief Executive Officer*

Amplify Credit Union

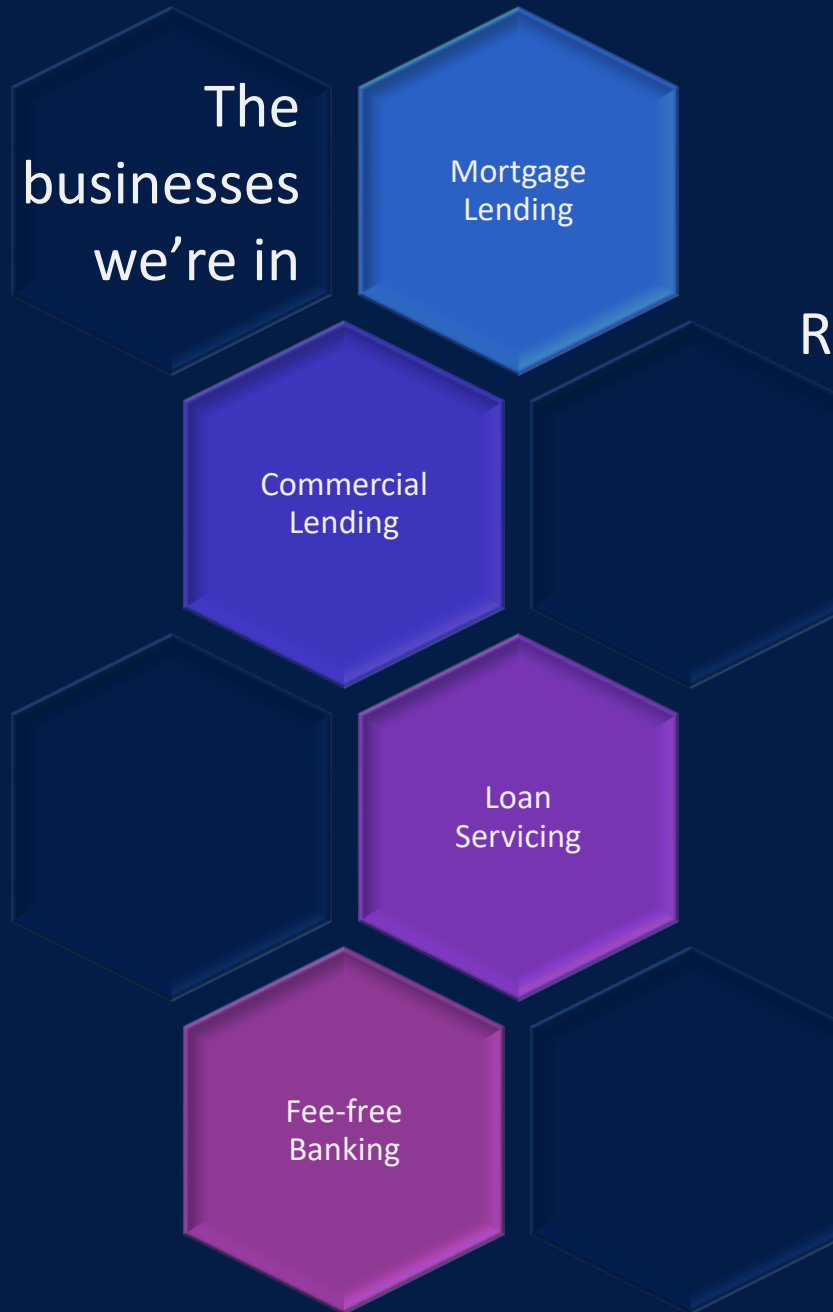
# Amplify Snapshot

Members:  
60,000

Assets Under Management:  
Almost \$3B

Field of Membership:  
Texas

Branches:  
4 (Austin Area Only)



## Recent milestones

- Shifted the loan portfolio from consumer to RE & commercial over 2016-2019
- Exited indirect auto and accelerated loan servicing growth in 2020



# Fee Free Business Case

One-too-many fees is one of the rare motivators that inspires consumers to move their primary transacting accounts

It's not (just) among consumers who can't afford fees. Consumers believe being charged fees is *wrong*

Saw an opportunity to turn a historical "weakness" of our business model into a marketplace advantage

Chasing two wins: Lower cost of funds to improve net interest margin + increased interchange income to cover expenses to serve



# Impact to Purpose & People

Dug deeper into the business case and learned more about who pays fees

(Hint: Not the people with \$)

Discovered a new philosophy: It's not (just) about giving back, it's about not taking in the first place

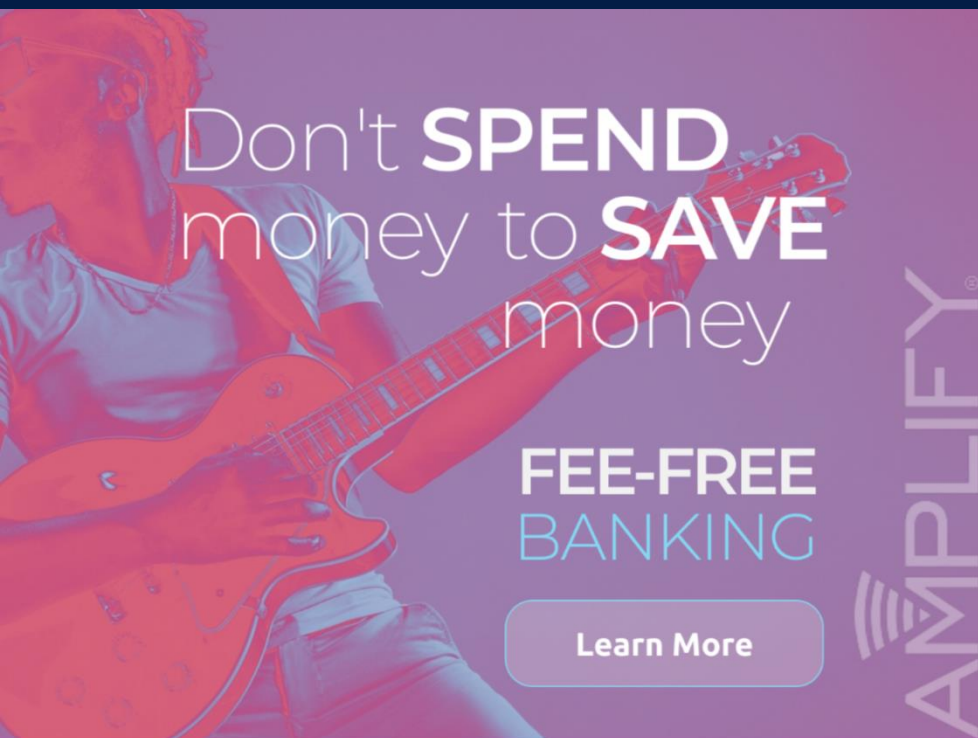
Eliminating fees = 3<sup>rd</sup> largest giveback in the CU industry

(And unlike dividends, benefits all members equally)

First full-service FI in the country to eliminate all fees for *all* members without reducing service

(B/c you can't take a moral stance on a half-measure)

Galvanizing for our employees, especially in Retail where the pandemic has had significant impact

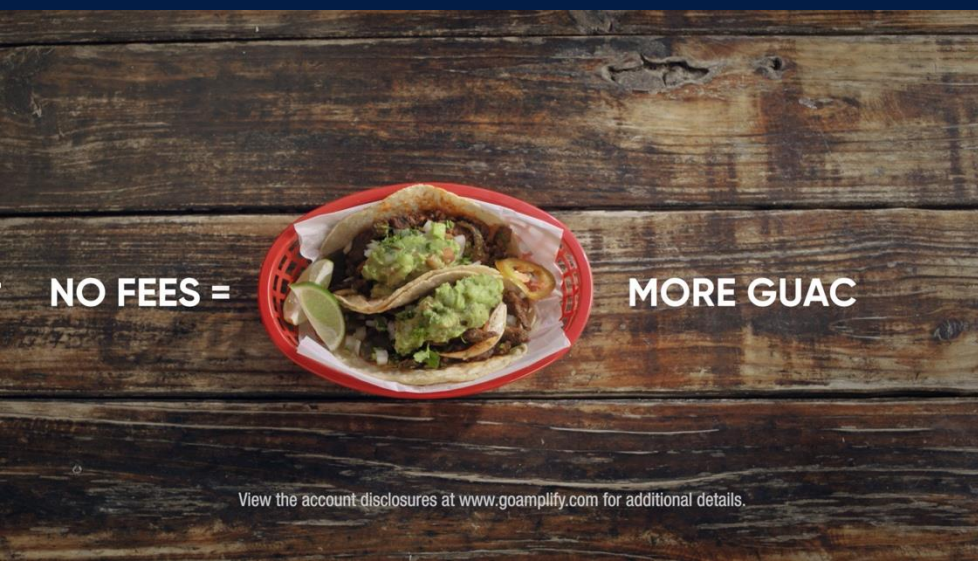


Don't **SPEND**  
money to **SAVE**  
money

**FEE-FREE  
BANKING**

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AMPLIFY



**NO FEES =**

**MORE GUAC**

View the account disclosures at [www.goamplify.com](http://www.goamplify.com) for additional details.

# Campaign Snapshot

**FEE-FREE BANKING**  
*= more money for movies*

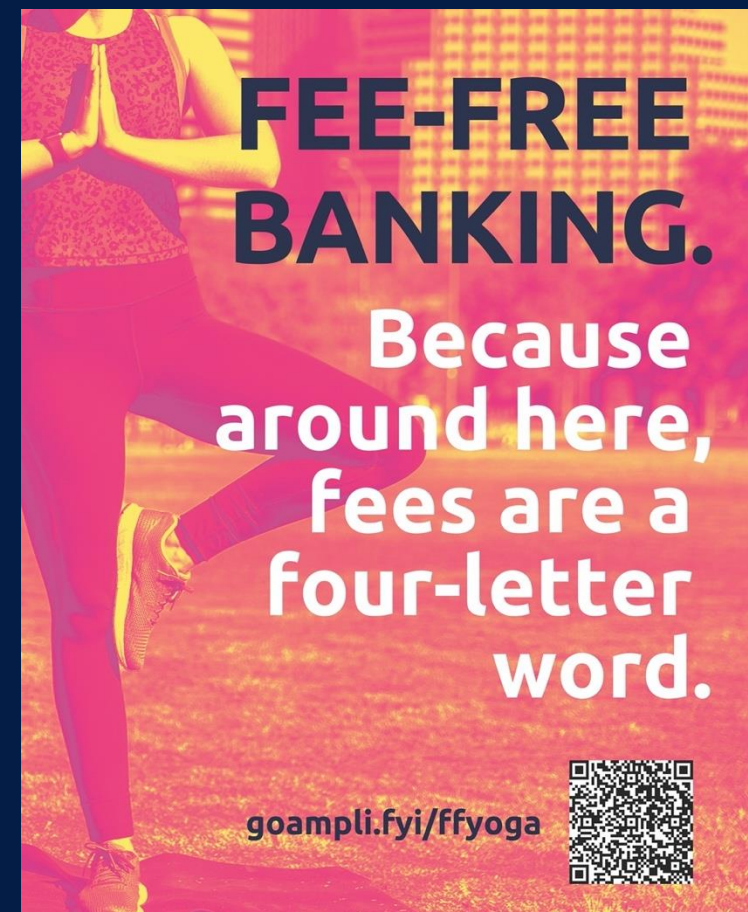
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Because  
we want to  
grow your  
wealth —  
not take it.


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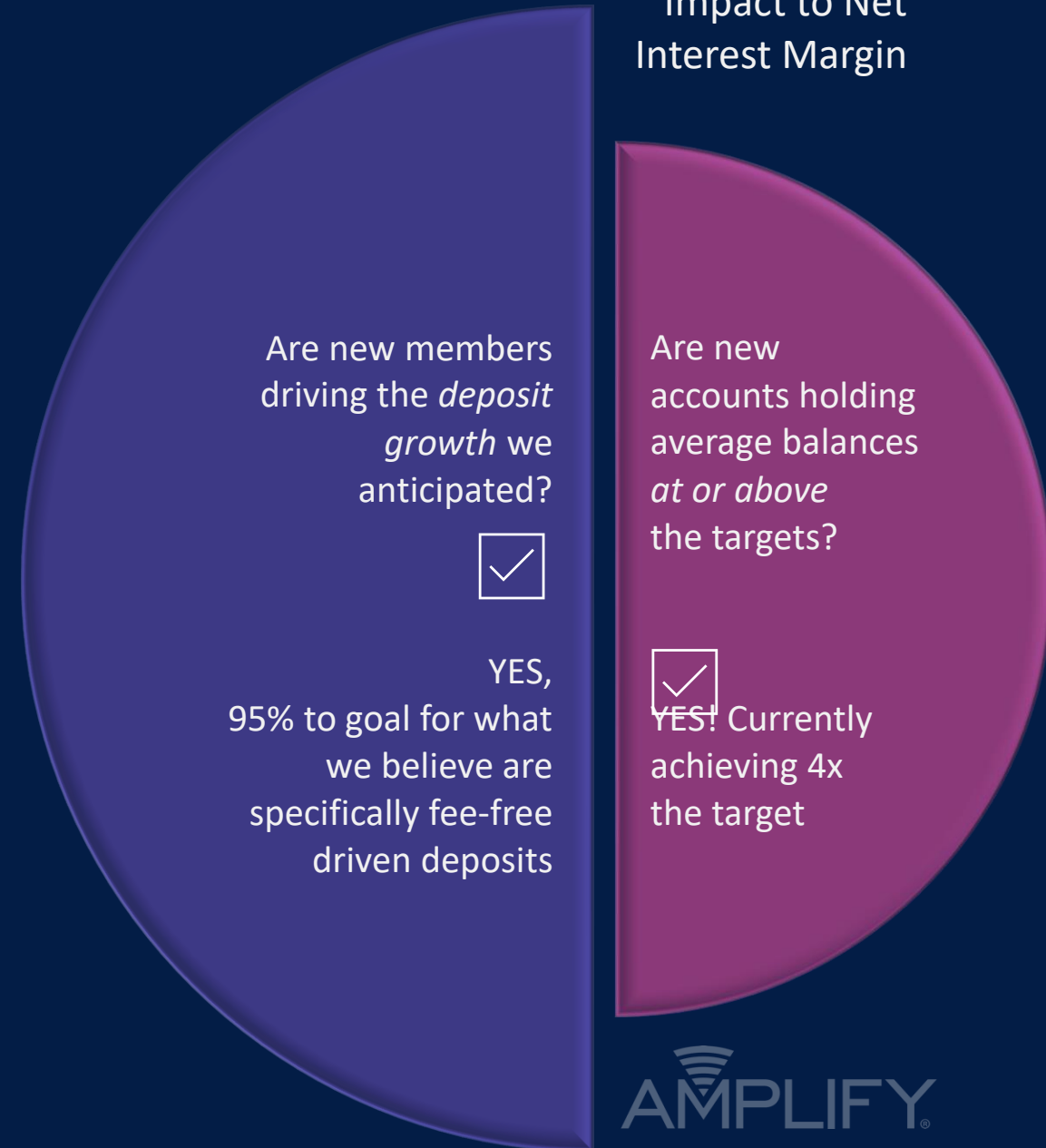
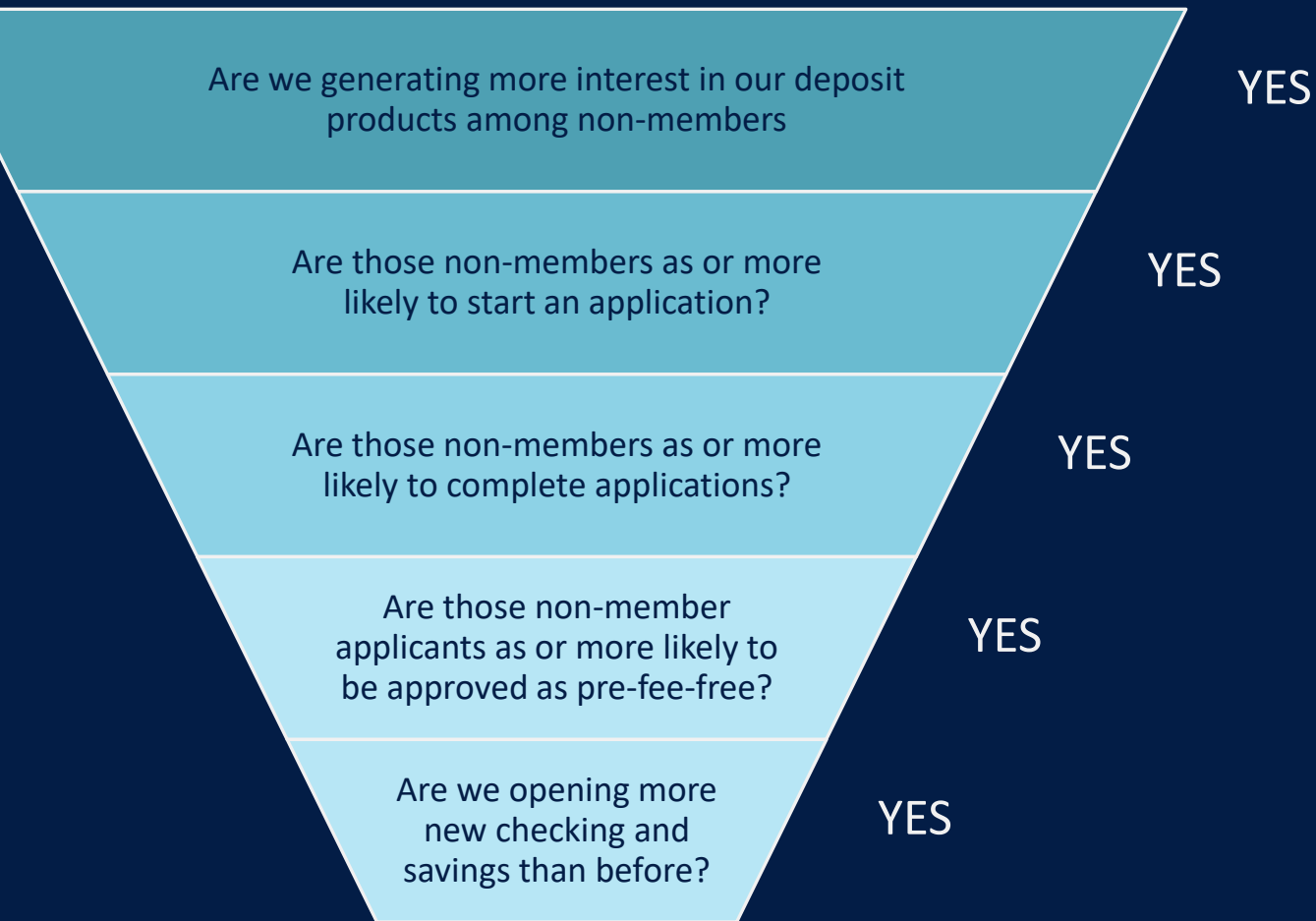
Because  
around here,  
fees are a  
four-letter  
word.

[goampli.fyi/ffyoga](http://goampli.fyi/ffyoga)



# Early Results

## Attraction & Conversion





Impact to Interchange Income

Are new checking accounts as or more likely to *activate a debit card* as pre-fee-free?



YES, accounts opened since launch are 10-15% more likely to have at least once debit card activated

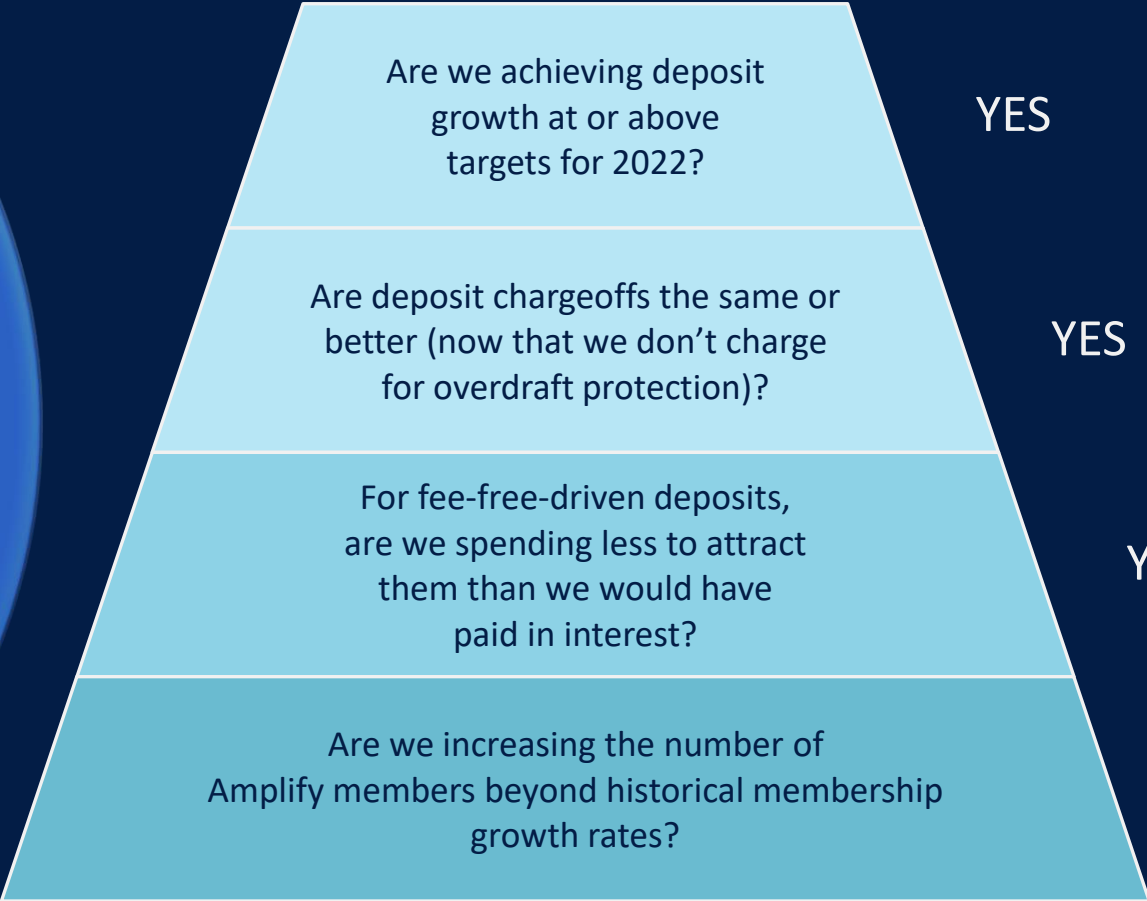
Are *new members with active debit cards* using them as or more often than pre-fee-free?



NOT YET; B/c it takes members 30 days to fund new checking accounts to balances they'll maintain long-term, and card usage lags similarly, so we haven't been live long enough yet.

Early Results

Organizational Impact



# What's Next

As an industry,  
we can deliver  
fee-for-service,  
not fee-for-  
failure. For us,  
interchange  
income and  
loan sales &  
servicing.

Consumer sentiment  
and regulatory  
pressure on fees will  
not go backward. CUs  
can get into the  
driver's seat before  
member attrition and  
regulators force them  
there.

That's income everyone feels good about...

- The member, who got a loan they wanted (not a fee they didn't)...
- The credit union, that purchased high-performing assets, driving more income for their organization...
- The community, because the income that model delivers fuels our community engagement work.

Win / Win / Win





Thank you

Kendall Garrison

Chief Executive Officer

Amplify Credit Union

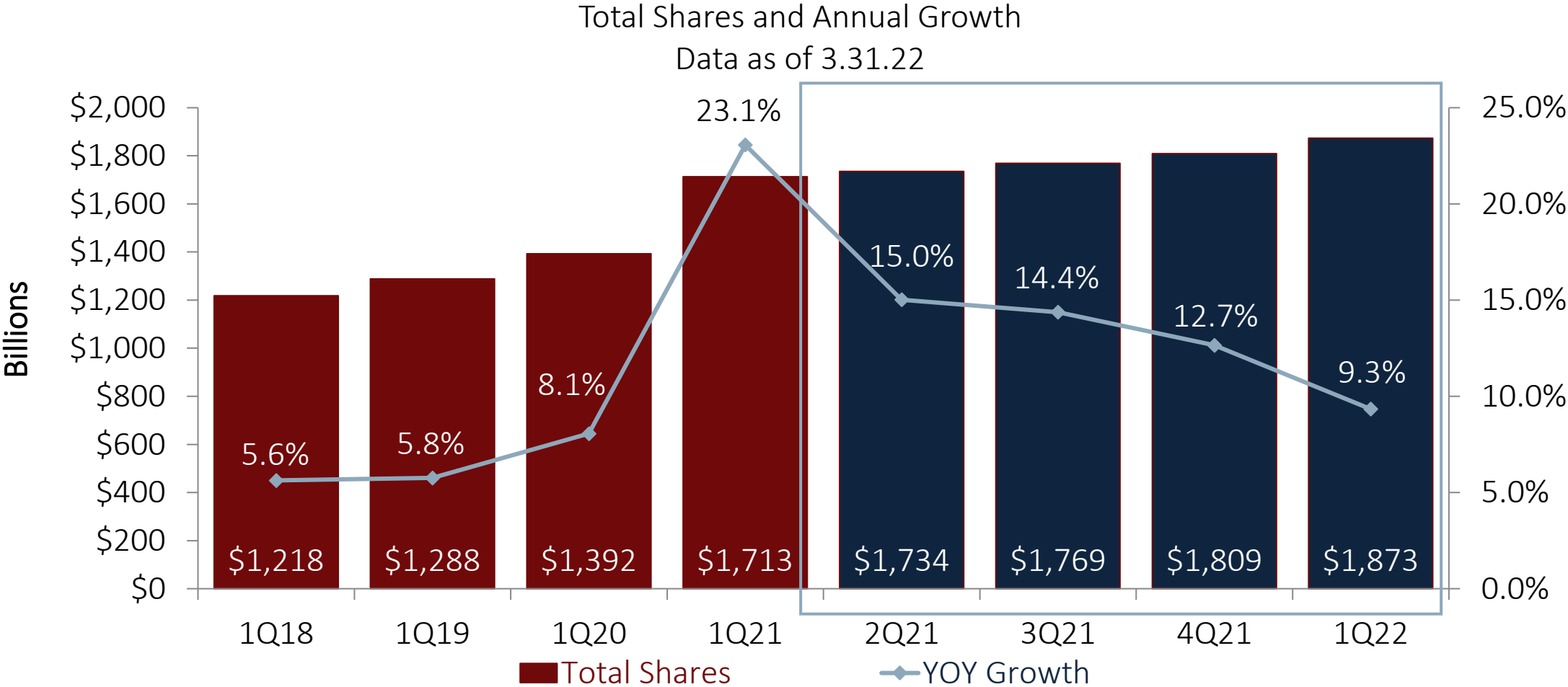
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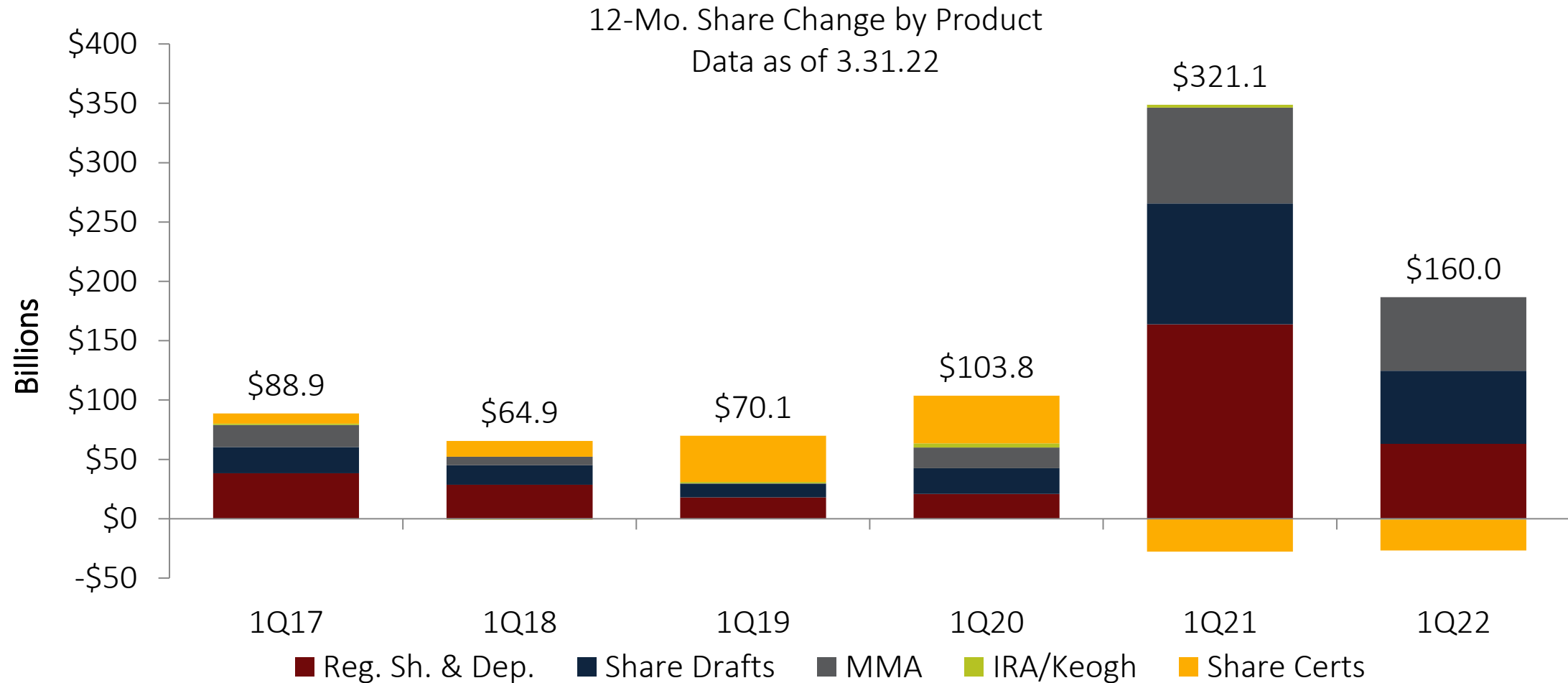
# Savings

# Annual share growth returns to single digits for the first time in two years

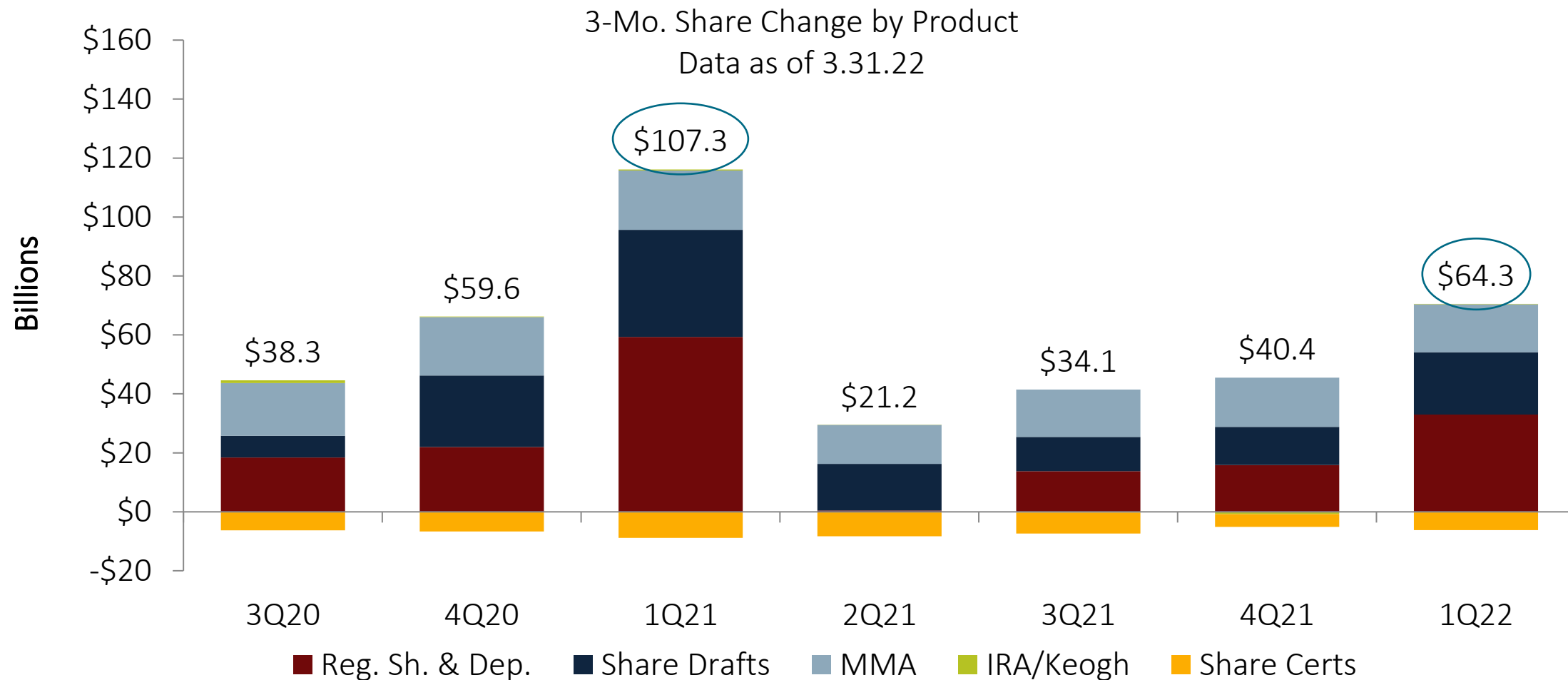




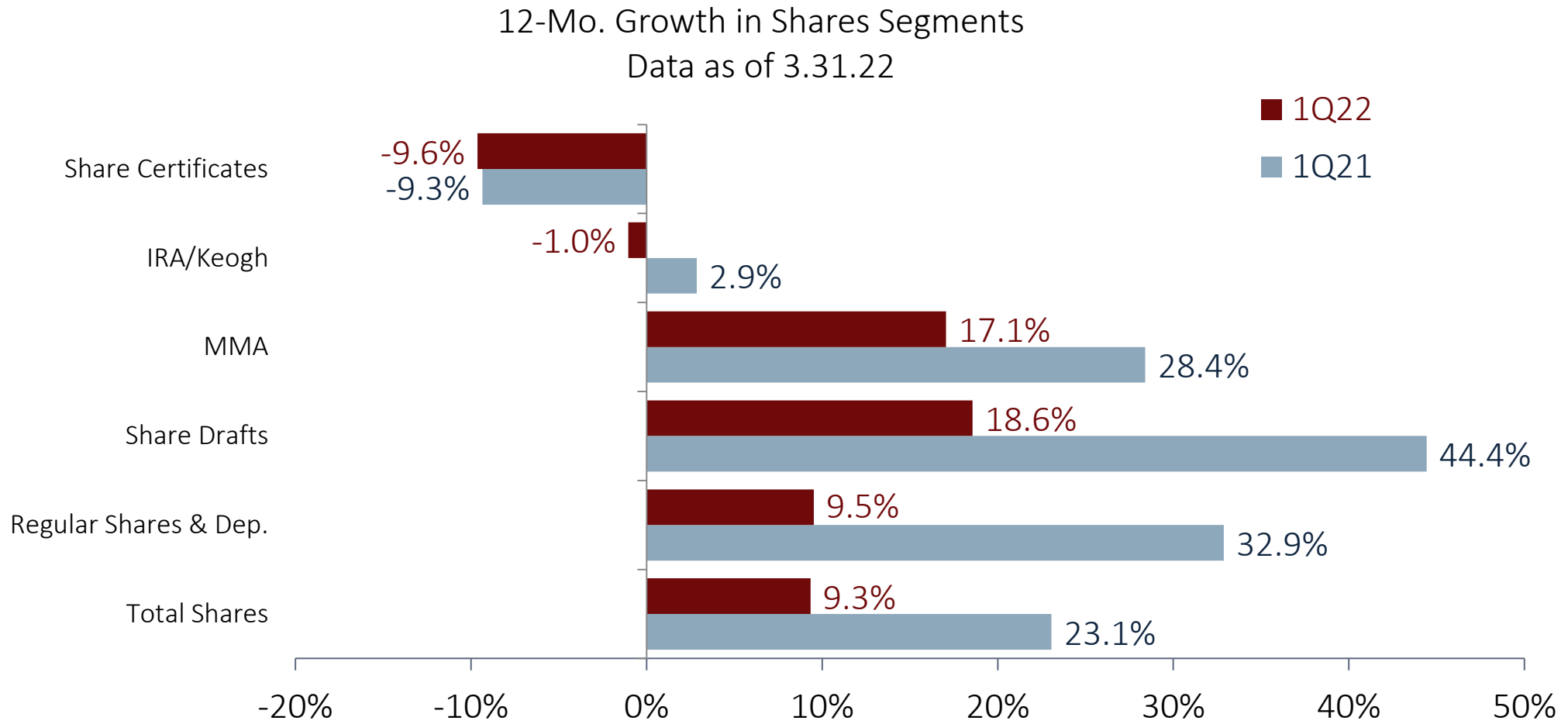
# Share certificates shrink as liquid core deposits continue to grow



# Quarterly share growth slows versus the prior year, continuing the trend from 2021

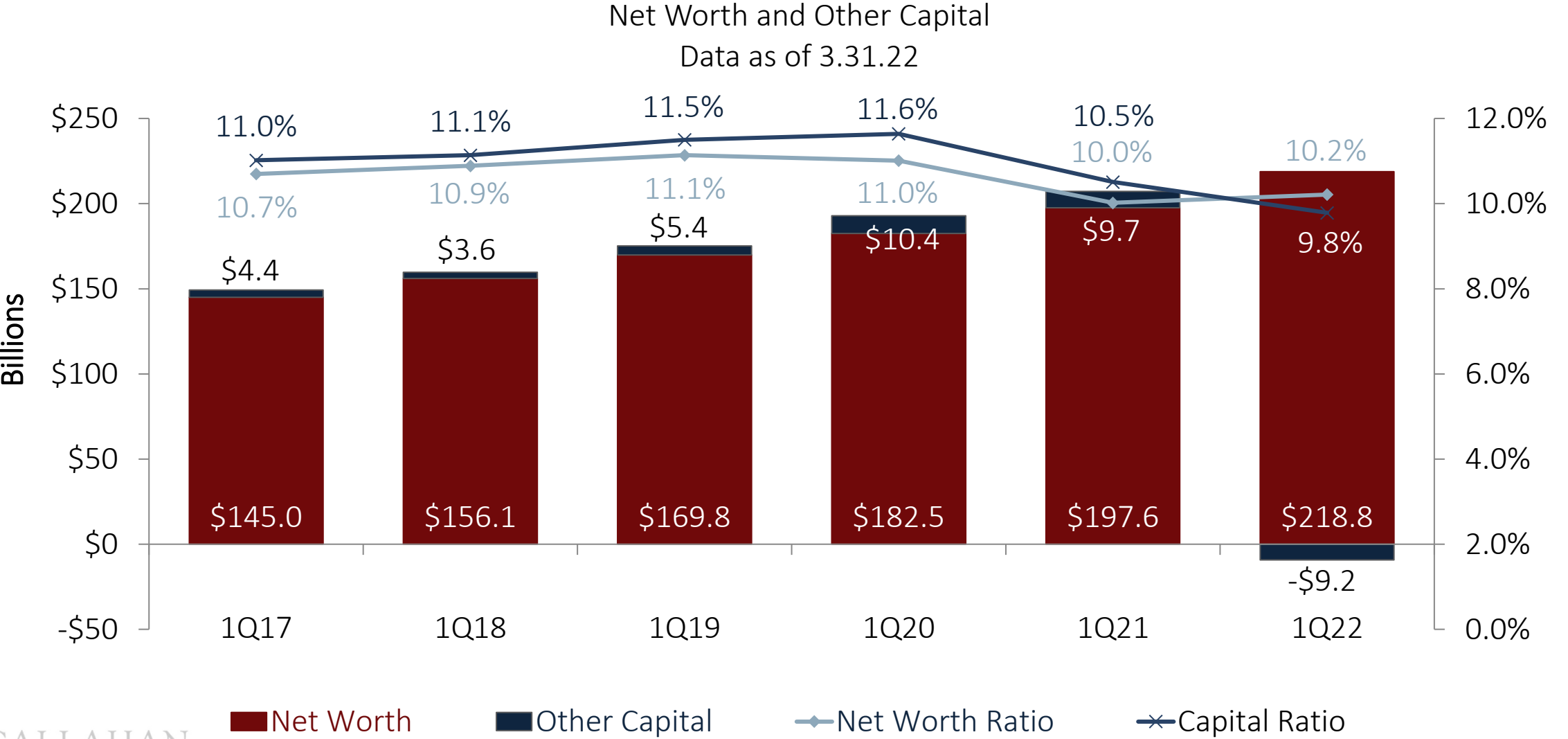


# Growth has slowed across all deposit products



# Capital

# The net worth ratio improves slightly but total capital is negatively impacted by unrealized investment losses



# The worst market for fixed income in over 40 years is evident in unrealized securities losses



## Impact of NCUA Capitalization Requirement Changes

	Total # of CUs	% of CUs Over 7% NWR	# of CUs over \$500M	% of \$500M CUs Over 7% NWR
4Q21	5048	95.2%	702	99.6%

	# of CUs under \$500M	% of <\$500M CUs over 7% NWR	# of CUs over \$500M	% Qualifying for CCULR (9%)
1Q22*	4223	93.9%	704	70.2%

210 of our reporting CUs – representing ~17.4% of industry assets – would need to complete RBC reporting

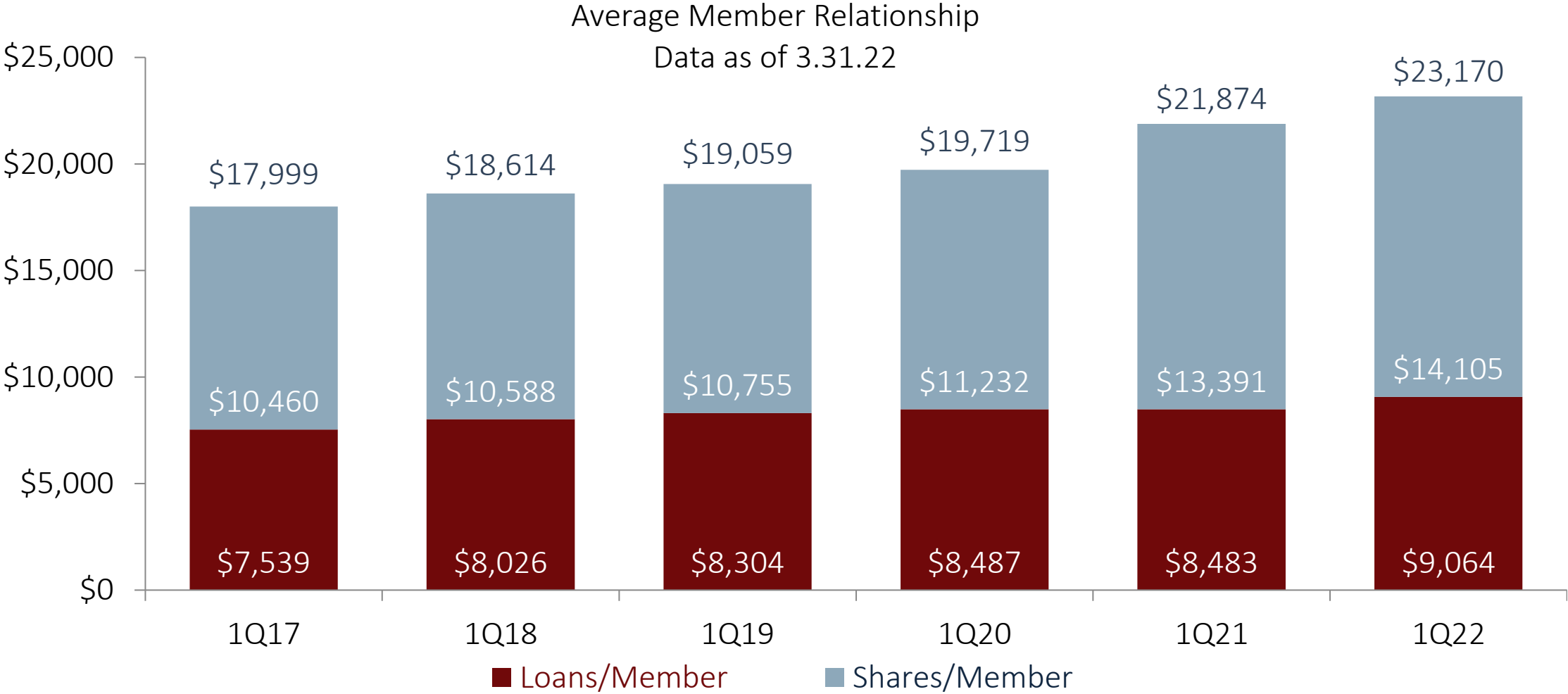
Source: Callahan's Peer-to-Peer Analytics – 99.2% of Industry Data

\*Using FirstLook data

# Lessons & Looking Forward



The average member relationship grew \$1,296 year-over-year,  
led by higher loan balances





## A Changing Environment Brings Opportunity

- Rising inflation is putting more financial strain on households and small businesses...Acknowledge their concerns, Confirm their needs, Take action
- Credit unions have ample liquidity, historically strong asset quality, solid earnings, and double-digit net worth
- By focusing on the needs of the members and communities they serve, credit unions can continue to differentiate their unique role in financial services and build more relationships

# THANK YOU FOR WATCHING



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