Crisis Management: Capital Adequacy, Delinquency Control and Loss Recovery during the COVID-19 Pandemic

A Credit Union Guide to COVID-19 Era Compliance with NCUA Rule 702.1, Member-Centric Delinquency Management, and Loss Recovery

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Like most college professors, Albert Einstein used graduate students as teaching assistants (TAs) to perform menial tasks such as copying examinations. Such was the case one warm spring afternoon at Princeton University when, while chatting in the Engineering Quad with a student, Einstein was abruptly interrupted by a breathless and anxious TA who exclaimed, "Professor, this year's final examination you gave me to copy is exactly the same as last year's final!" Einstein paused for a moment and replied, "This is true. The questions are the same, but this year all the answers are different."

The NCUA, the Credit Unions and the Virus.

The COVID-19 Pandemic has thrust the Credit Union industry into uncharted waters as millions of member-borrowers, through no fault of their own, cannot meet their financial obligations and many will fall deeper into default in the foreseeable future. This will have a profoundly negative impact on those Credit Unions that will suffer a decline in loan volume during an already historically low interest rate environment, an increase in deposits, and rising delinquency which will trigger the requirement for increased reserves.

Faced with a delicate balance of treating delinquent members with compassion, respect and access to credit while at the same time complying with capital adequacy requirements of NCUA Regulation 702, many Credit Unions are – or soon will be – finding themselves between a rock and a hard place.

All Credit Unions will need to focus on serving the needs of their members who have been thrust into financial hardship. Even well capitalized Credit Unions must work hard to control delinquency, prevent losses and recover charge offs and "prior prime" members during the COVID-19 era. This paper presents universal strategies to help Credit Unions balance member service and operational efficiency during this unique economic and social crisis.

In its Letter to Credit Unions No. 20-CU-18[1], the NCUA set the tone for capital adequacy during the current economic crisis. The letter clearly indicates the NCUA's acknowledgement that many Credit Unions will experience a distressed net worth ratio and addresses the administrative consequences as prescribed by NCUA Regulation 702. As we have witnessed through several negative economic cycles, a combination of low loan demand, an influx of deposits, increased delinquency and heightened loan loss reserves has negatively impacted the net worth of many Credit Unions, some of which have not survived.

Managing the balance sheet while serving the needs of members through past "normal" economic recessions has proven to be a daunting task. However, the current and unprecedented one-two punch of an economic recession further complicated by the rapid collapse of social and financial normality delivered by the COVID-19 Pandemic doesn't fit the description of "normal" and will require Credit Unions to think outside the box. "The questions are the same but this year all the answers are different."

If we have learned anything from the COVID-19 Pandemic, it is that doing nothing, waiting for the economy to recover and failing to take preventative measures early may well prove to be a fatal strategy.

The time to act is now, and the following suggestions for Capital Acquisition, Loss Prevention and Charge Off Recovery are offered to help Credit Unions manage this unique economic and social crisis:

1. Using Off-Balance Sheet Assets to Restore Capital and Maintain an Acceptable Net Worth Ratio: Turning Charge Offs into Cash.

Many Credit Unions are struggling to maintain capital adequacy and their net worth ratio is in danger of declining to an undercapitalized level.

An often-overlooked source of new capital lies in assets that have been previously written down to zero value and removed from the balance sheet. Consumer loan charge offs that are within the seven-year federal reporting statute have immediate cash value that can be monetized and put back on the balance sheet as capital.

Credit unions are advised to carefully investigate potential debt buyers and, as part of their due diligence, determine whether a potential buyer:

- Is in full compliance with federal, state and local collection statutes and regulations;
- Clearly understands the nature of "Credit Union-Centric Collections" and that even though the account has been charged off, the borrower may retain Credit Union membership;

[1] "Prompt Corrective Action Regulatory Relief Measures in Response to the COVID-19 Pandemic" (NCUA 20-CU018, June 2020)

- Can and will provide Credit Union references;
- Is part of the Credit Union industry and is registered with the NCUA as well as the CFPB;
- Is open and transparent with regard to their pricing model and policies;
- Is adequately capitalized;
- Is insured and licensed in all applicable jurisdictions;
- Provides indemnification to the Credit Union for any and all losses or damages Credit Union may suffer as a result of any act or omission of the debt buyer.

Debt buyers who do not specialize in the purchase and liquidation of Credit Union charge off portfolios should be avoided. Please see Page 7 for an example of a successful Credit Union charge off portfolio purchase program.

2. Member-Centric Delinquency Management and Loss Prevention: All Hands on Deck.

Millions of Credit Union member borrowers, through no fault of their own, cannot meet their financial obligations due to the effects of COVID-19. Since the start of the coronavirus pandemic in the U.S., Americans have skipped payments on 100 million student loans, auto loans and other forms of debt, according to The Wall Street Journal.

"The number of people who deferred payments or enrolled in forbearance or some other type of relief since March 1 rose to 106 million at the end of May, which is three times higher than it was at the end of April", the Journal reported. "Within student loans, 79 million accounts are in deferment or other relief status, up from 18 million a month earlier. Auto loans in some type of deferment doubled to 7.3 million accounts, and personal loans in deferment doubled to 1.3 million accounts".[2]

Many Credit Union members will need additional hand-holding while others may simply "go off the grid" and avoid any and all contact. Economic stress causes borrower embarrassment and it is important to maintain a positive relationship between a Credit Union and its borrowers during the COVID-19 crisis.

The best strategic planners always plan against the worst-case scenario. Consider the fact that this is the first time in history that the economy has been intentionally shut down, that it will take a long time to recover, and that there is no best-case

[2] "Americans Skip Millions of Loan Payments as Coronavirus Takes Economic Toll", The Wall Street Journal (June 18, 2020).

scenario. Consider the likelihood that unemployment will remain at a historic level and government stimulus programs will not protect all Credit Union members from financial chaos. Consider the likelihood that we will suffer the consequences of the COVID-19 pandemic for a long time, and for many Credit Unions loans will decline, delinquency will rise, defaults will increase, and capital will be impaired.

Veterans of multiple economic cycles advise lenders to work *with* their borrowers, not against them and to provide delinquent members with needed high-touch, consultative, empathetic treatment while protecting the needs of the Credit Union. Collection calls should be relationship-building calls. Lenders should help borrowers restructure their debt if necessary. It is important to be proactive, and not wait for borrowers to get further and further behind.

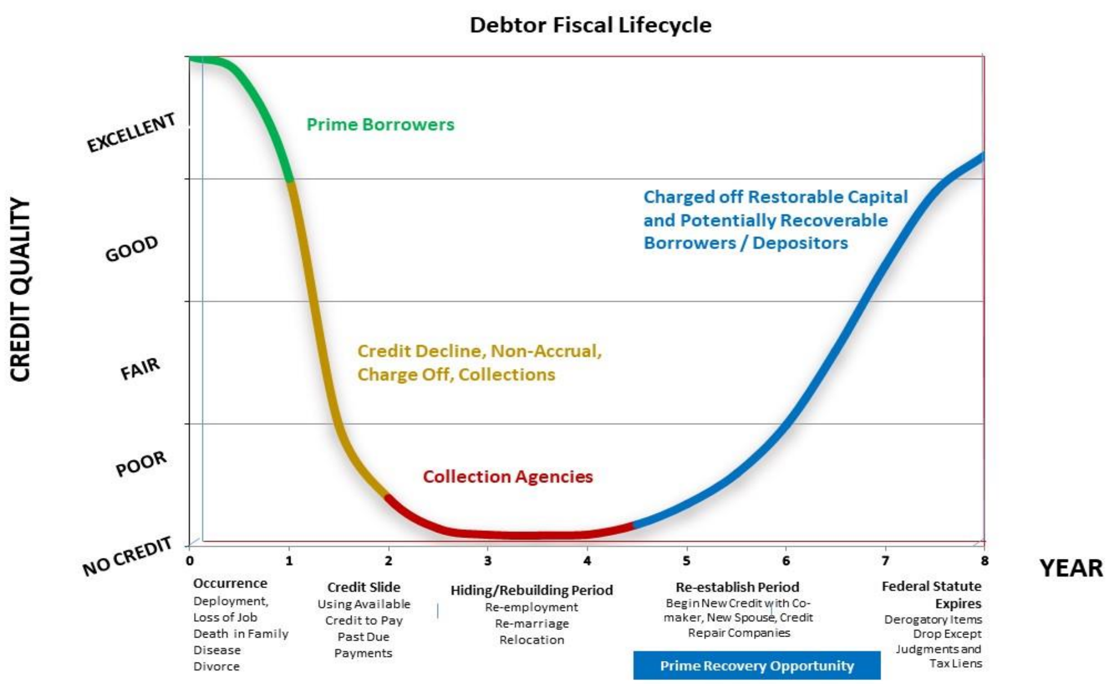
Many collection departments will need to shift their internal emphasis from loss recovery to loss prevention by increasing their focus on preemptive delinquency solutions and redirecting their loss recovery personnel from calling charge offs to working with 30, 60, 90, 180+ day accounts. Successful Credit Unions will be creative and will help members manage their obligations through what may be a long recovery period. This enhanced delinquency management focus will help reduce the number of potential consumer charge offs and the pressure to increase loan loss reserves.

A challenge for all credit unions, recognizing that those who are behind on their loans as a result of COVID-related issues are also member-owners of the institution itself, will be ensuring that any collections activity that is contracted outside the credit union recognizes the conundrum of attempting to collect from member-owners that have been granted forbearance on loans now subject to collection. A reputation risk for the credit union is clear. Any third-party collection efforts must be assigned to those with a clear understanding of the credit union member-ownership cooperative structure. Whereas pre-COVID a credit union might survive a handful of complaints from members with delinquent or charged-off loans about third-party collectors not being responsive to their needs, the post-COVID response for a lack of member sensitivity to issues caused by a global pandemic could undermine credit union credibility quickly with a sizable number of members. CFPB complaints could possibly follow. Member dissatisfaction is almost certain to follow. It is important for credit unions to free their own internal collections teams to work delinquent loans and assistance from a qualified, member-centric third party may be considered. However, without a member-centric approach by the third-party to these charged-off members, the results could be devastating to the credit union’s reputation in the community.

3. Outsourced Charge Off Recovery: Call in the Experts.

During the COVID-19 pandemic and protracted economic recovery period, every Credit Union employee from the mail room to the C-Suite should be actively involved in communications with current members. As illustrated above, enhanced delinquency management and loss prevention efforts during the Pandemic is critical. If charge off portfolios are not sold to generate needed capital, the recovery of charge off accounts should be outsourced to reputable and experienced experts. While collection agencies prefer to focus on the low hanging fruit of recently charged off accounts, better results are achieved by focusing on older “cold case,” post-agency charge offs. A commonly missed opportunity lies in accounts that have been charged off for several years, during which the borrowers have likely regained their capacity to repay.

The stages of the Debtor Fiscal Lifecycle are intuitive to every credit professional. When a financial crisis occurs, monetary and credit resources become strained or non-existent. In most cases, along with the decline in credit and creditworthiness comes embarrassment and a deterioration of self-respect and self-confidence. The communication between lender and borrower can become strained and may ultimately stop. Collection departments and third-party collection agencies do what they can, but both are limited by available resources. Accordingly, their attention becomes focused on loss mitigation or the recovery of the low hanging fruit in early stage charge offs; older ones become ignored and eventually abandoned. The result is that billions of dollars of charged off accounts simply fall through the cracks.



Ironically, as illustrated above, this phenomenon occurs at the time when many borrowers have regained their capacity to repay their obligation. Many Credit Union borrowers would, if given the chance, like to have their membership privileges reinstated by their Credit Union once their obligation has been repaid. This intangible bond, created on the foundation of member service, is unique to Credit Unions and virtually non-existent with commercial banks and other types of financial institutions. Therefore, the desire to regain financial credibility, self-respect, and the possibility of reinstated Credit Union membership privileges creates a strong incentive for the repayment of a charged off credit card balances, direct and indirect loans, HELOCs, mortgages, or negative share account balances. Unfortunately, most collection agencies believe that as time passes, collection becomes more difficult and they do not accept or effectively work older charge offs.

This Year All the Answers are Different.

If we have learned anything from the COVID-19 Pandemic, it is to take preventative action early. Ignoring the problem, thinking it will magically go away by itself, and waiting to "see what happens" has proven to be a deadly strategy.

The Credit Union industry does not have a vaccine to protect itself from the effects of this new economic crisis and Credit Unions must identify and use available, qualified resources. We offer the following strategies in hopes of providing solutions that will immediately benefit both Credit Unions and their members:

1. Increase Credit Union capital from the sale of your charged off consumer loan portfolio;
2. Focus your internal efforts on delinquency control, loss prevention, and member service. Engage qualified third-party resources to assist with your member contact efforts;
3. If you decide not to sell your charge off portfolio for immediate capital, outsource your efforts to recover prior losses and reinstate "prior-prime" members who have regained their creditworthiness.

Strategic Examples:

The following solutions available from CU Revest are offered to provide examples of available strategies to overcome the unique challenges created by the COVID-19 pandemic and a protracted economic recovery:

1. **Raise immediate capital through the sale of consumer charge offs.**
   CU Revest will purchase eligible consumer loan, credit card, stranded HELOC, mortgage and share draft charge off portfolios that are within the 7-year federal

reporting statute. CU Revest also accepts qualified judgments that are outside the federal reporting statute of limitations. Using our proprietary predictive analytics model which is built upon 26 repayment attributes of more than 1 million borrowers and over $4 billion in special assets under management since 1997, CU Revest will accurately forecast the recoverability of a charge off portfolio and provide a prospective Credit Union client with a guaranteed minimum liquidation valuation which can be paid immediately upon purchase of the charge off portfolio, or remitted monthly over a term of 36 months. Upon purchase, CU Revest will assume all responsibility, liability and reporting requirements. In addition, the selling Credit Union is indemnified, in writing, against any acts of misfeasance or malfeasance by CU Revest. *A valuation of eligible charge offs will be provided at no obligation for inquiring Credit Unions that are concerned about the potential COVID-19 impact on their capital adequacy and interested in selling their consumer charge off portfolio.*

2. Add needed horsepower to delinquency management and loss prevention efforts.

- **TAMI (Tracking and Monitoring Intelligence).** In order to help Credit Unions maintain contact with those members who have found it necessary to cease communication, hide collateral or relocate, this behind-the-scenes technology captures current data from credit inquiries and multiple databases. Running 24/7/365, TAMI can automatically capture current residential, employment, financial, credit and contact information for member borrowers who apply for auto pawn, credit, licenses, insurance, residential leases, employment, mobile carrier, and a myriad of other products or services.

- **Member-Centric First-Party Calling.** If a Credit Union does not want to ruin its reputation as a member-owned cooperative operating with a "people helping people" philosophy, it does not want to follow 180 days of forbearance with an aggressive, no-holds-barred collection effort that does not follow the Credit Union ethic that the same institution followed in granting the forbearance to begin with.

  On behalf of the Credit Union, CU Revest's sister company Credit Solutions Corp. (CSC) will contact your members who are past due by letter and telephone and arrange payment directly to the Credit Union. Outsourcing will increase your delinquency management horsepower by augmenting your member contact staff and providing your delinquent members with solutions to bring – and keep - their account(s) current. Credit Union employees can dedicate their time and expertise to servicing their members' needs while CSC takes care of helping member meet their financial obligations. CSC provides member-centric support staff, easy to use online portal and contactless debt payment to enable borrowers to manage their Credit Union obligations during the most difficult of times. To be clear, CSC protects each Credit Union client's capital while preserving and often enhancing the member relationship. That is why CSC's support staff is compensated by the number of positive testimonials that are received from members.

3. **Recover older, post-agency charge offs and prior-prime members.** Having recovered millions of dollars in "uncollectable" cold-case charge offs and returned over 4,000 re-qualified, prior prime members to their Credit Unions for reinstatement, CU Revest is the Credit Union industry's leading solution for loss recovery of post-agency, cold case charge offs.
    - CU Revest provides a no-obligation comprehensive written valuation of a potential client Credit Union's charge off portfolio that can be reviewed *before* any Credit Union decides whether or not to do business. Once engaged, CU Revest's Special Asset Officers' contact queues are automatically re-stacked by success probability every 24 hours based on ongoing portfolio scrubbing, our predictive analytics, automatic data retrieval from various agencies and databases and social media.
    - CU Revest takes all the risk, provides a guaranteed expense cap, remits recoveries monthly and will never ask a client for a check. CU Revest is member-centric: Special Asset Officers are compensated not by the number of calls they make, but by the number of verified, positive testimonials they receive from members whom we have helped satisfy their obligation to their Credit Union.
    - The Reperforming Loan Program offers 0.00% APR and no points and has refinanced millions of charged off dollars into current, reportable loan obligations, helping raise participating members' FICO score by an average of 80 to 90 points.

   Upon request, CU Revest will provide a comprehensive, customized loss recovery analysis and proposal to inquiring credit unions.

About CU Revest.

CU Revest, voted the 2017 New CUSO of the Year by the National Association of Credit Union Service Organizations, is a multiple Credit Union-owned CUSO dedicated to recovering abandoned capital and members for Credit Unions. Combining unparalleled industry experience with leading edge technology such as our proprietary predictive analytics model built on the payment attributes of more than one million borrowers and $4 billion in assets under management since 1997, and TAMI, our 24/7 Tracking and Monitoring Intelligence system, CU Revest delivers an innovative and laser-focused, member-centric approach to resolving charged off financial obligations.

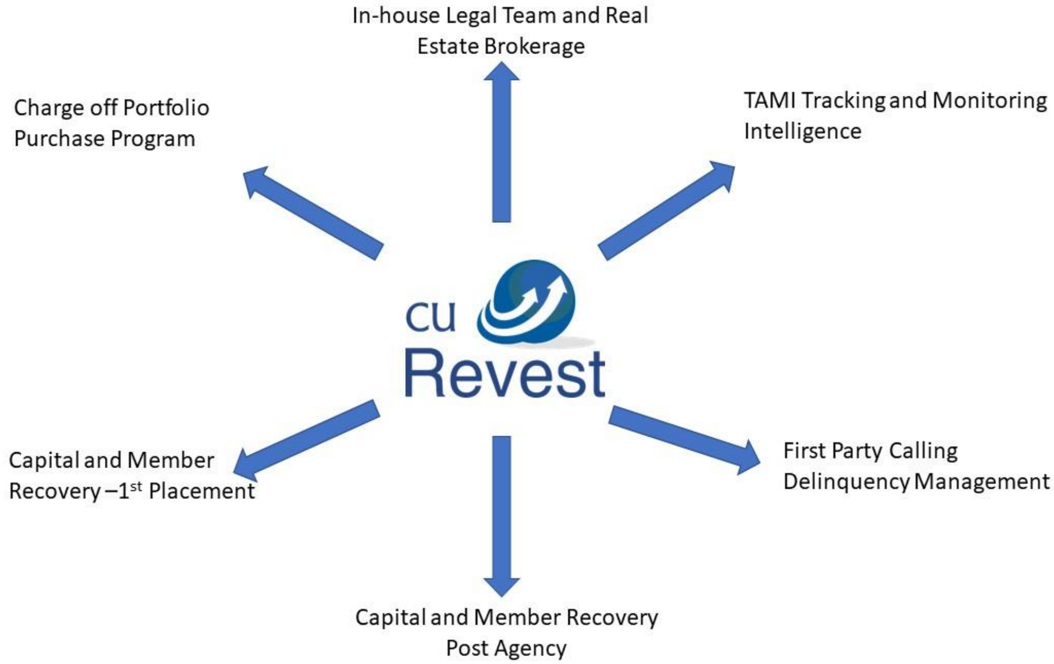
With nearly 100 Credit Union clients ranging in asset size from $200 million to $20 billion, CU Revest is an NCUA and CFPB-registered, regulatory compliant Special Asset Management CUSO with an unequalled history of succeeding where collection agencies have failed. Our unique, member-centric solutions and resources, such as our zero interest no-fee charge off refinance program for qualified borrowers, a professional team of experienced Special Asset Officers, and thousands of testimonials from Credit Union members whom we have helped satisfy their debt, all speak to our highly successful, member-centric, Credit Union exclusive recovery model. CU Revest is member-centric. Special Asset Officers are compensated not by the number of calls they make, but by the number of verified, positive testimonials they receive from members whom we have helped satisfy their obligation to their Credit Union.

CU Revest has helped financial institutions through multiple economic cycles and should be enlisted to help protect and preserve capital and assets so that current Credit Union staff can be focused on helping members get through what is predicted to be a very long and difficult period of social and financial disruption.

We're in this together. Just ask Larry Jackson, VP of Real Estate at $1.9 billion asset Together Credit Union in St. Louis, who writes:

> *"I first started a relationship with CU Revest in 2013, signing the contract in 2014. They beat expectations on our paper, meeting their 36 month projection in 24 months. We also signed up several of our Credit Union partners through the CUSO I ran at the time. Additionally, the VP of Collections enjoyed the relationship so much that we ended up working with CU Revest on early charge off collections as well.*
>
> *After I moved Credit Unions, I brought the CU Revest team on to help with our old charge off here as well. They have done a very good job in the first year of collecting the debt here. I know our collections manager loves working with them and says they are way easier to work with than our other agencies are. We originally were giving them about 50% of the collections pool available, but they quickly earned the other half. I have enjoyed my relationship with CU Revest on a business level. They are truly great people and the kind of people I wish all of our business partners could be."*

CU Revest. We have the Solutions.



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