A Wise Decision

NCUA's 2003 Expansion of Benefits Pre-Funding Options Is Proving Important

Common Purpose. Uncommon Commitment.

By amending Regulation 701.19 in 2003, the NCUA gave federally chartered credit unions the ability to invest in a variety of financial instruments that hadn't been permitted before. The idea was to give credit unions more options for increasing their investment returns to help offset the cost of employee benefits.

After all, at the time it didn't seem likely that benefit costs would decrease anytime soon—and indeed they haven't.

For example, according to a survey by the Kaiser Family Foundation and Health Research and Education Trust, the average annual premium for employer-provided family health care coverage in 2014 was $16,834. That's about 69% higher than in 2004 and 22% higher than in 2010[1].

The pressures of paying for ever-increasing benefits costs are only being exacerbated by credit unions' falling investment returns, which are negatively impacting net interest margins. The yield on average investments has fallen by more than 36%, from 1.95% to 1.24% over the last five years.[2] This has contributed to the industry's net interest margin dropping 13% over the same period. [2]

Two Reasons for the Slow Adoption of Pre-Funding

Even given these trends, it's natural that many credit unions took a wait-and-see approach to the new pre-funding options, despite the potential for higher yields. Two key reasons are:

An initial interpretation period: It took a few years of back-and-forth between the NCUA, investment services firms and credit unions to work out precisely which instruments would be allowed for benefits pre-funding. The parameters for using certain types of bank-owned life insurance (BOLI), mutual funds, stocks, annuities, bonds, and institutionally-managed portfolios had to be clarified.

Conservative culture: When it comes to investing members' capital, credit unions are, quite properly, risk averse. In addition to avoiding unnecessary losses, they don't want to introduce anything to their balance sheets that won't pass muster with NCUA examiners.

By now, however, these concerns have largely been addressed, as early adopters have had employee benefits pre-funding programs in place for several years—some for long enough to be battle-tested by the Great Recession.

Three Important Considerations for Pre-Funding Programs

If your credit union is considering a pre-funding program, here are some important steps to take:

1. Assess your employee benefits obligations: Determine the amounts actually spent for group health, 401(k), group life and disability insurance, etc. Consider the type of package you'll need to remain competitive for the talent your credit union requires to thrive, giving consideration to both broad-based employee benefits and executive benefits packages. This helps you set your pre-funding program's goals.

2. Do your due diligence in selecting providers, including both the vendors and the investment options those vendors bring forth such as insurance carriers and portfolio managers. These firms may have been using these financial instruments for many years for large banks or personal investors, but be sure they understand the credit union industry's unique needs and culture.
3. Seek expert guidance to inform your board and asset/liability committee about employee benefits pre-funding. Require potential vendors to address not only their track record for investment returns, but their program oversight and compliance capabilities as well.

A benefits pre-funding program should be designed as a sustainable, long-term strategy, not a quick-fix for your ROA. The goal is to keep your key ratios in good shape, which can help fund benefits programs that attract and retain excellent employees far into the future.

For more information about CUNA Mutual Group's Total Benefits Pre-Funding program, contact the Executive Benefits Service Center at 800.356.2644, ext. 665.1035, or visit www.cunamutual.com/executivebenefits.

[1] Kaiser Family Foundation/Health Research & Educational Trust (HRET) 2014 Employer Health Benefits Survey

[2] National Credit Union Association, 5300 Call Report Quarterly Data, December 2014