Big banks' earnings could hold coronavirus warnings for credit unions

By Jackie Stewart

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With financial institutions beginning to reveal their first-quarter results, credit unions are getting a fuller look at the fallout from the coronavirus.

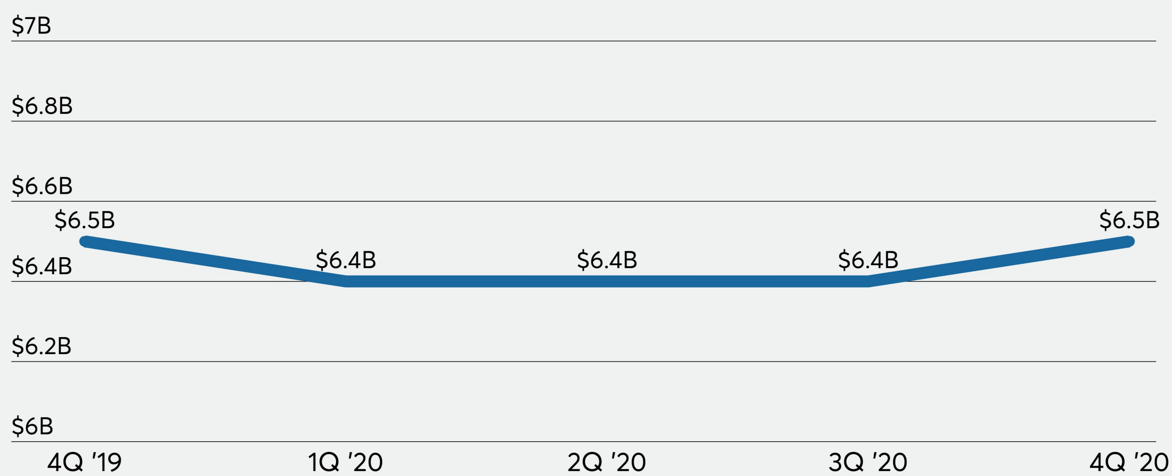
Publicly traded banks began releasing earnings from the first quarter last week, giving the rest of the financial services industry a glimpse into how they are handling the unprecedented pandemic that has shuttered businesses and dramatically slowed consumer spending. Credit unions don't have a similar luxury of seeing their peers publicly discuss their financial results and decision-making process. The National Credit Union Administration won't release industry-wide data for several weeks, and CUNA Mutual Group's Credit Union Trends Report generally runs two months behind.

Because of that, credit unions can turn to these bank results to get a better idea of how provisions and net interest margins are holding up more broadly amid the economic slowdown.

“Everything that has happened from the middle of March is a first for most people’s careers,” said Jeffrey Marsico, an executive vice president at the consulting firm the Kafafian Group, who noted he has gotten more calls in recent weeks from clients asking what others are doing than he ever has in his career. “Almost everything is new right now. [Executives] are keenly interested in what others are doing about it.”

Last week, the nation’s largest banks reported their first-quarter results. Although credit unions’ business models — and particularly those of smaller institutions — may vary vastly from that of these megabanks, Marsico said there’s still important information executives can glean from these results, especially concerning macro factors.

Era of steady CU loss provisions may be over



Source: NCUA

When credit unions and NCUA do release quarterly earnings, there is rarely a detailed discussion around what drove the results and why executives made certain decisions.

“JPMorgan has a team of economists looking at various things all over the globe to get insight into how this will affect their business,” said Greyson Tuck, a board member at the law and consulting firm Gerrish Smith Tuck. “Their team of economists is probably bigger than the number of employees at 95% of credit unions in the country.”

Jennifer Piepszak, chief financial officer of JPMorgan, said during the bank’s earnings call that its economists had predicted U.S. GDP would fall by 25% and unemployment would top 10% with a “solid recovery over the second half of the year.” However, the bank’s economists later updated their outlook to reflect “a more significant deterioration in the U.S." with GDP sagging 40% and unemployment rising to 20% in the second quarter, Piepszak added.

Overall JPMorgan's profits fell 69% in the first quarter from a year earlier.

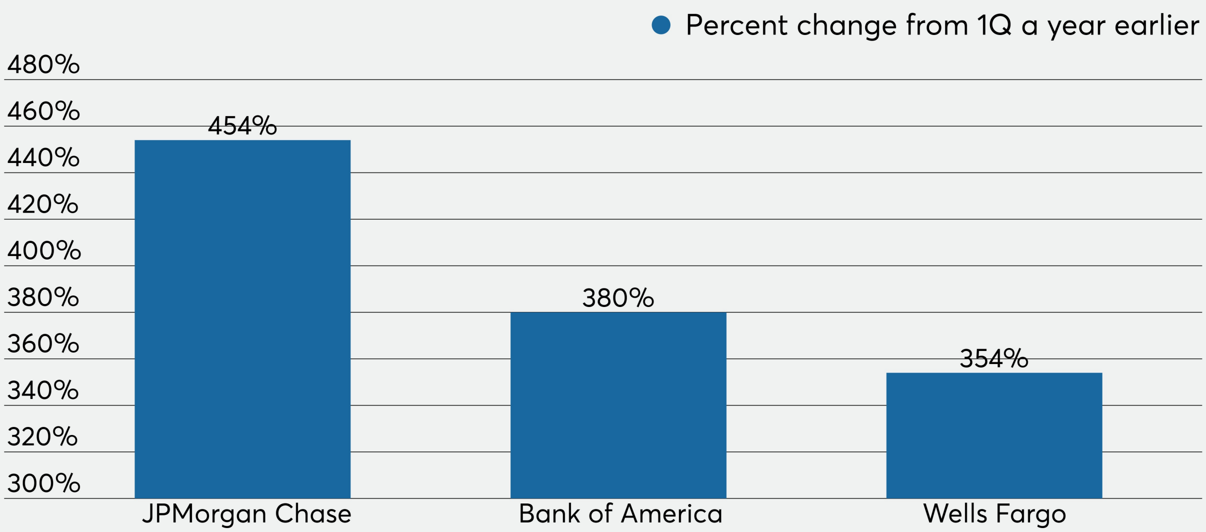
That type of commentary tells credit unions what to expect, said Peter Duffy, a managing director at Piper Sandler.

“If the largest bank in the country is reserving $6.8 [billion] … with no better insight than any of us as to what the ‘re-opening’ looks like or when it starts … it tells me I want a good supply of liquidity,” Duffy said. “[It tells me I want] earnings wherever I can find it to make up for lost earnings due to slowing loan demand, reduced investment yield and potential loan losses after all the forbearance is exhausted.”

Besides macro factors, there are also a few metrics that credit unions could track to better inform them of the overall state of the financial services industry, experts said. Provisions for loans losses is one area.

For credit unions, the provision for loan and lease losses has hovered around $6.5 billion for more than a year, according to fourth-quarter data from NCUA. That represents about 0.43% of the industry’s average assets, according to NCUA data.

Preparing for the worst



Source: The companies

But that’s likely to change now and the provision could potentially surge for credit unions. The major banks set aside billions of dollars to cover loans that could go bad.

JPMorgan’s provision was $8.3 billion for the first quarter, or 50% more than its entire provision for all of 2019. The company said in its earnings release that it was building its reserves because of "deterioration in the macro-economic environment as a result of the impact of COVID-19 and continued pressure on oil prices." That signals to other financial institutions how bad a highly sophisticated bank expects credit losses to be. Others looking at this may want to adjust their own expectations.

“That provision expense is very telling about what should be expected,” Tuck said. “They are saying the pain will be deep and will be severe.”

Credit unions could be helped by regulatory guidance on making loan modifications and because most of their loans tend to be smaller, Marsico said. However, that also means some credit unions could be overwhelmed if a larger number of small loans sour, which could put pressure on their infrastructure, he added.

Credit unions can take some solace in the fact that their consumer loan quality is likely to hold up better than that of commercial banks, said Brian Turner, president and chief economist at Meridian Economics. At the peak of the 2008 recession, delinquencies at commercial banks were 4.85% compared with just 1.84% for credit unions, he added.

Still, credit unions should brace for a rise in loan delinquencies starting in May and through the end of 2020, which will in turn cause an uptick in charge offs and provision expenses, Turner said. Credit unions, especially those that struggle to work out loans, could see their earnings decline by up to 30% this year, he added.

“In a nutshell, credit unions generally have sounder consumer lending practices than their FDIC-insured counterparts, which has led to a more stable delinquency rate,” Turner said.

Net interest margin is another area credit unions should be watching closely, experts said. Most CUs are asset sensitive, meaning their margins get a boost when rates rise and take a hit when they fall. The Federal Reserve has slashed rates to zero to help slow the economic pain from the coronavirus and that’s likely to eventually take a toll on the industry.

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For instance, U.S. Bancorp reported that its net interest margin was 2.91% in the first quarter, down 1 basis point from the fourth quarter and 25 basis points from a year earlier. That’s because of lower interest rates and keeping more cash on hand to meet loan demand.

But the bank anticipates that its net interest margin will face additional pressure this quarter. That’s because rates were lowered late in the first quarter so the full effect of that hasn’t been felt yet and it needs to maintain its liquidity to meet loan demand. Plus the bank can only do so much to lower its funding costs, Terrance Dolan, chief financial officer, said during a conference call last week discussing the bank’s results.

The credit union industry’s net interest margin was 3.16% in the fourth quarter, up 3 basis points from a year earlier, according to quarterly data from NCUA. This metric being squeezed, coupled with having to add to provisions for potential loan losses, will be hard for some shops to stomach.

“There is a period of unknown, which creates anxiety,” Duffy said. “I think we are on the precipice of significant change for community banks and credit unions.”

However, this could also be a chance for credit unions to shed less desirable funding sources, such as expensive CDs, since consumers are likely to keep deposits in their accounts and loan demand will fall, Turner said. That should help maintain margins at credit unions.

Still, CUs should prepare themselves for the fact that first-quarter results won't fully reflect the economic pain from COVID-19, experts said. The public health crisis and the related economic fallout didn't happen until March, more than two-thirds of the way through the quarter.

"We are really about five to six weeks into this and most folks are on a 30-day payment cycle, so they were probably able to make their March payments," Tuck said. "We don't know at this point the depth of this yet."

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Earnings **Loan-loss provisions** **Net interest margin** **Coronavirus**
Consumer lending **Consumer banking** **Interest rates** **Interest rate risk**