TruNorth FCU Closes Benefits Gap

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by John Pesh

Pre-funding helped the credit union boost ROA and retain employees.

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When **TruNorth Federal Credit Union**, Ishpeming, Mich., needed to reduce expenses in the aftermath of the Great Recession, General Manager George Isola was faced with a tough decision. He and his board searched for ways to improve return on assets without increasing member fees or cutting back the credit union's employee benefits package. Their benefits package included a competitive group health plan and a 401(k), for which TruNorth FCU contributed 9 percent of employees' annual salaries, regardless of employee contributions. "That's low-hanging fruit when you need to reduce expenses," he says.

With employee compensation and benefits now accounting for more than 50 percent of credit union operating expenses (according to data from the National Credit Union Administration), supporting the rising cost of benefits is more critical than ever. Declining investment yields and net interest margins make this an increasingly daunting task for credit unions. In the last five years, credit union yield on investments has fallen 36 percent and net interest margins have declined 13 percent, according to the **NCUA 5300 Call Report Quarterly Data** from December 2014. These trends have caused a benefits-funding gap to emerge for many credit unions.

Rather than reducing benefits, Isola sought a long-term solution to close this "gap." He discovered **benefits pre-funding** and began exploring several pre-funding options. He believed this could be the solution he was looking for.

What is Benefit Pre-funding?

A benefits pre-funding program allows credit unions to offset employee benefit obligations through the use of non-section 703 investments, as approved by the NCUA. These potentially higher-yielding investments would otherwise be considered “impermissible” by the NCUA. The returns on these investments allow credit unions to help cover the costs of a variety of employee benefits, including 401(k) plans, pensions, executive benefits plans, health insurance, life insurance and more.

Credit unions can customize a pre-funding program by choosing from a variety of funding options, including business-owned life insurance (BOLI), mutual funds, stocks, bonds and annuities. This flexibility can help keep risk to an acceptable level.

TruNorth FCU has used the flexibility of benefits pre-funding to its advantage in developing an investment plan. The CU used “a sensible percentage of our capital to invest – nothing too risky,” Isola explains. “I didn’t want to put all of our eggs into one basket.”

Why Benefit Pre-Funding?

There are several advantages in choosing to implement a pre-funding program. Primarily, the benefits can help alleviate the stress of supporting the rising cost of benefits. Credit unions can turn liabilities into performing assets by investing in potentially higher-yielding sources of income. The flexibility of these programs is an important factor in positively impacting a credit union’s bottom line. Investment returns are not tied to specific expenses, but rather, used flexibly to meet the actual needs that emerge. This flexibility makes pre-funding a great solution to closing the benefits-funding gap and allowing credit unions to provide a quality benefits package to employees.

Benefits pre-funding can also indirectly help boost leadership continuity in credit unions. The program can help fund competitive executive benefits that will retain and attract top talent. A strong benefits package can be the difference between retaining a star executive and losing them to a competitor.

Isola says that TruNorth FCU has maintained its culture as a stable employer through its benefits pre-funding program. Year after year, members are well taken care of by the same folks. “All but two employees – one of those is me – started as part-time tellers and worked their way up,” he explains. “We’ve got 40 employees, and every year the one or two people we lose are usually students who were working part-time jobs,” he says.

In order to get the most benefit with minimal risk from a pre-funding program, it is crucial to work with an experienced, knowledgeable partner to manage the program and ensure compliance with all applicable regulations. There are seven risk categories associated with pre-funding from the NCUA: credit, interest rate, liquidity, transactional, compliance, strategic and reputational. The right partner can help effectively manage these risks.

TruNorth FCU's benefits pre-funding program has made a positive impact on its ROA since 2011. In addition to improving ROA, benefits pre-funding has helped TruNorth FCU maintain leadership continuity, which benefits credit union members. Isola says he wishes he had been able to start a benefits pre-funding program when he joined the credit union as general manager 22 years ago.

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