



**SECU BOARD OF DIRECTORS**

# **Response to 2022 Annual Resolution**

December 22, 2022

# Response To 2022 Annual Resolution

During the 2022 SECU Annual Meeting, a resolution passed requesting the SECU Board of Directors answer questions regarding six actions SECU allegedly took over the past year.

The resolution contends that these actions will change the culture and direction of SECU, presumably to the detriment of members. While the resolution does not accurately characterize the issues, the questions posed are important. We welcome the opportunity to provide a thorough, fact-based explanation. It is our hope that these responses help members see that our Board and leadership remain focused on continuing to serve our members, now and into the future.

As the financial industry continues to evolve, the SECU Board remains cognizant of our mission while pursuing opportunities to further add value to our members. We believe members are best served when we constantly review all strategic options — not just stick with the status quo. While change may be difficult, it can significantly benefit our members and is often necessary to sustain and enhance our operations for the future.

Here is an overview of the six issues raised during the 2022 SECU Annual Meeting and a brief summary of our position on each. Detailed responses and additional information are provided on the following pages.

1. **Open Membership:** Will SECU expand our field of membership to allow more consumers to benefit from our services? It's too soon to say, but we will never "allow anyone to join" without belonging to a permissible common bond. Thoughtfully expanding our membership, as we have done in the past, could allow us to serve North Carolinians in underserved and unserved rural communities where other financial institutions have closed, leaving financial deserts for many citizens. Additional member participation also means we are better positioned to offer members better rates, better services, and lower fees.
2. **Proposal to Merge with Local Government Federal Credit Union (LGFCU):** SECU never made a formal proposal to merge with LGFCU. In dialog about advancing our technology, we discussed a wide range of strategic options for a continued partnership. However, LGFCU's Board of Directors recently decided that, after nearly 40 years of partnership, it is ready to explore a move toward independence. LGFCU had been strategically planning to become independent for years. LGFCU leadership, led by their newly appointed CEO, recently initiated the process to separate its operations from ours so they could operate independently. When that occurs, it will not significantly impact our business operations. However, it will allow them to serve their members with products and services best suited for them.

3. **Introduction of Risk-Based Lending:** We believe SECU can be the best lending option for most of our members, not just a select few. Risk-based pricing methodologies have been part of our lending policy and practices for years. Our current lending products employ this method based on factors such as length of loan terms, new versus used cars, and loan to value on mortgage loans. We are simply expanding our current methodology to include credit rating. Expanding our pricing practice allows us to be a competitor across market rates for all, not just some. We do so because currently our members with higher credit scores can and do find better options at other financial institutions. The result: SECU serves as the lender of choice only for a small segment of our members. This represents a lost opportunity for both SECU and our membership and does not provide value to the vast majority of our members.
4. **Business/Commercial Lending:** Business lending does NOT put our tax-exemption at risk, nor are we trying to compete with banks for their business lending. There are rural communities where financial deserts exist creating a void especially for small independent businesses. We are considering offering business services because our members want, need and continue to ask for these services. Offering business services is not new for credit unions. Nationally, nearly one in three credit unions already provides business services to its members. This is a service that could be especially valuable for small business owners in communities across North Carolina.
5. **Eliminating Tax Preparation Services:** Less than two percent of our members used this service, but providing the service created a tremendous burden on our staff and disrupted services in our branches. We determined that we could better serve our members in other ways. Additionally, we provide access to self-service options via our website.
6. **Ending North Carolina Focus and Regional Expansion:** SECU's Board is, as they have always been, focused on servicing North Carolina. The Board has not discussed expanding SECU beyond North Carolina or changing our name. This is nothing more than rumor.

## ISSUE 1

# Open Membership

The resolution contends that SECU spearheaded an effort to change North Carolina law to allow “anyone to join.” Question: How would open membership in SECU benefit members?

## Response

**To provide clarity, below is a statement from the Carolinas Credit Union League.**

“Any suggestion that SECU spearheaded an effort to amend field of membership laws to allow “anyone to join” a credit union is just not true. There is no such effort, spearheaded by SECU or anyone else.

What is true is the Carolinas Credit Union League, not SECU, has been leading an initiative to modernize North Carolina’s credit union statutes, which have not been updated since 1975. That initiative began in 2020, when the League invited each of its 28 state-chartered credit union members to participate in a thorough review of Chapter 54 to identify outdated sections of state law and develop proposals to modernize them. Several member credit unions, including SECU, joined the League’s working group. The proposed draft changes to Chapter 54, which number in the hundreds, bring North Carolina’s credit union statutes into the 21<sup>st</sup> century. They’re the result of nearly two years of meetings and consensus-building among League members, the N.C. Credit Union Division, and other stakeholders.

To be perfectly clear about the field of membership provisions in the League’s draft, we do not propose any change to the fundamental nature of credit union membership, and we certainly do not propose allowing “anyone to join.” The League’s draft does permit credit unions to serve historically underserved populations, including those in our most economically distressed counties and those living below the poverty line. The reality is that 600 bank branches have closed in the past decade, many of them in rural and underserved areas. Those populations deserve access to financial services just like everybody else, and not-for-profit credit unions have the right model to serve them.”

Any decision to expand our field of membership will be made with a focus on our current members, always keeping our members’ best interest top of mind. SECU has and will always have a commitment to serve members across North Carolina.

## ISSUE 2

# Proposal To Merge with The Local Government Federal Credit Union (LGFCU)

Question: How would this merger have benefited SECU members?

## Response

SECU never made a formal proposal to merge with LGFCU. In dialog about advancing our technology, we discussed a wide range of strategic options for a continued partnership. However, LGFCU's Board of Directors decided that, after 40 years of partnership with SECU, they are ready to explore independence. LGFCU strategically built the best-in-class technology infrastructure to support their credit union's needs. LGFCU had been making this investment towards independence, in response to their members asking for products and services specifically addressing the needs of NC local government. Examples include services designed for organizations and small businesses, green lending, and affordable housing. We will continue to support LGFCU as we have for the past 40 years. We stand by their decision and effort to move toward independence and do what is required to best serve their members.

In 2017, LGFCU chartered a new credit union, Civic Federal Credit Union, to serve as a standalone financial institution to provide products and services to its members that were outside of the capabilities of current SECU technology. Newly appointed CEO Dwayne Naylor says LGFCU and Civic may consider merging to establish one credit union focused completely on North Carolina local government. Just as SECU is focusing its efforts on serving its members and not multiple credit unions, the same focus on local government could allow for greater efficiencies and impact. Local government stakeholders have shared that having two brands (LGFCU and Civic) serving the same membership is confusing. The members are right. Guided by their new vision, the LGFCU Board decided to move toward independence after years of planning and thoughtful reflection.

LGFCU has been working toward obtaining operational independence for decades. The pivot to pursue independence is a monumental decision representing the culmination of years of careful deliberation — not a hasty reaction to a conversation with its trusted credit union partner. The relationship between LGFCU and SECU has never been stronger, a testament to the open, honest communication and mutual respect between the leadership of our two organizations.

As SECU prepares to modernize core systems to deliver enhanced digital services to our members, we discussed a range of strategic options with the credit unions we serve. Upgrading key financial systems is a complex and resource-intensive undertaking for a single institution. Performing this task for four other institutions adds a magnitude of difficulty and cost that required the Board to consider certain foundational options before making such a profound investment of our resources.

**To provide additional clarity, below is a statement from incoming LGFCU and Civic CEO, Dwayne Naylor.**

“Our two organizations have a tremendous history of exemplifying the 6th Cooperative Principle – Cooperation Among Cooperatives. SECU has consistently stood up for North Carolina’s public servants at key points in our partnership. Each time resulted in a powerful outcome that improved the existing services to members being provided.

**1983**

The first historical event of cooperation was the pivotal decision back in the 80s that led to the creation of LGFCU. SECU provided support in working with NC local government leadership, and provided the infrastructure necessary to ensure our local government employees had a credit union to call their own.

**2014**

The second example of a historical event of cooperation is when SECU changed their model and became even more focused on serving consumers. The result was an important decision by SECU to no longer service business and organization accounts. At the time, LGFCU had built a strong book of business supporting business accounts, specifically the NC’s fire departments. For LGFCU to serve these important members independently of SECU meant we needed time to build a best-in-class independent credit union service platform. This ultimately became Civic. Once again, SECU partnered with us, patiently waiting four years for the creation of an advanced credit union from the ground up to successfully pull this off in record time – another historical display of our cooperative model.

**2022-2024**

The third historical event of cooperation can be seen today. We are faced with a new opportunity to bring our best efforts together and move our members towards their own independent infrastructure that adds value in experience and pricing. As LGFCU explores our path to independence, our SECU partner for the last 40 years continues to demonstrate cooperation among cooperatives by working alongside each other. The transition of LGFCU creates a win-win for the members of both credit unions. LGFCU members are moving to an infrastructure that the LGFCU members own, and SECU will be undergoing their own technology

transformation and can focus on their members and ongoing partner credit unions. We also continue to set the standard for what's possible with shared values, a shared vision and shared belief.

Throughout these three pivotal moments, when leadership told the naysayers no, the cooperation provided an opportunity for innovation and greater service to North Carolina local government. Over the last four decades, LGFCU and SECU's partnership has represented the most successful cooperative partnership in credit union system history, and it is humbling to realize that both SECU and LGFCU members, through their actions, are asking us to serve them differently. Digital transformations are challenging, but they also provide opportunities. While SECU focuses on improving the member experience, LGFCU will continue to focus on co-creating an independent credit union and expanding the local government ecosystem to better serve the public servants of North Carolina.

What's most exciting is that the work doesn't stop here. This transition isn't the end of a partnership, it's the beginning of a new era of working together to design the best for our members and the State of North Carolina.”

## ISSUE 3

# Introduction Of Risk-Based Lending

The resolution contends that SECU's move to risk-based lending constitutes profiling and means higher rates for all members. Question: How is charging higher loan rates to members who have always repaid their SECU loans justified? Does profiling members by credit score best serve members?

## Response

SECU is implementing tier-based pricing because doing so represents sound financial management and enables us to be the best lending option for most all of our members. The Board carefully and exhaustively studied the issue over several meetings before reaching this decision. It challenged assumptions and poured over impact data, to be deliberate to especially consider lower credit scores. Ultimately, the Board elected to move forward with tier-based pricing because the move will benefit the credit union as a whole.

SECU already employs risk-based pricing practices based on various factors. Examples of such include but are not limited to:

- **Loan terms** - loans with longer maturities are priced higher than shorter term loans
- **Collateral risk** - used cars are priced higher than new cars
- **Loan to value** - mortgages with higher loan to value percentages are priced higher than mortgages with lower loan to value percentages.

As such, the concept of risk-based pricing is not new or unfamiliar to SECU. We are simply expanding this pricing methodology to include credit risk where loans with lower credit quality have slightly higher rates than those with higher credit quality. This practice is standard throughout the financial services industry and beyond. Credit scores are used to evaluate rates for most everyday living expenses, such as, insurance, utilities, rental agreements, even for cellular service. With increasing frequency, more members are finding better options from other financial institutions that offer tier-based pricing. Historically, our interest rates have been much more competitive for a small subset of our members. As a credit union owned by our members, we endeavor to provide competitive rates for all members. Additionally, a well-balanced loan portfolio across the entire membership enhances the safety and soundness of the credit union.

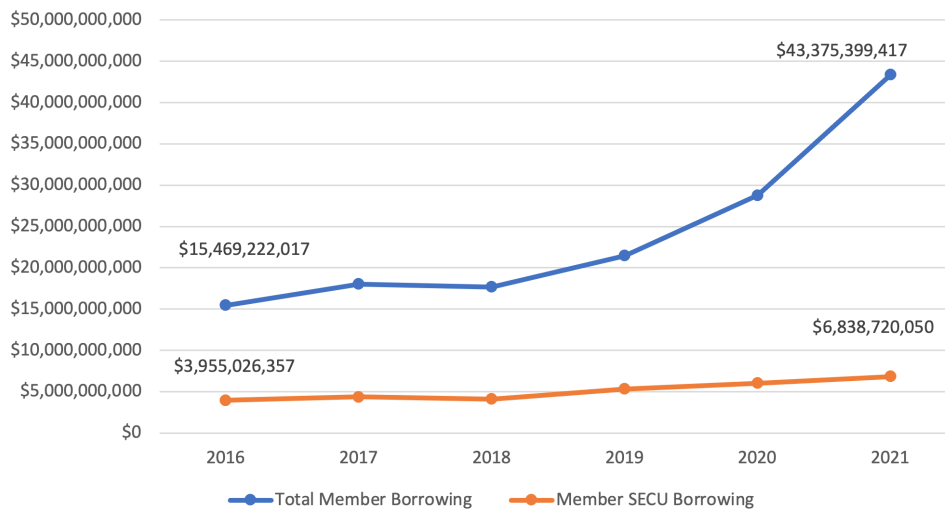


## Why?

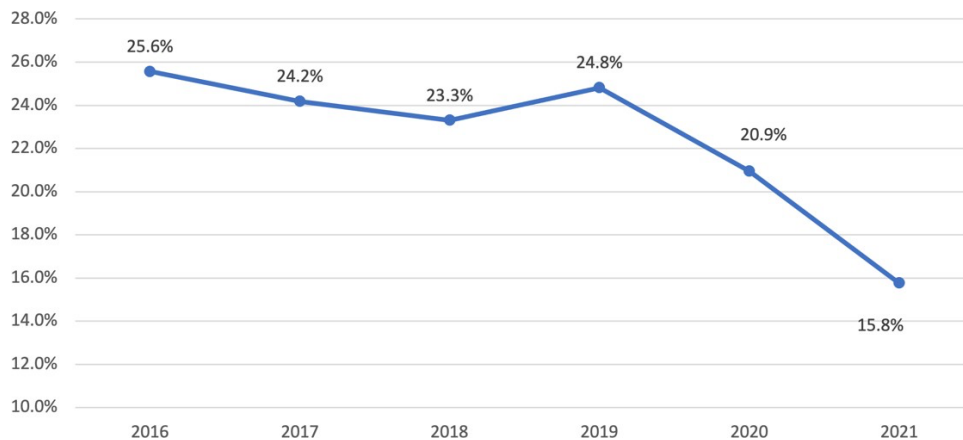
To understand why, we must look at current trends and factors evident in our member response to our current loan options.

Most of the lending industry adopted tier-based pricing by the 1990s, while SECU has stuck with a “one-size-fits-all” interest rate policy. Over the past five years, our members’ total borrowing from all lenders has almost tripled. As depicted below in chart one, our members borrowed over \$43 billion (blue line). However, less than \$7 billion (orange line) was borrowed from SECU. Members are increasingly turning to other lenders to meet their borrowing needs, most of which offer risk-based pricing. As a result, SECU’s share of total member borrowing plummeted over the past five years (as shown in chart two):

**Chart 1: SECU Member Total Borrowing Balances**



**Chart 2: SECU Percent of Member Total Borrowing Balances**



These borrowing trends tell us our current pricing methodology no longer meets the needs of the vast majority of our members. SECU believes we can be the best lending option in town for most all of our members. Tier-based pricing will permit us to be just that.

The SECU Board believes that the Credit Union should spread benefits as broadly as possible across the membership. SECU's Board is elected to represent the entire membership. Members are owners of SECU and should benefit from SECU's profits. The expansion of tier-based interest rates will allow SECU to offer all of our members competitive interest rates to benefit from SECU's success.

### **How is our approach to tiered pricing different from risk-based?**

Typical risk-based pricing for most financial institutions covers a large rate spread across credit tiers where lending options are available. Many lenders focus their lending programs and marketing campaigns to attract top level credit tiers, while limiting programs or even further not providing any lending options for lower credit tier borrowers. As SECU moves to include credit as an attribute in the pricing model, we are intentionally keeping the rate spread across all credit tiers to a minimum. Providing a narrow difference across tiers and offering options across all tiers is what makes the SECU tiered based model different.

In addition, we should strive to balance the overall benefits offered by the Credit Union to not only our borrowing members but also to our saving members. We use the income earned on member loans to pay interest on member deposits as well as cover the operating expenses of the Credit Union and set aside reserves as a financial cushion for the uncertainty of the future. The current pricing methodology impacts our ability to pay higher rates on our deposit products.

## ISSUE 4

# Business/Commercial Lending

The resolution contends that SECU plans to provide commercial lending for which it has no staff expertise, and such activity could jeopardize its not-for-profit tax status. Question: How does entering into business/commercial lending benefit the current members of the credit union? Is it worth the tax- exempt status of the CU? How much would that loss cost the member-owners of the CU?

## Response

Providing business services and business loans does NOT put SECU at risk of losing its tax exempt status. SECU is considering offering business services to our members because they are asking for business services. Nothing in current federal or state law prohibits credit unions from offering business lending. Many credit unions already provide such services and retain their tax-exempt status. And to contend that our employees lack the expertise to provide business services is an affront to the smart, hardworking employees across our organization.

A small business owner is no less a member. We feel the credit union should, where feasible and prudent, offer services that meet the changing needs of the membership. SECU has evaluated offering business services at various points over our long history, and we are doing so again. SECU always strives to provide financial services that meet our members' needs. Over the years, our members have consistently asked for basic business services and we want to serve those members. This is especially the case in more rural parts of North Carolina, where financial institutions have shuttered branches and left residents without meaningful access to business services.

The idea that credit unions will lose their tax exemptions for offering their members business services simply isn't true. Credit unions' tax exemption has nothing to do with the presence or absence of business lending. Congress made this clear in 1998 when it stated that credit unions "are exempt from Federal and most State taxes because they are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors and because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means." Pub. L. No. 105-219, 112 Stat. 913 (1998). Congress said nothing about the tax exemption hinging on whether credit unions refrain from providing business services.

Many credit unions today offer some form of modest business lending and have been doing so for years. Nationally, nearly one out of every three credit unions has member business loans on its books. Examples abound at home and nationally as shown in the graphics below:

Institution	June 2022	Institution	June 2022
Allegacy	\$455,019,361	BECU	\$2,730,749,087
Truliant	\$446,470,366	GreenState	\$2,586,973,700
Skyla	\$249,193,823	Pentagon	\$2,264,265,297
Self-Help	\$197,054,239	Bellco	\$1,907,011,470
Coastal	\$137,388,590	Lake Michigan	\$1,555,187,798
Marine	\$100,745,474	Alliant	\$1,521,749,143
Self-Help FCU	\$71,530,423	Bethpage	\$1,422,842,346
Civic	\$34,414,852	UNIFY Financial	\$1,388,177,987
Champion	\$19,413,078	Mountain America	\$1,340,763,761
Summit	\$17,201,965	Magnifi Financial	\$1,295,282,642

## ISSUE 5

# Eliminating The Tax Preparation Service

Why was elimination of the tax preparation service viewed as a benefit?

## Response

SECU decided to stop offering tax preparation services because the services benefited only a tiny segment of our membership while imposing an extreme burden on staff and disrupting services to the rest of our membership.

We are proud of the low-cost tax preparation services we provided to members over the past decade. While the program started out as a free service, SECU charged a modest fee for the program in recent years. While we pride ourselves on providing uncomplicated products and services, the tax code is anything but. We did not feel it was fair to our employees — or our members — to expect our staff to become temporary tax experts once a year. With required training and additional staffing requirements, the program placed an extreme burden on our branch staff that inhibited our ability to deliver our core financial services to our members during tax season. For all this disruption, only a small percentage of our members actually utilized the tax preparation service. In fact, in 2022, fewer than 2% of our members used the program.

Because of the disruptive impact the tax preparation program had on our staff and our overall services, SECU decided it was best to discontinue the service, especially when there exists an array of free and low-cost full-time professional tax preparation services in the marketplace (such as, IRS's Volunteer Income Tax Assistance (VITA), Tax Counseling for the Elderly (TCE) programs and IRS Free File Program). We want our employees to spend their time on areas of the business where they provide the most value to our members. Doing so requires that we focus on our core expertise. Although our staff diligently and competently prepared tax returns for several years, we've come to believe that members are best served by receiving tax preparation services from providers that specialize in tax preparation services. As such, we have offered self-service options on our website, as well as information on free tax preparation resources for those who qualify.

## ISSUE 6

# Ending The “North Carolina Focus” And Regional Expansion

How does regional expansion of the services of SECU help to improve the financial condition of the current member-owners?

## Response

The Board has not discussed expanding the geographic scope of SECU activities.

The resolution refers to expansion plans and name changes as a rumor. It is just that: a rumor. The Board has not discussed expanding beyond North Carolina or changing SECU’s name. As we have been for 85 years, our unwavering focus remains on the great citizens of North Carolina.

## SUMMARY

# Answering Who We Are? And Where Are We Going?

In summary, we are who we have always been, your SECU. The Board of Directors intends for SECU to continue to be who we are, The Trusted Provider of Financial Services to Every Eligible Member and to Enhance the Value of their Lives and Financial Well Being While Maintaining our Fiscal Strength. SECU will continue to be the same credit union it always has been. Our members and serving our members continue to be our highest priorities and only reason we exist. This Board of Directors has never put growth goals in place for any part of the credit union. The focus has solely been on member service and safety and soundness.

As we look at our current demographic, we realize we need to pivot certain aspects of our products and services to adequately serve our evolving membership. We know that 80% of our 2.7 million members are not state employees, public school teachers and administrators or retirees from the state system. These include family members of state employees as well as former state employees. Our focus and goal is to support all of our members by providing various products and services which support all members, not just a small segment of the membership. Many of our members receive direct deposit and in turn are making loan payments outside of SECU to other financial providers. As referenced earlier, our members are increasingly borrowing from other lending sources. We need to provide products and services to remain relevant to our members for decades to come. The successful execution of key initiatives will bring more value to members by promoting greater efficiencies, expanding member choices and channels, and positioning SECU for ongoing sustainability.

It has never been more necessary for SECU to fill the role of a trusted service provider. With shifting demographics, emerging technologies, industry consolidation, and enterprise risk, the stakes have never been higher. Our charge is to remain diligent in our focus on and our approach to providing excellent member service, and to continually provide stability amid a volatile environment. Our members need us, our employees need us, and our community needs us to service them well into the next 85 years and beyond.