Qwick Views for credit unions September 2010

The Corporate Dilemma – And Possible Solutions

by Shawn O'Brien, President, QwickRate

A dilemma is a situation in which one must choose between equally unfavorable or unpleasant alternatives. Many credit unions feel caught in the grips of just such a predicament.

The economic climate has seriously impacted investment earnings. Losses experienced by corporate credit unions – and successive NCUA assessments – are adding even more pressure. And with regulators increasingly focused on liquidity management and contingency planning, credit unions seem wedged between a rock and a hard place.

Fortunately, certain options can help provide a soft landing for your investment strategy. In light of recent events, this paper discusses approaches you can take to improve earnings at a time when every basis point counts.

Event:

NCUA Corporate Credit Union Stabilization Fund Assessment, June 2010

On June 17, 2010, the National Credit Union Administration (NCUA) approved a charge calculated to raise $1 billion from its federally insured credit union members. By mid August, each credit union is due to pay a 13.4 basis point assessment, equal to 0.134% of its insured shares and deposits in NCUA. The assessment was levied in order to cover a $1.5 billion loan repayment due in December to the Department of the Treasury, which provided NCUA with funds to mitigate losses sustained by corporate credit unions over the last seven years.

The NCUA borrowings were necessary to stabilize the corporate credit union system. Stable corporates are deemed essential for maintaining liquidity and investment services for thousands of natural-person credit unions, and for providing electronic settlement services to their members. However, the assessment will place even more pressure on the earnings of the nation's 7,800 natural-person credit unions. According to NCUA, half of the institutions reported losses for fiscal 2009.

"I understand that this is a challenging year and the assessment will negatively impact all credit unions. The decision to levy this assessment was not taken lightly."

— Debbie Matz
National Credit Union Administration Chairman

Guidance:

Going forward in 2010, it will be crucial for credit unions to closely monitor their investments and rates in order to achieve optimal yield for their institutions. Carefully surveying and selecting the best available rates will help to offset some of the negative impact created by NCUA assessments.

Focused attention should be paid to the sources and durations attached to investments. Significant disparities exist among yields that can be expected from various investment instruments.

How QwickRate can help:

As the premier online CD marketplace, QwickRate can help credit unions recover some of the basis points lost to assessments. More than 1,100 credit unions are now investing direct through QwickRate and earning as much as 132 basis points more on each CD. Since no third party, rate stripping or broker fees are involved, investments made through QwickRate mean more yield for your credit union. Plus, QwickRate makes it convenient to compare, connect and invest, by providing access to 3,000 institutions in a single marketplace.

A Comparison of Investment Options

Duration	Top Rates Corporates (Avg.)*	Top Rates SimpliCD*	Top Rates QwickRate*
180 days	.25	.40	1.19
1 year	.32	.66	1.44
2 years	.53	1.02	1.85

** Rates as of 9/1/2010*

"In November 2009 the NCUA Board projected a range for the 2010 Share Insurance Fund assessment of 10 to 25 basis points."

— Debbie Matz
National Credit Union Administration Chairman

Event:

The Share Insurance Fund Assessment to be announced in September, 2010

The Corporate Stabilization Fund assessment announced by NCUA in June covers losses at corporate credit unions. At the same time, losses at natural-person institutions are also taking a toll, reducing the equity ratio in the National Credit Union Share Insurance Fund so that it is now near the bottom of its normal operating range. Therefore, in September, NCUA is scheduled to announce an additional assessment to replenish the fund's reserves.

According to the Credit Union Times on June 17, NCUA Board Member Michael Fryzel said that the final additional total assessment will be between 15 and 40 basis points, as the agency had originally estimated. He recommended that credit unions budget toward the higher end of that range.

Guidance:

The assessments are not over. Invoices already scheduled by NCUA will take more chunks out of credit unions' earnings in 2010, and additional assessments may follow in the year(s) to come. Institutions are advised to put resources and processes in place now to offset the challenges ahead. In the months to come, you'll need to be even more diligent about portfolio and yield management.

How QwickRate can help:

Investing direct through QwickRate, rather than going through a broker or third party, can increase the returns on your investments. On average, our members save 30 to 60 basis points by following this strategy. QwickRate experts can provide a complimentary, customized Investment Cost analysis of your portfolio to help you determine your best options. For an example increased earnings achieved through QwickRate, go to the Investment Cost Calculator page at www.qwickrate.com/calculator.

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Event:

Interagency Policy on Funding and Liquidity Risk Management, March 2010

Following market turmoil that depleted the capital reserves of financial institutions, NCUA joined the other federal banking agencies to issue an interagency policy statement that specifies the process that institutions should follow to appropriately identify, measure, monitor and control their funding and liquidity risk.

In the policy statement, the agencies emphasize the need to have diversified funding sources and a cushion of liquid assets, along with a formal well-developed contingency funding plan (CFP). The agencies advise that insured institutions should be prepared for any contingencies that will apply to them if they become less than Well Capitalized, according to Prompt Corrective Action (PCA) requirements and restrictions established by the Federal Credit Union Act and NCUA rules and regulations.

In addition, the agencies indicate they expect liquidity risk management processes and CFPs to be tested, well documented and available for supervisory review.

Guidance:

Now, more than ever, it's vital for credit unions to have contingency funding sources in place and tested as preparation for unforeseen events. "Tested" means the institutions have formally secured the funding sources and can easily access them in case of an emergency – or events such as NCUA assessment invoices.

Assessments are just one part of the corporate problem. As a result of market events, many credit unions now find they're unable to rely on their corporates as a funding source and are looking for reliable options. Finally, those credit unions that fall into Prompt Corrective Action due to assessments will need alternative, diversified sources to support their contingency funding strategies.

How QwickRate can help:

With previous funding avenues no longer available, you may prefer to reach out to other natural-person credit unions as reliable funding sources. QwickRate gives you an expedient path for doing just that. Currently more than 1,100 credit unions are QwickRate subscribers - and that volume is steadily growing. This makes the marketplace an excellent option for federally insured credit unions as a contingency liquidity source. However, simply listing QwickRate as a funding source is not enough. Regulators will look for proof that you have a current subscription agreement, and that you've properly tested your access to the marketplace. A single subscription fee to QwickRate provides unlimited opportunities for investing and funding. And when a credit union posts deposit rates, the marketplace ensures that only subscribing credit unions have access to view its rates.

To make investing and funding as efficient as possible, QwickRate provides tools to automate portfolio management, month-end accruals and reporting. These tools also enhance your ability to document transactions to satisfy regulatory requirements.

"Failure to maintain an adequate liquidity risk management process will be considered an unsafe and unsound practice... Critical elements of sound liquidity risk management include… an appropriately diverse mix of existing and potential future funding sources. Because liquidity pressures may spread from one funding source to another during a significant liquidity event, institutions should identify alternative sources of liquidity and ensure access to contingent funding sources…"

— Interagency Policy Statement on Funding and Liquidity Risk Management, March, 2010

Event:

New Safeguards Established for Corporate Credit Unions, Summer 2010

When regulators seized U.S. Central in 2009 and placed it into conservatorship, all 26 corporates lost 100% of their equity in the entity, leaving most severely undercapitalized. This upheaval prompted NCUA to propose a rule, to be finalized in the summer of 2010, strengthening the regulation of corporate credit unions.

In April, NCUA Chairman Debbie Matz said that proposed capital thresholds will be attainable for some corporates, while others will need to find a new business model. "We recognize that the search for alternative providers would pose hard choices, especially for smaller credit unions," Ms. Matz said, adding that NCUA is ready to work as a constructive partner as they confront difficult choices. The corporate shakeup can significantly impact credit unions that depend on corporates for investment services, credit and loan services, and more.

"Ultimately, the future of the corporate system will be determined by all of you – the leaders of natural person credit unions. You will soon be facing the choice of either recapitalizing a corporate or finding other ways to obtain the same type of services that corporates have provided."

— NCUA Chairman Debbie Matz, speaking at the Texas Credit Union League Annual Meeting, April 2010

Guidance:

In its June letter to credit unions, NCUA advised that natural-person credit unions will have crucial choices to make about the future of corporates. You must be prepared to decide whether to:

- Recapitalize your corporate credit union
- Switch to another corporate credit union
- Seek similar services from a non-credit union

How QwickRate can help:

All credit unions have experienced the harmful effects of interdependency risk gone awry. QwickRate can serve as a reliable outside source for meeting your liquidity and investment needs. For 24 years, our nationwide marketplace has provided credit unions with convenient connections for investing and funding – no third-party, rate stripping or broker fees involved. Our online, automated tools simplify work and documentation. And ongoing regulatory information and guidance from our experts will help you stay knowledgeable and compliant in the new financial environment.

About the Author:

Shawn O'Brien is President of QwickRate and is responsible for leading the strategic direction of the CD marketplace. His efforts are centered on further enhancing QwickRate's value and ensuring that credit union subscribers continue to secure the best rates in the country through the highly-respected marketplace. Shawn has more than 20 years of financial services experience in the areas of Finance and Management. He holds a B.A. in Business from the University of Notre Dame.

About QwickRate:

QwickRate is the premier online CD marketplace for non-brokered funding and investing. With more than 3,000 members, QwickRate offers credit unions a cost-effective way to gain access to a nationwide CD market. Our automated QwickTools™ put credit unions in control to get the best rates for their institutions and more efficiently manage their portfolios. With no third party or broker fees, and unlimited support and regulatory guidance, QwickRate is a fast and efficient source for higher investment yield and reliable liquidity.

For more information contact us at 800.285.8626 or visit www.qwickrate.com.

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