A Strategic Approach to Financial Literacy

Webinar #37

Hosted by David L. Tuyo II, CLE

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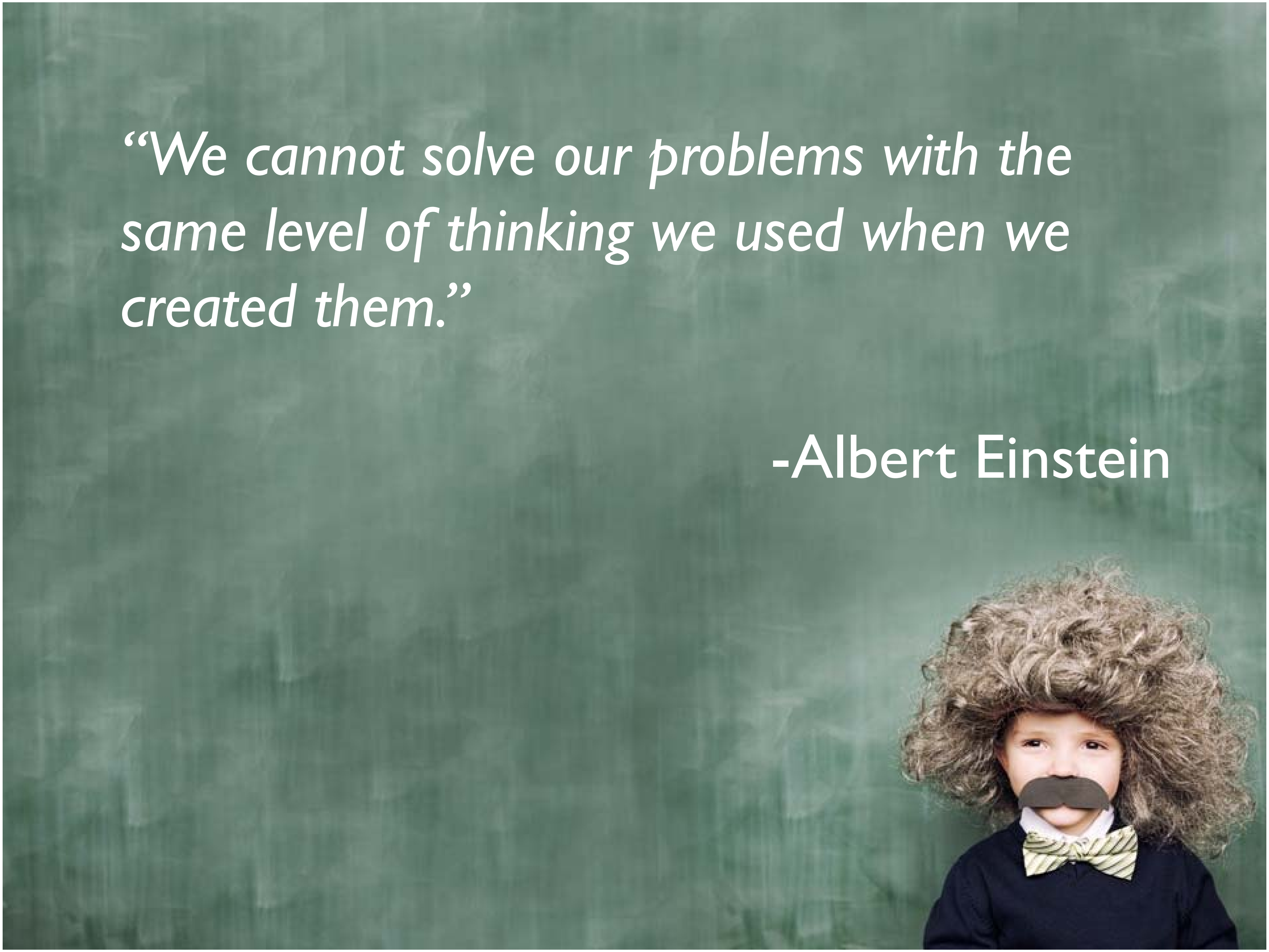
“We cannot solve our problems with the same level of thinking we used when we created them.”
-Albert Einstein

Outline

- Introductions
- Challenges
- Applied Analytics
- Financial Analysis Skills Applied to YOUR Credit Union
- Strategic Review

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NCUA LETTER TO FEDERAL CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION
1775 Duke Street, Alexandria, VA 22314

DATE: **February 2011** **LETTER NO.: 11-FCU-02**

TO: **Federal Credit Unions**

SUBJ: **Duties of Federal Credit Union Boards of Directors**

ENCL: **NCUA Regulation §701.4**

Dear Board of Directors:

Certain provisions of NCUA final rule 701.4, *General authorities and duties of Federal credit union directors*, took effect on January 27, 2011. The purpose of this rule is to clarify and document the important duties of boards of directors of federal credit unions.

This letter provides general information about directors' duties, specifically focusing on the financial skills requirements which will take effect on July 27, 2011.

General Duties of Directors

The final rule contains the following six key provisions:

1. The board of directors is responsible for the general direction and control of a federal credit union. The board may delegate operational functions to management, but not the responsibility for the credit union's direction.

2. A director must carry out his or her duties in good faith, in a manner reasonably believed to be in the best interests of the membership, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.

3. A director must administer the affairs of the credit union fairly and impartially and without discrimination in favor of or against any particular member.

4. A director must have at least a working familiarity with basic finance and accounting practices, including the ability to read and understand the credit union's balance sheet and income statement and the ability to ask, as appropriate, substantive questions of management and auditors.

5. A director must direct the operations of the federal credit union in conformity with the Federal Credit Union Act, NCUA's Rules and Regulations, other applicable laws, and sound business practices.

6. A director may rely on information prepared or presented by employees or consultants the director reasonably believes to be reliable and competent and who merit confidence in the particular functions performed.

Basic Financial Skills Required

The board of directors of a federal credit union is charged with the general direction and control of the institution. Credit unions, however, are not like many other commercial entities in that they do not produce observable physical goods or services. Instead, credit unions receive deposits from the membership and, in turn, lend or invest these funds. The key measure of the credit union's success or failure is its financial statements. As such, a director must understand these financial statements to participate in a meaningful manner in the direction and control of the institution.

Accordingly, to be an effective director, an individual must have a certain base level of financial skills, consistent with the size and complexity of the credit union operation they serve. At a minimum, directors must have the ability to read and understand the credit union's balance sheet and income statement. If directors do not have the requisite skills when elected or appointed, they must obtain these skills in a timely manner, as discussed below.

What a Director Should Know

At a minimum, a director should be able to examine the credit union's balance sheet, income statement and be able to answer the following questions:

- What does this line item mean?
- Why is it important to the credit union?
- Is the value of the line item changing over time? If so, what does that change (either positive or negative) mean?
- Is the change important to the credit union?

A director must understand the specific activities in which his or her credit union engages. In particular, a director must understand not only how these activities generate revenue for the credit union but also, and perhaps most importantly, the various risks associated with these activities that could lead to financial loss.

To do their job in a meaningful manner, it is essential that directors understand the risks found in depository institutions -- that is, credit, liquidity, interest rate, compliance, strategic, transaction, and reputation risk. Moreover, directors must understand the internal control structures at the credit union that limit and control these risks.

Timetable for Acquiring Financial Skills

NCUA understands that directors are, generally, uncompensated volunteers who have other important demands that compete for their time. The decision to serve as a director, however, is a commitment which includes understanding the financial statements, risks and controls of the credit union so as to properly exercise authority over the credit union's direction.

Directors who were elected or appointed on or after January 27, 2011, and who come to the position without the requisite financial skills will have six months from the date of election or appointment to acquire the enumerated skills. Sitting directors who already understand their federal credit union's financial statements and risk controls will not have to do anything further to meet the financial requirements of NCUA's directors' duties rule. Sitting directors who were appointed or elected before January 27, 2011, and do not have these skills, have until July 27, 2011 to satisfy the minimum financial standards.

How to Acquire Necessary Financial Skills

It is NCUA's intent to ensure that all federal credit union directors have a basic understanding of their credit union's finances. It is **not** NCUA's intent to increase examiner scrutiny of the financial skills of particular directors. Rather, examiners will evaluate whether the credit union has a policy in place to make available the appropriate training to enhance the financial knowledge of the directors. The policy should provide:

- Opportunities and funding for directors to acquire the skills needed to evaluate the credit union's finances. Some directors may come to the director position with the necessary financial knowledge. Other directors may obtain the necessary financial skills through internal credit union training, external training, self education, on-the-job experience, or a combination of these activities.

- Education alternatives for directors commensurate with the size and complexity of the credit union. Alternatives could include, but not be limited to, training provided by vendors or trade associations; college courses or other opportunities at colleges or universities; NCUA's Office of Small Credit Union Initiatives (OSCUI) training program presented at various workshops across the country beginning March 5, 2011; and NCUA's Office of Examination and Insurance (E&I) internet-based training. We will distribute additional information when the development is complete.

- The timeframes noted in the *Timetable for Acquiring Financial Skills* section.

Guidance on Other Director Duties

Obtaining the necessary financial skills will enable directors to exercise the general control and direction of credit unions and carry out the other, associated duties summarized above. Some of those duties deserve additional discussion and emphasis.

Paragraph 701.4 (a) Management of a Federal Credit Union

Paragraph 701.4(a) provides, in part, that "while the board may delegate execution of operational functions to [management], the ultimate responsibility for [the credit union's] direction and control is not delegable."

The board may delegate management functions to senior management. The board, however, must directly exercise its authority to hire, fire, determine duties, set compensation, and discipline senior management. The board must also ensure that appropriate policies are in place to guide senior management in the execution of their duties.

To properly exercise the control and direction of the credit union, directors must ensure they are properly informed about what is happening in the credit union. Directors should not rely solely on the reports of senior management, but also consider the reports of the supervisory committee and internal and external auditors. Where necessary, the board may also request credit union employees provide information directly to the board, and not through senior management. The board may also hire consultants that report directly to the board, and not to senior management.

Paragraph 701.4(b) Duties of Federal Credit Union Directors

Paragraph 701.4(b)(1) provides that "[a] director must carry out his or her duties in good faith, in a manner reasonably believed to be in the best interests of the membership of the credit union, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances."

"Good faith" means, generally, that directors should take care not to violate the law, and also not be involved in decisions that benefit the director personally. When in doubt, a director should look carefully at the conflict of interest provisions in the credit union bylaws and NCUA regulations and seek legal counsel if unclear how to proceed on a particular issue.

Directors must always focus on the best interests of the membership as a whole. Credit unions are not-for-profit cooperatives designed to provide financial services to their member-owners. As such, a credit union's primary purpose is not to seek the biggest possible profit or return on assets (ROA); nor is it appropriate to seek asset growth just for the sake of growth. The primary purpose of a credit union is to provide quality, low-cost financial services that the members need.[1] When making important decisions, directors should always keep in mind the following questions:

- What financial services do my members need and want? How do I know this?

- Will my decision today help the credit union provide these member services in a quality manner and at low cost to the members?

The requirement for "*reasonable inquiry*" means that the more complex a decision, and the more important the decision is to the financial interests of the members, the more due diligence the directors need to do in an attempt to make a good decision.

Paragraph 701.4(b)(4) provides that a director must "direct management's operations of the Federal credit union in conformity with the requirements set forth in the Federal Credit Union Act, NCUA's rules, other applicable law, and sound business practices." When making a decision, a director should consider applicable laws and alternative business practices. If unsure, a director should ask questions and gather information before voting on a proposal.

If you have any questions related to this letter, you should contact your regional office or district examiner.

Sincerely,

/S/

Debbie Matz
Chairman

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[1] Of course, a credit union must have sufficient net worth to 1) meet its statutory prompt corrective action (PCA) requirements; 2) facilitate borrowing and the engagement of third party vendors, where necessary; and 3) facilitate the absorption of possible future losses associated with reasonably foreseeable risks. The credit union should also seek some positive ROA to maintain and protect an appropriate net worth ratio. But maximizing growth, simply for the sake of growth, is not an appropriate goal for a credit union.


Questions???

Leadership

- A leader's job is to look into the future and see the organization, not as it is, but as it should be.
- To achieve a goal never achieved before, you must start doing what you have never done before.
- If every other area of the organization remained at its current level of performance, what is the one area where change would have the greatest impact?

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Board Governance

- The combination of processes and structures implemented by the board of directors to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives.

Why Other’s Failed

- They don’t assess risks
- The don’t really understand their oversight roles
- They don’t understand what it means to be a fiduciary
- Misplaced/too much reliance on executives
- Failure to understand/monitor the corporate culture
- Failure to appreciate the signals they send about the values and ethics of the organization

We Won’t Repeat

- Failure to appreciate and use the oversight tools at their disposal
- Failure to observe good governance practices
- Failure to perform legal duties
- Board education
- Poor appreciation of conflicts of interest

*From “Corporate Governance and the Liability of Board of Directors”, John H. Stout

Applied Analytics

- Lead versus Lag Measures
- Goals for any Credit Union
- Spread Analysis
- Strategically Analyzing the Balance Sheet
- Strategically Analyzing the Income Statement

Get to the Unshakable Facts

- What are we measuring?
- Is it driving the results we need?
- What is the cost/benefit?
- Is this in line with the strategic plan?
- How do we know we are successful?

Lead Versus Lag Measures

- Lag measures are typically end results and are what most organizations call goals; move from x to y by when.
- Lead measures are predictive of end results and are influencable.
- If luck is playing a significant role in the organizations success, then the organization is focusing on Lag measures.

R-Squared

- Coefficient of Determination
- More than a statistic
- A numerical explanation of how much the variability of one factor can be explained by the movement of another factor

Example

- A Lag measure would be to get to work on time everyday; a Lead measure would be getting your automobile serviced every 3,000 miles so it doesn't break down.
- Movie: Moneyball
  - A Lag measure is having a full stadium and winning games; another lag measure would be most runs in the game to win. A Lead measure is tracking on base percentages to increase number of runs.

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Today's Trivia

- A hundred years ago:
  - There were only 8,000 cars on the road
  - The average worker made between $200 and $400 per year
  - Only 8% of homes had a telephone
  - Alabama, Mississippi, Iowa and Tennessee were all more populated than California
  - Only 6% of Americans had graduated from High School

The Most Important Question

- If every other area of the organization remained at its current level of performance, what is the one area where change would have the greatest impact?
- If you could only track one ratio over time, what would it be?

Questions???

The Big 4

- Loan Growth
- Loan Yield
- Charge-Offs
- ROA

Spread Analysis

- Gross Income/Assets Minus
- Cost of Funds/Assets = NIM/Assets Minus
- Operating Expenses/Assets (Should be Positive) Plus
- Fee Income/Assets Minus
- Provision for Loan Loss/Assets Minus
- NCUSIF+TCCUSF/Assets Equals
- Return On Assets

Financial Performance

- Please turn to your FPR's now
- We will review and analyze strategically

	Dec-2009	Dec-2010	% Chg	Dec-2011	% Chg	Dec-2012	% Chg	Sep-2013	% Chg
ASSETS:	Amount	Amount		Amount		Amount		Amount	
Cash & Equivalents	63,122,023	67,064,832	6.2	115,237,944	71.8	116,470,921	1.1	144,925,503	24.4
TOTAL INVESTMENTS	96,960,896	66,896,587	-31.0	92,243,122	37.9	81,042,099	-12.1	89,187,136	10.1
Loans Held for Sale	0	0	N/A	0	N/A	0	N/A	472,000	N/A
Real Estate Loans	481,877,584	494,092,748	2.5	441,101,263	-10.7	472,820,248	7.2	447,164,814	-5.4
Unsecured Loans	49,114,044	49,448,679	0.7	46,790,493	-5.4	49,319,817	5.4	52,666,126	6.8
Other Loans	58,689,644	59,723,303	1.8	50,947,648	-14.7	66,071,359	29.7	113,069,887	71.1
TOTAL LOANS	589,681,272	603,264,730	2.3	538,839,404	-10.7	588,211,424	9.2	612,900,827	4.2
(Allowance for Loan & Lease Losses)	(3,311,914)	(4,237,311)	27.9	(5,021,942)	18.5	(5,836,585)	16.2	(4,140,456)	-29.1
Land And Building	4,858,993	2,467,504	-49.2	2,337,809	-5.3	3,834,944	64.0	3,556,315	-7.3
Other Fixed Assets	4,633,643	5,045,931	8.9	3,911,643	-22.5	3,794,090	-3.0	3,142,071	-17.2
NCUSIF Deposit	6,746,478	6,571,534	-2.6	6,505,206	-1.0	7,057,147	8.5	7,170,293	1.6
All Other Assets	4,411,538	6,005,891	36.1	4,386,197	-27.0	8,564,216	95.3	9,407,876	9.9
TOTAL ASSETS	767,102,929	753,079,698	-1.8	758,439,383	0.7	803,138,256	5.9	866,621,565	7.9
LIABILITIES & CAPITAL:									
Dividends Payable	0	0	N/A	0	N/A	0	N/A	0	N/A
Notes & Interest Payable	0	0	N/A	0	N/A	0	N/A	0	N/A
Accounts Payable & Other Liabilities	6,606,580	9,301,379	40.8	7,540,888	-18.9	8,300,980	10.1	8,348,275	0.6
Uninsured Secondary Capital and Subordinated Debt Included in Net Worth[3]	0	0	N/A	0	N/A	0	N/A	0	N/A
TOTAL LIABILITIES	6,606,580	9,301,379	40.8	7,540,888	-18.9	8,300,980	10.1	8,348,275	0.6
Share Drafts	135,892,748	139,213,293	2.4	145,402,221	4.4	170,084,860	17.0	172,050,893	1.2
Regular shares	92,228,497	102,145,713	10.8	107,114,605	4.9	143,463,233	33.9	155,645,866	8.5
All Other Shares & Deposits	478,782,375	448,851,318	-6.3	443,640,990	-1.2	424,205,331	-4.4	473,181,950	11.5
TOTAL SHARES & DEPOSITS	706,903,620	690,210,324	-2.4	696,157,816	0.9	737,753,424	6.0	800,878,709	8.6
Regular Reserve	17,582,101	17,582,101	0.0	17,582,101	0.0	17,582,101	0.0	17,582,101	0.0
Other Reserves	-3,718,322	-4,815,160	-29.5	-5,454,011	-13.3	-4,911,555	9.9	-8,107,620	-65.1
Undivided Earnings	39,728,950	40,801,054	2.7	42,612,589	4.4	44,413,306	4.2	47,920,100	7.9
TOTAL EQUITY	53,592,729	53,567,995	0.0	54,740,679	2.2	57,083,852	4.3	57,394,581	0.5
TOTAL LIABILITIES, SHARES, & EQUITY	767,102,929	753,079,698	-1.8	758,439,383	0.7	803,138,256	5.9	866,621,565	7.9
INCOME & EXPENSE									
Loan Income*	32,944,471	31,457,726	-4.5	28,532,452	-9.3	28,706,333	0.6	22,926,539	6.5
Investment Income*	2,471,310	1,499,136	-39.3	1,582,631	5.6	1,789,074	13.0	1,047,530	-21.9
Other Income*	4,812,387	4,136,381	-14.0	1,152,010	-72.1	3,587,603	211.4	2,334,835	-13.2
Total Employee Compensation & Benefits*	13,078,934	12,004,204	-8.2	11,362,323	-5.3	13,596,653	19.7	10,403,968	2.0
Temporary Corporate CU Stabilization Expense & NCUSIF Premiums[12]	1,011,972	1,716,318	69.6	1,626,301	-5.2	669,432	-58.8	573,456	14.2
Total Other Operating Expenses*	10,056,632	8,912,557	-11.4	8,041,557	-9.8	11,225,627	39.6	8,695,637	3.3
Non-operating Income & (Expense)*	2,226,270	-211,820	-109.5	1,702,116	903.6	2,436,144	43.1	2,208,197	20.9
NCUSIF Stabilization Income*	3,365,000	0	-100.0	0	N/A	0	N/A	0	N/A
Provision for Loan/Lease Losses*	2,660,000	4,070,500	53.0	3,545,000	-12.9	4,325,000	22.0	2,150,000	-33.7
Cost of Funds*	15,241,600	9,105,741	-40.3	6,582,493	-27.7	4,901,726	-25.5	3,187,245	-13.3
NET INCOME (LOSS) EXCLUDING STABILIZATION EXPENSE & NCUSIF PREMIUM[11]	4,782,272	2,788,421	-41.7	3,437,836	23.3	2,470,148	-28.1	4,080,251	120.2
Net Income (Loss)*	**3,770,300**	**1,072,103**	**-71.6**	**1,811,535**	**69.0**	**1,800,716**	**-0.6**	**3,506,795**	**159.7**
TOTAL CU's	1	1	0.0	1	0.0	1	0.0	1	0.0

* Income/Expense items are year-to-date while the related %change ratios are annualized.

Count of CU in Peer Group : 422					Dec-2012			Sep-2013	
	Dec-2009	Dec-2010	Dec-2011	Dec-2012	PEER Avg	Percentile**	Sep-2013	PEER Avg	Percentile**
CAPITAL ADEQUACY									
Net Worth/Total Assets	7.47	7.75	7.93	7.82	10.34	8	7.66	N/A	N/A
Net Worth/Total Assets--Including Optional Total Assets Election (if used)	7.47	7.75	8.00	7.87	10.38	8	7.92	N/A	N/A
Total Delinquent Loans / Net Worth [3]	27.74	28.16	41.95	30.86	6.71	98	16.43	N/A	N/A
Solvency Evaluation (Estimated)	#NAME?	#NAME?	#NAME?	#NAME?	112.15	#NAME?	#NAME?	N/A	#NAME?
Classified Assets (Estimated) / Net Worth	5.78	7.26	8.34	9.29	8.34	71	6.23	N/A	N/A
ASSET QUALITY									
Delinquent Loans / Total Loans [3]	2.70	2.72	4.69	3.30	1.08	97	1.78	N/A	N/A
* Net Charge-Offs / Average Loans	0.33	0.53	0.48	0.62	0.71	53	0.85	N/A	N/A
Fair (Market) HTM Invest Value/Book Value HTM Invest.	0.00	0.00	0.00	0.00	101.86	N/A	0.00	N/A	N/A
Accum Unreal G/L On AFS/Cost Of AFS	-0.34	-0.14	0.21	0.10	1.19	11	-3.82	N/A	N/A
Delinquent Loans / Assets [3]	2.07	2.18	3.33	2.41	0.65	98	1.26	N/A	N/A
EARNINGS									
* Return On Average Assets	0.51	0.14	0.24	0.23	0.93	5	0.56	N/A	N/A
* Return On Average Assets Excluding Stabilization Income/Expense & NCUSIF Premium [2]	#NAME?	#NAME?	#NAME?	#NAME?	1.00	#NAME?	#NAME?	N/A	#NAME?
* Gross Income/Average Assets	5.47	4.88	4.14	4.37	5.10	25	4.20	N/A	N/A
* Yield on Average Loans	5.88	5.27	5.00	5.09	5.27	43	5.09	N/A	N/A
* Yield on Average Investments	1.58	1.04	0.95	0.91	1.20	32	0.67	N/A	N/A
* Fee & Other Op.Income / Avg. Assets	0.65	0.54	0.15	0.46	1.50	7	0.37	N/A	N/A
* Cost of Funds / Avg. Assets	2.07	1.20	0.87	0.63	0.70	43	0.51	N/A	N/A
* Net Margin / Avg. Assets	3.40	3.68	3.27	3.74	4.40	27	3.69	N/A	N/A
* Operating Exp./ Avg. Assets	#NAME?	#NAME?	#NAME?	#NAME?	3.19	#NAME?	#NAME?	N/A	#NAME?
* Provision For Loan & Lease Losses / Average Assets	0.36	0.54	0.47	0.55	0.33	82	0.34	N/A	N/A
* Net Interest Margin/Avg. Assets	2.74	3.14	3.11	3.28	2.90	75	3.32	N/A	N/A
Operating Exp./Gross Income	#NAME?	#NAME?	#NAME?	#NAME?	61.96	#NAME?	#NAME?	N/A	#NAME?
Fixed Assets & Foreclosed & Repossessed Assets / Total Assets [1]	1.60	1.44	1.09	1.29	2.48	21	1.02	N/A	N/A
* Net Operating Exp. /Avg. Assets	#NAME?	#NAME?	#NAME?	#NAME?	2.40	#NAME?	#NAME?	N/A	#NAME?
ASSET / LIABILITY MANAGEMENT									
Net Long-Term Assets / Total Assets	#NAME?	#NAME?	#NAME?	#NAME?	35.26	#NAME?	#NAME?	N/A	#NAME?
Reg. Shares / Total Shares & Borrowings	13.05	14.80	15.39	19.45	28.10	29	19.43	N/A	N/A
Total Loans / Total Shares	83.42	87.40	77.40	79.73	69.54	71	76.53	N/A	N/A
Total Loans / Total Assets	76.87	80.11	71.05	73.24	59.95	81	70.72	N/A	N/A
Cash + Short-Term Investments / Assets	11.52	10.25	17.88	16.56	15.88	63	18.73	N/A	N/A
Total Shares, Dep. & Borrs / Earning Assets	94.70	93.98	93.90	94.78	93.34	68	95.34	N/A	N/A
Reg Shares + Share Drafts / Total Shares & Borrs	32.27	34.97	36.27	42.50	41.22	61	40.92	N/A	N/A
Borrowings / Total Shares & Net Worth	0.00	0.00	0.00	0.00	2.34	1	0.00	N/A	N/A
Supervisory Interest Rate Risk Threshold / Net Worth	#NAME?	#NAME?	#NAME?	#NAME?	286.29	#NAME?	#NAME?	N/A	#NAME?
PRODUCTIVITY									
Members / Potential Members	33.12	31.33	30.10	18.31	21.37	61	13.01	N/A	N/A
Borrowers / Members	43.87	47.02	43.93	51.85	52.34	52	58.31	N/A	N/A
Members / Full-Time Employees	300.21	320.72	291.63	304.37	389.06	19	337.89	N/A	N/A
Avg. Shares Per Member	$13,810	$14,252	$14,966	$13,429	$11,778	78	$12,313	N/A	N/A
Avg. Loan Balance	$26,261	$26,494	$26,368	$20,650	$15,932	83	$16,161	N/A	N/A
* Salary And Benefits / Full-Time Empl.	$76,709	$79,498	$71,237	$75,328	$70,705	69	$72,062	N/A	N/A
OTHER RATIOS									
* Net Worth Growth	7.03	1.87	3.10	4.42	10.69	13	7.60	N/A	N/A
* Market (Share) Growth	10.09	-2.36	0.86	5.98	7.46	44	11.41	N/A	N/A
* Loan Growth	11.12	2.30	-10.68	9.16	6.24	71	5.60	N/A	N/A
* Asset Growth	9.14	-1.83	0.71	5.89	7.27	42	10.54	N/A	N/A
* Investment Growth	0.85	-16.35	54.45	-6.11	10.87	16	25.94	N/A	N/A
* Membership Growth	-3.45	-5.39	-3.95	18.11	3.87	96	24.52	N/A	N/A

* Annualization factor: March = 4; June = 2; September =4/3; December = 1 (or no annualizing)

Warning Signs

- Trifecta
  - Increasing Loans
  - Increasing Delinquency as a %
  - Increasing Charge Offs as a %
- Above Market Growth Without Controls
- Not Willing to Face Brutal Facts

The Most Important Relationship

- The key to healthy and managed growth:
- Net Worth = Equity/Assets
- ROA = Net Income/Assets
- Asset Growth = Targeted and Sustainable Rate of Growth
- Remember, the rule of 72


Questions???

Changing the World

- The road to service is traveled with integrity, compassion, and understanding
- You cannot discover new oceans unless you have the courage to lose sight of the shore
- The quality of your people will determine your destiny

Good To Great

- Jim Collins
- Hedgehog Concept
- Flywheel and Doom Loop
- Big Hairy Audacious Goal

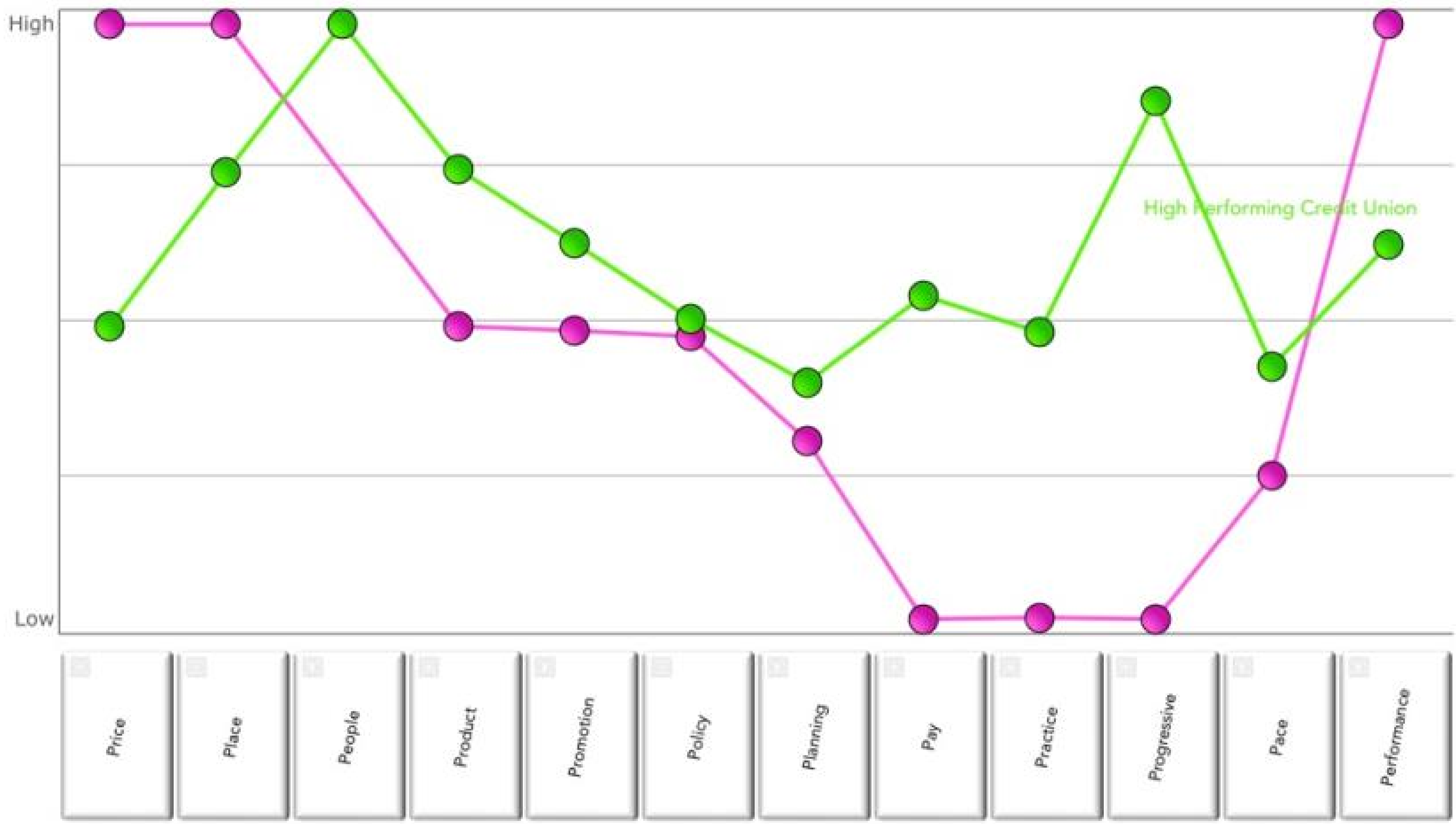
Hedgehog Concept

- What are we deeply passionate about?
- What can we be best in the world at?
- What drives our economic engine?

Strategic Canvas

- Blue Ocean Canvas
- 5 – 12 Factors
- ERRC – Eliminate, Reduce, Raise, Create
- A Dashboard Approach
- Strategic To Do List and Not To Do List

12 P's



Progress is the constant replacing of the best there is... --Filene

Questions???

Grow Grass, Not Kill Weeds

- Understanding Fundamentals
- Foundational Knowledge Supports Robust Planning

Pulling on the Rope Together

- **TEAM**
- **T**ogether
- **E**veryone
- **A**chieves
- **M**ore

NCUA and Peer Data

- http://www.cutimes.com/2012/10/07/ncua-examiners-look-at-the-bigger-picture
- http://www.ncua.gov/News/Pages/NW20130214AmericaMilitary.aspx
- http://www.ncua.gov/Legal/Pages/FCUAct.aspx

FROM THE OCTOBER 10, 2012 ISSUE OF CREDIT UNION TIMES MAGAZINE • SUBSCRIBE!

NCUA Examiners Look at the Bigger Picture

Enterprise Risk Managers Get Rundown from NCUA Executive

BY HEATHERN ANDERSON
October 7, 2012 • Reprints

WASHINGTON — The financial services industry is a risk-taking industry, NCUA Deputy Director of the Office of Examination and Insurance Tim Segerson told CU Enterprise Risk Management trainees during a lunch speaking slot Oct. 1 at the Capital Hilton. Credit unions that don't take risk earn less income, which makes them a risk to the share insurance fund, he said.

To effectively regulate risk, Segerson said the NCUA has instructed its examiners in its Examination Guide to step back from examination details and key ratios and think about the big picture. Examiners are also supposed to assess management's ability to correctly identify and manage risks.

That marks a long-term trend away from mathematical CAMEL matrices to a more qualitative review, which began in 2003 when the NCUA began conducting risk-based exams, he said. Now, examiners implement an enterprise risk management approach in which they review seven risk categories–credit, liquidity, operational, reputation, interest rate, strategic and compliance–and weigh how they fit into the CAMEL matrix.

Those seven categories are very close to the seven risk categories that make up enterprise risk management, according to an introductory guide to ERM provided by the event's sponsor, The Safety & Soundness Report. According to the guide, which was reviewed in depth by instructor Bill Nayda, principal of the Glen Allen, Va.-based Second Pillar Consulting, the seven risk categories that an effective ERM program address mirror the NCUA's exam reviews, with the

Matz Encourages Credit Unions to Educate Families about Building Wealth

America Saves and Military Saves Week Runs Feb. 25 through March 2

ALEXANDRIA, Va. (Feb. 13, 2013) – National Credit Union Administration (NCUA) Board Chairman Debbie Matz today encouraged credit unions to help educate members and their families about the importance of saving during the annual America Saves and Military Saves Week, which starts Feb. 25.

"Having a savings account is the first step towards financial stability, but a recent study indicated a little more than 29 percent of America's households do not have a savings account," Chairman Matz said. "People need to learn more about how to save and have a place to save. This year's campaign is a perfect opportunity for credit unions to educate and empower their members and their families so they can balance their budgets, buy a home, or put money aside for their children's educations."

This year's America Saves and Military Saves Week runs from Feb. 25 through March 2. America Saves Week and Military Saves Week are national campaigns that unite government, nonprofit and corporate groups to encourage individuals and families to save and build personal wealth. American Saves Week is coordinated by America Saves and the American Savings Education Council. Military Saves is part of the Defense Department's Financial Readiness Campaign and has been a partner with the department since 2003.

Both programs encourage saving, debt reduction and wealth building and are managed by the Consumer Federation of America. Credit unions can partner with local campaigns to offer motivational workshops and obtain posters, brochures and other resources.

For additional information about saving, borrowing and managing credit, consumers can visit NCUA's MyCreditUnion.gov.

NCUA is the independent federal agency created by the U.S. Congress to regulate, charter and supervise federal credit unions. With the backing of the full faith and credit of the U.S. Government, NCUA operates and manages the National Credit Union Share Insurance Fund, insuring the deposits of more than 95 million account holders in all federal credit unions and the overwhelming majority of state-chartered credit unions.

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Federal Credit Union Act

The Federal Credit Union Act (FCUA) is the source of authority for all federally chartered credit unions and governs the coverage and terms of insured accounts at all federally insured credit unions. It also determines the structure and duties of NCUA. The Congress of the United States found the following, and embodied the same in the Federal Credit Union Act of 1934 (Amended):

> *The American credit union movement began as a cooperative effort to serve the productive and provident credit needs of individuals of modest means.*
>
> *Credit unions continue to fulfill this public purpose, and current members and membership groups should not face divestiture from the financial services institution of their choice as a result of recent court action.*
>
> *To promote thrift and credit extension, a meaningful affinity and bond among members, manifested by a commonality of routine interaction, shared and related work experiences, interests, or activities, or the maintenance of an otherwise well understood sense of cohesion or identity is essential to the fulfillment of the public mission of credit unions.*
>
> *Credit unions, unlike many other participants in the financial services market, 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.*
>
> *Improved credit union safety and soundness provisions will enhance the public benefit that citizens receive from these cooperative financial services institutions.*

The entire text of the Act is here: The Federal Credit Union Act (Revised April 2013)

Credit Scoring Models

- FICO
- HYLS
- Other:
  - Internal
  - Rules of Thumb
  - Guidelines

It All Starts With How the Loan Was Made.....*Scoring Models*

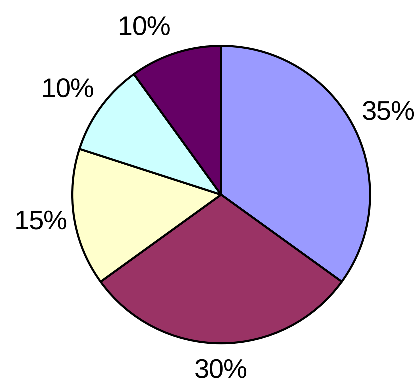
Range of Scores

850	=	Outstanding
680	=	Average
300	=	Lowest

Paper Grade

730+	=	A+
680-729	=	A
640-679	=	B
600-639	=	C
550-599	=	D
549 and below	=	E

Weight of Five Factors That Make Up Scores



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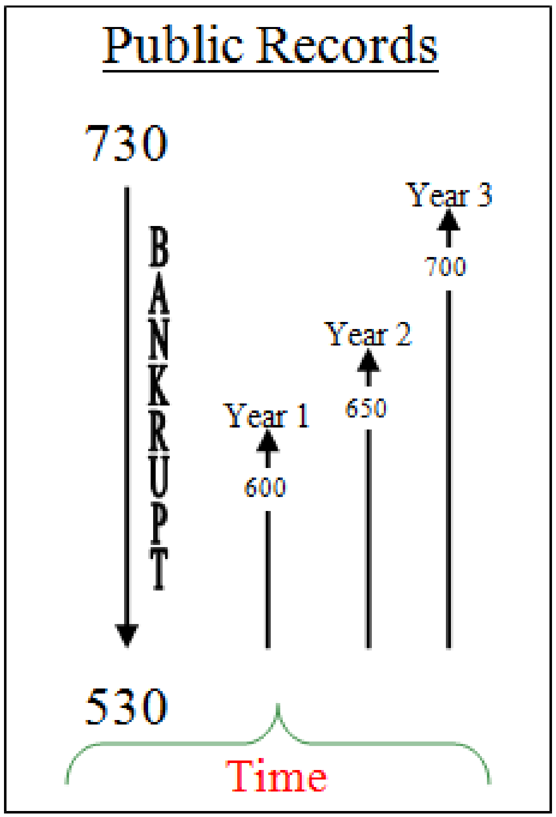
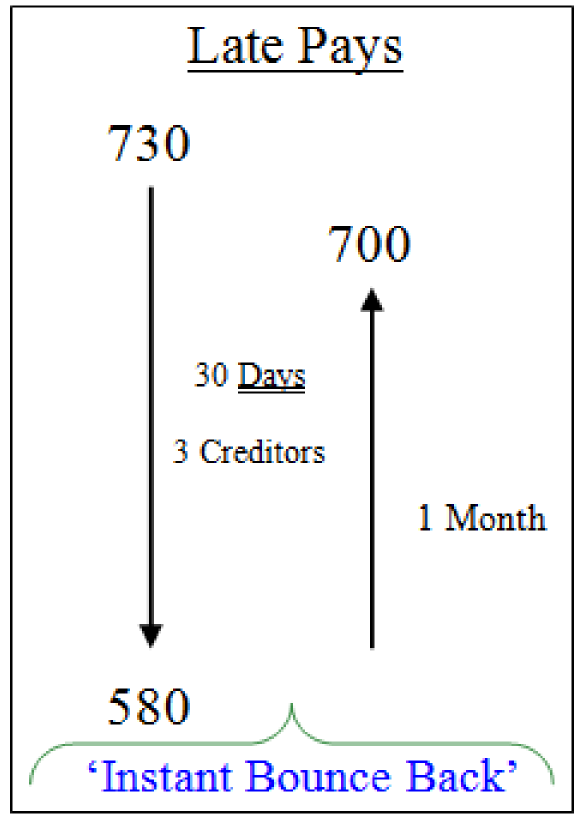
How You Pay = 35%





Capacity = 30%

Revolving Debt

- Credit Cards
- Home Equity L.O.C.
- Unsecured L.O.C

Limits	Balances	Available	Used Up
$10,000	$4,000	60%	40%

Lose/Gain Approximately 1 Point For Every Percent That You Use Up or Pay Down

Note: If You Grant The Member a Signature (Installment Loan) For $4,000, The Member's Score Will Increase Approximately 40% Immediately, As You Are Increasing Capacity

Length of Credit = 15%

Sears 10 Yrs = Oldest

HSBC 2 Yrs

Average Age = 6 Years

Member Adds New Trade

- Capital One = "0 Years"
- First USA = "0 Years"
- CU = "0 Years"
- Discover = "0 Years"

Average Age = 2 Years

Accumulation of Debt = 10%

Inquiries

Voluntary

- *List for 24 Months*
- *Scoring = Last 12 Months Only*
- *Each Inquiry = 5 Points*
- *Like Inquiries Count as 1*

Autos

Mortgages

Involuntary

Does not impact score

- *Account review*
- *Promotional*
- *Insurance inquiries*
- *Consumer inquiries*
- *Medical*
- *Credit counseling inquiries*
- *Employee inquiries*
- *Utilities*

New Trade Lines

Last

0 - 18 Months

Mix of Credit = 10%

Revolving | Installment | Mortgages

- The majority of debt should not be revolving
- Home Equity L.O.C.s are usually reported as revolving and can drive the score down
- Moving revolving to installment will increase score

Worth 20-25 Points + Frees Up Capacity

Factors With the Largest Impact on Credit Scores

35% How You Pay or Payment History
30% Capacity or Percent of Revolving Used Up

Much Lesser Impact

15% Length of Credit History Plus Opening New Credit
10% Accumulation of Debt or Opening new Account and Running Up Debt
10% Mix or Percent of Debt That's Revolving, Installment or Mortgage Debt

Components of a Credit Report

1. **Identity & Demographic**
   - Name/address/date of birth
   - Employment
2. **Score & Summary Section**
   - Credit score identified
   - Factors contributing to the score
   - Revolving and installment trades added up
3. **Trade lines**
   - Placement of information on reports
   - Creditors
   - Public Records/Collections
4. **Inquiries**
   - Voluntary versus involuntary
   - Like inquiries

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What it Takes to Get a Score

- Only 1 trade line
- 6 months of payment history
- Activity reported in the last 6 months

How Fast Your Score Can Change

- The member's score can change whenever the credit report changes.
- The member's score probably won't change much from one month to the next.
- Bankruptcies and other public records or collections can have a major impact on credit scores and it takes time to recover.
- Simply missing a payment can also impact the credit score. However, the score can recover quickly if the payment on the account is current, provided the credit report has substance.

Determining The Direction Of The Score

Questions?	Direction of Score
Does the member have recent late payments?	Down
Is the member a “B or C” paper and never missed a payment?	Down
Is the member a “C” paper and claimed bankruptcy in the recent past?	Up
Is the member a “C” paper and has collections in the recent past?	Up
Does the member have a lot of recent inquiries?	Down
Does the member have recent loans through sub-prime lenders? (Lenders of last resort)	Down
Does the member have low balances on revolving accounts opened in the last 3 yrs?	Up
Are the revolving debt maxed out within the last 12-18 months?	Down
Has the member opened up a lot of new accounts in a short time frame?	Down
Has the member refinanced revolving debt into installment debt?	Up
Does the member have more in revolving debt than installment debt?	Down

March Madness

WHAT ROAD TO CHOOSE

Understanding the Credit Score

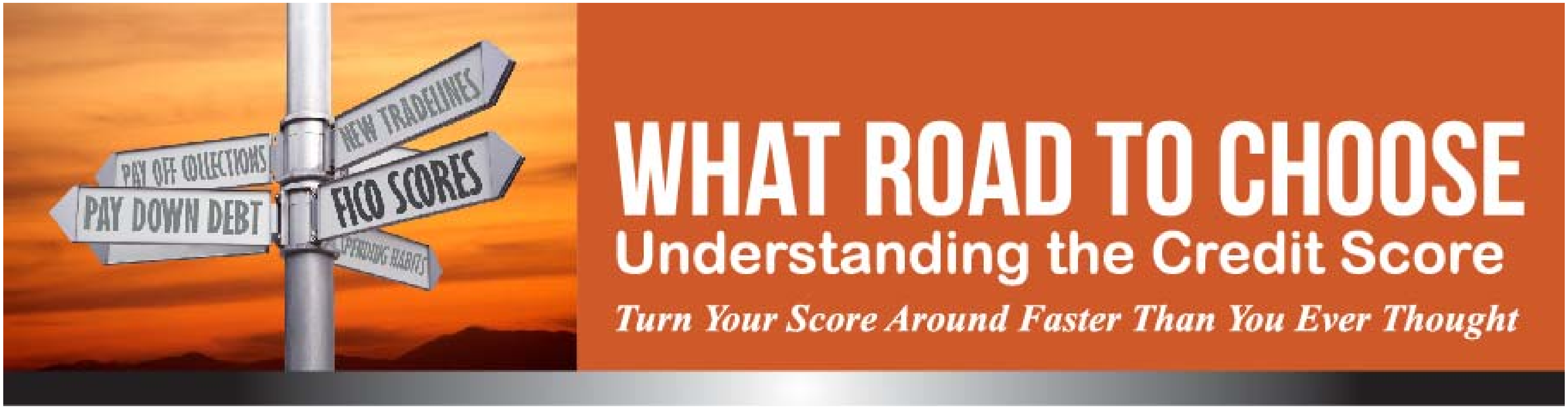
Turn Your Score Around Faster Than You Ever Thought

1. What Makes Up your Credit Score?

- 35% = Based on payment history (i.e. on-time pays or delinquencies)
  - More weight on current pay history
- 30% = Capacity (capacity is King)
- 15% = Length of credit
- 10% = Accumulation of debt in the last 12-18 months
  - # of inquiries
  - Opening dates
- 10% = Mix of credit
  - Installment (can raise) vs. revolving (can lower)
  - Finance company loans-They can lower your score

2. What Actions Will Hurt Your Score?

- Missing payments (Regardless of $ amounts, it can take 24 months to restore credit with one late payment)
- Credit cards at capacity (i.e. maxing out credit cards)
- Shopping for credit excessively
- Opening up numerous trades in a short time frame
- Having more revolving debts in relation to installment debts
- Closing credit cards out (this could lower available capacity)
- Borrowing from finance companies



3. How You Can Improve Your Score:

- Pay off or pay down on your credit cards
- Do not close credit cards because capacity may decrease
- Move your revolving debt into installment debt
- Continue to make payments on time (older late pays will become less significant with time)
- Slow down on opening new accounts
- Acquire a solid credit history with years of experience

4. Approximate Credit Weight for Each Year:

- 40% = Current to 12 months
- 30% = 13-24 months
- 20% = 25-36 months
- 10% = 37+ months

Using the Credit Report as an ‘Opportunity Sheet’

Calculating interest rates of the competition

- *Autos*
- *Mortgages*
- *Unsecured loans*

Trade in your credit card debt

Accessorize

Do you want fries with that?
Not Anymore!

What rate is your member paying the competition?
How much can we save them?

SUBNAME	SUBCODE	OPENED	HIGHCRED	TERMS	MAXDELQ	PAYPAT 1-12 MOP
ACCOUNT#		VERFIED	CREDLIM	PASTDUE	AMT-MOP	PAYPAT 13-24
ECOA COLLATRL/LOANTYPE		CLSD/PD	BALANCE	REMARKS		MO 30/60/90
GOODYEARCBNA	A	12/05	$1600			111111111111 R01
		7/11A	$1000	$0		111111111111
I CHARGE ACCOUNT			$ 950			48 0/ 0/ 0
5TH 3RD BK	B	2/10	$18.0K	72M310		111111111111 I01
		6/11A		$0		1111
I AUTOMOBILE			$15.5K			16 0/ 0/ 0
5TH 3RD BK	B	6/07	$24.0K	72M442		111111111111 I01
		6/11A		$0		111111111111
I AUTOMOBILE			$11.1K			48 0/ 0/ 0
CUFCTRBL	Q	3/07	$36.8K	180M373		111111111111 I01
		6/11A		$0		111111111111
I MANUFACTURED HOUS			$30.8K			48 0/ 0/ 0
KAY JEWELERS	J	10/06	$1562			111111111111 R01
		3/10A	$1562	$0		111111111111
			$1200			

show members what they can save

By Calculating Interest Rates of the Competition

Be Sure to Use a Texas Instuments BA II Plus Calculator!

NOTE: The credit report must show the following 3 factors:

- Gross loan amount
- Monthly payment (On mortgages, if the payment includes taxes and insurance. They must be backed out.)
- The term (You can only calculate the rate on installment loans.)

Step 1: Enter the high credit off the credit reports or original balance = $20,000

Step 2: Press PV (Present Value) ***PV=20000.00***

Step 3: Enter the number of months on loan = 60

Step 4: Press N ***N=60.00***

Step 5: Enter payment of loan = 444

Step 6: Press +/- (To make the payment negative)

If this is not completed, an ERROR 5 will appear when computing interest.

Step 7: Press PMT

Step 8: Press CPT (Compute)

Step 9: Press I/Y to figure the interest the member is paying at your competition.

*There may be a slight delay while calculating. ***I/Y= 11.91***

To compute the savings the member would receive by refinancing with the credit union...****Do not erase any of the above****

Step 10: Enter your current rate on loan = 5.95

Step 11: Press I/Y ***I/Y=5.95***

Step 12: Press CPT

Step 13: Press PMT (To calculate the payment at the credit union) **PMT= -386.19**

Step 14: Add old payment to new payment.

(This will figure the difference between the credit union & the competition = 149)

(-386.19+ 444 = 57.81)

Step 15: Multiply the number of payments left in the loan = 53

57.81 x 53 = $3,063.87

$3,063.87

HYLS – High Yield Lending Strategy

1. *Number of years as an active member*
2. *Total dollar amount on deposit with the credit union*
3. *Number of current & prior satisfactory loans in excess of $1,000 with the CU*
4. *Highest dollar loan amount the member has had with the credit union*
5. *Direct deposit*
6. *Length of residence*
7. *Length of employment*
8. *Valid credit score*
9. *Credit score with no credit flaws*
10. *Inquiries in the past 24 months*
11. *Number of open or closed trade lines in the past 24 months*
12. *Number of Open or Closed Trade Lines as a Percentage of the Member's Age*
13. *Total dollar amount past due with all creditors*
14. *Payment history on most recent auto loans*
15. *Payment History on the Last Prior Vehicle Loan*
16. *Loan to value on vehicle loan*
17. *Number of vehicle loans in the past 24 months*
18. *Loan amount versus term*
19. *New vehicle loan being purchased vs annual gross income*
20. *Total secured loan balances outstanding vs annual gross income*
21. *Debt to income ratio*
22. *Total outstanding unsecured debt vs annual gross income*
23. *Total unsecured dollar amount outstanding*
24. *Total mortgage debt vs annual gross income*
25. *Number of late payments on mortgage loans*
26. *Available equity in real estate*
27. *Cashing out real estate equity*

SAMPLE SCORE CARD

HYLS

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Log Off

HYLS Underwriting Guide

Scorecard for: Roseanne Example

How to Interpret the Adjusted Credit Score: [More]

New Loan Application

Top Positive Factors

25. Number of Current and Prior Satisfactory Loans in Excess of $1,000 w/the CU
7. Length of Time the Member has been employed at their Current Job and Previous Job
14. Payment History on the Most Recent Open Vehicle Loan - granted in the past 4 yrs
15. Payment History on the Last Prior Vehicle Loan
24. Total Mortgage Debt vs. Annual Gross Income

Top Negative Factors

25. Number of Late Payments on Mortgage Loans
11. Number of Open or Closed Trade Lines as a Percentage of Member's Age
13. Total Dollar Amount Past Due With All Creditors
8. Valid Credit Score
10. Inquiries on the Past 24 Months

Total Positive Points	455
Total Negative Points	-200
Total Factor Points	255
Credit Score	539
Adjusted Credit Score	794

Live Examples

- FICO, HYLS
- Opportunities
- How could we improve?
- Risk Based Pricing
- Remember the 4 C's: Cars, Credit Cards, and Checking Accounts, Consolidation

Wealth Builder

- Goal: Leave the member better than we found them
- Approve more loans
- Capitalize on opportunities from credit reports
- Utilize savings in payments to build wealth

Personality Traits

- Enjoy monetary rewards
- Positive, Yes we can attitude
- Love a Challenge
- Love to compete
- Goal oriented
- Feedback and Recognition
- Not Patient
- Find a way to get things done
- Great Listening Skills
- Believe and use the Credit Union's offerings
- Don't like paperwork

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Incentive Template

- Excel Template for front line team
- Another example:
  - CSE FCU pays for entire "Pay for Performance" program through its Gap earnings

INCENTIVE TRACKING SHEET

Employee: ______________________________

Name of Member	Account Number	(1) Referrals on Competitor Pay Offs of Vehicles RV's, Boats, etc.	(2) Competitor Buy Out (Not a Referral) Loan Officers or MSR's	(3) Mortgage	(4) MBI or GAP Insurance	(5) Debt Consolidation Buy Out	(6) Credit Cards Tellers, MSR's FSR's, etc.	(7) Home Equity	(8) Repo Auto Sold	(9) Score Enhancement	(10) Loan Goal Growth	Total
Incentives Of the Month *"This is reserved for any special products you are trying to get the employees to sell"*		$100 per referral Loan must be closed Primarily for Tellers, MSR's, etc.	**Competitor** **<u>Buy Out</u>** $2.50 - A+ & A $5.00 - B & C $7.50 - D & E per thousand paid off **<u>Example: "E"</u>** 15,000 GMAC P.O.= $112.50	**<u>Mortgage</u>** $100 Mortgage loan stolen	**GAP** **<u>Insurance</u>** $100 for every policy sold	**Debt** **Consolidation** **<u>Buyout</u>** $5.00 - A+ & A $10.00 - B & C $15.00 - D & E per thousand paid off	**Credit** **<u>Cards</u>** $25 each provided card is issued	**Home** **<u>Equity</u>** Any H.E. loan sold and closed $50	**<u>Repo Auto</u>** $250 for every repossessed auto sold at low blue book or better	**Score** **<u>Enhancement</u>** $25 per credit report pulled *(Provided employee goes over CBR with member while in the office.)*	**Loan Goal** **<u>Growth</u>** $100 = goal $200 = 125% of goal $300 = 150% of goal $500 = 200% of goal	

Thank You!!

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Questions???