

NCUA LETTER TO CREDIT UNIONS

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

DATE: November 2001 **LETTER NO.: 01-CU-17**

TO: Federally Insured Credit Unions

**SUBJ: Office of Credit Union Development
Program & Activity Report**

ENCL: Program & Activity Report, First Half of 2001

DEAR BOARD OF DIRECTORS:

Enclosed is the Program and Activity Report for the Office of Credit Union Development (OCUD) for the first half of 2001. The attached report reflects the agency's continuing commitment of making available credit union service to interested Americans from all walks of life.

Sincerely,

/s/
Dennis Dollar
Chairman

Enclosure

Introduction

The Office of Credit Union Development (OCUD) and NCUA regions work together to further the Agency's low-income credit union initiatives. It further provides support to the regions in their efforts in supervising small and low-income credit unions. OCUD administers the Community Development Revolving Loan Fund and acts as a liaison between NCUA, low-income designated credit unions, other government agencies, trade associations, and other interested parties.

OCUD's mission is to:

- Foster business development of credit unions by providing the guidance and education needed for the delivery of financial services.
- Facilitate the expansion of credit union services through the chartering of new credit unions and field of membership expansions.
- Coordinate efforts — with third-party organizations — to improve the viability and successful operation of credit unions.

Small Credit Union Program

The NCUA board approved a national Small Credit Union Program (SCUP) in 1999. The purpose of the SCUP is to facilitate the Board's goals of promoting the development of financially healthy small and low-income designated credit unions, and encourage the formation of newly chartered credit unions. This program was designed to provide assistance to credit unions that fall within the following criteria:

1. credit unions with assets under \$5 million;
2. newly chartered credit unions in operation less than 10 years and with assets under \$10 million; and
3. low income designated credit unions.

Credit unions that fall within the SCUP criteria (refer to above paragraph) can participate in the program and can contact their regional office to request assistance. There is no obligation for credit unions to participate in this program, but the program does provide the unique opportunity for those smaller credit unions to obtain advice and/or assistance in areas where they may need to strengthen their expertise.

Figure 1 shows the distribution of federal and state charters that are eligible and those credit unions that are participating in the regional SCUP as of June 30, 2001.

Figure 1

| | FCUs ¹ | FISCUs ² | Total |
|---|-------------------|---------------------|-------|
| Eligible to Participate In SCUP | 2,808 | 1,447 | 4,255 |
| Participating in the Regional SCUP as of 6/30/01 | 549 | 74 | 623 |

The number of credit unions participating in the SCUP has increased by 130 during 2001.

Specialized Assistance

The NCUA has 82 specialized field staff, located throughout the nation, to assist credit unions participating in SCUP and to facilitate regional SCUP workshops.

SCUP Workshops

During the first half of 2001, the regions held several workshops that were well attended by small asset-sized credit unions. The topics of each workshop vary and are well-received by the credit union attendees. The regions have scheduled 32 workshops

¹ Eligible federal credit union numbers were produced using June 30, 2001, call report data.

² Eligible federally insured state credit union numbers were produced using June 30, 2001, call report data.

to be held in 2001. Most of the workshops will be held in the next semi-annual period.

Field of Membership (FOM) – Underserved Areas Expansions

The OCUD provided information regarding FOM Expansion into underserved areas via the March 31, 2001, *Credit Union Opportunities Newsletter*. NCUA’s staff has also provided information relating to FOM expansion into underserved areas during the examination process. Because of the interest expressed by credit unions to serve the underserved population, as well as the information provided by the agency on how to expand into those areas, we see a sharp increase in the number of underserved areas expansions as shown in Figure 2.

Figure 2

| Period | 1/1/00 to 12/31/00 | 1/1/01 to 6/30/01 | 1/1/01 to 6/30/01 |
|--------------|------------------------|------------------------|-------------------|
| Region | # of Potential Members | # of Potential Members | # of Requests |
| I | 154,615 | 659,026 | 12 |
| II | 222,586 | 355,834 | 4 |
| III | 665,245 | 863,461 | 26 |
| IV | 217,358 | 557,942 | 13 |
| V | 948,534 | 1,239,869 | 26 |
| VI | 161,437 | 1,295,975 | 16 |
| Total | 2,369,775 | 4,972,107 | 97 |

Low Income

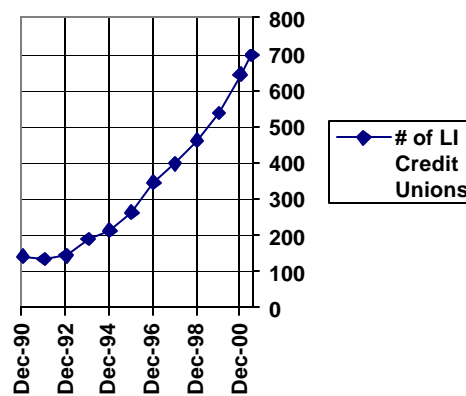
“Low-income” (LI) is an official NCUA designation granted to a credit union that serves a membership of which more than half its members earn less than 80 percent of the average for all wage earners or those members whose annual household income falls at or below 80 percent of the median household income for the nation. These income measurement standards can be obtained from OCUD. Credit unions with this designation are measured against the

same standards of financial soundness and operational professionalism as other credit unions, and are granted these benefits:

1. *Nonmember Deposits.* Greater authority to accept deposits from nonmembers.
2. *Participation in the Community Development Revolving Loan Fund (Fund).* Access to low-interest loans, deposits, and technical assistance from the Fund.
3. *Special Field of Membership Rules.* Flexibility in defining FOM.
4. *Secondary Capital.* Ability to include this account (as outlined in the NCUA Rules and Regulations Part 701.34 and 702) in the credit union’s net worth.
5. *Member Business Loans.* Exception to the aggregate loan limit for business loans.

The number of LI designated credit unions (LICUs) increased by 53 during the first six months of 2001. As of June 30, 2001, the number of LI designated credit union was 698. Figure 3 illustrates the growth of the number of LI designated credit unions.

Figure 3



Regional staff provided guidance to credit unions wishing to become LI designated during the last several months. Figure 4 illustrates the growth of LICUs by region.

Figure 4

| Region | 1998 | 1999 | 2000 | 6/2001 |
|--------------------|------------|------------|------------|------------|
| I | 54 | 58 | 64 | 64 |
| II | 49 | 54 | 69 | 89 |
| III | 95 | 103 | 145 | 144 |
| IV | 48 | 58 | 65 | 85 |
| V | 162 | 178 | 205 | 214 |
| VI | 54 | 87 | 97 | 102 |
| Total LICUs | 462 | 538 | 645 | 698 |

Financial Growth

Figure 5 displays how LICUs compared to all Federally Insured Credit Unions in various growth rate areas at June 30, 2001³.

Figure 5

| Growth % Rates Semiannual June 30, 2001 FPR (annualized)⁴ | | |
|---|--------------|--------------------------------------|
| | LICUs | All Credit Unions⁵ |
| Share Growth | 16.86 | 19.46 |
| Net Worth Growth | 8.04 | 8.55 |
| Loan Growth | 5.82 | 5.63 |
| Asset Growth | 15.30 | 17.84 |
| Investment Growth | 44.34 | 51.70 |
| Current Member Growth | 3.96 | 1.50 |
| Potential Mbr. Growth | 14.04 | 7.00 |

Asset Growth

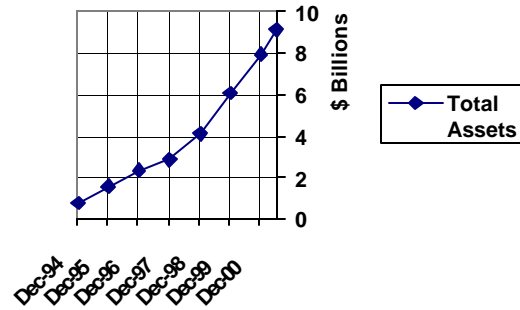
Credit unions with the LI designation had combined assets of \$9.1 billion as of June 30, 2001. Figure 6 illustrates a \$1.2 billion growth in total assets of LICUs during the first half of 2001 with \$47 million of the growth attributed to the LI designation of 53 credit unions.

³ The information displayed in this table and subsequent charts and graphs reflect data from the June 30, 2001, Financial Performance Reports.

⁴ The June 30, 2001, Financial Performance Reports' growth rates are annualized for comparison purposes.

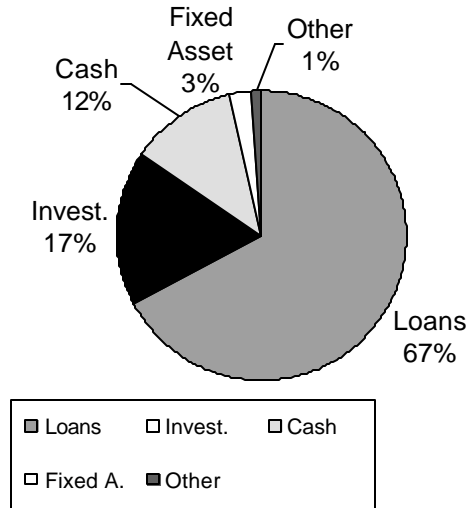
⁵ All Federally Insured Credit Unions

Figure 6



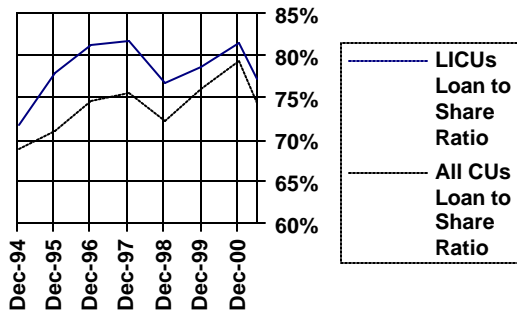
The asset structure for all LICUs is shown in Figure 7. LICUs have an average loan to asset ratio of 67 percent, which compares to the 65 percent ratio of all federally insured credit unions.

Figure 7



All credit unions primarily fund loan programs with member deposits. Figure 8 illustrates the loan to share ratio trend for LICUs and all federally insured credit unions. The LICUs historically have higher loan to share ratios.

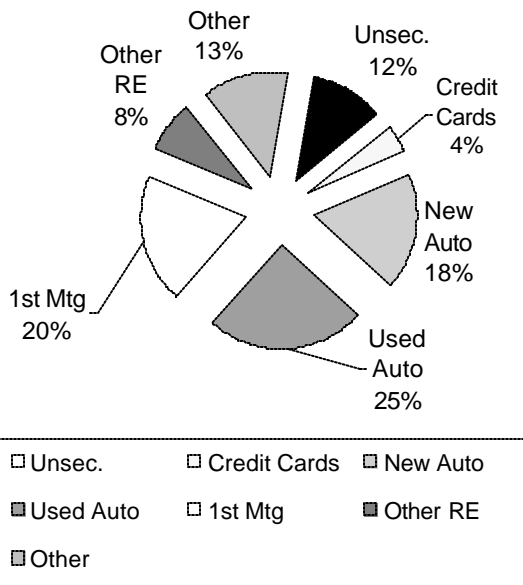
Figure 8



Loans

LICUs reported holding \$6.2 billion in loans as of June 30, 2001. Their loan portfolio mix for June 2001 is illustrated in Figure 9. There were minimal changes to the portfolio mix during the last 6 months.

Figure 9

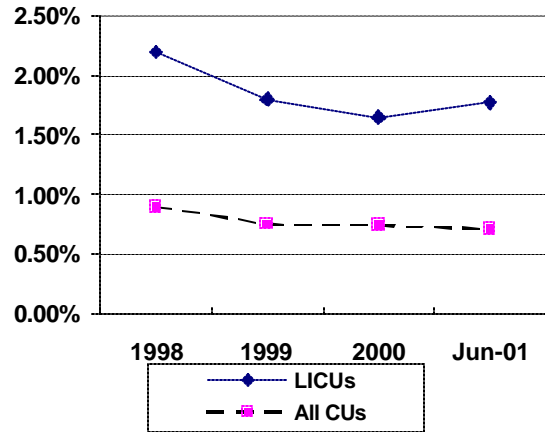


Loan Quality

The June 30, 2001, delinquent loan to total loans ratio for LICUs is 1.77 percent. The delinquency ratio for LICUs has historically been one percent higher than the ratio for all federally insured credit unions as shown in Figure

10. The LICU delinquency ratio has returned to the higher level recorded in December 1999.

Figure 10



The LICU delinquency ratio in the 2 to 6 months range has grown by 0.07 percent with decreases of 0.06 percent in the 6 to 12 months range and 0.05 percent in the greater than 12 months range during the last 18 months. Figure 11 lists the June 30, 2001, delinquency ratios for each range.

Figure 11

| Delinquency Range | LI Credit Unions | All Credit Unions |
|--------------------------|------------------|-------------------|
| 2 to 6 months | 1.14 | 0.48 |
| 6 to 12 months | 0.40 | 0.16 |
| 12 months and more | 0.23 | 0.06 |
| Total Delinquency | 1.77 | 0.71 |

Reasons for the higher delinquency ratio found in LICUs could include:

- The LICU’s loan portfolio mix consists of 3 percent more in the unsecured credit category (e.g., unsecured and credit cards) and 5 percent more in the used auto loan category than all credit unions.
- The LICUs members’ income levels are lower which restricts

the liquid funds of members that are used for loan repayments.

- The amount of outstanding loans subject to bankruptcy has risen by .02 percent in 2001 to 0.28 percent.

The charge-off ratios for both LICUs and federally insured credit unions are shown in Figure 12. The LICUs net charge-offs ratio is comparable with the ratio of all federally insured credit unions even though the delinquency ratio for LICUs is 1 percent higher. The amount of loans charged-off during the first six months of 2001 due to bankruptcy for LICUs was 28.5 percent whereas the ratio was 41 percent for all federally insured credit unions. Therefore, LICUs had a greater opportunity to collect from the delinquent members due to the decreased level of bankruptcies.

Figure 12

| | Percentage of Average Loans | | | |
|-----------------------------|-----------------------------|-----------|--------------|--------------|
| | 2001 LICU | 2000 LICU | 2001 All CUs | 2000 All CUs |
| Charge-off ratio | 0.83 | *6 | 0.52 | 0.50 |
| Recoveries ratio | 0.15 | * | 0.09 | 0.08 |
| Net Charge-off ratio | 0.68 | 0.69 | 0.43 | 0.42 |

Investments

The June 30, 2001, combined financials for LICUs indicate that the investment portfolio tends to be more liquid (refer to Figure 14 for investment mix) than the portfolio held by all federally insured credit unions.

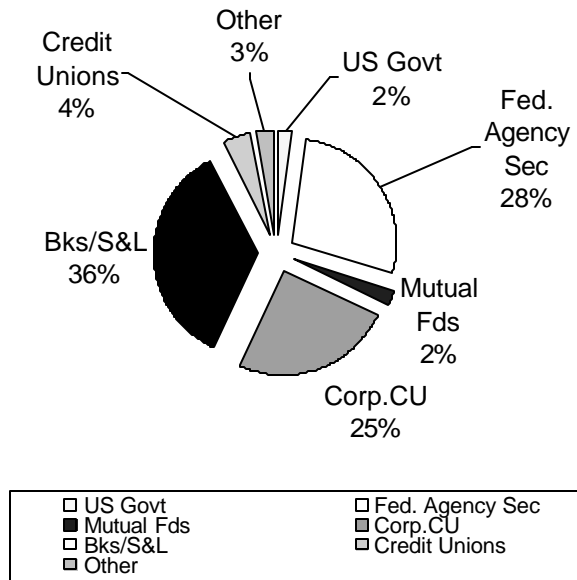
⁶ Data is unreliable due to growth in the number of credit unions and loans that caused the average loans amount to be skewed and to absence of this information in the December 31, 2000, report. However, the net charge-offs ratio is based on the December 31, 2000, report.

Figure 13

| Investment Maturity or Repricing Interval | Percentage of Total Investments June 2001 | |
|---|---|---------|
| | LICUs | All CUs |
| <1 year | 73% | 63% |
| 1 to 3 years | 18% | 23% |
| 3 to 10 years | 8% | 12% |
| > 10 years | 1% | 2% |

LICUs reported \$1.5 billion in investments at June 30, 2001. Changes in the investment portfolio mix during 2001 included a two percent movement from the federal agency securities portfolio to the corporate credit union investment portfolio and a 6 percent movement from the other category to banks/S&Ls. The portfolio mix for LICUs is illustrated in Figure 14.

Figure 14



The more simplified LICUs investment portfolio mix differs from all federally insured credit unions as follows:

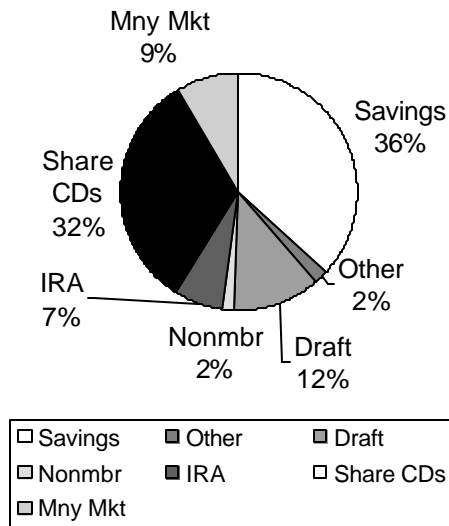
- Investments in banks/S&Ls are 20 percent higher in LICUs than all credit unions.

- Investments in Federal Agency Securities are 21 percent lower in LICUs than all credit unions.
- Investments in Corporate Credit Unions are 6 percent higher in LICUs than all credit unions.

Shares

LICUs promote their savings programs among their membership. As of June 30, 2001, LICUs report over \$8 billion in savings and deposits. Another source of deposits can be obtained from nonmembers. There were no changes to the share portfolio mix during the last six months. Figure 15 shows the share portfolio mix for LICUs.

Figure 15



Notable differences in the share portfolio mix between the LICUs and all credit unions include:

- The LICUs portfolio has 5 percent less in the money market category than all credit unions.
- The LICUs portfolio has 4 percent more in the share certificates category than all credit unions.

Net Worth

Low-income credit unions as a group are well capitalized with a net worth ratio of 11 percent. Figure 16 lists Net Worth⁷ to Assets ratios over the past eight (8) periods. LICUs Net Worth ratios continue to be at the same level as all credit unions; however the Net Worth ratio for LICUs includes the secondary capital account. The total amount of secondary capital accounts increased by 9.4 percent (annualized rate) during the first six months of 2001 as shown in Figure 17.

Figure 16

| | LICUs Net Worth Ratio (percent) | All CUs Net Worth Ratio (percent) |
|---------------|---------------------------------|-----------------------------------|
| December 1994 | 9.7 | 9.5 |
| December 1995 | 9.2 | 10.3 |
| December 1996 | 10.7 | 10.8 |
| December 1997 | 11.1 | 11.1 |
| December 1998 | 10.8 | 10.8 |
| December 1999 | 11.1 | 11.0 |
| December 2000 | 11.3 | 11.4 |
| June 2001 | 11.0 | 11.0 |

Figure 17

| | 1999 | 2000 | June 2001 |
|----------------------|-----------|-----------|-----------|
| Secondary Capital \$ | 4,530,823 | 7,965,840 | 8,339,354 |

Earnings

The combined 2001 Return on Average Assets (ROA) ratio for all LICUs was 0.83 percent. This compares to the 0.96 percent ROA recorded by the combined federally

⁷ Net worth includes the retained earnings balance of the credit union at quarter end as determined by generally accepted accounting principles. For LICUs, net worth also includes secondary capital accounts that are uninsured and subordinate to all other claims, including claims of creditors, shareholders, and the NCUSIF.

insured credit unions. Figure 18 illustrates the composition of the ROA. Refer to subsequent topic headings for more detail.

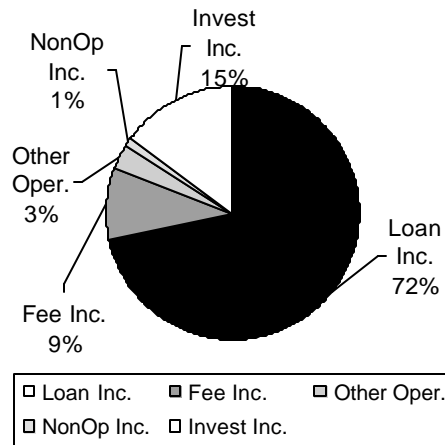
Figure 18

| | Percentage of Average Assets | | | | |
|---|------------------------------|-----------|-----------|-----------|--------------|
| | 1998 LICU | 1999 LICU | 2000 LICU | 6/01 LICU | 6/01 All CUs |
| Gross Income | 10.2% | 10.1% | 9.9% | 9.1% | 8.2% |
| Provision for Loan Loss Expenses | 0.7% | 0.7% | 0.6% | 0.5% | 0.3% |
| Cost of Funds Expenses | 3.7% | 3.7% | 3.7% | 3.5% | 3.6% |
| Operating Expenses | 4.9% | 4.9% | 4.7% | 4.3% | 3.4% |
| ROA | 0.9% | 0.9% | 0.9% | 0.8% | 0.9% |

Gross Income

LICUs Gross Income to Average Assets ratio declined from 9.9 percent at year-end 2000 to 9.06 percent as of June 30, 2001. The main reason for the decline was that the yield on average loans declined by 0.7 percent in the first six months of 2001. However the percentage is still higher than the percentage for all credit unions. LICUs have a larger percentage of assets in loans that usually earn higher rates than investments. Figure 19 illustrates the breakdown of the elements that compose LICUs' gross income.

Figure 19



Expenses

Figure 20 shows the breakdown of expenses for LICUs. Their ratios are comparable with all federally insured credit unions.

Figure 20

| Expenses to Total Expenses Ratio | LI CUs 2000 | LI CUs 2001 | All CUs 2000 | All CUs 2001 |
|----------------------------------|-------------|-------------|--------------|--------------|
| Employee Comp & Benefits | 44.4 | 45.1 | 44.9 | 45.4 |
| Travel & Conference | 1.4 | 1.5 | 1.5 | 1.4 |
| Office Occupancy | 5.7 | 6.0 | 5.9 | 6.0 |
| Office Operation | 19.6 | 19.8 | 20.5 | 20.4 |
| Education & Promotion | 2.8 | 2.8 | 3.0 | 3.1 |
| Loan Servicing | 3.2 | 3.2 | 4.7 | 4.6 |
| Professional & Outside Services | 6.5 | 6.8 | 6.7 | 6.8 |
| Provision for Loan Losses | 11.0 | 9.4 | 8.6 | 8.1 |
| Member Insurance | 1.6 | 1.8 | 1.1 | 1.0 |
| Operating | 0.7 | 0.6 | 0.6 | 0.5 |
| Misc. | 2.9 | 2.9 | 2.7 | 2.7 |

There had been historically a larger percentage in the Provision for Loan Loss (PLL) expense category for LICUs than all federally insured credit unions. The PLL expense is used to record the periodic charge(s) to operating expense necessary to maintain a reasonable Allowance for Loan Losses (ALL) account. The ALL account balance represents a valuation allowance showing management's judgment as to probable losses that may be incurred in the normal payoff of outstanding loans, both current and delinquent. LICUs historically have carried a higher percentage of delinquent loans than all credit unions; therefore the percentage of the PLL expense to their total expenses ratio is higher to cover the additional probable losses from delinquent loans.

Cost of Funds

The LICUs June 2001 Cost of Funds to Average Assets ratio is comparable with all federally insured credit unions (refer to Figure 18).

Community Development Revolving Loan Fund

Introduction

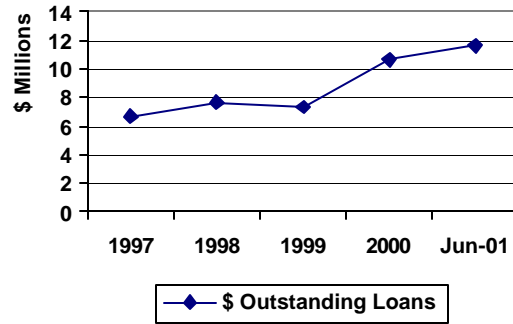
The Office of Credit Union Development administers the Community Development Revolving Loan Fund (Fund). The Fund is a source of low interest loans and technical assistance grants to low-income designated credit unions. The Fund's objective is to foster community development through the improvement of credit union operations and service to members and community.

Loan Program

The Fund granted 21 loans totaling \$2,507,000 during the first half of 2001. The Fund's loan portfolio at June 30, 2001, had 95 loans with outstanding balances totaling \$11,651,448. At that time, the Fund's

loan demand exceeded available resources. Figure 21 shows the amount of loans approved since 1997.

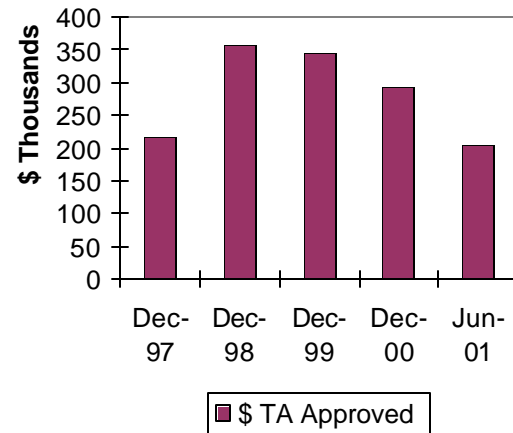
Figure 21



Technical Assistance Grant Program

The Fund's Technical Assistance (TA) Grant Program provides operational funding for training, marketing, audits, strategic planning and other needed items during 2001. Overall the TA program received 132 requests, totaling \$555,482. In all, 93 grants were approved totaling \$203,446 during the first half of 2001. Figure 22 shows the amount of grants awarded credit unions since 1997.

Figure 22



Student Internship Program

The NCUA introduced the 12-week summer Student Internship Program in 1998. The program is a stipend grant-assisted program. The program encourages collaboration and coordination between credit unions, colleges and universities.

During the summer of 2001, 52 credit unions – 26 host credit unions and 26 partner credit unions – participated in the program. The Community Development Revolving Loan Fund's Technical Assistance Program awarded \$65,000 in college internship stipend grants.

Program Objectives

The program has three objectives:

- introduce colleges, universities, and their students to credit union philosophy and to possible career opportunities in credit unions;
- foster credit union development through the sharing of operational methods and best practices; and,
- improve the safety and soundness of credit unions.

Program Requirements

The general requirement for participation in this program is: the student must be a business, finance, economic or accounting major attending a college or university full-time and the host credit union must be participating in NCUA's Low-Income Designation Program.

For more information regarding the Fund and its programs, contact your NCUA regional office.