

# NCUA LETTER TO FEDERAL CREDIT UNIONS

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

**DATE:** May 2003                      **LETTER NO.:** 03-FCU-04  
**TO:** All Federal Credit Unions  
**SUBJ:** Credit Union Development Initiatives  
**ENCL:** Yearend 2002 Credit Union Development  
Program & Activity Report

**DEAR BOARD OF DIRECTORS:**

Enclosed is NCUA's credit union development program and activity report for calendar year 2002. We are pleased to report that the agency's initiatives to facilitate the efforts of credit unions to expand their membership base and provide access to low-cost financial services and products are achieving impressive results.

Among the numerous programs incorporated within the agency's Access Across America initiative are the Small Credit Union Program and Low-Income Credit Union Program. These programs, as well as the agency's efforts to facilitate partnerships, are designed to foster business development of credit unions and to create economic empowerment for people from all walks of life by providing access to affordable credit union services and products especially in underserved neighborhoods and communities.

I encourage you to consider the potential benefits the programs described in the attached report may provide your credit union and its surrounding community.

Sincerely,

Dennis Dollar  
Chairman

Enclosure

### **Access Across America Initiative**

The Access Across America Initiative focuses on creating economic empowerment through credit union access into neighborhoods and communities lacking access to low-cost financial services. Different aspects of this initiative are described in subsequent sections of this report and are listed below:

- *Public and Private Partnerships.* The Office of Credit Union Development (OCUD) and regional offices have been facilitating partnerships between organizations and credit unions. The program is designed to partner with key federal departments and agencies to counter the growing predatory lending problem in America as well as broaden access to affordable financial services to underserved communities. There are both governmental and non-governmental resources for credit unions. These resources include nonmember deposits, capital grants, loans, secondary capital, loan guarantees, networking opportunities, and various other types of technical assistance. Resources available for credit unions are featured in periodicals published by the OCUD and available on the NCUA Web site. Refer to the Appendix for the Web address.
- *Field of Membership Expansions into Underserved Areas.* Many federal credit unions are seeking new membership groups to serve. In response to this need and to facilitate outreach to underserved communities, the NCUA Board approved flexible policies to make expansion into investment (underserved) areas less burdensome. Investment areas can be found in both rural and urban areas. Any federal credit union may include in its field of membership, regardless of size, location, or charter type, communities satisfying the definition for serving underserved (investment) areas in the Federal Credit Union Act. Today over 90 million Americans reside in investment areas. Over 23.5 million residents of underserved areas were added to credit union fields of membership during 2002.
- *Small Credit Union Program.* The Small Credit Union Program (SCUP), with implementation by the regions and monitoring from the Office of Credit Union Development (OCUD), promotes credit union development. The main objective of SCUP is to promote successful, financially healthy small credit unions through appropriate use of technical and financial assistance and partnerships. SCUP participation is voluntary. Not all eligible credit unions are participating in the program. As of December 31, 2002, 841 of the 3,796 eligible credit unions are participating in the SCUP.
- *Low Income Credit Union (LICU) Program.* OCUD administers the Community Development Revolving Loan Fund (Fund). The Fund's objective is to foster community development through the improvement of credit union operations and service to members and community. The Fund is a source of low interest loans and technical assistance (TA) grants to low-income designated credit unions. LICUs financial accomplishments are outlined in this report. Credit unions can either contact their regional office or OCUD for more information regarding receiving a low-income designation. Income derived from the loans and congressional appropriations fund the TA program. Congress appropriated an additional \$350,000 for TA and \$650,000 for loans to be used in 2002.

## **Partnerships**

OCUD and the regional offices have facilitated several partnerships during 2002. Examples of partnership activities that have been fostered include:

*Department of Agriculture:* Credit unions can participate in the USDA Rural Housing Service, Rural Business—Cooperative Service and the Rural Community Development Initiative.

*Community Development Financial Institutions:* CDFI selected 21 credit unions for awards in 2002 amounting to nearly \$3.7 million. The list of certified credit unions is displayed on the CDFI Web site. Refer to the Appendix for the Web address.

*Department of Housing and Urban Development:* HUD has programs for community and economic development ideal for credit union-community partnerships to provide financial literacy, first-time home buying, home improvement, and home ownership counseling programs.

*Internal Revenue Service:* IRS has embarked on a nationwide partnership initiative to help families with low- to moderate-income build assets and increase financial literacy. This partnership is in conjunction with the IRS' well-established Voluntary Income Tax Assistance (VITA) Program initiative.

*Neighborhood Reinvestment Corporation:* NRC is a network of community-based organizations that facilitates community-revitalization initiatives. Information can be found on the NRC Web site. See the Appendix for the Web address.

*Small Business Administration:* Credit union small business lending received a monumental boost with the recently issued opinion by the Small Business Administration (SBA) that all credit unions can participate in SBA's 7(a)

loan program. Currently, about 75 community chartered credit unions are SBA lenders. The SBA 7(a) program will allow more credit unions to positively serve their members and impact their communities through being a conduit for start-up business capital. Information regarding SBA programs can be found on their Web site. SBA's Web address is shown in the Appendix.

## **Field of Membership (FOM) – Underserved Areas Expansions**

NCUA continues to provide information relating to FOM expansion into underserved areas during the examination process and during workshops. The FOM underserved areas expansion activity for the last three years is shown in Figure 1.

NCUA will continue to highlight the need to bring credit union service to underserved communities through the *Access Across America* initiative.

**Figure 1**

<b>Period</b>	<b>1/1/00 to 12/31/00</b>	<b>1/1/01 to 12/31/01</b>	<b>1/1/02 to 12/31/02</b>
Region	# of Potential Members	# of Potential Members	# of Potential Members
I	154,615	754,458	1,749,268
II	222,586	1,440,625	5,705,478
III	665,245	4,283,816	3,489,840
IV	217,358	1,766,971	4,234,721
V	948,534	5,650,892	5,578,120
VI	161,437	2,229,875	2,793,646
<b>Total</b>	<b>2,369,775</b>	<b>16,126,637</b>	<b>23,551,073</b>

## **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:

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

Credit unions that fall within the SCUP criteria (refer to prior 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 2 shows the total number of all federally insured credit unions that are eligible and those credit unions that are participating in the regional SCUP as of December 31, 2002.

**Figure 2**

	<b>Eligible to Participate in SCUP</b>	<b>Participating in SCUP</b>
<b>Total at Dec-01<sup>1</sup></b>	4,381	721
<b>Total at Dec 02<sup>2</sup></b>	3,796	841

<sup>1</sup> Eligible federally insured credit unions' numbers were produced using December 31, 2001, call report data.

<sup>2</sup> Eligible federally insured credit unions' numbers were produced using December 31, 2002, call report data.

The number of credit unions participating in the SCUP has increased by 120 during 2002.

Assistance is also provided to groups interested in chartering a credit union. There were 10 credit unions chartered during 2002 – seven federal and three state charters.

***Specialized Assistance***

The NCUA has 77 specialized field staff, located throughout the nation, to assist credit unions participating in SCUP and to facilitate regional SCUP workshops.

***SCUP Workshops***

The regions completed 49 workshops that were attended **by more than 2,290 credit union representatives**. These workshops were targeted toward assisting credit unions to reverse adverse trends caused by the current economy and to correct safety and soundness issues that if left unresolved can result in the cancellation of the charter, reduction of the CAMEL composite code, and/or reduction of the net worth ratio.

**Community Development Revolving Loan Fund**

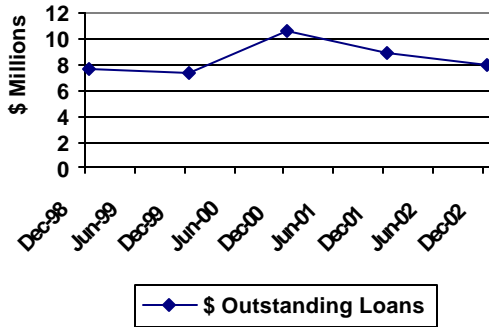
The OCUD administers the Community Development Revolving Loan Fund (Fund). The Fund is a source of low - interest loans and technical assistance grants to low-income designated credit unions. The Fund's objective is to foster community development through the improvement of credit union operations and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

**Loan Program**

The Fund approved 24 loans totaling \$3.3 million during 2002. The Fund's loan portfolio at December 31, 2002, had 77 loans with outstanding balances totaling \$7,979,067. Economic factors have impacted credit unions' liquidity levels and ability to

arbitrage the loan funds; therefore current loan demand is low. Figure 3 shows the amount of loans outstanding since 1998.

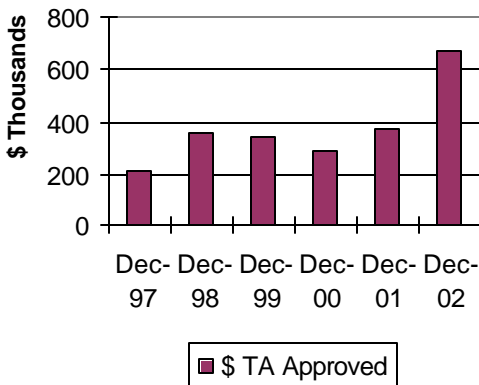
**Figure 3**



**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 2002. During 2002, the Fund received 274 technical assistance requests totaling \$1.7 million and approved 230 requests amounting to \$668,044. Figure 4 shows the amount of grants awarded credit unions since 1997.

**Figure 4**



**Low Income Designation**

“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 in addition 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 ratio computation.
5. *Member Business Loans.* Exception to the aggregate loan limit for business loans.

The number of LI designated credit unions (LICUs) increased from 789 at the end 2001 to 913 at December 31, 2002, for a net increase of 124 credit unions during 2002. LICU activity during 2002 consisted of the following: 145 new designations, 7 new charters, 16 mergers and 12 liquidations. Figure 5 illustrates the growth of the number of LI designated credit unions. A list of LI designated credit unions can be found on the NCUA Web site. See the Appendix for the Web address.

**Figure 5**

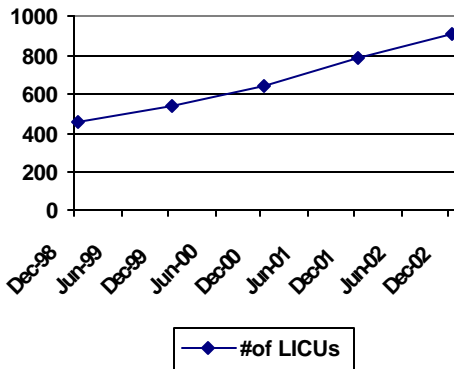


Figure 6 illustrates the growth of LICUs by region.

**Figure 6**

Region	1999	2000	2001	2002
I	58	64	62	69
II	54	69	122	137
III	103	145	171	216
IV	58	65	98	138
V	178	205	223	236
VI	87	97	113	117
<b>Total LICUs</b>	<b>538</b>	<b>645</b>	<b>789</b>	<b>913</b>

**Financial Growth<sup>3</sup>**

Figure 7 displays how LICUs compared to all federally insured credit unions in various growth rate areas at December 31, 2002.

Of special note is the sharp increase of potential members added to credit unions' charters. As stated in previous section, credit unions have added underserved areas to their membership (refer to Figure 1).

<sup>3</sup> The statistics displayed in this table and subsequent charts and graphs reflect data reported on Financial Performance Reports by the same credit unions for the periods December 31, 2001, and December 31, 2002.

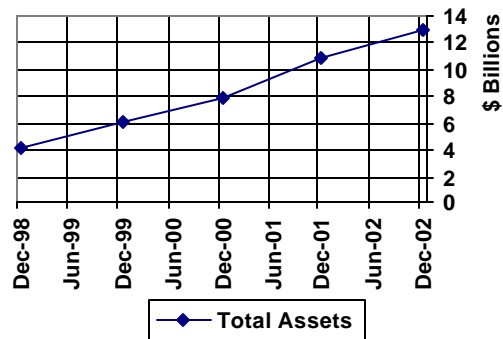
**Figure 7**

Growth % Rates (Annualized)		
	LICUs	All Credit Unions <sup>4</sup>
Share Growth	9.3	10.8
Net Worth Growth	8.9	9.9
Loan Growth	6.9	6.3
Asset Growth	9.5	11.1
Investment Growth	18.9	25.3
Current Member Growth	3.4	2.0
Potential Mbr. Growth	13.4	33.9

**Assets**

The assets of LI designated credit unions increased \$2 billion during 2002, from \$10.9 billion at yearend 2001 to \$12.9 billion as of December 31, 2002. Nearly 55 percent of the growth (\$1.1 billion) was attributed to 145 new designations during 2002. Figure 8 illustrates the growth in total assets of LICUs since 1998.

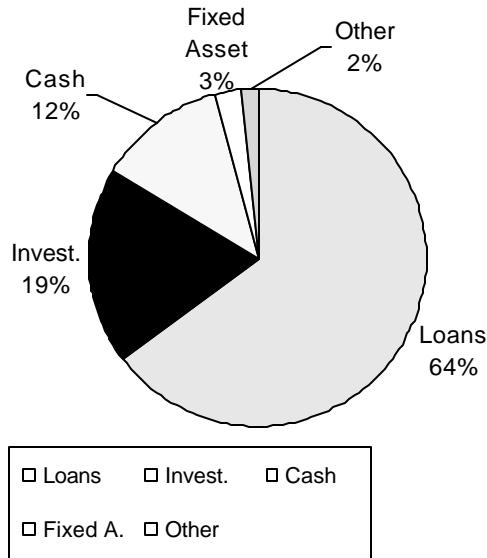
**Figure 8**



The asset structure for all LICUs is shown in Figure 9. LICUs have a loan to assets ratio of 65.2 percent, which compares to the 61.5 percent ratio of all federally insured credit unions.

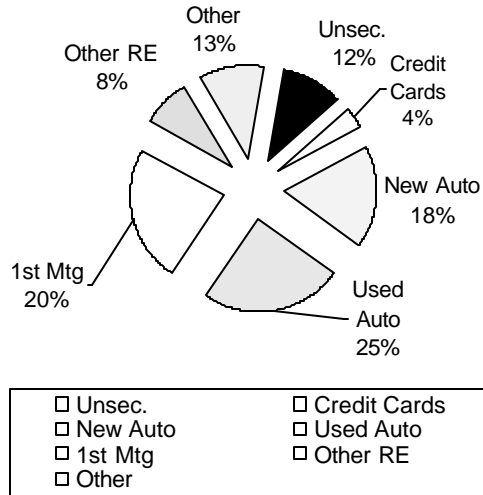
<sup>4</sup> All federally insured credit unions.

**Figure 9**



no material changes to the portfolio mix during the last 6 months.

**Figure 11**

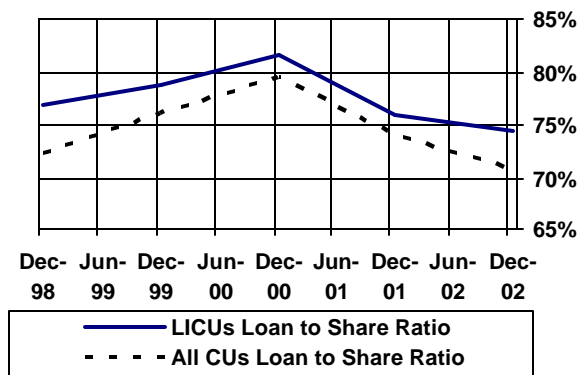


All credit unions primarily fund loan programs with member deposits. Figure 10 illustrates the loan to share ratio trend for LICUs and all federally insured credit unions. The LICUs historically have higher loan to share ratios than all federally insured credit unions.

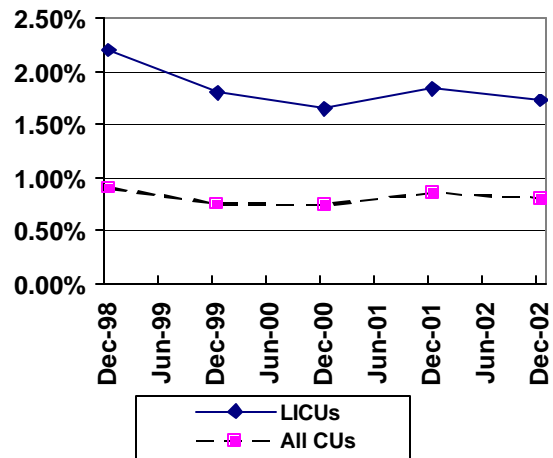
**Loan Quality**

The December 31, 2002, delinquent loan to total loans ratio for LICUs is 1.73 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 12.

**Figure 10**



**Figure 12**



**Loans**

LICUs reported holding \$8.4 billion in loans as of December 31, 2002. Their loan portfolio mix for December 2002 is illustrated in Figure 11. There were

Reasons for the higher delinquency ratio found in LICUs appear to be:

- The LICU's loan portfolio mix consists of four percent more in the unsecured credit category (e.g., unsecured and credit cards) and four percent more in the used auto loan category than all credit unions. In addition, the LICU's loan portfolio mix consists of 15 percent less in the real estate loans category.
- The LICUs members' income levels are lower which restricts the liquid funds of members that are used for loan repayments.

The delinquency ratio of the low-income credit unions increased slightly (.04 percent) during 2002 while the delinquent ratio for all federally insured credit unions declined (.02 percent) slightly for the same period. Figure 13 lists the December 31, 2002, delinquency ratios for each range.

**Figure 13**

Delinquency Range	LI Credit Unions	All Credit Unions
2 to 6 months	1.09	0.75
6 to 12 months	0.42	0.21
12 months and more	0.22	0.04
<b>Total Delinquency</b>	<b>1.73</b>	<b>0.80</b>

The charge-off ratios for both LICUs and federally insured credit unions are shown in Figure 14. 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 nearly one percent higher (0.93 percent). The amount of loans charged-off during 2002 due to bankruptcy for LICUs was 37.6 percent whereas the ratio was 39.1

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 14**

	Percentage of Average Loans			
	Dec 01 LICU	Dec 02 LICU	Dec 01 All CUs	Dec 02 All CUs
<b>Charge-off ratio</b>	0.81	0.86	0.54	0.60
<b>Recoveries ratio</b>	0.15	0.15	0.08	0.09
<b>Net Charge-off ratio</b>	0.66	0.71	0.46	0.51

**Investments**

The December 31, 2002, combined financials for LICUs indicate that the investment portfolio tends to be slightly less liquid (refer to Figure 15 for investment mix) than the portfolio held by all federally insured credit unions.

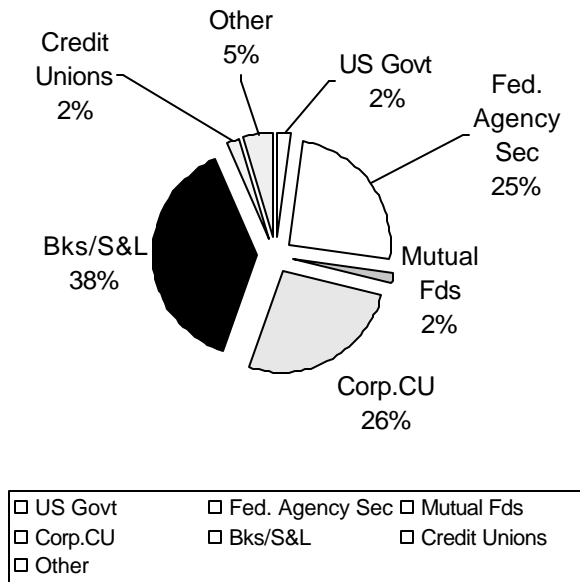
**Figure 15**

Maturity or Repricing Period	Percentage of Total Investments 2002	
	LICUs	All CUs
<1 year	52.0	55.1
1 to 3 years	34.0	32.0
3 to 10 years	12.2	11.7
> 10 years	1.8	1.2

LICUs reported \$2.5 billion in investments at December 31, 2002. Changes in the investment portfolio mix during 2002 included a one percent movement to the banks/S&Ls from Federal Agency Securities category. The portfolio mix for LICUs is illustrated in Figure 16.



**Figure 16**



The LICU's investment portfolio mix differs from all federally insured credit unions as follows:

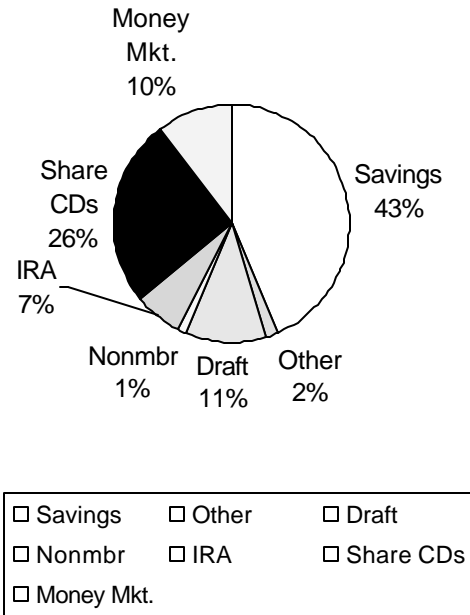
- Investments in banks/S&Ls are 21.6 percent higher in LICUs than all credit unions.
- Investments in Federal Agency Securities are 27.9 percent lower in LICUs than all credit unions.
- Investments in corporate credit unions are 7.3 percent higher in LICUs than all credit unions.

**Shares**

LICUs promote their savings programs among their membership. As of December 31, 2002, LICUs report over \$11.3 billion in savings and deposits. Another source of deposits can be obtained from nonmembers. Changes in the share portfolio mix during 2002 included a four percent movement from share certificates that was divided into the following share categories: two percent increase in regular savings category, one percent increase in IRAs, and a one percent increase in the money market

category. Figure 17 shows the share portfolio mix for LICUs.

**Figure 17**



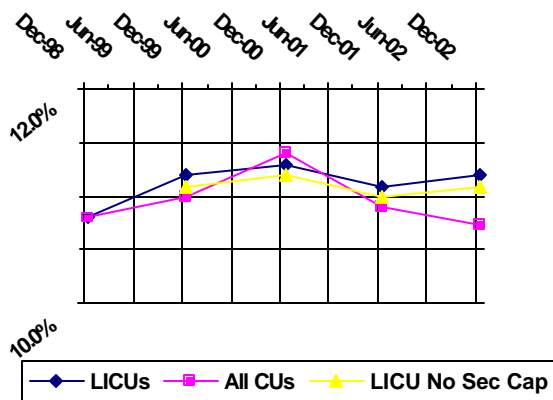
Notable differences in the share portfolio mix between the LICUs and all credit unions include:

- The LICUs portfolio has eight percent less in the money market category than all credit unions.
- The LICUs portfolio has eight percent more in the regular share category than all credit unions.
- The LICUs portfolio has one percent more in the share certificates category than all credit unions.
- The LICUs portfolio has two percent less in the IRA category than all credit unions.

**Net Worth**

Low-income credit unions as a group are well capitalized with a net worth ratio of 11.2 percent including secondary capital and 11.1 percent without secondary capital. Figure 18 displays net worth<sup>5</sup> to assets ratios. LICUs net worth ratios continue to be slightly higher than all credit unions (10.7 percent). The total amount of secondary capital accounts increased by 46 percent during 2002. The year-end secondary capital account balances over the past three periods are shown in Figure 19.

**Figure 18**



**Figure 19**

	Dec -00	Dec-01	Dec-02
<b>Secondary Capital \$</b>	7,965,840	8,860,506	12,432,327

**Earnings**

The 2002 return on average assets (ROA) ratio for all LICUs was 0.87 percent. This compares to the 1.07 percent ROA recorded by the

<sup>5</sup> 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.

combined federally insured credit unions. Figure 20 illustrates the composition of the ROA. Refer to subsequent topic headings for more detail.

**Figure 20**

	Percentage of Average Assets				
	Dec 00 LICU	Dec 01 LICU	Dec 02 LICU	Dec 01 All CUs	Dec 02 All CUs
<b>Gross Income</b>	9.9%	8.5%	7.6%	8.0%	6.9%
<b>Provision for Loan Loss Expenses</b>	0.6%	0.5%	0.5%	0.3%	0.4%
<b>Cost of Funds Expenses</b>	3.7%	3.2%	2.2%	3.3%	2.3%
<b>Operating Expenses</b>	4.7%	4.0%	4.0%	3.4%	3.3%
<b>ROA</b>	0.9%	0.8%	0.9%	1.0%	1.07%

**Income**

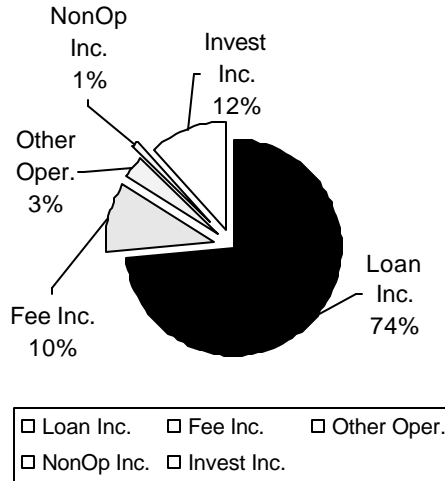
LICUs gross income to average assets ratio declined by one percent since 2001. Figure 21 illustrates the breakdown of the elements that compose LICUs' gross income. Changes in the income portfolio mix in 2002 included a 2.9 percent decline in investment income, 0.4 percent decline in loan income with an increase of 1.3 percent in fee income and 0.2 percent and 0.1 percent increases respectively in other operating and non-operating income categories.

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

- The LICUs income from investments is 4.3 percent lower than all credit unions. Whereas, LICU loan income is 4.9 percent higher than all credit unions.
- The LICUs fee income is 0.5 percent higher than in all credit unions.

- The LICUs other operating income is 1.6 percent lower while non-operating income is 0.6 percent higher than in all credit unions.

**Figure 21**



**Expenses**

Figure 22 shows the breakdown of expenses for LICUs. Most of their ratios are comparable with all federally insured credit unions except the Provision for Loan Losses expense. There had been historically a higher percentage in the Provision for Loan Losses (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 and Lease Losses (ALLL) account. The ALLL account balance represents a valuation allowance showing management's judgment as to probable losses that have been 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.

**Figure 22**

Expenses to Total Expenses Ratio	LI CUs Dec-01	LI CUs Dec-02	All CUs Dec-01	All CUs Dec-02
Employee Comp & Benefits	44.3	44.3	44.9	44.8
Travel & Conference	1.5	1.4	1.3	1.3
Office Occupancy	5.7	5.6	5.9	5.8
Office Operation	19.2	19.1	20.2	19.8
Education & Promotion	2.8	2.8	3.0	3.0
Loan Servicing	3.2	3.4	4.7	4.9
Professional & Outside Services	6.7	6.7	6.7	6.7
Provision for Loan Losses	11.3	11.6	9.0	9.4
Member Insurance	1.8	1.7	0.9	0.8
Operating	0.6	0.6	0.5	0.5
Misc.	2.8	2.8	2.7	2.9

**Cost of Funds**

The LICUs' 2002 cost of funds to average assets ratio is comparable with all federally insured credit unions (refer to Figure 20).

## **Summary**

The Access Across America Initiative is furthering partnerships between credit unions and key federal agencies along with other organizations in an effort to facilitate access to affordable financial services especially to underserved and low-income communities as well as foster the business development of credit unions.

Credit unions continue to expand into underserved areas with more than 23.5 million potential members being added from these areas this year.

One program that promotes credit union development is the Small Credit Union Program (SCUP). As of December 31, 2002, there are 841 credit unions participating in this program. Credit unions that participate in the program receive assistance through on-site assistance contacts or regional workshops. As of December 31, 2002, the regions completed 49 workshops that were attended by more than 2,290 credit union representatives. Credit unions can contact the NCUA regional offices for more information regarding the SCUP.

The number of LI designated credit unions (LICUs) increased from 789 at yearend 2001 to 913 at December 31, 2002. Credit unions receiving this designation can participate in the benefits described on page 3 of this report. Credit unions can contact the NCUA regional offices for more information regarding attaining a low-income designation.

Financial highlights for low-income designated credit unions (LICUs) are as following:

- Asset growth of 9.5 percent -- comparable to the 11.1 percent reported by all federally insured credit unions.
- Current member growth of 3.4 percent -- all credit unions reported a 2.0 percent growth.
- A total loan to assets ratio of 65.2 percent -- all credit unions reported a ratio of 61.5 percent.
- A delinquency ratio of 1.73 percent -- all credit unions reported a ratio of 0.80 percent. The delinquency ratio for LICUs has historically been one percent higher than all credit unions.
- A net charge-off ratio of 0.71 percent -- comparable to the 0.51 percent reported by all credit unions.
- A net worth ratio of 11.1 percent -- comparable to the 10.7 percent reported by all credit unions.
- A return on average assets ratio of 0.9 percent -- all credit unions reported a 1.1 percent ratio.

The Community Development Revolving Loan Fund Program (Fund) approved grants totaling \$668,044 and loans totaling \$3.3 million during 2002.

For more information regarding the programs outlined in this report, contact your NCUA regional office or the Office of Credit Union Development.

## APPENDIX

### Web site Addresses:

#### **CDFI Designated Credit Unions**

List of certified Community Development Financial Institutions credit unions –  
Community Development Financial Institutions Fund Web site:  
[http://www.cdfifund.gov/docs/2002\\_certification\\_byorgtype.pdf](http://www.cdfifund.gov/docs/2002_certification_byorgtype.pdf)

#### **Low-Income Designated Credit Unions**

List of Low-Income designated credit unions -- NCUA's Office of Credit Union  
Development Web site: <http://www.ncua.gov/org/orgchart/ocud/lowincome>

#### **NRC Community-Revitalization Initiatives**

Information about and scheduled NRC workshops -- Neighborhood Reinvestment  
Corporation's Web site: <http://www.nw.org>

#### **Partnership Resources**

Public and private partnership resources available for credit unions – NCUA's Office of  
Credit Union Development Web site:  
<http://www.ncua.gov/org/orgchart/ocud/newsletters.html>

#### **SBA Certified Lender**

Information about SBA – Small Business Administration's Web site:  
<http://www.sba.gov>