

**NATIONAL CREDIT UNION ADMINISTRATION
NATIONAL CREDIT UNION SHARE INSURANCE FUND
LETTER TO CREDIT UNIONS**

LETTER NO. 167 DATE: May 1995

DEAR BOARD OF DIRECTORS:

In December 1994, the National Credit Union Administration released Letter to Credit Unions No. 161. The letter discussed the updated CAMEL Rating System. Since issuing

Letter No. 161, modifications have been made to specific components of four ratios outlined in enclosures (2) and (3) of the letter. The ratios are:

1. *Net Capital/Assets (Key Ratio - Capital)*
2. *Classified Assets/Capital (Supporting Ratio - Capital)*
3. *Solvency Evaluation (Supporting Ratio - Capital)*
4. *Net Capital Growth / Asset Growth (Supporting Ratio - Other)*

The *Net Capital/Assets*, *Classified Assets/Capital*, and *Solvency Evaluation* ratios were modified for clarification purposes. The **Book Value of Investments - Fair (Market) Value of Investments** component of the ratios have been revised to **reflect Book Value of Investments {Excluding "Held to Maturity" Investments} - Fair (Market) Value of Investments {Excluding "Held to Maturity" Investments}**. The purpose of this component of the ratios to capture differences between book and fair value of "Available for Sale" and "Trading" securities that have not been adjusted by the credit union as of the examination date.

A component of the *Net Capital Growth/Asset Growth* ratio was inadvertently excluded from the calculation. This error has been corrected. Additionally, upon closer review, it has been determined that this would be a more meaningful ratio if asset growth was **subtracted** from net capital growth instead of being **divided** by net capital growth. The ratio has been modified to reflect this change.

Revised enclosures (2) and (3) of Letter No. 161 are enclosed. The revised enclosures reflect the modifications made to the ratios discussed above. As discussed in Letter No. 161, the updated CAMEL Rating System, including the most recent ratio modifications, will be effective with the implementation of the new AIREs examination program, currently scheduled for release in the Fall of 1995.

For the National Credit Union

Administration Board,

Norman E. D'Amours
Chairman

Enclosures

FICUs

ENCLOSURE (2)

CAMEL RATIOS

CAPITAL

*Capital/Assets

*Net Capital/Assets

Total Delinquent Loans/Capital

Solvency Evaluation

Classified Assets/Capital

ASSET QUALITY

*Delinquent Loans/Loans

*Net Charge Offs/Average Loans

Fair (Market) Value/Book Value {for investments held to maturity}

Accumulated Unrealized Gains or (Losses) on Available for

Sale Securities/Cost of Investments Available for Sale

Delinquent Loans/Assets

EARNINGS

*Return on Average Assets {new name for Net Income/Average Assets before Reserve Transfers}

Net Operating Expenses/Average Assets

Fixed Asset + OREOs/Assets

Gross Income/Average Assets

Cost of Funds/Average Assets

Net Margin/Average Assets {Gross Income/Average Assets ratio minus Cost of Funds/Average Assets ratio}

Operating Expenses/Average Assets excludes PLL, PIL, and cost of funds}

PLL Expense/Average Assets

Net Interest Margin/Average Assets excludes other operating and fee income}

Operating Expenses/Gross Income {excludes PLL, PIL, and cost of funds}

ASSET/LIABILITY MANAGEMENT

Net Long Term Assets/Assets

Regular Shares/Total Shares and Borrowings

Total Loans/Total Shares

Total Loans/Total Assets

Cash + Short-term investments/Assets {short term investments are less than 1 year based on estimated remaining maturity}

Total Shares, Deposits, and Borrowings/Earning Assets

Borrowings/Total Shares and Capital

Estimated Loan Maturity in Months {Loan Turnover}

OTHER RATIOS

Market Growth {shares}

Capital Growth

Net Capital Growth-Asset Growth

Loan Growth

Asset Growth

Investment Growth

New ratios denoted in bold

* Key Ratios

ENCLOSURE (3)

CAMEL RATIOS

1. CAPITAL

Key Ratios

CAPITAL/ASSETS

(Allowance for Loan Losses + **Allowance for Investment Losses + Regular Reserve + Investment Valuation Reserve + Other Reserves + Accumulated Unrealized Gains or (Losses) on "Available for Sale" Investments + Undivided Earnings + Net Income or (Loss)) / Total Assets

NET CAPITAL/ASSETS

([Allowance for Loan Losses + **Allowance for Investment Losses + Regular Reserve + Investment Valuation Reserve + Other Reserves + Accumulated Unrealized Gains or (Losses) on "Available for Sale" Investments + Undivided Earnings + Net Income or (Loss)] - [Collection Problem Loans {includes both individually classified loans plus the amount calculated for the historic loss} + (Book Value of Investments {Excluding "Held to Maturity" Investments}) - Fair (Market) Value of Investments {Excluding "Held to Maturity" Investments}) + Other Identified Losses] / Total Assets

Supporting Ratios

TOTAL DELINQUENT LOANS / CAPITAL

Total Delinquent Loans / (Allowance for Loan Losses + **Allowance for Investment Losses + Regular Reserve + Investment Valuation Reserve + Other Reserves + Accumulated Unrealized Gains or (Losses) on "Available for Sale" Investments + Undivided Earnings + Net Income or (Loss,))

SOLVENCY EVALUATION

((Total Assets + Allowance for Loan Losses + **Allowance for Investment Losses) - (Liabilities + Collection Problem Loans {includes both individually classified loans plus the amount calculated for the historical loss} + [Book Value of Investments {Excluding "Held to Maturity" Investments}] - Fair (Market) Value of Investments {Excluding "Held to Maturity" Investments}) + Other Identified Losses) / Total Shares

CLASSIFIED ASSETS /CAPITAL

(Collection Problem Loans {includes both individually classified loans plus the amount calculated for the historical loss} + [Book Value of Investments {Excluding "Held to Maturity Investments"} - Fair (Market)

Value of Investments {Excluding "Held to Maturity" Investments}] + Other Potential Losses) / (Allowance for Loan Losses + **Allowance for Investment Losses + Regular Reserve + Investment Valuation Reserve + Other Reserves + Accumulated Unrealized Gains or (Losses) on "Available for Sale" Investments + Undivided Earnings + Net Income or (Loss))

2. ASSET QUALITY

Key Ratios

DELINQUENT LOANS / LOANS

Total of Loans Delinquent More Than 2 Months / Total Loans

NET CHARGE OFFS / AVERAGE LOANS

(Total of Loans Charged Off {prior 12-month period} - Total Recoveries {prior 12-month period}) / Average Loans

Supporting Ratios

FAIR (MARKET) VALUE / BOOK VALUE (for investments held to maturity)

Market Value of Investments Held to Maturity / Book Value of Investments Held to Maturity

ACCUMULATED UNREALIZED GAINS OR (LOSSES) ON AVAILABLE FOR SALE SECURITIES {+ debits - credits}/COST OF INVESTMENTS AVAILABLE FOR SALE {the purpose of this ratio is to determine the decline or increase in the value of the investments available for sale}

Separate Equity Account for Accumulated Unrealized Gains or (Losses) on Available for Sale

Securities / (Book Value of Investments Available for Sale + Accumulated Unrealized Gains or (Losses) on Available for Sale Securities)

DELINQUENT LOANS / ASSETS

Total of Loans Delinquent More Than 2 Months / Total Assets

3. EARNINGS

Key Ratio

RETURN ON AVERAGE ASSETS {annualized}

{New name for Net Income/Average Assets before Reserve Transfers}

(Net Income (Loss) After All Operating Expenses and All Cost of Funds) / ((Current Period Assets + Prior Year-end Assets) / 2)

Supporting Ratios

NET OPERATING EXPENSES / AVERAGE ASSETS {annualized}

(Total Operating Expenses - Provision for Loan Losses - Fee Income) / ((Current Period Assets + Prior Year-end Assets) / 2)

Note: Fee Income is defined as fees charged to members for services or membership (e.g., overdraft fees, ATM fees, credit card fees, etc.). Fee Income includes loan origination fees except when such fees were deferred consistent with Statement of Financial Accounting Standard (SFAS) 91. Reference Section 6010 of the Accounting Manual for Federal Credit Unions for an explanation of SFAS 91. Fee Income does not include Other Miscellaneous Income.

FIXED ASSETS + OREOs / ASSETS

(Land + Building + Other Fixed Assets + Other Real Estate Owned {OREOs}) / (Total Assets)

GROSS INCOME / AVERAGE ASSETS {annualized}

Gross Income / ((Current Period Assets + Prior Year-end Assets) / 2)

COST OF FUNDS / AVERAGE ASSETS {annualized}

Cost of Funds / ((Current Period Assets + Prior Year-end Assets) / 2)

NET MARGIN / AVERAGE ASSETS {annualized}

(Gross Income/Average Assets ratio - Cost of Funds /Average Assets ratio)

OPERATING EXPENSES / AVERAGE ASSETS {annualized}

(Total Operating Expenses - Provision for Loan Losses - Provision for Investment Losses) / ((Current Period Assets + Prior Year-end Assets) / 2)

PROVISION FOR LOAN LOSSES / AVERAGE ASSETS {annualized}

Provision for Loan Losses / ((Current Period Assets + Prior Year-end Assets) / 2)

NET INTEREST MARGIN/AVERAGE ASSETS {annualized}

(Interest on Loans + Income from Investments - Cost of Funds) / ((Current Period Assets + Prior Year-end Assets) / 2)

OPERATING EXPENSES / GROSS INCOME

(Total Operating Expenses - Provision for Loan Losses - Provision for Investment Losses) / Gross Income

4. ASSET/LIABILITY MANAGEMENT

Supporting Ratios

NET LONG-TERM ASSETS / ASSETS

(Long-term Investments {remaining average life or maturity and repricing greater than 3 years} + Fixed Rate Real Estate Loans {any real estate loans that will not reprice, refinance, or mature in the next 3 years} + Adjustable Rate Real Estate Loans {any real estate loans that will not reprice, refinance, or mature in the next 3 years} + Commercial Loans + Agricultural Loans + Fixed Assets) / Total Assets

REGULAR SHARES / TOTAL SHARES AND BORROWINGS

Regular Shares / (Total Shares + Notes and Interest Payable)

TOTAL LOANS / TOTAL SHARES

Total Loans / Total Shares

TOTAL LOANS / TOTAL ASSETS

Total Loans / Total Assets

CASH + SHORT-TERM INVESTMENTS / ASSETS

(Cash + Investments less than 1 year based on estimated remaining maturity) / Total Assets

TOTAL SHARES, DEPOSITS, AND BORROWINGS / EARNING ASSETS

(Total Shares + Deposits + Notes and Interest Payable) / (Total Loans + Total Investments)

BORROWINGS / TOTAL SHARES AND CAPITAL

Notes and Interest Payable / (Total Shares + Allowance for Loan Losses + Allowance for Investment Losses + Regular Reserve + Investment Valuation Reserve + Other Reserves + Accumulated Unrealized Gains or (Losses) on "Available for Sale" Investments + Undivided Earnings + Net Income or (Loss))

ESTIMATED LOAN MATURITY IN MONTHS (LOAN TURNOVER) {annualized}

Loans outstanding at the end of the prior year / (Loans outstanding at the end of the prior year + loans granted during the current period - Loans outstanding for the current period)

5. OTHER RATIOS

MARKET GROWTH (shares) {annualized}

(Current Period Shares - Prior Year-end Shares) / Prior Year-end Shares

CAPITAL GROWTH {annualized}

[(Allowance for Loan Losses + **Allowance for Investment Losses + Regular Reserve + Investment Valuation Reserve + Other Reserves + Accumulated Unrealized Gains or (Losses) on "Available for Sale" Investments + Undivided Earnings + Net Income or (Loss)) {current period} - (Allowance for Loan Losses + **Allowance for Investment Losses + Regular Reserve + Investment Valuation Reserve + Other Reserves + Accumulated Unrealized Gains or (Losses) on "Available for Sale" Investments + Undivided Earnings +

Net Income or (Loss)) **{prior year-end}**] / (Allowance for Loan Losses + Allowance for Investment Losses + Regular Reserve + Investment Valuation Reserve + Other Reserves + Accumulated Unrealized Gains or (Losses) on "Available for Sale" Investments + Undivided Earnings + Net Income or (Loss)) **{prior year-end}**)

NET CAPITAL GROWTH - ASSET GROWTH {annualized}

([Allowance for Loan Losses + **Allowance for Investment Losses + Regular Reserve + Investment Valuation Reserve + Other Reserves + Accumulated Unrealized Gains or (Losses) on "Available for Sale" Investments + Undivided Earnings + Net Income or (Loss)] - [Collection Problem Loans {includes both individually classified loans plus the amount calculated for the historic loss} + (Book Value of Investments {Excluding "Held to Maturity" Investments} - Fair {Market} Value of Investments {Excluding "Held to Maturity" Investments}) + Other Identified Losses] {current period} ([Allowance for Loan Losses + **Allowance for Investment Losses + Regular Reserve + Investment Valuation Reserve + Other Reserves + Accumulated Unrealized Gains or (Losses) on "Available for Sale" Investments + Undivided Earnings + Net Income or (Loss)] - [Collection Problem Loans {includes both individually classified loans plus the amount calculated for the historic loss} + (Book Value of Investments {Excluding "Held to Maturity" Investments} - Fair {market} Value of Investments {Excluding "Held to Maturity" Investments}) + Other Identified Losses] **{prior year-end}**) / ([Allowance for Loan Losses + **Allowance for Investment Losses + Regular Reserve + Investment Valuation Reserve + Other Reserves + Accumulated Unrealized Gains or (Losses) on "Available for Sale" Investments + Undivided Earnings + Net Income or (Loss)] - [Collection Problem Loans {includes both individually classified loans plus the amount calculated for the historic loss} + (Book Value of Investments {Excluding "Held to Maturity" Investments} - Fair {Market} Value of Investments {Excluding "Held to Maturity" Investments}) + Other Identified Losses] **{prior year-end}**) - ((Total Assets **(current period)**) - Totals Assets **{prior year-end}**) / Total Assets **{prior year-end}**)

NOTE: Compliance with FAS 115 became mandatory for all credit unions effective 1/1/95. Prior to this, effective July 1993, compliance with FAS 115 was optional. As a result, the allowance for investment losses account (prior year end) component of the above ratio may reflect pre-FAS 115 accounting standards.

LOAN GROWTH {annualized}

(Current Period Loans - Prior Year-end Loans) / Prior Year-end Loans

ASSET GROWTH {annualized}

(Current Period Assets - Prior Year-end Assets) / Prior Year-end Assets

INVESTMENT GROWTH {annualized}

(Current Period Investments - Prior Year-end Investments) / Prior Year-end Investments

**Allowance for Investment Losses - Under FAS 115, this account would ordinarily not be used.

However, if the credit union experiences a permanent decline in either "Available for Sale" or "Held to Maturity securities, the cost basis of the individual security must be written down to fair (market) value as a new cost basis through the Allowance for Investment Losses account (Refer to Accounting Bulletin 94-1).