NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION SHARE INSURANCE FUND

LETTER TO CREDIT UNIONS

LETTER NO. 132

DATE: March 1992

DEAR BOARD OF DIRECTORS:

In an on-going effort to maintain the CAMEL Rating System as a valuable tool for evaluating credit unions' performance, NCUA continues to study each area of CAMEL in detail.

We revised the Liquidity component materially during our last review by adding the Estimated Short-Term Cash Availability Ratio. There was much controversy and discussion concerning this ratio and, as a result, we studied the entire Liquidity area again. We concluded that no one or two key ratios can adequately address this highly volatile area. Consequently, we have instructed examiners to stop using the Estimated Short-Term Cash Availability Ratio. The other key and supporting ratios will continue to be evaluated, but in a more subjective manner.

This Letter amends those sections of NCUA Letter No. 117, dated December 1990, regarding Liquidity. The Liquidity matrix ratios will no longer be used as the basis for assigning the component rating to this area. The rest of NCUA Letter No. 117 will, however, remain in effect as a valid guideline.

To aid you in your review of the CAMEL Rating System and to give you insight into what to expect during your next examination, an enclosure addressing these changes has been included. This details the primary process examiners will use to evaluate Liquidity.

As always, we welcome your comments and suggestions on ways to improve the system further.

For the National Credit Union Administration Board,

Roger W. Jepsen Chairman

Enclosure FCU

LIQUIDITY ANALYSIS CHANGES

The Estimated Short-Term Cash Availability Ratio will no longer be used in the evaluation of the Liquidity component.

The remaining key ratios will be used as support for, and only as initial indicators for the Liquidity component rating. The other "supporting" ratios will continue to be used as additional information for the examiner when assigning the final rating. These ratios include the following:

(1) Long-term assets to assets;
(2) Net long-term assets to assets;
(3) Total borrowings to total shares and capital;

(4) Regular shares to total shares and borrowings; and
(5) Total loans to total shares.

The credit union's written policies and procedures for this area will be evaluated. Therefore, in addition to the above ratios, the following areas will be reviewed and evaluated based on the size and complexity of the credit union:

(1) Has a funds management plan been developed and implemented?

(2) Is it commensurate with the size and complexity of the credit union?

(3) Is the credit union measuring and/or monitoring its GAP position (rate sensitive assets versus rate sensitive liabilities)? Are the credit union's assumptions for this reporting mechanism reasonable and documented? Does their GAP position appear reasonable?

(4) Does the board have sufficient training in this area to understand the GAP report and its implications?

(5) Is the board using the report as a tool in their decision-making process or is the report "for the examiner" only?

(6) Are there indications of cash flow problems (e.g., habitual short-term borrowing indicating a lack of proper cash management; high ratio of non earning cash to total assets)?

Enclosure

a. Component Rating 1. These credit unions must be sound in every respect and resistant to external economic and financial disturbances. Funds management policies and procedures are in place and are being used and understood by both management and officials.

b. Component Rating 2. These credit unions must also be basically sound with minor weaknesses which are easily correctable. Fine tuning of policies, procedures or reporting mechanisms may be necessary, but the basic funds management philosophy is sound and appropriate for the size and complexity of the credit union.

c. Component Rating 3. These credit unions display a combination of weaknesses which if not addressed and corrected may impair their ability to respond and adjust to fluctuating economic conditions. Failure would only be a remote possibility.

d. Component Rating 4. These credit unions have serious deficiencies in this and other component areas. For example, the long-term assets to assets ratio would be excessive, borrowing to fund short-term cash needs could be evident, and policies and procedures could be totally lacking. Strong supervisory action would be necessary to correct the problems and weaknesses.

e. Component Rating 5. Failure is imminent.