CUEG

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	**Steve Brewer**: Steve Brewer has been the Chief Financial Officer for Michigan Schools and Government Credit Union in Clinton Township, Michigan since 2002. Prior to joining MSGCU, Mr. Brewer held finance and accounting positions with two credit unions, a savings and loan and a cruise line. Mr. Brewer earned a Bachelor's degree in Finance and Real Estate from the University of Texas, an M.B.A. from Texas A&M Corpus Christi and is a licensed Texas CPA.
	**David Colby**: Dave Colby is the Chief Economist for the CUNA Mutual Group in Madison, Wisconsin. Mr. Colby joined CUNA Mutual in 1977 as a Corporate Research Specialist and has progressed through the organization holding various corporate, operational and financial planning positions. Mr. Colby is a graduate of the University of Wisconsin - LaCrosse where he received his Bachelor of Science degree in Economics. He holds the designation of Fellow, Life Office Management Institute.
	**Bruce Fox**: Bruce M. Fox is the Executive Vice President and Chief Investment Officer of Southwest Corporate Federal Credit Union. Mr. Fox joined Southwest in January 1991 as an investment adviser. Mr. Fox is a member of Southwest's asset-liability committee and chairman of the loan committee. Prior to that, he was an investment portfolio manager at the Members Insurance Companies of the Texas Credit Union League. Mr. Fox has Bachelor's and Master's degrees in Finance from East Texas State University.
	**Samuel Inman**: D. Samuel Inman is the Chief Financial Officer of Community First Credit Union of Florida. Mr. Inman is responsible for assuring overall financial condition and viability of the credit union, while developing and implementing long-term strategies, policies and operating objectives. During his spare time, Mr. Inman serves on the Board of the Florida CFO Council and Florida CUES Board of Directors. He holds a Master's degree from Brenau University, as well as a Bachelor's degree in Finance from the University of North Florida.
	**Cory Johnston**: Cory Johnston has been with Georgia Central since May 2002. In September 2007, he was promoted to Senior Vice President. He is also a key contributor to the senior management team and liaison to the ALCO and regulatory agencies. Before coming to Georgia Central, Cory worked for U.S. Central as a Director/Portfolio Strategist. Cory has a Bachelor's Degree from Kansas State University and a M.B.A. from the Olin School of Business at Washington University in St. Louis.
	**Glen Olpin**: Glen W. Olpin is Senior Vice President, Treasurer & Chief Economist for America First Credit Union in Ogden, Utah, the nation's sixth-largest credit union. Mr. Olpin earned a B.A. in Business Economics from Weber State University and an M.B.A. from the University of Utah. He serves on the America First Credit Union Asset-Liability Management (ALM) and Pension Committees, and is President of the company's Investment & Insurance Services Corporation. Mr. Olpin is a graduate of the Western CUNA Management School at Pomona (California) College, is a member of several professional organizations and has served on several community boards.
	**Paul Parrish**: Paul Parrish has been with Nevada Federal since 1981 where he has held positions of Controller, Sr. Vice-President Finance, and his current position of Executive Vice President, CFO. Prior to his start with Nevada Federal he earned a Bachelor's Degree in Accounting from the University of Nevada at Las Vegas. In addition to his duties as EVP, CFO, he currently serves as Chairman of Member Gateways, LLC and as a Board Member of X-Card Systems, LLC. He also currently serves as the Managing Member of Community Title and Escrow Services of Nevada, LLC, Community Insurance Services of Nevada, LLC, and Community Realty Services of Nevada, LLC.
	**Frank Vassallo**: Frank Vassallo is currently the Chief Financial Officer at Bank-Fund Staff FCU, a position that he has held for three years. Prior to joining Bank-Fund Staff FCU, Mr. Vassallo was the CFO at Fort Belvoir FCU for six years. Mr. Vassallo is currently a member of the CUNA CFO Council. During his time on the Council, he was elected to be a member of the Executive Committee for four years. Mr. Vassallo has a B.A. in Economics from the State University of New York, College at Geneseo, and a MA in Finance from the Catholic University of America. He was awarded the CFA Charter in 2000.
	**Eli Vazquez**: Eli Vazquez is Senior Vice President and Chief Financial Officer of American Airlines Federal Credit Union in Fort Worth, Texas, a position he's held since 2006. Mr. Vazquez joined AA Credit Union in 2005 as SVP of Financial Services. Prior to American Airlines CU, Mr. Vazquez worked for American Airlines in several capacities. Mr. Vasquez holds a bachelor's degree in chemical engineering from Tulane University and a master's degree in business administration from the University of California at Berkeley.
	**Tun Wai**: Dr. Tun A. Wai is the Director of Research and Chief Economist for NAFCU in Arlington, Virginia and is in his twenty-first year there. Dr. Wai is responsible for creating many products and services for NAFCU member credit unions. Dr. Wai has a Bachelor of Science in Business Administration in Management and a Ph.D. in Economics from Georgetown University, as well as an M.B.A. in finance from New York University. Prior to NAFCU, he held research positions with the World Bank, the Federal Reserve, and the Brookings Institution.

Executive Summary

- As of June 2011, federally insured credit unions' (FICU) year-to-date asset growth was 3.1 percent. And while all the regions experienced positive growth, Region III showed the greatest result with 4.2 percent growth in total assets compared with a 1.6 percent in Region V.

- Return on average assets (ROA) for all federally insured credit unions' was 0.2 percent. Compared to June 2010, ROA for all FICUs rose by 9 basis points in June 2011. Region II showed the greatest result with an ROA of 0.25 percent in 2011.

- Share drafts saw an increase of 5.1 percent for all FICUs in 2011. Region II experienced the largest growth of 6.9 percent, compared to 3.6 percent in Region V. Overall, share growth was up 3.3 percent. Regular Shares growth, at over 8 percent is responsible for over 70 percent of the growth in total shares.

- New vehicle lending declined by 5.4 percent in the first half of 2011 on the national level, with Region V reporting the strongest decline of 9.2 percent. In Region IV used vehicle loans rose by 3.4 percent, while new vehicle loans decreased by 2 percent. Used vehicle lending grew 2 percent year-to-date nationwide in 2011.

- First-mortgage real estate loans have grown by 1.9 percent during the first half of 2011. Other real estate loans experienced a 3.8 percent decline. First mortgages were the strongest loan segment of total loans, which experienced a negative 0.1 percent total growth.

- In June 2011, the delinquency ratio decreased slightly by 14 basis points from June 2010 to 1.6 percent for all FICUs. Across the country, the delinquency ratio was as low as 1.3 percent in Region II and as high as 2.4 percent in Region V.

- With the likelihood of non-interest income decreasing because of new burdensome regulatory reforms (e.g., limitations on interchange income which have reduced fee income), several credit unions would be left with negative net income if they could not apply non-interest income to their bottom lines. This fear coupled will leave many credit unions cautious moving forward.

- Credit unions will be evaluating their relationship with corporate credit unions, the Federal Reserve, and other sources of quick liquidity. Fears of a double-dip recession are still present and even the most financially stable credit unions will need to be prepared in the event of another credit crunch.

CUEG Region One

CUEG Region I (Northeast) consists of the states Connecticut, Maine, Massachusetts, Michigan, New Hampshire, New York, Rhode Island and Vermont. As of June 2011, there were 1,238 federally insured credit unions in the region, with total assets of $153.7 billion and total membership of 14.1 million.

Lending

Loans in Region I during 2011 grew by a positive 0.6 percent to $89.9 billion, more than the negative 0.14 percent pace for all federally insured credit unions (FICUs) nationwide. During 2011, loan growth was concentrated in first-mortgage real estate loans and, to a lesser extent, used vehicle loans. The region's credit unions experienced a relatively stronger demand for first-mortgage loan products than found nationwide, while home equity lending contracted less than the negative figure found nationwide. During this year, first-mortgage lending expanded by 2.5 percent, while other real estate loan demand (home equity/second mortgage) declined by nearly 2 percent. At mid-year, real estate loans comprised 62.4 percent of all loans in the region. Vehicle loan portfolio growth was almost non-existent (0.1 percent) during the first half of 2011. New vehicle loans decreased 3.4 percent for the first six months of 2011 and 9.5 percent from June 2010. Used vehicles rose during the first half of the year, posting gains of 2 percent.

Credit unions in Region I, and the nation as a whole, experienced a decrease in unsecured lending growth. The nation's unsecured lending decreased by 2.7 percent since December 2010. Region I unsecured lending contracted by 4.4 percent over the same time. In the first half of 2011 credit card lending decreased by 4.8 percent; non-credit card unsecured lending decreased by 4 percent over the same period. Despite the positive loan growth found among regional credit unions, the loan-to-share ratio fell from 71 percent at year-end 2010 to 68.6 percent in mid-2011 because savings growth outpaced lending. Member business loans outstanding grew 5 percent to $6.4 billion.

Credit union leaders have indicated that their near-term expectations for loan demand in unsecured lending, real estate, new vehicles, and used vehicles held a more unfavorable expectation than credit unions in other regions.

Member Shares (Savings)

During the first half of 2011 total share growth in Region I was 4.1 percent, much higher than the 3.3 percent share growth experienced among all FICUs. Many FICUs in the region saw share growth in "Other" shares and regular shares outpacing the figures for all credit unions, increasing by 14 percent and 9.4 percent, respectively (the growth in regular shares made up over 64 percent of change in total shares since December 2010). Share certificates decreased 2.9 percent in the first half of the year, while IRA accounts have seen positive growth of 0.8 percent growth over the same time period. Money market shares also saw an increase of 6.8 percent. The interest rates among the CDs have been declining and the largest decline has occurred for the 2 and 3 year jumbo CD rate last year (minus 17 basis points). This has helped to keep the cost of funds low and support the improvements in net income.

Many of the region's credit unions anticipate share growth to grow over the near term, a sentiment shared by credit union leaders across the nation. Last year, negative loan demand- coupled with stronger share growth- caused the region's credit unions' loan-to-share ratio to decrease from 71 percent in 2010 to 68.6 percent in 2011. Among all credit unions, the loan-to-share ratio decreased from 72 percent to 69.6 percent over the same time periods.

Earnings and Asset Quality

During the first half of 2011 the credit unions in Region I had an annualized return on average assets (ROA) before stabilization costs of 0.81 percent, up from 0.73 percent in all of 2010. This is less than what all FICUs experienced as they saw annualized ROA before stabilization increase from a 0.73 percent in 2010 to 0.89 percent in 2011. After stabilization costs, Region I's annualized ROA was 0.75 percent and the nation's was 0.8 percent. While the region's credit unions' loan yields were slightly lower than the average, the region's investment yields were highest among all CUEG regions. In addition, the region's cost of funds (0.9 percent) was below the national average. However, credit unions in Region I generated, on average, substantially less non-interest income (annualized at 0.6 percent of average assets) than the nation (annualized at 0.7 of average assets).

The asset quality in the region was better in comparison to the asset quality of all FICUs during last year. The delinquency ratio in the region was 2.3 percent compared to 2.7 percent for the nation, while the net charge-offs ratio of 0.3 percent in the region was lower than the overall rate of 0.5 percent. During the first half of 2011, member bankruptcies were less of a problem in Region I when compared to other regions. The loan amounts subject to bankruptcy as a percentage of loans outstanding decreased significantly. The total number of bankruptcy filings over a 12-month period in the region decreased by 6.6 percent to 137,538 and the loan dollars subject to bankruptcy decreased from $356.9 million in mid-2010 to $287.9 million in mid-2011.

Many credit unions are working harder than ever to identify cross-sell opportunities. Most members have relationships with multiple financial institutions. Converting these loans that have been made to existing members may be more cost effective than recruiting new members. Many credit unions have found this to be an effective method of deepening relationships with existing members and at the same time increasing corporate profitability.

Competition and Credit Union Operational Concerns For 2011

In contrast to other parts of the country, Region I credit unions are seeing slight improvement in their delinquency and net charge-off ratios. Also bankruptcies appear to be falling as seen by the lower percentage for loans subject to bankruptcies. In Region I specifically, there have been concerns about the historically low home values, high foreclosure rate, and the high level of unemployment; Region I's unemployment rate is still at 8.1 percent in mid-2011.

Credit unions have noticed that the quality of lending applications has improved. However, the loan volume remains tepid. As consumers' financial situations improve, their confidence in their ability to pay any debt they take on should improve as well. Once their confidence is in place, we expect their loan demand to increase to take advantage of the excellent rates available to them. Until then, credit unions are finding that more operational efficiency is necessary in this economic environment. With limitations on the ability to generate income, expense reduction has become the next reasonable alternative to increase net income. Once these cost-reduction efforts are realized, credit unions with lower operating expense ratios have a significant competitive advantage over less efficient organizations. In particular, many credit unions have reduced their marketing and travel/education expenses. Such reductions may increase pressure on future credit union performance, especially when competing with banks and other financial institutions. In addition to cutting expenses, credit unions are trying to attract low cost sources of funds. However, share certificates are a declining source of funds as members seek higher returns.

Member Concerns and Economic Conditions In 2011

Members of Region I credit unions remain concerned about the economy and its implication for 2012 and beyond. If the Fed keeps the interest rates low as it has promised to do through mid-2013, it is likely that credit unions' cost of funds will decline further and compressed margins will thus be alleviated to some degree. However, the experience of low loan demand has forced many credit unions to find alternative revenue sources. Credit unions are hoping that the economy will improve further, especially in the area of employment.

The economy needs to expand significantly for consumers to resume spending at robust levels. Rising foreclosures and high unemployment will also depress real estate loan performance. Members who are unemployed or underemployed are unlikely to pay their debts in a timely manner. Additionally, decreased home values have caused members to evaluate the pros and cons of continuing to make payments on mortgages that are under water. Provision for loan losses expenses have grown to a significant level for most credit unions. With the economy improving marginally (uncertainty in financial markets in the US and abroad, elevated unemployment and low improvement in consumer spending) it is unlikely that there will be a sharp increase in market interest rates in the foreseeable future.

CUEG Region Two

NCUA Region II (Mid-Atlantic) consists of the states Delaware, Maryland, New Jersey, Pennsylvania, Virginia and West Virginia, plus the District of Columbia. The region's federally insured credit unions (FICUs) have 17 percent of the total assets of the nation, down by 0.1 percentage points from December 2010. There are 14.6 million members in this region as of June 2011, up from 14.4 million (1.4 percent increase) from December 2010. These percentages mirror the regional economy where the gross domestic product by state is about 13.7 percent of the U.S. gross domestic product. Regional production is more concentrated in professional services, government and health/education services than the average concentrations found nationwide.

Lending

Region II FICUs generated positive loan growth of 0.2 percent in 2011, compared to the national rate of negative 0.1 percent. Although it is the smallest component of total loans outstanding, short-term small amount loans experienced the sharpest growth, increasing 8.5 percent in 2011. First mortgage loans grew by 2.3 percent during the year. Region II FICUs expect used vehicle lending to be less than those in other regions over the next 12-month period.

Total vehicle loans in Region II decreased by 0.4 percent during 2011, compared to a rate of negative 0.8 percent for all FICUs. In Region II used vehicle loans rose by 2.6 percent, while new vehicle loans decreased by 4.8 percent. Looking forward to 2011, Region II FICUs anticipate lower loan growth for new vehicle loans than do FICUs in other regions.

Unsecured loans (excluding credit cards) represent 6.1 percent of all FICU loans in the region. This portfolio segment has decreased by 0.2 percent during 2011. Credit card loans increased 1.6 percent during the same period, representing 11.1 percent of all FICU loans in the region. The credit union leadership in the region believes that unsecured loans will experience a negative rate of growth for the near term, and likely lower than growth among all credit unions across the country.

Member Shares

Total savings and deposits reached $131.1 billion in June 2011, up $4.7 billion (3.7 percent growth) from December 2010. During the period, Region II FICU share drafts (12 percent of Region II shares) increased 6.9 percent. Regular shares (27.8 percent of Region II shares) increased 8.2 percent during the same time period. Money market share accounts (21 percent of Region II shares) reached $27.1 billion as of June 2011, up by $1.5 billion (20.5 percent growth) from 2010. FICU share certificates (27.6 percent of shares) experienced a 2.8 percent decrease during 2011. IRA accounts (11.2 percent of FICU shares) were a safe haven for members' precious retirement funds in 20110. This deposit segment advanced 1.9 percent from 2010 compared to a national growth rate of 0.8 percent. For the next twelve months, the share growth anticipated by Region II FICUs is slower than the overall expectations, but still increasing.

Return on Average Assets (ROA), Spreads and Asset Quality

Region II's credit unions experienced growth in consolidated ROA during the first half of 2011. Annualized at 1 percent (annualized ROA for all FICUs was 0.79 percent) this profitability measure increased by 12 basis points since 2010 for the region's credit unions. This figure does not include the Stabilization Fund assessment of 25 basis points. Comparing income before these costs, Region II annualized ROA was 1.1 percent in June 2011, up from 0.9 percent in 2010. This increase in ROA is mainly due to the decrease in cost of funds, which has declined from 1.5 percent in 2010 to 0.6 percent in 2011. We expect to see yields on assets continue to fall as the Federal Reserve is taking steps to keep rates in the marketplace low. Their stated desire to keep short-term rates anchored at current levels until mid-2013 will drive yields on investments and loans lower over the next 12 months as asset prices change. The low market rates should keep the overall cost of funds low for the foreseeable future as well. Deposit yields are already extremely low, and realistically cannot go much lower, so we expect to see continued downward pressure on Net Interest Margins over the short term. We continue to see non-interest income and expenses remain steady. These factors, when taken together, point to a fairly steady or slightly decreasing ROA.

Gross income decreased by 1.5 percent from $4.05 billion in June 2010 to $3.99 billion in 2011. Fee income/average assets declined by 1.5 basis points from 2010 and operating expenses/average assets increased by 1.9 basis points.

Loan Loss Trends

In the area of loan quality, Region II FICUs had lower delinquency and charge-off ratios than credit unions nationwide during 2011. Reportable delinquencies (those which are 60 days late or more), fell from 1.3 percent in 2010 to 1.2 percent. Net charge-offs declined slightly, from 1.1 percent in 2010 to 1 percent through June 2011. During this period, mortgage charge-offs increased from 0.1 percent to 0.06 percent. Region II FICUs experienced a lower loan exposure to bankruptcies compared to the pattern found among credit unions nationwide. During 2011 the portion of total loans subject to bankruptcy was 0.4 percent among Region II FICUs; nationwide the ratio was the same.

Member Concerns and Region II Economic Conditions In 2011

Credit union leadership in Region II stated they have gotten strong savings growth, despite having reduced the interest rate and this is making managing asset growth more difficult. Some credit unions believe that this savings growth may be due to the more stable economy found in the region when compared to other parts of the country. This growth may also be attributed to the current uncertainty in the investment markets. As members look for safe places to keep their money, we are seeing them increase their deposits in the credit unions.

Bankruptcies and real estate foreclosures will continue to be a focus over the coming year. Although some pockets of the region are seeing housing prices stabilize or even increase slightly, most of the region has still not reached a point of price stability in the housing markets, so there will be continued pressure from 1st mortgage loans that are “upside down” and 2nd mortgage loans that are essentially unsecured. There is similar concern that credit card loan portfolios will continue to underperform because of large losses. Some credit unions have indicated that the trend of members resolving such problems may continue throughout the year.

Corporate Credit Union Stabilization costs this year were 25 basis points. The NCUA had previously indicated that they expected to assess anywhere from 20 to 35 basis points, which caused many credit unions to put their business plans on hold. Guidance for 2012 is that total assessments for the NCUSIF premium and the Corporate Credit Union Stabilization costs will be between 8 and 18 basis points. This is still creating uncertainty for FICUs with respect to planning for 2012. In order for credit unions to plan better for the coming year, the NCUA needs to continue working with FICUs in order to provide more transparency.

CUEG Region Three

CUEG Region III (Southeast) consists of the states Alabama, Florida, Georgia, Indiana, Kentucky, Mississippi, North Carolina, Ohio, South Carolina, and Tennessee, and of the territories Puerto Rico and U.S. Virgin Islands. Region III finished 2Q 2011 with 1,483 federally insured credit unions (FICUs). This represents a net decline of 47 or 3.07 percent of Region III FICUs over the past year. Region III holds 20.5 percent of all FICUs, 19.7 percent of all assets and 22.4 percent of all FICU members. Total assets in the region rose to $185.9 billion. This translates into a growth rate of 4.2 percent for the first six months, which is 1.2 percentage points above the reading for the nation as a whole. Membership in the region climbed to 20.4 million, up 106,675 over the past year. Year-to-date membership growth in Region III was at 0.5 percent in 2Q 2011 and just fell short of the 0.6 percent national growth rate. Total employment (full- and part-time FICU employees) was 55,199, which had no year-over-year change. The 50 largest FICUs in the region hold 54.1 percent of all assets and 44.3 percent of the total membership in the region. Included in this group are 35 FICUs with assets in excess of $1 billion.

Region III covers a wide expanse of geography. The impact of the recession continues to affect this region, especially credit unions in Florida, which is known as one of the sand states impacted greatly by declining home values. Mergers continue to be a major factor impacting credit unions in the region as today there are 47 fewer credit unions in the region when compared to one year ago. Loan growth is negative and savings growth was slightly higher than that found among other credit unions nationwide. Automobile loans are particularly a challenge as credit unions compete with the captive financing companies offering zero percent loan options for new automobile loans and compete with nontraditional lenders to maintain a fair share of the used automobile market. Unsecured lending and mortgage refinancing are the two positive areas of growth as rates remain at historic lows. Managing the margin squeeze, improving loan quality and increasing operational efficiencies to offset threats to fee income remain top priorities for credit unions in the region.

Credit unions in the region are working to get the message out to consumers and businesses that, as an industry, credit unions remain fiscally safe and sound. They also have money to lend and checking products that are better than banks. Seizing the market opportunity to gain checking accounts from banks is a growing theme for credit unions in the region. Banks are implementing new fees or increasing existing fees to checking accounts and debit cards to offset the impact of the loss interchange income and creating an opportunity for credit unions to gain market share. As of June 2011, Region III FICUs collectively remained in good health and their net worth ratio rose to 10.3 percent from 10.2 percent at mid-year 2010. Region III's annualized Return on Average Assets (ROA) increased by 26 basis points to 0.66 percent over the past year (before NCUSIF assessments). Loan delinquencies are unchanged from their year-end level of 2 percent of total loans. Net loan charge-offs declined 6 basis points from their December 2010 levels.

Extraordinary economic events during the past several years have had a materially negative impact on financial performance. The costs of resolving the conservatorship of corporate credit unions are a concern of many of the region's credit unions. The NCUA currently estimates remaining losses to the corporate stabilization fund at between $1.9 and $6.2 billion. The 2011 assessment related to the corporate stabilization fund was announced to be 25 basis points of insured shares, effectively canceling out the improvement in year-over-year ROA. In 2010 the total cost was 25.8 basis points.

Lending

At negative 0.2 percent, annual loan growth in Region III was lower than the national average of negative 0.1 percent. The 96 FICUs in North Carolina posted the strongest year-to-date loan growth at 1.9 percent. FICUs in Mississippi and Florida posted the lowest performance in loan growth with decreases of 3.2 and 2.6 percent respectively.

At 66.6 percent, the loan-to-share ratio was down 3.1 percent year-to-date. Region III FICUs are under-performing the total U.S. which had a loan-to-share ratio of 69.6 percent. The U.S. loan-to-share ratio has declined 2.4 percent since December 2010.

An $885 million gain in first mortgages and lines of credit accounted for the majority of loan growth year-to-date while new vehicle lending fell $778 million during the year. Despite the crisis in the overall housing market, first mortgage originations totaled $4.7 billion during the first half of 2011 which is a slight increase from the same period in 2010. First mortgage originations were largely driven by refinancing activity. First mortgage loan sales to the secondary market were $1.5 billion for the regional credit unions and produced a 2.1 percent year-to-date first mortgage portfolio gain. When the 4.3 percent drop in home equity and second mortgages is added to first mortgages, the combined real-estate portfolio segment accounted for 54.5 percent of total loans for FICUs in Region III. Used automobile lending was also a growth segment between year-end 2010 and mid-year 2011 1.8 percent growth.

A 6.5 percent contraction in new vehicle loans outstanding for Region III FICUs was partially offset by the 1.8 percent increase in used vehicle portfolio. However, total vehicle loans outstanding in the region declined 1.1 percent over the past six months. A total of 379 FICUs in Region III reported having an indirect lending channel, compared to 370 FICUs at year-end 2010. Indirect loans outstanding are down 5.9 percent over the past year and now account for 11 percent of total loans.

The economy demonstrated early signs of sustainability during the early half of 2011; however, concerns of a double-dip recession were pronounced this summer and reinforced by what appears to be a slowing in global economic growth. Fears of the European debt crises spreading to the U.S. and fierce political debate regarding U.S.

deficit spending have stifled business and consumer confidence. Consumers' utilization of credit displays the trends typical of the recent economic recession. Home equity lending and unsecured credit declined while used vehicle and first mortgages posted positive gains. The strong competition from the captive finance markets has impacted new automobile loans on credit unions balance sheets. These loans posted a 14.4 percent decline over the last 12 months. Consumers continue to work to pay down unsecured debt and, those who can, take advantage of the opportunities to refinance their mortgage debt. Keeping access to credit card lines of credit remains a priority for individuals whose home values have declined and may be at risk of foreclosure.

The foreclosure process was slowed nationally in 2010 as the large national banks legal review processes for foreclosures was challenged. This appears to be behind us but we continue to see long delays for getting foreclosures cleared by courts in many areas and off the balance sheets of the large financial institutions. The real estate market is reporting increased activity in many markets but a deeper look at the data reveals this to be largely driven by a large percentage of distressed sales. Unemployment concerns and low home values continue to impact the willingness of consumers to take on new debt. However, low mortgage loan rates, especially for terms of 15 years or less, kept the mortgage refinance market alive last year.

Member Shares

During the first six months of 2011, total shares in Region III rose 4.1 percent to $161.9 billion. This 4.1 percent gain was above the national average of 3.3 percent. Share drafts, regular shares, money market shares and IRA/KEOGH accounts all posted year-to-date growth while share certificate balances fell 2.9 percent across Region III. Sharp increases in regular shares and money market accounts combined with falling certificate concentrations indicate an increasing balance of "hot" money on the balance sheet. The 96 FICUs in North Carolina and 180 FICUs in Tennessee generated the strongest rates of share growth during the first half of 2011.

The low interest rate environment and a multi-year shift in the savings structure away from higher cost CDs have moved Region III FICUs' cost-of-funds down 28 basis points to 0.97 percent of average assets over the past six months. Given the economic uncertainty, slowing loan demand and a growing savings rate, we expect the cost-of-funds to continue drifting downward, although at a slowing rate by the middle of 2012. Managing the cost-of-funds will continue to be important as one of the tools that credit unions in the region exercise in working to absorb higher loan losses and the anticipated additional charges from the NCUA. It will be imperative that credit unions manage growth in deposits in relation to loan demand and capital growth.

Asset Quality and Operational Results

At mid-year 2011, the annualized ROA for Region III FICUs was 0.66 percent, reflecting an 18 basis point increase from the December 2010 level. A total of 1,065 FICUs (71.8 percent of the region's FICUs) reported a positive ROA, while 418 reported losses or no gain. The FICUs with a negative ROA represented 5.2 percent of the region's assets. This is an improvement from the prior year, which showed 13.8 percent of the region's assets were at a negative ROA institution.

A pervasive combination of slow economic recovery and continued high unemployment in Region III continues to suppress asset quality. The loan delinquency rate was unchanged over the past six months, and held at 2 percent of total loans. The national FICU delinquency rate at mid-year 2011 was 1.6 percent of total loans, down 19 basis points year-to-date. Over the same period, net charge-offs decreased from 1.2 percent of average loans to 1 percent nationwide and from 1.1 to 1 percent among FICUs in Region III.

One measure of operating efficiency (the ratio of operating expenses to average assets) was down to 3.3 percent or 18 basis points from December's 3.5 percent. However, operating expenses to gross income increased from 59.3 percent to 60.8 percent as income declined in proportion to operating expenses. Expenses related to share insurance costs, office occupancy and loan servicing were growing the fastest. This growth is reflective of costs associated with the corporate credit union stabilization, recession level loan performance and loan growth plus credit unions growing to fill the void created by traditional competitors pulling back.

Low loan demand and credit quality continue to be a concern. New vehicle loan volume has been anemic and mortgage volume continues to be driven by refinances; the purchase mortgage market has been slow to return. Home values have not stabilized and are not expected to until the foreclosure back-log is liquidated and unemployment improves. The value of used automobiles has improved as the supply of new automobiles declined. Improving efficiencies by aligning operating expenses with demand will continue to be the challenge. Larger credit unions seem to be again opening new branches and all credit unions are being challenged to reduce expenses. The challenge will be to leverage technology and to assure that service does not suffer as the result of these reductions.

We are seeing some stabilization of the U.S. and global economies and the national unemployment rate has fallen from its highs. Credit unions have an opportunity to seize market share from banks as they implement new fees. However, we will need to be smart and be sure the accounts we gain do not create a financial drain to our bottom lines. Corporate Credit Unions are continuing to consolidate and the dust continues to settle from the new regulations on these organizations. Cooperative effort will be required to make sure credit unions continue to benefit from their ownership of corporate credit unions, which includes vital access to payment systems, investments and liquidity.

In aggregate, the capital cushion appears to be adequate as individual FICUs have benefited from lowering their provision for loan losses. As the economy recovers and employment improves, the current challenges of slow loan growth will continue until the consumer feels more positive about the future. Credit Unions will need to compete for market share of the loan demand that is available. Last of all, driving operational efficiencies and creating the positive member experience will be the key to maintaining relevance with active members.

CUEG Region Four

NCUA Region IV (Austin) consists of 2,160 federally insured credit unions (FICUs) in the states of Arkansas, Illinois, Iowa, Kansas, Louisiana, Minnesota, Missouri, Nebraska, North Dakota, Oklahoma, South Dakota, Texas, and Wisconsin as of mid-year 2011. The credit unions in this region represent 29.8 percent of all FICUs and with total assets of $196 billion, hold 20.8 percent of all FICU assets. Total membership in Region IV reached 20.3 million and now accounts for 22.3 percent of all FICU members. A high level summary shows a net loss of 62 Region IV FICUs over the past year and 31 of those occurred in the first half of 2011. Asset growth of 5.5 percent is well above the national average and the second highest of the regions. Region IV FICUs added slightly more than 101,000 members over the past six months. Loan growth was 1.4 percent versus a decline nationally and the net worth ratio was fractionally below the national average at 10.1 percent. At mid-year, total employment (full and part-time FICU employees) was 58,514 and there were 5,447 branches within the region. The 50 largest FICUs in the region held 45 percent of all assets and 35 percent of the total membership. Included in this group are 33 FICUs with assets in excess of $1 billion.

Loan Growth

Annual loan growth in Region IV FICUs was 2.7 percent, but the year-to-date gain is just 1.4 percent. Second quarter loan growth was much stronger at 1.6 percent. Region IV loan growth over the first six months exceeded the national average by 1.3 percentage points – the highest growth rate of all regions. Total loans outstanding in Region IV now equal $120.3 billion. Loans represent 61.5 percent of total assets down from 62.9 percent at December 2010. Most credit unions attribute this to very soft member demand for consumer loans and most are reluctant to hold long-term fixed-rate assets (1st mortgages), when rates are at historic lows. However, credit unions' hunt for yield drove them to portfolio more of their real estate loans, with the ratio of real estate loans sold to loans granted declining from 53.9 percent in 2010 to 39.8 percent in mid-year 2011.

Over the past year, 1st mortgages were the largest component of loan growth. This portfolio segment increased 6.4 percent during the year and accounted for almost 77 percent of all loan growth. On a year-to-date basis, 1st mortgages are up 3.3 percent. Other real estate loans/lines of credit declined 5.1 percent since mid-2010. Through the first half of 2011, this portfolio segment is down 2.2 percent. The $54 billion in real estate secured loans now equal 44.7 percent of all loans, up from 44.5 percent at mid-year 2010.

Mortgage interest rates hit record lows which more than offset the lack of a major tax credit. At $7.4 billion, total 1st mortgage originations are 8.7 percent above year-to-date mid-year 2010 levels. Detailed NCUA data indicates 65 percent of the increase in originations is attributable to fixed-rate 1st mortgages with a maturity of 15 years or less. This clearly indicates refinances. In contrast, fixed-rate 1st mortgages with a maturity greater than 15 years (a proxy for purchase money mortgages) are down 36 percent from year-to-date 2010 levels. Through the first half of 2011, roughly 66 percent of 1st mortgage originations were fixed-rate, 20 percent balloon/hybrid and 14 percent adjustable-rate. Other real estate loans granted are down 11 percent from same period 2010 results. All sub-components of second mortgages and HELOCs declined.

Total vehicle loan growth in Region IV FICUs was positive, whereas the national average showed a portfolio decline. This portfolio segment was up 2.2 percent over the past year in Region IV while the nation as a whole contracted 2.7 percent. Used vehicle loans are up 7.8 percent over the past year and 3.4 percent year-to-date. New vehicle portfolios in Region IV are down 5.6 percent since mid-year 2010 and 2 percent year-to-date. Total vehicle loans have increased 1.2 percent year-to-date in Region IV versus a 0.8 percent decline nationally. Indirect lending is a key contributor to vehicle loan growth success in the region. Indirect loans climbed 4.9 percent over the past year versus a 3.9 percent decline nationally. This trend continues as Region IV indirect loans are up 1.7 percent year-to-date compared to a decline of 1.5 percent posted nationally.

Region IV credit card balances grew 3.5 percent over the past year, but are down 1.8 percent through the first half of 2011. Business loans are up 5.1 percent over the past twelve months (2.8 percent year-to-date) and now equal roughly 4.4 percent of assets, down from 4.5 percent at the end of June 2010. FICUs in Region IV granted $1.6 billion in member business loans year-to-date, down 8.1 percent from same period 2010 results.

Shares and Deposits

Total shares and deposits increased 3.8 percent since December 2010 and 5.9 percent over the past year with 85 percent of the increase coming in the fourth quarter 2010 and first quarter 2011. Over the past year, Region IV FICUs grew shares and deposits 1.4 percentage points faster than the national average. Total shares and deposits were $170 billion at the end of June. Members continue to prefer short duration instruments with regular shares, share drafts and money market shares (liquid deposit accounts) accounting for 103 percent of all growth. CDs were down just 2.3 percent over the last 12 months, while the nation as a whole experienced a 5.4 percent decline.

Since mid-year 2010, about 51 percent of share growth is attributable to regular shares, 27 percent to money market shares and 25 percent to share drafts. This trend continues through the first half of 2011 with liquid deposit accounts contributing 104 percent of the year-to-date gain in Region IV FICUs. Nationally, total shares are up just 3.3 percent with liquid deposit accounts contributing 123 percent of all share growth.

Share certificates (CDs) are down 2.3 percent since mid-year 2010 with 64 percent of the $1.0 billion loss occurring in the past six months. The duration premium between CDs and liquid deposit accounts continues to narrow, thus members see much less financial incentive to lock up deposits. The combination of lower overall interest rates and members directing more of their deposits into low-cost liquid accounts has lowered

Region IV FICUs' cost-of-funds to 99 basis points, a 26 percent decline over the past year and a 21.4 percent decline over the past six months. Most credit union financial leaders believe this trend will continue well into 2013. The cost-of-funds in Region IV is only 3 basis points above the national average.

Last year at this time we reported a flight to fixed-rate (insured) safety with IRA/KEOGH accounts up 8.6 percent year-over-year. Since that time, the average rate paid on these accounts has fallen 19 percent and annual growth has slipped to 3.3 percent.

Credit unions will continue to manage deposit and asset growth down to protect their net worth and other key ratios; this implies slower share and deposit growth going forward. Those who maintain above market interest rates, risk large inflows of new money. Currently, few if any credit unions are able to earn a positive yield spread on new dollars in the door, especially if you include assessment basis points in your cost-of-funds calculation.

Loan Quality

At mid-year, the loan delinquency ratio (loans two or more months delinquent as a percent of total loans outstanding) stood at 1.2 percent, down 15 basis points over the past six months and 3 basis points since March. Delinquent loans are 0.8 percent of total assets at Region IV FICUs. In addition to the decline in delinquencies, at 0.7 percent, net charge-offs as a percentage of average loans are retreating, down 4 basis points in the past quarter and nine since mid-year 2010. Although both key measures of loan quality in Region IV are above historical levels, they remain significantly better than the results for the nation as a whole. Looking at high level detail, we see that real estate secured loan delinquencies are down fractionally with all of the improvement concentrated in fixed-rate product. At 0.4 percent, total real estate charge-offs to average real estate loans declined during the quarter, but remains 4 basis points above the prior year level.

Investments

With deposit growth more than double loan growth, total investments climbed 9.1 percent over the past year. Roughly 61 percent of the gain is attributable to cash on deposit. At $50.7 billion, investments now equal 26 percent of assets, up from 25 percent at mid-year 2010. Region IV FICUs are very liquid with 32 percent of investments in cash and equivalents. Falling interest rates pushed the average yield on investments down to 1.6 percent. This is down 38 basis points over the past year and 29 year-to-date. While average results are down, results at the margin are very concerning. Credit unions appear to be comfortable taking longer duration risk on investments since investments maturing in over 3 years rose 4.8 percent despite that fact that deposit growth is predominantly in liquid deposits.

Earnings and Capital Adequacy

Region IV annualized mid-year ROA was 74 basis points (84 basis points before effects of NCUSIF stabilization expense and premiums). Results improved from mid-year 2010 and are up year-to-date. Region IV FICUs underperformed ROA results for the nation as a whole by a small margin. Year-to-date, 25 percent of the FICUs in the Region reported a negative annualized ROA, but these 550 credit unions held just 6 percent of the Region's total assets.

At mid-year 2011, the Region IV FICU net worth ratio was 10.1 percent. This reflects a 13 basis point increase over the past year. The Region's net worth ratio is 6 basis points below the national average. A look at the detailed data shows 102 FICUs with a net worth ratio below seven percent. These FICUs held just 3.5 percent of the Region's assets. At mid-year 2010, there were just 118 FICUs with a net worth ratio below 7.0 percent holding 4.0 percent of all assets in the Region.

CUEG Region Five

CUEG Region Five is comprised of 13 states: Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, New Mexico, Nevada, Oregon, Utah, Washington, Wyoming, and the territory Guam. In the first six months of 2011, western region credit unions continued their trend of decreasing membership. Though membership growth remains slow nationally, Region V is the only segment with consistently decreasing membership figures. Year-to-date, total shares ($215.5B) are up $3.4 billion in Region V, but strong share growth in the first quarter was offset by a decrease of nearly $1.4 billion in Q2. Clearly the western region is still trying to find its footing in a shaky economy.

Loan Growth and Trends

Loan balances continue to decline in region V. While gains in other regions remain modest at best, region V is the only area with no positive loan growth over the past six quarters. Given the high unemployment in the region, particularly in California and Nevada, it is not surprising that loan demand remains depressed.

New auto loan balances continue to decline across all regions (down 5.4 percent year-to-date) as consumers defer new purchases or opt for less expensive used vehicle options. Reflective of this move away from new vehicles is the growth in the used auto vehicle market. So far in 2011, Region V has posted a modest, but positive gain of $136 (0.5 percent) million to its auto loan portfolio. Nationwide, that growth is more than $2 billion (2 percent).

Indicative of the troubled western housing market, first mortgage growth in Region V (0.2 percent, $139 million year-to-date) lags well behind the national trend (up 1.9 percent). Low long-term mortgage rates are prompting a refinancing boom. These refinanced loans are often sold in the secondary market, which decreases balances held on credit unions' books as they trade risk for more certain, albeit lower, short-term fee income.

Nationally, business lending is showing fairly strong growth in 2011 (up $799 Million, 2.6 percent), but that trend is reversed in Region V, where business loan balances are down $141 million (-1.3 percent). From Q1 to Q2, however, Region V did post a gain of $56.7 million (0.5 percent), perhaps signaling a reverse of the previous year's trend.

Loan Quality

Less we paint too grim a picture of Region V, it should be noted that it is making significant strides with regard to loan quality. Year-to-date, the national delinquency ratio has decreased 0.2 percent. In region V that figure is nearly doubled at -0.3 percent. Total reportable delinquent balances are down an impressive 16.1 percent (-$556 million). Similarly, charge-offs are showing an encouraging trend. Net total charge-offs have decreased $145.8 million (-24.6 percent) this year in Region V, more than double the amount of any other region.

Shares

Strong total share growth in the first quarter of 2011 (3.2 percent nationally) flattened out considerably in the second quarter (0.1 percent). Region V shares grew $3.4 billion (1.6 percent) in 2011, in spite of losing 1.4 billion (-0.6 percent) in the second quarter. Regular and Money Market shares show good to modest growth (7.1 percent and 3 percent), but this is offset by the sharp decline in time deposit balances. This year, share certificates have declined by $2.9 billion (-5.6 percent) as many credit unions, already flush with liquidity, are not aggressively bidding for additional deposits. With limited options for better yields, many credit union members are choosing not to renew current CDs, but rather let that money sit in liquid savings accounts until better rates become available.

Investments

With the Federal Reserve's recent announcement of its intentions to hold the Fed Funds target rate at current low levels through 2012, there is very little room left to find yields for credit union investors. Cash remains extremely high system wide, growing by 10.9 billion (14.6 percent) so far in 2011 nationally. Region V cash balances are up $1.9 billion (9.6 percent) so far this year. Since first quarter's initial burst of growth (up $3.75 billion), however, cash balances in Region V have declined 7.3 percent (-$1.8 billion) in the second quarter. Since loan growth remains sluggish, much of this decrease in cash can be attributed to other investing activities.

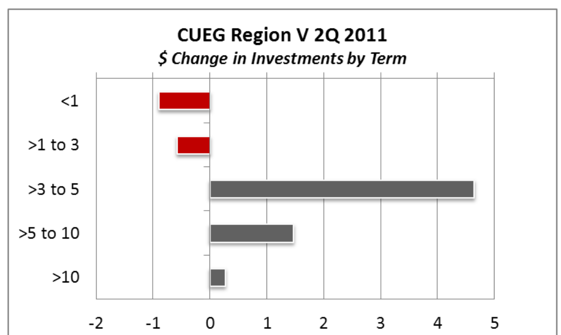


Figure 1

Investment balances are up 7.6 percent in 2011 for the region and 7.1 percent nationally. Most of that growth took place in the first quarter, as growing cash balances were invested in longer term investments for better yields. As we can see in Figure 1, credit unions are moving their investment dollars in large part to the 3 to 5 year maturity bucket. With short term and overnight yields at near record lows, this seems to be the current "sweet spot" for improving investment yield without locking up liquidity at excessive length. Figure 2 shows a fairly even distribution between short term, 1 to 3 year investments, and 3

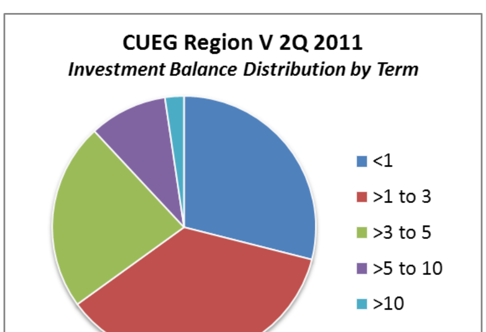


Figure 2

to 5 year investments. If short term rates remain at low levels, then we will likely see a continued shift of investment dollars to the middle ranges for maturities in an effort to prop up investment yields. Despite low yields, the industry is trying to preserve its flexibility, so that as loan demand returns, credit unions will still have ample ability to fund via their investment and cash balances.

Earnings and Equity

After several quarters of underperformance, Region V has now caught up to its peers in terms of profitability. Return on Assets (annualized) averages 0.1 percent nationally. Region five exceeded the national mark and averaged 0.1 percent, the highest of any of the CUEG regions. Net income is another bright spot, especially when compared to 12 months prior. In June 2010, Region V had a quarterly net income of $142 million. As of June 2011, that figure has climbed to $490 million; a 244 percent increase.

Operating expense has grown 4.5 percent ($166 million) since June 2010. Interest expense continues to decrease, as credit union managers try to maintain spreads while enticing loan growth through lower rates. There is a limit to how low deposit rates can sink. Interest expense declined almost 27 percent ($172 million) over the last 12 months.

Until loan demand returns or short term market rates increase, the pressures on interest margin will likely increase as we run out of room to decrease deposit rates much further. In region V, the net interest margin is showing the signs of this strain. Compared to the same time in 2010, regions one through four all increased their net interest margins. In that same time period, Region V's NIM decreased $73 million.

Despite the challenges of the past year, Region V has seen strong capital growth. Net worth has climbed $928 million in 2011 and $1.5 billion since June of 2010. Within those same timeframes, the net worth ratio has risen by 22 and 48 basis points and now stands at 9.7 percent. While this still lags the other four regions, Region V's net worth ratio paced the nation in its growth.

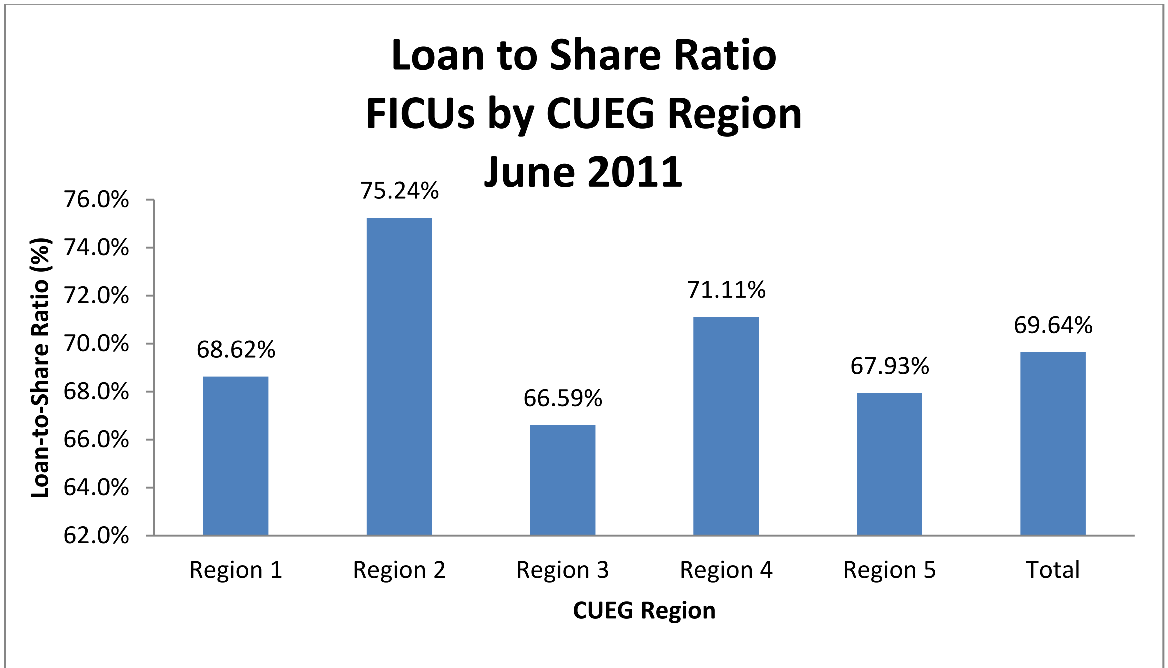
Commentary

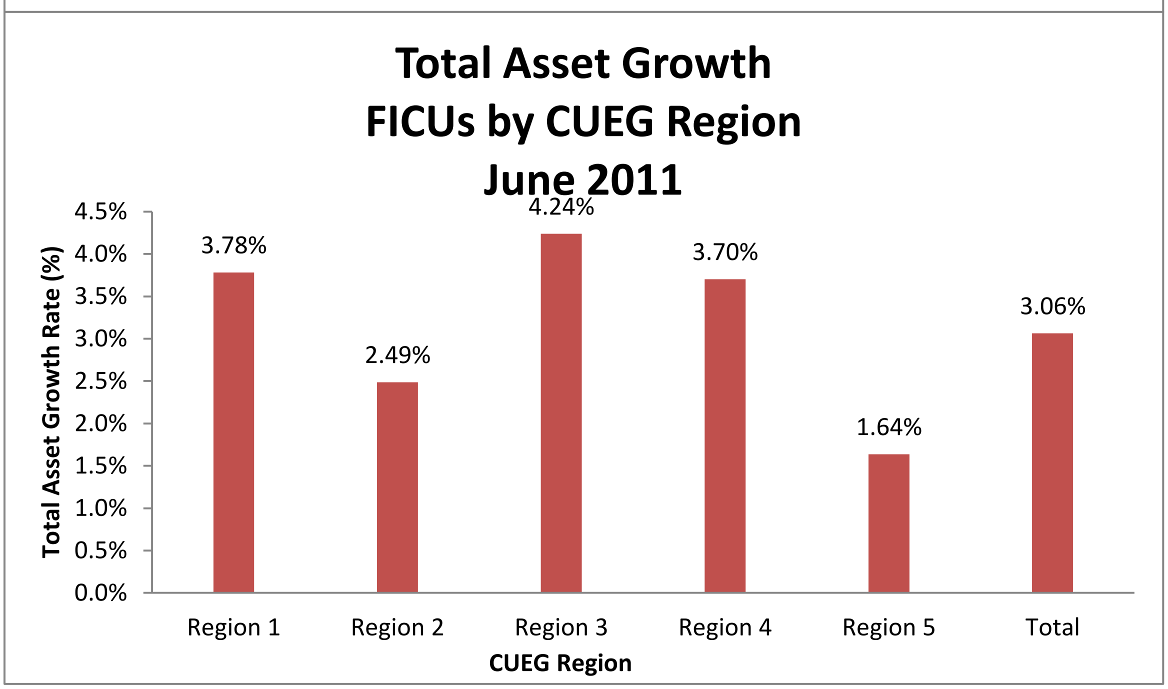
Region V has certainly endured a rough and stormy journey over the past few years. For those institutions that have endured the harsh economic conditions, hope now appears on the horizon. Earnings and capital are up, write-offs and delinquencies are down. However, caution must be maintained as not all dangers are past.

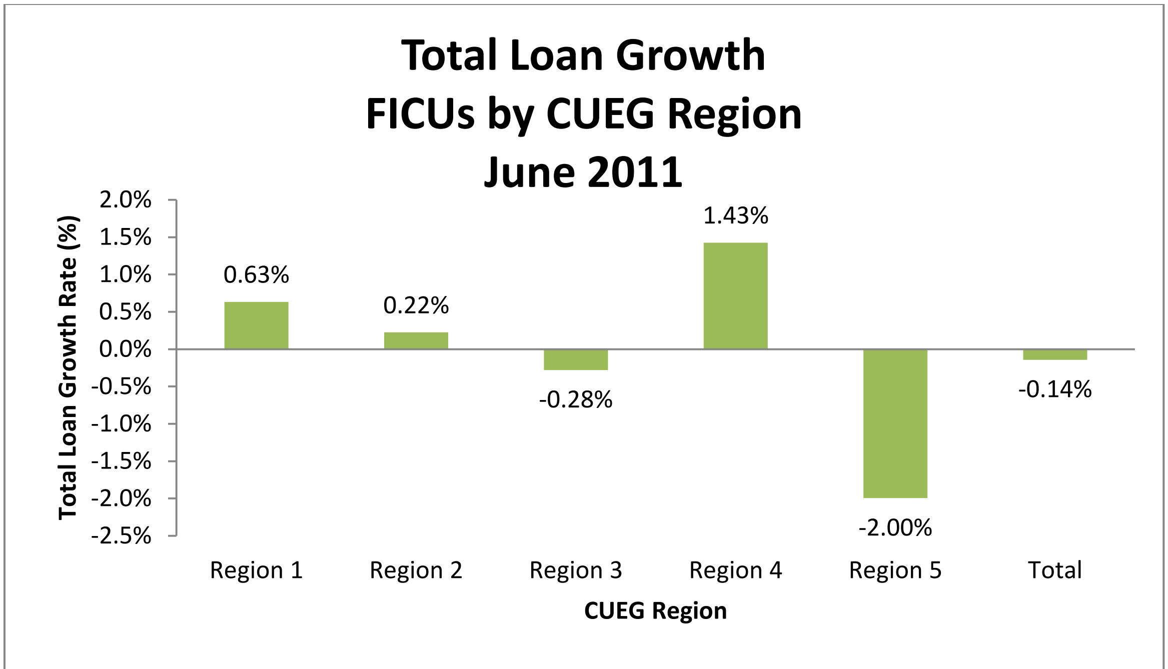
Lingering high unemployment and the accompanying consumer cautiousness threaten to stall or derail an economic recovery. Inflation will put pressure on low borrowing rates, possibly depressing consumer loan demand even further. Interest margins and investment yields are going to be increasingly difficult to maintain as long as the Federal Reserve holds target rates and bond yields at artificially low levels. Continued assessments from the NCUA to prop up failing institutions will hinder capital growth. Though we see sunlight peeking through on the horizon, we should keep our umbrellas at the ready, because the forecast still calls for a little more rain.

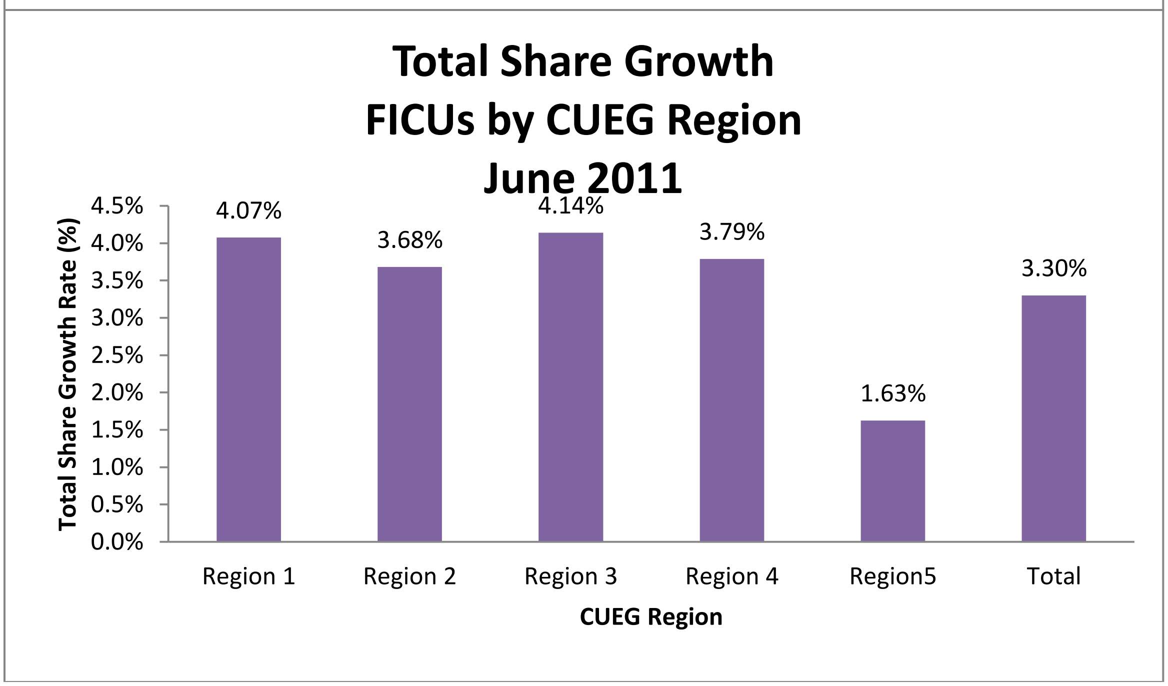
Credit Unions should continue to do their best to offer their members refuge from the storm. Willingness to make good loans to good members and to secure our members hard-earned savings will go a long way to earning their loyalty when the winds finally shift and prosperity shines down again.

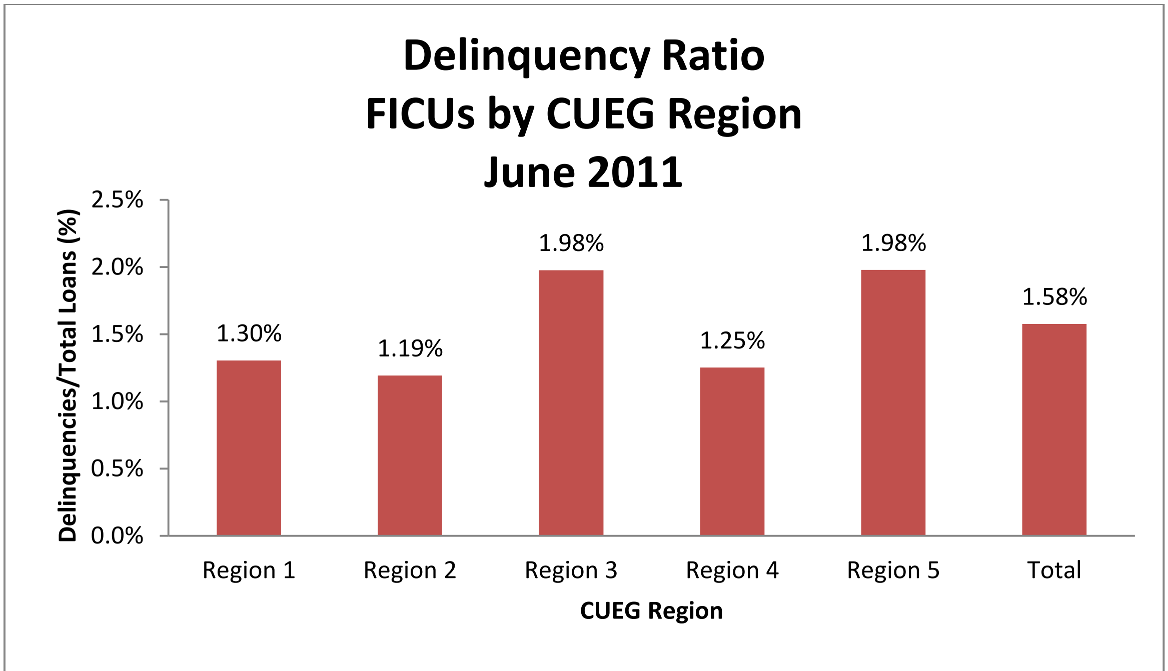
Appendix A:
CUEG Regional Financial Ratio Analysis

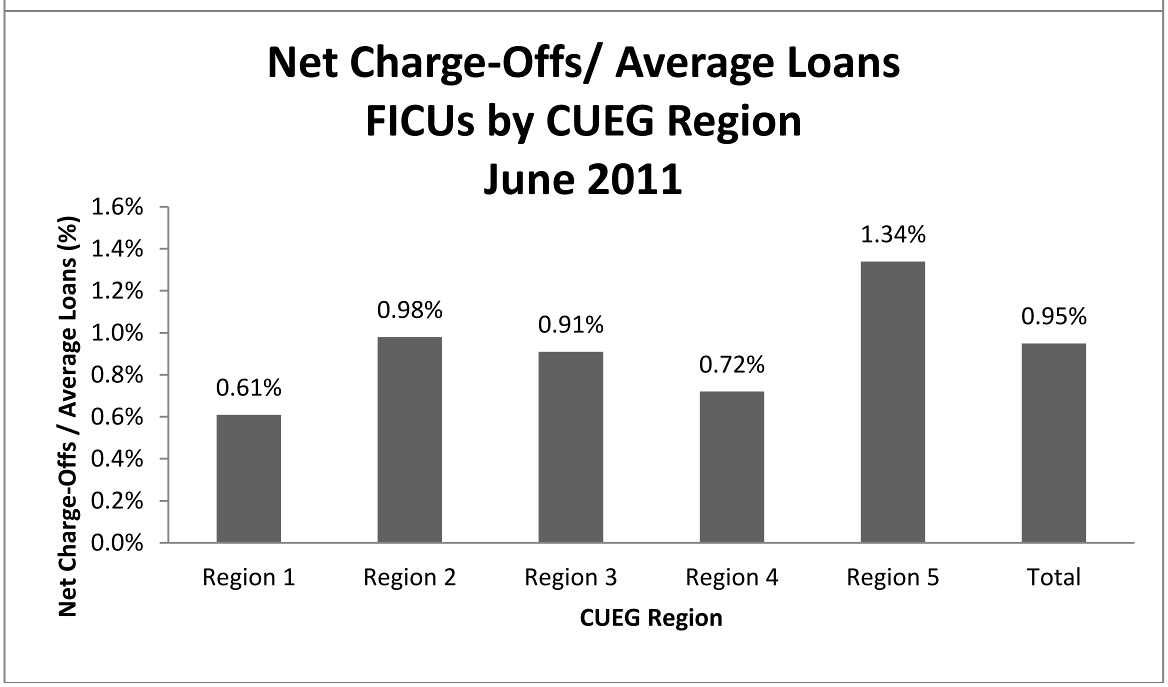


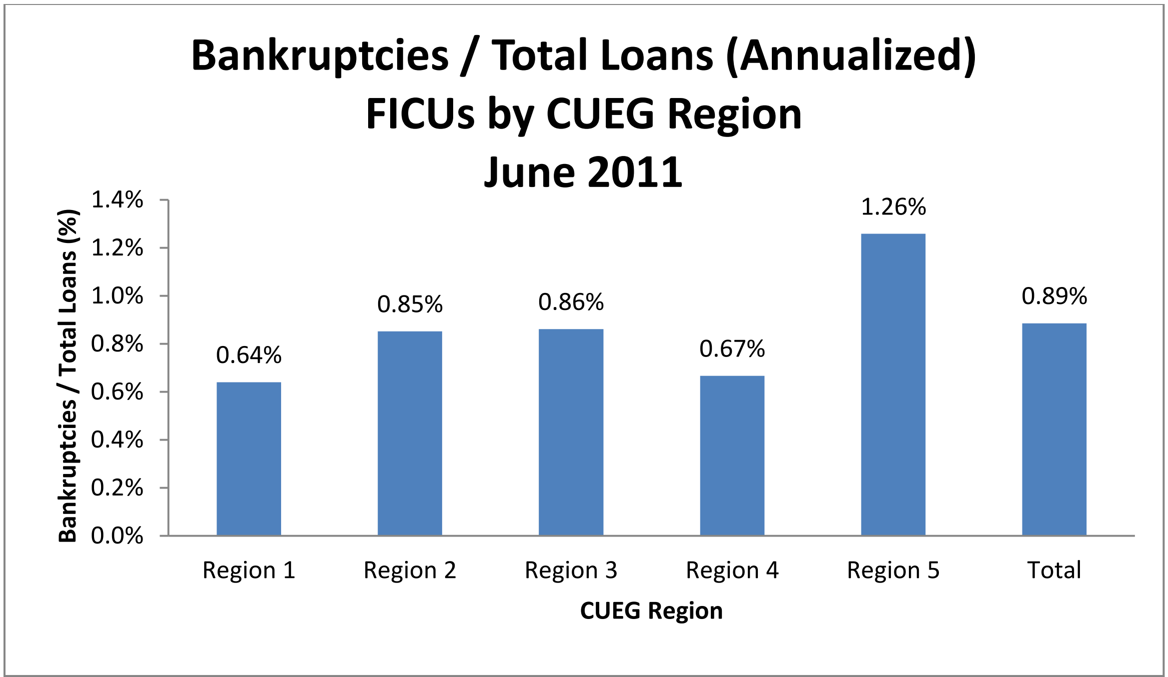


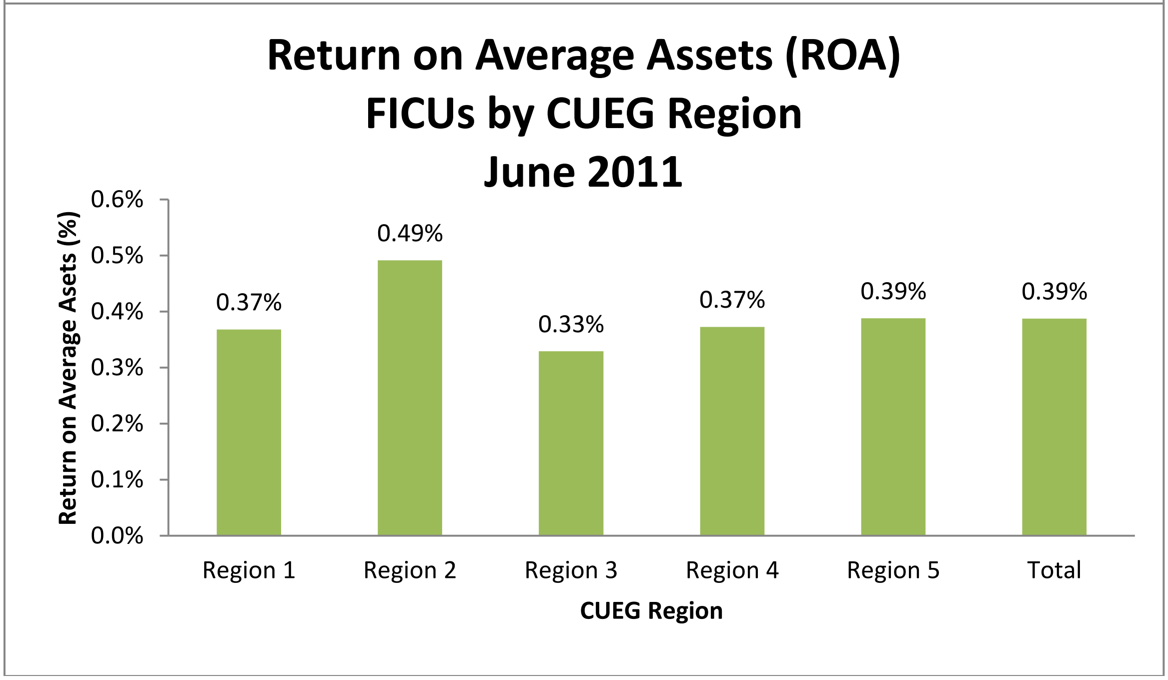

Total Loan Growth
FICUs by CUEG Region
June 2011
Total Loan Growth Rate (%)
2.0%
1.5%
1.0%
0.5%
0.0%
-0.5%
-1.0%
-1.5%
-2.0%
-2.5%
0.63%
0.22%
-0.28%
1.43%
-2.00%
-0.14%
Region 1
Region 2
Region 3
Region 4
Region 5
Total
CUEG Region


Total Share Growth
FICUs by CUEG Region
June 2011
Total Share Growth Rate (%)
4.5%
4.0%
3.5%
3.0%
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
4.07%
3.68%
4.14%
3.79%
1.63%
3.30%
Region 1
Region 2
Region 3
Region 4
Region5
Total
CUEG Region


Delinquency Ratio
FICUs by CUEG Region
June 2011
Delinquencies/Total Loans (%)
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
1.30%
1.19%
1.98%
1.25%
1.98%
1.58%
Region 1
Region 2
Region 3
Region 4
Region 5
Total
CUEG Region


Net Charge-Offs/ Average Loans
FICUs by CUEG Region
June 2011
Net Charge-Offs / Average Loans (%)
1.6%
1.4%
1.2%
1.0%
0.8%
0.6%
0.4%
0.2%
0.0%
0.61%
0.98%
0.91%
0.72%
1.34%
0.95%
Region 1
Region 2
Region 3
Region 4
Region 5
Total
CUEG Region


Bankruptcies / Total Loans (Annualized)
FICUs by CUEG Region
June 2011
Bankruptcies / Total Loans (%)
1.4%
1.2%
1.0%
0.8%
0.6%
0.4%
0.2%
0.0%
0.64%
0.85%
0.86%
0.67%
1.26%
0.89%
Region 1
Region 2
Region 3
Region 4
Region 5
Total
CUEG Region


Return on Average Assets (ROA)
FICUs by CUEG Region
June 2011
Return on Average Asets (%)
0.6%
0.5%
0.4%
0.3%
0.2%
0.1%
0.0%
0.37%
0.49%
0.33%
0.37%
0.39%
0.39%
Region 1
Region 2
Region 3
Region 4
Region 5
Total
CUEG Region

Appendix B: CUEG Regions

CUEG REGIONAL BREAKDOWN