Credit Union Economics Group
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Executive Summary

- As of December 2011, federally insured credit unions' (FICU) year-to-date asset growth was 5.2 percent. And while all the regions experienced positive growth, Region IV showed the greatest result with 6.6 percent growth in total assets compared with a 3.5 percent in Region V.

- Annual return on average assets (ROA) for all federally insured credit unions' was 0.7 percent. Compared to year-end 2010, ROA for all FICUs rose by 17 basis points in 2011. Region II showed the greatest result with an ROA of 0.8 percent in 2011.

- Share drafts saw an increase of 12 percent for all FICUs in 2011. Region IV experienced the largest growth of 14.8 percent, compared to 9.5 percent in Region I. Overall, share growth was up 5.2 percent. Regular share growth was 11 percent for the year while share certificates were down 4.4 percent over the same time period.

- New vehicle lending declined by 7.3 percent since year-end 2010 on the national level, with Region V reporting the strongest decline of 14 percent. This is a sector to watch as the fourth quarter's period-to-period change was positive in 3 of the 5 regions for the first time in over a year. Used vehicle lending grew 5.1 percent nationwide in 2011.

- First-mortgage real estate loans have grown by 4.2 percent during 2011. Other real estate loans experienced a 7 percent decline. First mortgages made the strongest contribution to total loan growth of 1.2 percent.

- In December 2011, the delinquency ratio decreased slightly by 14 basis points from December 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 percent in Region III.

- Although the economy continues its recovery and employment is improving, the challenges of slow loan growth appear to be the norm moving into 2012. The improvement in the economy may be hampered by rising fuel prices and continued pressure in housing, constraining the consumer from quickly adding to their debt levels.

- Credit Unions will need to compete for market share of the loan demand that is available with competitive pricing and reaching out to their membership. Driving operational efficiencies and creating a positive member experience will be the key to maintaining relevance with active members.

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 December 2011, there were 1,214 federally insured credit unions in the region, with total assets of $156.6 billion and total membership of 14.2 million.

Lending

During 2011, loans in Region I grew by 3.7 percent to $92.7 billion, outpacing the 1.2 percent growth rate for all federally insured credit unions (FICUs) nationwide. Through 2011, loan growth was concentrated in real estate loans and, to a lesser extent, used vehicle loans. The region's credit unions experienced relatively stronger loan growth for first-mortgage loan products (6.6 percent) than found nationwide (4.2 percent), while other real estate lending contracted less (-2.3 percent) than the nation as a whole (-7 percent). At year-end, real estate loans comprised 62.3 percent of all loans in the region. Vehicle loan portfolio growth was strong (2.3 percent) through 2011, especially when compared to growth for the whole nation (0.4 percent). New vehicle loans decreased 3.7 percent in 2011. Used vehicle loans rose, posting gains of 5.6 percent.

Credit unions nationwide experienced gains in unsecured lending growth. The nation's unsecured lending increased by 2.5 percent since December 2010. Region I unsecured lending inched up by 0.8 percent over the same time. In 2011, credit card lending in the region increased by 0.5 percent; non-credit card unsecured lending grew by 1.2 percent over the same period. Member business loans outstanding grew 13.8 percent to $7 billion.

Credit union leaders have indicated that their expectations for the next 12 months of loan demand in unsecured lending and new vehicle loans are unfavorable, when compared to the previous 12 months. They do not expect to see any significant change in loan demand for used vehicle loans or real estate loans over the next 12 months.

Member Shares

At year-end 2011, total share growth in Region I was 5.6 percent, higher than the 5.2 percent share growth experienced among all FICUs. FICUs in Region I saw share growth in "other" shares and regular shares outpacing the other deposit subdivisions, increasing by 11.8 percent and 10.6 percent, respectively (the growth in regular shares made up over 53 percent of the change in total shares since December 2010). Share certificates decreased 3.4 percent over the last 12 months, while IRA accounts have seen positive growth of 2.1 percent growth over the same time period. Money market shares also saw an increase of 9.8 percent. As we expect interest rates to remain low, members will continue to move funds into liquid deposits such as money market and savings accounts. The interest rates among the CDs have been declining and the largest decline has

occurred for the 3 year, 100K jumbo CD rate last year (minus 41 basis points). We expect this trend to continue through the end of the year.

The region's credit union leaders anticipate share growth to increase over the next 12 months, a sentiment shared by credit union leaders across the nation. The loan-to-share ratio fell from 71 percent at year-end 2010 to 69.7 percent at year-end 2011 because savings growth outpaced lending.

Earnings and Asset Quality

The credit unions in Region I had a return on average assets (ROA) before stabilization costs of 0.86 percent, up from 0.73 percent at year-end 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 ROA was 0.65 percent and the nation's was 0.68 percent. Though the region's loan yields were slightly lower than the national 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).

Region I's asset quality was superior to that of the nation on the whole, as measured by delinquencies and net charge-offs. The delinquency ratio for reportable delinquencies in the region was 1.4 percent compared to 1.6 percent for the nation. The net charge-offs ratio of 0.6 percent in the region was lower than the national rate of 0.9 percent, and the lowest among the five regions. Member bankruptcies were less of a problem in Region I when compared to other regions in 2011. The loan amounts subject to bankruptcy as a percentage of loans outstanding decreased from 0.6 percent in December 2010 to 0.5 percent by December 2011. The total number of bankruptcy filings over a 12-month period in the region decreased by 12 percent to 152,256 and the loan dollars subject to bankruptcy decreased from $553.9 million at year-end 2010 to $471.5 million at year-end 2011.

Many credit unions are focusing on improving their cross-selling skill set. Many members have up to three quarters of their loan balances with other financial institutions. Convincing existing members to convert loans held elsewhere increases efficiency; it would also be an effective method of deepening relationships with existing members and at the same time increasing corporate profitability.

Membership Growth

In October and November of 2011, word spread of a "Bank Transfer Day." This sprang up when Bank of America announced a monthly $5 debit card fee and bank costumers decided they had had enough and wanted to take their business elsewhere. The buzz of Bank Transfer Day gave credit unions the opportunity to educate potential customers on

the credit union philosophy, what a credit union is and the benefits credit unions offer that banks cannot. Region I has experienced tremendous growth since Bank Transfer Day.

Technology for many years has been something that banks have invested heavily in. As credit unions gain members from banks, technology levels must be increased to retain these members. More and more consumers are turning to convenient services like online and mobile banking to check balances, transfer funds and pay bills from their homes and mobile devices, instead of coming into a branch.

Member Concerns and Economic Conditions

In contrast to other parts of the country, Region I credit unions are seeing improvement in their delinquency and net charge-off ratios. As the economic recovery continues, many credit unions will continue to see reductions in credit losses and continue to focus on cross-selling products to members to increase revenues. Increased non-interest revenue and reduced provision expense will have a positive impact on the bottom line. While Region I's unemployment rate is still at 8.1 percent in early 2012, it is expected to improve by year end. As employment picks up in this region so will lending opportunities. As the recovery begins to gain traction, lending institutions will need to look past consumers' credit scores, which have taken a hit during the economic downturn. Finding the right balance of risk while making loans to borrowers with less than stellar credit will be a challenge for some financial institutions.

Members of Region I credit unions remain cautiously optimistic about the economy. There are many signs that that the economic recovery is taking hold. The economy is creating jobs, albeit at a lackluster pace. Consumer confidence has been marginally improving over the past few months. As consumers become more confident with their personal finances they will be more inclined to finance the purchase of vehicles and other consumer goods, creating opportunities for credit unions.

Whether the housing market has hit rock bottom is still open to debate, despite small gains in home values in some regions. Consumers that are underwater on their mortgage (home values significantly less than the amount owed) have resorted to walking away from their obligations and leaving the house and the resulting losses with their financial institutions. Stabilization of the housing market will help to curb the losses lenders are experiencing associated with strategic default - the event where borrowers have the wherewithal to pay their obligations but rather shift the loss to the lender.

Interest rates are another concern for credit unions and regulators alike. In order to be competitive in the mortgage lending market, financial institutions are forced to book new mortgage loans at record low interest rates. The negative impact that a sharp increase in interest rates would have on the balance sheet and the bottom line resulting from holding mortgage loans at historically-low interest rates is a risk that must be considered and managed.

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 14.7 million members in this region as of December 2011, up from 14.4 million (2.1 percent increase) from December 2010. These percentages mirror the regional economy where the gross domestic product by state is about 13.8 percent of the U.S. gross domestic product. Regional production is more concentrated in professional services, government, health/education services and transportation/utilities than the average concentrations found nationwide.

Lending

Region II FICUs generated positive loan growth of 0.8 percent in 2011, compared to the national rate of 1.2 percent. Credit card loans experienced the sharpest growth, increasing 8.7 percent in 2011. First mortgage loans grew by 2.9 percent during the year. Compared to the national average, Region II FICUs have stronger expectations for real estate lending over the next twelve months than FICUs in other regions.

Total vehicle loans in Region II increased by 0.6 percent during 2011, compared to a rate of 0.4 percent for all FICUs. In Region II used vehicle loans rose by 5.2 percent, while new vehicle loans decreased by 6.3 percent. Looking forward to 2012, Region II FICUs anticipate flat loan growth for new vehicle loans, while used vehicle loan growth is expected to remain strong.

Unsecured loans (excluding credit cards) represent 6.2 percent of all FICU loans in the region, which is unchanged from December 2010. Credit card loans grew in prominence – that segment now represents 11.8 percent of the region's loan portfolio, which is up 85 basis points from year-end 2010. The credit union leadership in the region believes that unsecured loans will experience flat growth for the near term, which is slightly more optimistic than the rest of the country.

Member Shares

Total savings and deposits reached $134.3 billion in December 2011, up $6.5 billion (5.1 percent growth) from December 2010. During 2011, Region II FICU share drafts (12.5 percent of Region II shares) increased 12.3 percent. Regular shares (27.8 percent of Region II shares) increased 9.6 percent during the same time period. Money market share accounts (20.7 percent of Region II shares) reached $27.8 billion as of December 2011, up by $2.2 billion (8.4 percent growth) from 2010. FICU share certificates (27 percent of shares) experienced a 3.5 percent decrease during 2011. IRA accounts (11.2 percent of FICU shares) were a safe haven for members' precious retirement funds in 2011. This

deposit segment advanced 3.6 percent from 2010 compared to a national growth rate of 1.6 percent. Expectations for share growth in Region II over the next 12 months are for positive growth, albeit at a slower pace than that of the nation as a whole.

Earnings and Asset Quality

Region II's credit unions experienced growth in consolidated ROA during 2011. At 0.81 percent (ROA for all FICUs was 0.68 percent), this profitability measure increased by 12 basis points since 2010 for the region's credit unions. This figure includes the stabilization fund assessment of 25 basis points. Comparing income before these costs, Region II annualized ROA was 1 percent in December 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 1.2 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 at least late-2014 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 before insurance premiums and stabilization fund assessments.

Gross income decreased by 2.1 percent from $8.14 billion in 2010 to $7.97 billion in 2011. Fee income/average assets declined by 1.8 basis points from 2010 and operating expenses/average assets decreased by 1.6 basis points.

Loan Loss Trends

In the area of loan quality, Region II FICUs had lower delinquency ratios than credit unions nationwide during 2011, but higher charge-off ratios. Reportable delinquencies (those which are 60 days late or more), fell seven basis points from 2010 to 1.3 percent. Annualized net charge-offs declined slightly, from 1.1 percent in 2010 to 0.9 percent in 2011. During this period, mortgage charge-offs decreased three basis points from 2010 to 0.4 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 among Region II FICUs was only one basis point below the nationwide the ratio of 0.7 percent.

Member Concerns and Economic Conditions

Credit union leadership in Region II stated they have gotten strong savings growth despite having reduced the interest rate, and this is making asset growth management 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. If

credit union members become convinced that recent improvements in the equity markets are sustainable, it may reduce the incentive to increase deposit levels at credit unions as a "flight to safety" measure.

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 first mortgage loans that are "upside down" and 2nd mortgage loans that are essentially unsecured.

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 stabilization costs will be between 8 and 18 basis points and NCUSIF premium assessments, if required, will be no more than 7 basis points. Some credit unions in this region have put business plans on hold or are modifying them as a response to the recommended premium range. 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 fourth quarter 2011 with 1,459 federally insured credit unions (FICUs). This represents a net decline of 43 (2.9 percent) of Region III FICUs over the past year. Region III holds 20.6 percent of all FICUs, 19.6 percent of all assets and 22.4 percent of all FICU members. Total assets in the region rose to $188.8 billion. This translates into a growth rate of 5.8 percent for 2011, at the same time the national growth rate for FICU assets was at 5.2 percent. Membership in the region climbed to 20.6 million, up from the 20.3 million recorded December 2010. Year-to-date membership growth in Region III kept pace with the national growth rate which was at 1.5 percent in 2011. Total employment (full- and part-time FICU employees) in Region III was 54,967, a decline of 0.7 percent from year-end 2010. The 50 largest FICUs in the region held 54.4 percent of all assets and 44.8 percent of the total membership in the region. Included in this group were 38 FICUs with assets in excess of $1 billion.

Although the economy continues to improve and signs are pointing to the housing market beginning to mend itself, the impact of the recession and housing crisis continues to affect this region, especially credit unions in Florida. This was one of the states in the region most impacted by significant declines in real estate values and placing many credit unions in the position of rebuilding their balance sheets. Because of these challenges, mergers continue to be a major factor impacting credit unions in the region as today there are 43 fewer credit unions in the region when compared to one year ago. Loan growth was just under 1 percent in the region, with some states showing much stronger growth than others. Growth rates of savings were slightly higher than those found among other credit unions nationwide. Automobile loans are a particular challenge as credit unions compete with the captive financing companies still offering zero percent loan options for new automobile loans and compete with nontraditional lenders to maintain a fair share of the used automobile market. Leasing options have also come back in vogue, providing incentive for consumers with a low monthly rate. Unsecured lending and mortgage refinancing have been the two positive areas of growth as rates remain at historic lows and home affordability has been at historic highs. 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.

As the banking sector goes through stress tests and continues to raise fees as they try to boost earnings and capital, 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 have money to lend and checking products that are better than those offered by banks. Seizing the market opportunity to gain checking accounts from banks continues to be the theme for credit unions in the region. At year-end 2011, Region III FICUs collectively remained in good health and their net worth ratio rose to 10.4 percent from

10.3 percent in June 2011. Region III's annualized Return on Average Assets (ROA) increased by 8 basis points to 0.79 percent over the past year (before NCUSIF assessments). Loan delinquencies were unchanged from their year-end level of 2 percent of total loans. The net loan charge-offs ratio declined 20 basis points from their December 2010 levels to 0.9 percent, equal to the national net loan charge-off rate.

Lending

At 0.7 percent, annual loan growth in Region III was lower than the national average of 1.2 percent. Georgia's FICUs posted the strongest year-to-date loan growth of all the Region III states & territories at 4.8 percent, followed by Puerto Rico (4.4 percent), and Ohio (3.7 percent). Mississippi FICUs experienced the worst year-to-date loan declines with a negative 3.6 percent rate, followed by Florida (-3.3 percent), South Carolina (-2.1 percent) and Alabama (-1.6 percent).

At 66.1 percent, the loan-to-share ratio was down 3.4 percentage points for the year; Region III under-performed the nation's loan-to-share ratio of 69.1 percent. The U.S. loan-to-share ratio declined 2.7 percentage points since December 2010.

A $1.6 billion gain in first mortgages and lines of credit accounted for the majority of loan growth year-to-date but new vehicle lending fell $1.1 billion during the year nearly canceling out the first mortgage gains. First mortgage originations totaled $10.7 billion during 2011, which is a slight decrease from the same period in 2010. First mortgage originations were largely driven by refinancing activity, with over 34.1 percent of loans sold to the secondary market. First mortgage loan sales to the secondary market were $3.7 billion for the region's credit unions and produced a 3.5 percent year-to-date first mortgage portfolio gain. When the 7.3 percent drop in home equity and second mortgages is added to first mortgages, the combined real-estate portfolio segment accounted for 54.3 percent of total loans for FICUs in Region III.

A 9.4 percent contraction in new vehicle loans outstanding for Region III FICUs was partially offset by the 4.3 percent increase in the used vehicle portfolio. Total vehicle loans outstanding in the region declined 0.6 percent over the year. Indirect loans outstanding were down 4.5 percent over the past year and now account for 10.7 percent of total loans.

As we begin 2012, the economy continues on its path to recovery as a host of data trends are pointing upward. Unemployment stood at 8.3 percent in February, much lower than the 10 percent level that was reached in October of 2009. Manufacturing shows continued strength while inflation remains in check. Consumer confidence has been inching slightly higher, helped mainly by the improving jobs picture and stock markets that ended the year in positive territory. But as we head into the summer months, higher gasoline prices may hamper confidence and impede additional consumer spending needed to keep the US economic recovery going forward. The market remains focused on the progress being made in the European region, specifically Greece. 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 vehicle loans on credit unions balance sheets. These loans posted a 9.4 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 at historically low rates. Maintaining access to credit card lines of credit remains a priority for individuals whose home values have declined, significantly diminishing home equity. The foreclosure process has taken much longer than many anticipated due to varying underwriting issues and the differences in state law.

The foreclosure process continues to be a drag on the overall economy, especially in Region III. Although the real estate market continues to see increased activity in many markets, mainly because of distressed sales, this process needs to take place to help begin to move the inventory overhang in housing. Continued pressure regarding job prospects and low home values continue to impact the willingness of consumers to take on new debt. Mortgage rates remain historically low and affordability levels are at an all-time high, which is helping to improve some markets within the region. Low mortgage loan rates, especially for terms of 15 years or less, kept the mortgage refinance market alive last year.

Member Shares

During 2011, total shares in Region III rose 5.7 percent to $164.4 billion. This gain was above the national average of 5.2 percent. Share drafts, regular shares, money market shares and IRA/KEOGH accounts all posted year over year growth while share certificate balances fell 4.4 percent across Region III. Sharp increases in regular shares and money market accounts combined with falling certificate concentrations indicate consumers are still waiting for a higher rate environment. Credit unions will need to prepare for when rates move higher, meaning a large portion of their short-term funds may move to other accounts or out of the credit union all together. While total share growth was up in every state & territory in Region III, North Carolina and Alabama experienced the strongest growth at 8.4 and 7.8 percent respectively.

The low interest rate environment remains in place and is anticipated to be the norm for the remainder of 2012 and possibly beyond. The Fed has repeatedly announced their commitment to keep rates low for an extended period of time, and their own forecast is that this will be the case until late 2014. Region III FICUs' cost of funds crept down 30 basis points to 0.9 percent of average assets over the past twelve months. The economic landscape remains uncertain which has continued to keep loan demand low as consumers continue to pay down debt and increase savings. In addition, some credit unions have moved away from riskier loans and have tightened underwriting, which has also helped put a damper on loan-to-share ratios. We expect the cost of funds to continue drifting lower, given shrinking loan demand coupled with lower reinvestment rates recognized today versus where investment rates were in the latter part of 2011. It will still be

imperative that credit unions continue to manage growth in deposits in relation to loan demand as they try to manage capital growth.

Asset Quality and Operational Results

At year-end 2011, the annualized ROA for Region III FICUs was 0.79 percent before NCUSIF assessments, reflecting an 8 basis point increase from the December 2010 level. A total of 992 FICUs (68.3 percent of the region's FICUs) reported a positive ROA, while 461 reported losses or no gain. The FICUs with a negative ROA represented 5.6 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 held by an institution with a negative ROA.

Although the economic and employment picture continues to improve, Region III continues to experience suppressed asset quality as the recovery continues to crawl along. The loan delinquency rate was unchanged over the past twelve months, and held at 2 percent of total loans. The national FICU delinquency rate at year-end 2011 was 1.6 percent of total loans, down 16 basis points year-to-date. Over the same period, net charge-offs decreased from 1.1 percent of average loans to 0.9 percent for both Region III FICUs and for the nation as a whole.

One measure of operating efficiency, the ratio of operating expenses to average assets, was down to 3.4 percent (5 basis points) from 2010's 3.5 percent. Operating expenses to gross income increased from 59.3 percent to 63.4 percent as income declined in proportion to operating expenses. Total non-interest expenses were up 2.9 percent from last year for Region III FICUs. Expenses related to travel & conferences, the corporate stabilization fund and miscellaneous operating expenses 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. In addition, credit unions have had to increase their investment portfolios due to the decline in loan demand; this has impacted earnings. Overnight rates remain below 0.25 percent while longer-term rates continue to trend lower.

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 begun to stabilize in much of the country, and in some areas, have actually seen some price appreciation. More homes are becoming rental properties as individuals and other investment groups are beginning to buy distressed properties inexpensively and are able to turn around and charge higher rents given the continued stress in the mortgage market. The value of used automobiles continues to show strength as consumers are focusing more on the cost and gas mileage of a smaller used car than buying a bigger, newer vehicle. Credit unions have begun to run out of ways to dramatically improve internal efficiencies to counter still anemic loan demand and extremely low investment rates, causing continued pressure on margins. Credit unions appeared to have slowed their expansion with building branches,

and are now focused on leveraging technology to ensure that service levels don't suffer as the result of the reductions of expenses.

We are seeing continued stabilization of the U.S. economy. The global economy still struggles with a variety of issues, with no remedy in sight for the near-term. There have been a number of "solutions" introduced in countries like Greece and Italy, but still the market waits for a consensus solution. Credit unions may not directly be impacted by these events, but they are concerned it may dampen the recovery here in the U.S. Credit unions continue to be active in capturing market share from the for-profit sector as the banks implement new fees and continue to battle other regulatory and internal challenges.

Credit unions still need to be aware of their own capital constraints as well as pressure to improve their bottom lines. The corporate credit union landscape continues to stabilize and will remain in a rebuilding process for years to come. However, the corporates that remain have continued to reinvent themselves under a new regulation that took effect in October 2011 and remain the key partner for many credit unions to access payment systems, investments and liquidity.

CUEG Region Four

CUEG Region IV (Austin) consists of 2,105 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 year-end 2011. The credit unions in this region represent 29.7 percent of all FICUs and with total assets of $201 billion, hold 20.9 percent of all FICU assets. Total membership in Region IV reached 20.5 million and now accounts for 22.3 percent of all FICU members. A high-level summary shows a net loss of 86 Region IV FICUs during 2011, but 6.6 percent asset growth. Region IV FICUs added 366,900 members in 2011 and loan growth of 3.9 percent was more than triple the 1.2 percent increase for the total market. The net worth ratio was unchanged at just fractionally below 10.1 percent. At the end of 2011, total employment (full and part-time FICU employees) was 58,785 and there were 5,453 branches within the region. The 50 largest FICUs in the region held over 46 percent of all assets and over 36 percent of the total membership. Included in this group are 33 FICUs with assets in excess of $1 billion, a net increase of three from year-end 2010.

Lending

Region IV FICUs generated 3.9 percent loan growth in 2011, up from 2.2 percent in 2010. FICUs in Region IV added $4.6 billion to loans and accounted for almost 68 percent of reported loan growth in the nation. Total loans outstanding in Region IV now equal $123.2 billion, representing 61.3 percent of total assets, down from almost 69 percent at the beginning of the recession. Roughly 60 percent of all loan growth in 2011 was attributable to the 50 largest FICUs.

Over the course of 2011, first mortgages and used vehicle loans were the largest components of loan growth, accounting for just over 100 percent of the annual change. First mortgages increased 6.4 percent during the year and accounted for over 54 percent of all loan growth. Used vehicle loans rose 7.7 percent in 2011 and accounted for over 46 percent of Region IV loan growth. Significant declines were reported in the new vehicle and other real estate loan categories. A resurgence in new vehicle sales in early 2012 could reverse this trend.

While down $2.6 billion from 2009's record pace, 2011 was a solid year for originating member real estate secured loans. A total of $17.2 billion in first mortgages were originated in 2011, the fourth-highest year ever. Roughly 71 percent of 2011 originations were in fixed-rate product, 22 percent in balloon/hybrid and just 7 percent in adjustable-rate loans. Other real estate loans granted were down 21.6 percent in 2011 as fixed-rate loans with historically low rates offered a much better member value. Consistent with the national trend, Region IV credit unions further decreased the proportion of real estate loans sold to 48.6 percent of loans granted as compared to 53.9 percent sold in 2010 and 57 percent in 2009.

Although improved from last year, FICUs nationwide continue to struggle with their vehicle loan portfolio. While Region IV FICUs saw new vehicle loans decline 1.4 percent, this was significantly less of a drag than in 2010 when this portfolio segment fell 9.5 percent. Used vehicle loan growth was solid, increasing 7.7 percent during the year. In total, the vehicle loan portfolio in Region IV rose 4.1 percent. This is much better than the entire FICU market, which posted a 0.4 percent increase. In 2011, just 47 percent of Region IV FICUs reported vehicle loan portfolio gains and 31 percent reported gains in new vehicle loans outstanding (in 2010 this share was only 16 percent). In total, Region IV vehicle loans increased just $1.8 billion in 2011 with 48 percent of the increase showing up in point-of-sale indirect loans which were up $894 million.

Region IV credit card balances grew 5.4 percent in 2011 and their share of loans increased fractionally to 4.7 percent. Member business loan (MBL) growth of 5.6 percent was solid, but well below growth rates in 2009 and 2010 (13.3 percent and 7.0 percent respectively). MBLs represented 7.2 percent of total loans, up 12 basis points during the past year. FICUs in Region IV granted $3.1 billion in MBLs in 2011, down 16.1 percent from 2010 origination volumes. The average MBL outstanding is $150,300, down 3.1 percent since year-end 2010.

Member Shares

Total shares and deposits finished the year up $11.1 billion or 6.8 percent. Growth results in 2011 were fractionally better than 2010 and 1.6 percentage points above the national average. Historically low deposit yields were part of an overall strategy to discourage large deposit inflows. Total shares and deposits finished the year at $174.8 billion, with more than 95 percent of the gain coming from highly liquid accounts (share drafts, regular shares, and money market accounts).

Since peaking at $46.5 billion in 2009, the CD (or share certificate) component of the deposit portfolio has come down 2.3 percent. The Region IV decline was much less than the 9.5 percent contraction reported by all FICUs. This portfolio segment now equals 26 percent of all deposits, down from 30 percent in 2009. After advancing 5.8 percent in 2010, IRA/KEOGH balances were up just 2.2 percent in 2011. At $14.9 billion, this portfolio now represents 8.5 percent of all deposits.

Regular shares grew 9.8 percent during the year with 69 percent of the gain occurring in the first quarter. Regular shares were the largest contributor to deposit growth despite weighted average yields falling from 0.57 percent in 2010 to 0.42 percent. Two major credit unions bias this yield higher, as 67 percent of all Region IV FICUs reported regular share yields below 0.42 percent. The $5.1 billion increase in this portfolio segment accounted for 46 percent of all deposit growth in 2011 and regular shares now equal 31.4 percent of all deposits.

Again in 2011, credit unions lowered deposit yields across the board. With low loan portfolio demand it remained difficult to profitably deploy deposits. The loan-to-asset

ratio finished 2011 down 161 basis points at 61.3 percent. Even the Fed-engineered yield curve wasn't enough for Region IV FICUs to sustain their net interest margin as it fell 11 basis points to 3.14 percent. Over the course of 2011, the average cost-of-funds for credit unions in the region fell to 95 basis points. Until FICUs can deploy more assets in member loans, they will not aggressively pursue member deposit growth as the marginal deposit in the door is likely earning a negative yield when accounting for expenses, insurance and assessments versus short-term investment yields. Once again, this implies slow deposit and asset growth in 2012.

Asset Quality

Over the course of 2011, loans two or more months delinquent as a percent of total loans outstanding (delinquency ratio) fell to 1.3 percent or seven basis points below the year-end 2010 and 22 basis points down from the 2009 peak. Delinquent loans now equal 0.8 percent of assets. In addition to lower delinquencies, charge offs moved down from 0.8 percent of average loans in 2010 to 0.7 percent at year-end 2011. Both key measures of loan quality in Region IV improved in 2011 and were much better than the results for the nation as a whole. Looking at high-level detail, we see that real estate secured loans (first mortgages, second mortgages and home equity loans/lines of credit) two or more months delinquent rose just 1.6 percent in 2011, but the real estate delinquency ratio fell fractionally to 1.5 percent. Credit card delinquencies fell almost 17 percent and are 33 percent off their peak in 2009. The credit card delinquency ratio now stands at 1.2 percent of outstanding balances. With net charge offs down 10.6 percent in 2011 and the provision for loan losses falling 17.2 percent, we have passed the peak of credit quality challenges for this cycle. This conclusion should hold, barring further market shocks and a continuation of the trend of improving employment conditions within the region. Credit unions also appear to be maintaining a healthy allowance for loan loss. The allowance to delinquent loan ratio increased to a 5 year high of 84.3 percent from a low in 2008 of 67.5 percent. This ratio, however, is below the national average of 96 percent.

Investments

With deposit inflows outpacing loan growth by almost three percentage points, Region IV credit union investments rose by over 10 percent to $52.8 billion. Investments now equal 26 percent of Region IV assets, up from 20 percent before the recession. When combined with cash and cash equivalents, the year-end 2011 ratio climbs to almost 35 percent. Given that the yield on average loans is 428 basis points above the yield on average investments, this higher share of cash and investments is constraining bottom line growth. Credit unions in the region continue to maintain an investment portfolio with relatively longer maturity which could present interest rate risk when rates rise.

Earnings and Capital Adequacy

Region IV full-year return on average assets (ROA) was 63 basis points, an increase of 11 basis points from full-year 2010. Estimates show that without stabilization expense

and NCUSIF premiums, the Region IV ROA would have been 84 basis points. Region IV results were just fractionally worse than the nation as a whole, primarily due to a smaller reduction in the provision for loan and lease losses. At the end of 2011, 30 percent of the FICUs in the region reported a negative ROA and these FICUs held 7.5 percent of the Region's assets. Just four credit unions with assets over $500 million reported a negative ROA.

Despite credit quality issues, stabilization assessments, NCUSIF premiums and minimal loan portfolio growth, Region IV FICUs were able to hold their collective net worth ratio at 10.1 percent. This key measure of safety and soundness is fractionally less than the national average, but these more stable credit unions need less of a capital buffer. A closer look at the data indicates 92 Region IV FICUs had a net worth ratio below 7 percent. These credit unions held just 3 percent of the Region's assets.

CUEG Region Five

CUEG Region V is comprised of 13 states: Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, New Mexico, Nevada, Oregon, Utah, Washington, Wyoming, and the territory Guam. In 2011, western region credit unions grew their membership by 0.8 percent. Membership growth remains slow nationally, and once again Region V has demonstrated the lowest growth rate in membership figures. Year-to-date, total shares ($215.5B) were up 3.6 percent in Region V. In spite of the positive share growth, Region V continues to experience markedly weaker year-over-year share growth compared to the other regions. One plausible reason for the comparatively weaker share growth could be a higher concentration of credit unions that operate within the region having strategic priorities to protect capital as opposed to encouraging share growth. Continued anemic loan demand is allowing for over-abundant liquidity thereby relieving the pressure to create deposit growth.

Lending

Loan balances continue to decline in Region V. While gains in other regions remain modest at best, Region V is the only region with negative total loan growth (-1.9 percent) over the past 12 months. Continued high unemployment, combined with substantially eroded residential and commercial real estate equity, particularly in California and Nevada, is an ongoing challenge to Region V's ability to generate any notable loan growth. However, fourth quarter 2011 saw the first positive quarter-to-quarter growth for the region in over a year.

New auto loan balances continued to decline across all regions (down 7.3 percent year-to-date) as consumers deferred new purchases or opted for less expensive used vehicle options. Reflective of this move away from new vehicles is the growth in the used vehicle market. In 2011, Region V posted a modest, but positive gain of $797 million (3 percent) to its used vehicle loan portfolio. Nationwide, that growth is more than $5 billion (5.1 percent).

Indicative of the ongoing weakness of the western real estate market, first mortgage growth in Region V (2.4 percent, $1.445 billion year-to-date) lagged well behind the national trend (4.2 percent). Despite the historically-low interest rate environment, reduced equity has substantially tempered refinance activity. Purchase activity remains relatively robust, but prices are much lower than even a year ago. It has taken about 20 percent more loan volume to equal the dollar volume of closings from just two years ago. Combine these trends with the recently ramped-up pressure upon credit unions to avoid interest rate risk and you have a recipe for lousy mortgage growth.

Nationally, business lending showed strong growth in 2011 (up $1.9 billion, 5.1 percent), but that trend was not matched by Region V, where business loan balances were down $301 million (-2.1 percent). Both regulators and credit union management within the

region have cast a wary eye upon increasingly negative commercial real estate trends. These trends have lagged the residential market somewhat, due in part to guarantors' financial ability to "carry" properties a bit longer after losing tenants and/or lowering rents. The trend in Region V, for the most part though, will continue to mirror the residential trends, particularly as the guarantors run out of steam. To put a positive light on the matter though, the quarter-to-quarter changes have been increasing over the last three periods.

Asset Quality

It should be noted that Region V is making significant strides with regard to loan quality. Year-to-date, the national delinquency ratio has decreased 8.2 percent. Region V has brought that ratio down by 17.7 percent compared with December 2010. Similarly, charge-offs have shown an encouraging trend. Net total charge-offs have decreased $642.4 million (-25.5 percent) through 2011 in Region V, more than in any other region.

Before we get too excited about these trends though, we need to remind ourselves that Region V has been pre-positioned for "most improved" performance simply because, comparatively, it had previously fallen much further than other regions in the areas of delinquency and charge-offs. The trends are positive nonetheless and most likely an indicator of anticipated improved ROA performance as a result of reduced loan loss provisions.

Member Shares

Region V shares grew $7.7 billion (3.6 percent) in 2011, in spite of losing $1.4 billion in the second quarter. Regular and Money Market shares experienced solid growth (11.9 percent and 5.2 percent, respectively), but this was offset by the sharp decline in time deposit balances. Over the last 12 months, share certificates have declined by $48.9 billion (-8.4 percent) as many credit unions, already flush with liquidity, are not aggressively bidding for additional deposits.

Credit unions and their members are now betting on rising rates. Traditionally, in a relatively low-rate environment, credit unions would be making a bit more of an effort to lock in longer-term funding. But the extraordinary liquidity trends and capital preservation priorities have relegated those pricing strategies to the past. From the member's perspective, with limited options for better yields, most are choosing not to renew current certificates, instead choosing to let that money sit in liquid savings accounts until better rates become available. Alternatively, increasing numbers are starting to explore brokerage options (for those credit unions with such investment programs) in search of higher returns.

Investments

With the Federal Reserve's continuing policy to hold the Fed Funds target rate at current low levels through 2014, there is very little room left to find reasonable yields for credit union investment portfolios, without unreasonable term extension, or having to accept inordinately high securities premiums. Cash remains extremely high system wide, having grown by 20.6 billion (27.7 percent) in 2011 nationally. Region V cash balances have grown $4.5 billion (22.1 percent) since December 2010. Since the dramatic drop between the first and second quarters (-$1.8 billion), there was a dramatic rise in the third quarter ($3 billion) and a decline in the fourth (-$418 million). Marginal increases in loan demand and decreasing share growth trends probably spurred the drop in this most recent quarter.

Investment balances were up 9.1 percent in 2011 for the region and 7.6 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 have moved their investment dollars in large part to the 1 to 3 year and 3 to 5 year maturity buckets. 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 the 1 to 3 year investments were just shy of the majority of investment holdings. The industry seems to be 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.

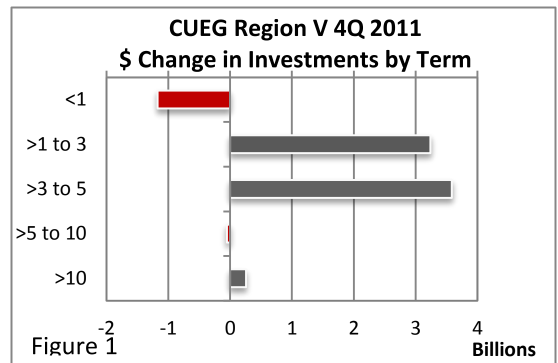


Figure 1

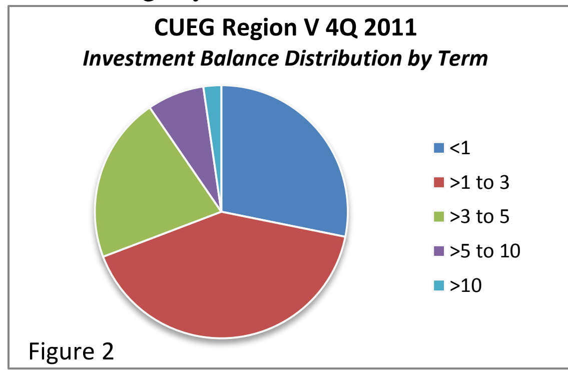


Figure 2

Earnings and Equity

Region V caught up to its peers in terms of profitability in 2011. Return on Assets averaged 0.68 percent nationally. Region V exceeded the national mark and averaged 0.69 percent. Net income has been another bright spot, especially when compared to 12 months prior. In December 2010, Region V had a quarterly net income of $396 million. As of December 2011, that figure had climbed to $509 million - a 28.5 percent increase.

Operating expense has grown 1.4 percent ($109 million) since December 2010. Credit unions continue to exercise extreme caution in controlling operating expenses. Interest expense continued to decrease, as credit union managers have tried to maintain spreads

while enticing loan growth through lower rates. Interest expense declined 25.6 percent ($632 million) over the last 12 months.

The velocity of the decline in cost of funds is waning however, and 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 has shown the signs of this strain. Compared to the same time in 2011, Regions one through four all increased their net interest margins. In that same time period, Region V's NIM decreased $307 million.

Despite the challenges of the past year, Region V has seen strong capital growth. Net worth has climbed $1.7 billion in 2011. Within that same timeframe, the net worth ratio has risen by 35 basis points and now stands at 9.8 percent. While this still lags the other four regions, Region V's net worth ratio nearly paced the nation in its growth.

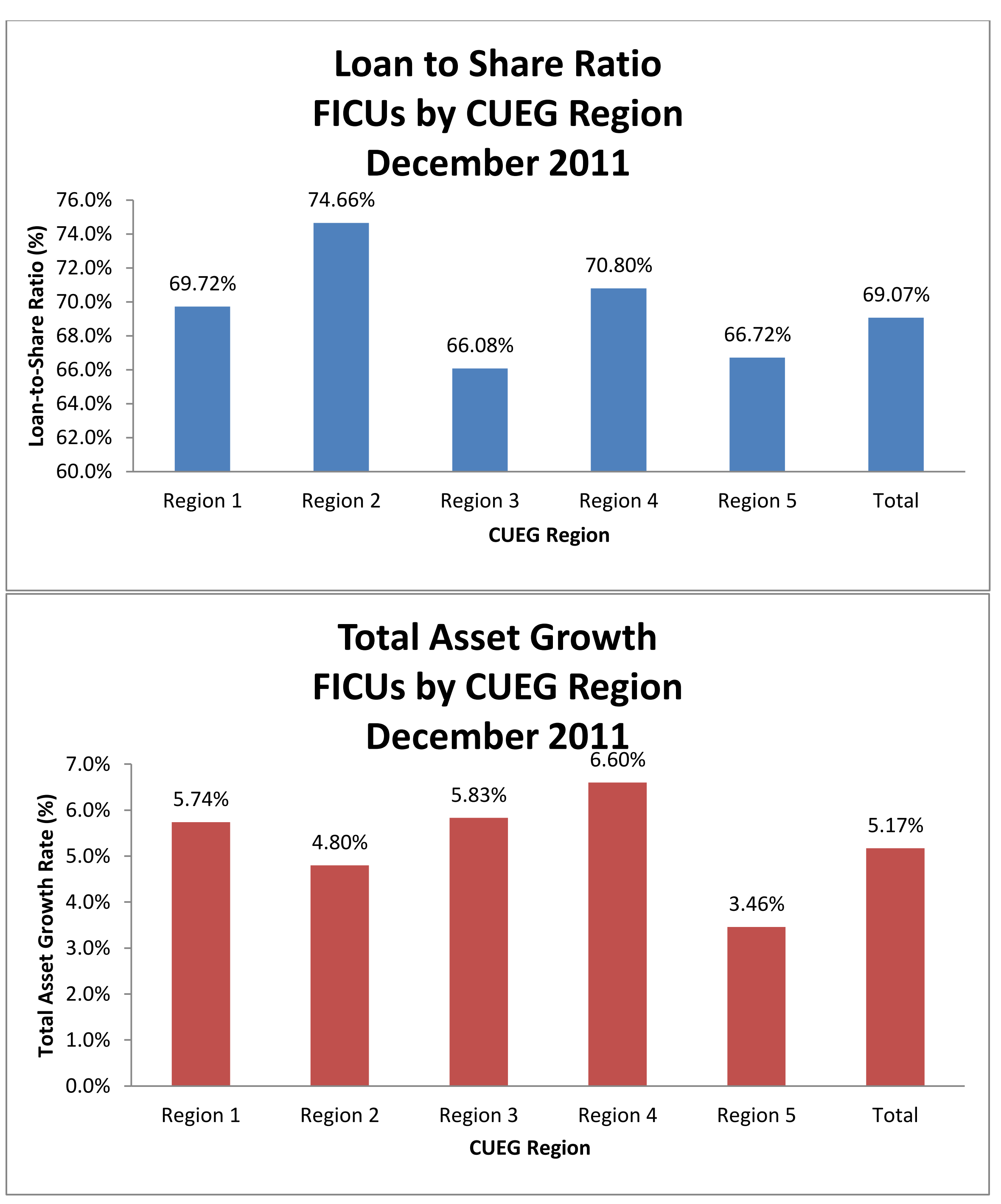
Commentary

Region V operations continue to weather a relatively anemic recovery. Improved profits, driven primarily by reduced pressure to fund allowances, have provided a much deserved respite. Among the biggest hurdles for Region V management teams may be regaining an aggressive attitude toward growth. After being hunkered down for a couple years, watching one bizarre economic statistic after another make its way onto our collective screens, it won't be an easy (or rapid) transition.

Cautious optimism combined with recession fatigue will probably spur most boards and management teams to start taking a few more risks, particularly as it relates to balance sheet strategies and addressing the ongoing and anticipated hits to net interest income. The options available here still seem quite murky. Can we generate any type of reasonable loan demand while unemployment remains at extremely challenging levels, real estate equity and appreciation is still a distant memory, and credit quality continues to diminish?

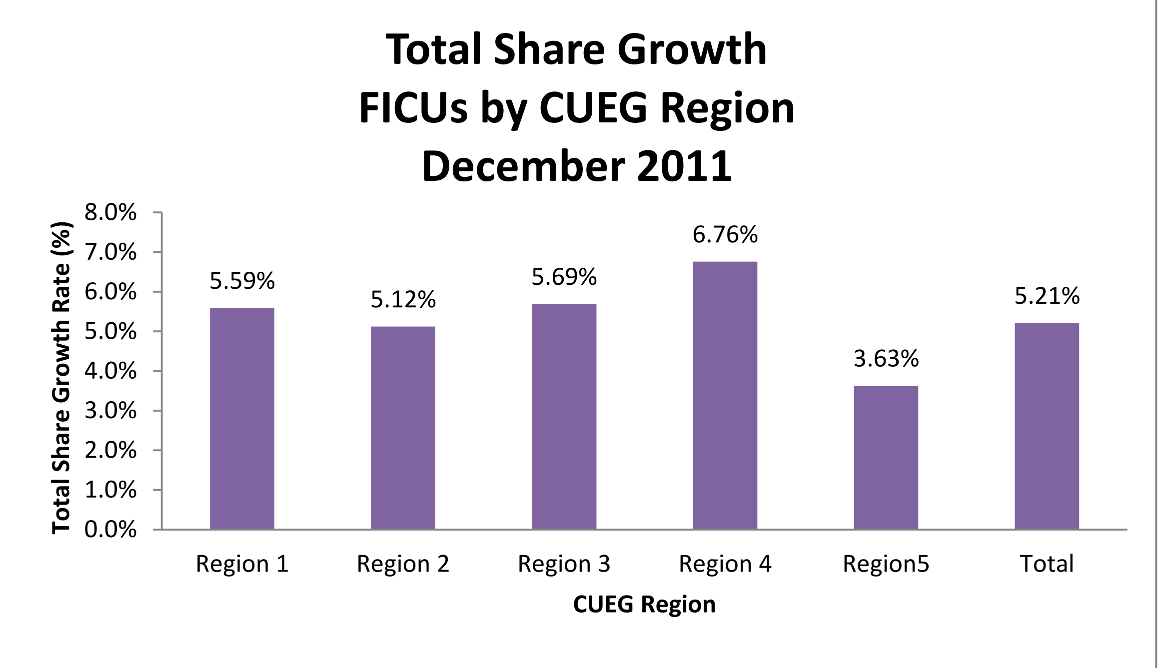
The region as a whole is watching closely for reliable signals that the worst is behind us; but at the same time, realizing that the signals will be varied and tenuous at best. Marketing budgets are increasing and new & updated products are starting to emerge to create attractive options for prospective new members who have become dissatisfied with how their bank chose to grapple with the economic recovery and with Dodd-Frank. Also, more credit unions are becoming comfortable wandering down into the B and C levels of the credit pool in an effort to productively sop up liquidity and alleviate the pinch on net interest income. Credit unions need to continue to exercise caution as they move forward in capitalizing on the opportunities presented by the economic recovery at hand. Hopefully the lessons we have learned during the Great Recession will carry the industry forward successfully for many years.

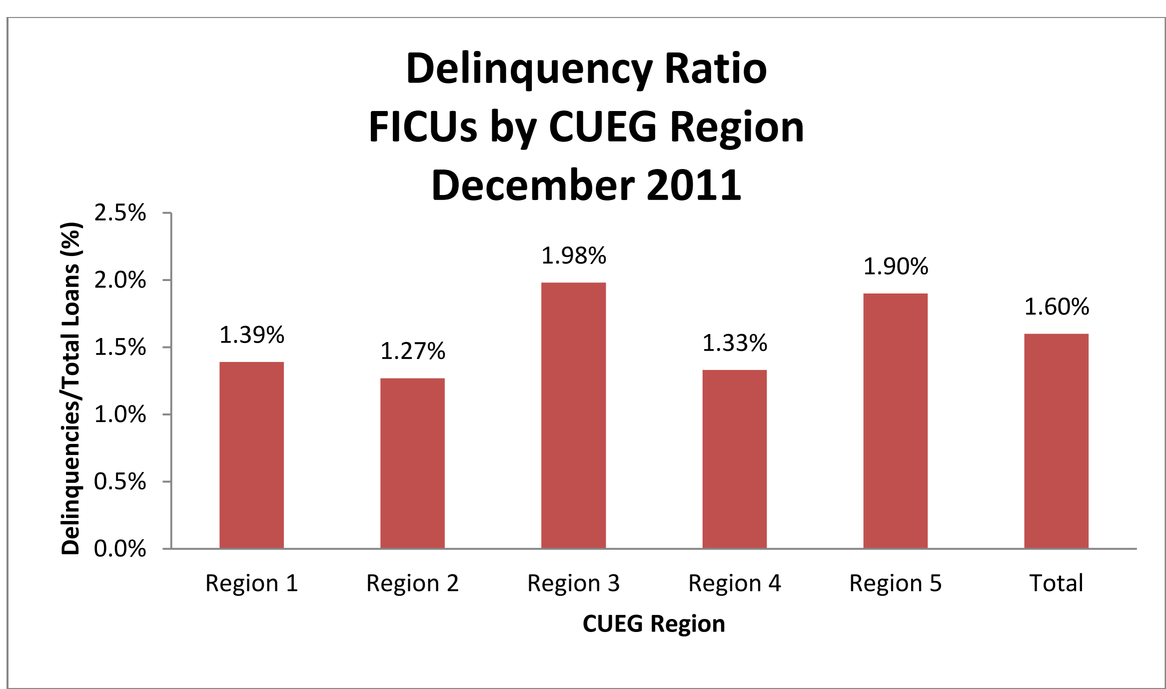
Appendix A:
CUEG Regional Financial Ratio Analysis

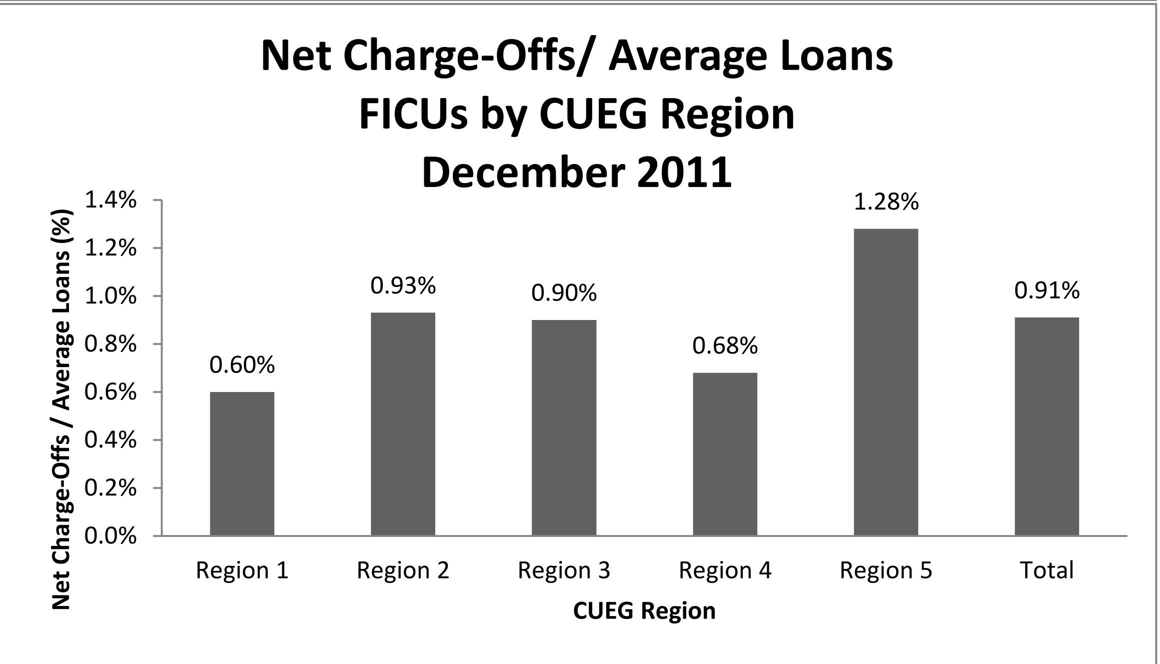


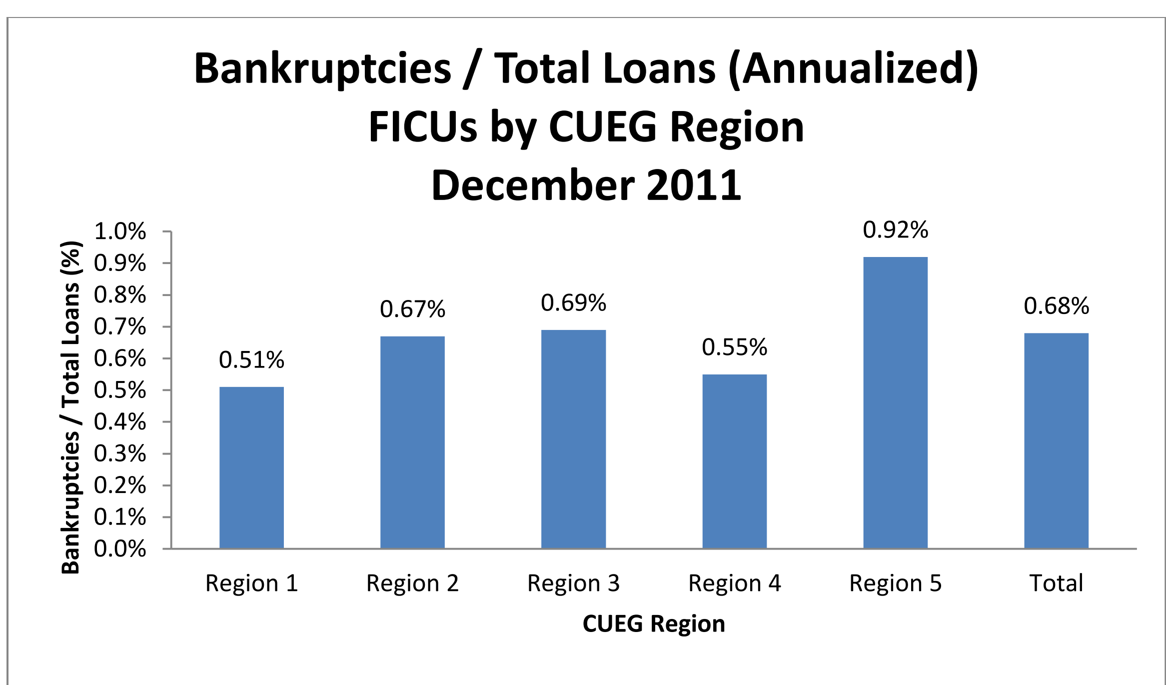
Total Loan Growth
FICUs by CUEG Region
December 2011

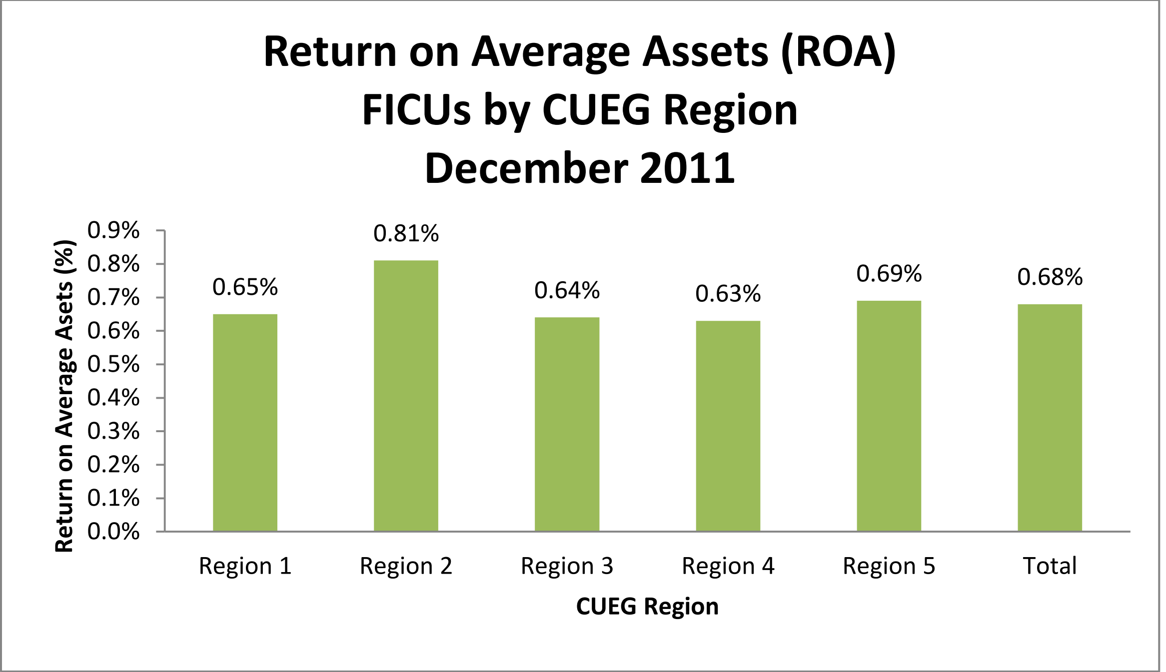
Total Loan Growth Rate (%)
5.0%
4.0%
3.0%
2.0%
1.0%
0.0%
-1.0%
-2.0%
-3.0%
3.70%
0.83%
0.68%
3.87%
-1.85%
1.18%
Region 1
Region 2
Region 3
Region 4
Region 5
Total
CUEG Region




Delinquency Ratio
FICUs by CUEG Region
December 2011
Delinquencies/Total Loans (%)
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
1.39%
1.27%
1.98%
1.33%
1.90%
1.60%
Region 1
Region 2
Region 3
Region 4
Region 5
Total
CUEG Region


Net Charge-Offs/ Average Loans
FICUs by CUEG Region
December 2011
Net Charge-Offs / Average Loans (%)
1.4%
1.2%
1.0%
0.8%
0.6%
0.4%
0.2%
0.0%
0.60%
0.93%
0.90%
0.68%
1.28%
0.91%
Region 1
Region 2
Region 3
Region 4
Region 5
Total
CUEG Region


Bankruptcies / Total Loans (Annualized)
FICUs by CUEG Region
December 2011
Bankruptcies / Total Loans (%)
1.0%
0.9%
0.8%
0.7%
0.6%
0.5%
0.4%
0.3%
0.2%
0.1%
0.0%
0.51%
0.67%
0.69%
0.55%
0.92%
0.68%
Region 1
Region 2
Region 3
Region 4
Region 5
Total
CUEG Region


Return on Average Assets (ROA)
FICUs by CUEG Region
December 2011
Return on Average Assets (%)
0.9%
0.8%
0.7%
0.6%
0.5%
0.4%
0.3%
0.2%
0.1%
0.0%
0.65%
0.81%
0.64%
0.63%
0.69%
0.68%
Region 1
Region 2
Region 3
Region 4
Region 5
Total
CUEG Region

Appendix B: CUEG Regions

CUEG REGIONAL BREAKDOWN