

CREDIT UNION ECONOMICS GROUP (CUEG) PANEL

**National Association of
Federal Credit Unions
Annual Conference
Honolulu, Hawaii
July 19, 2007**

For more information on CUEG:

www.cueg.org

PROBLEMS & SOLUTIONS

INVERTED YIELD CURVE

- Tun Wai
NAFCU
- Bob Burrell
WesCorp FCU

FUTURE FUNDING SOURCES

- Bruce Fox
Southwest Corp FCU
- Eli Vazquez
American Airlines FCU

ATTRACTING NEW MEMBERS

- Dave Colby
CUNA Mutual Group
- Bruce Beaudette
Sunmark FCU

CU Performance

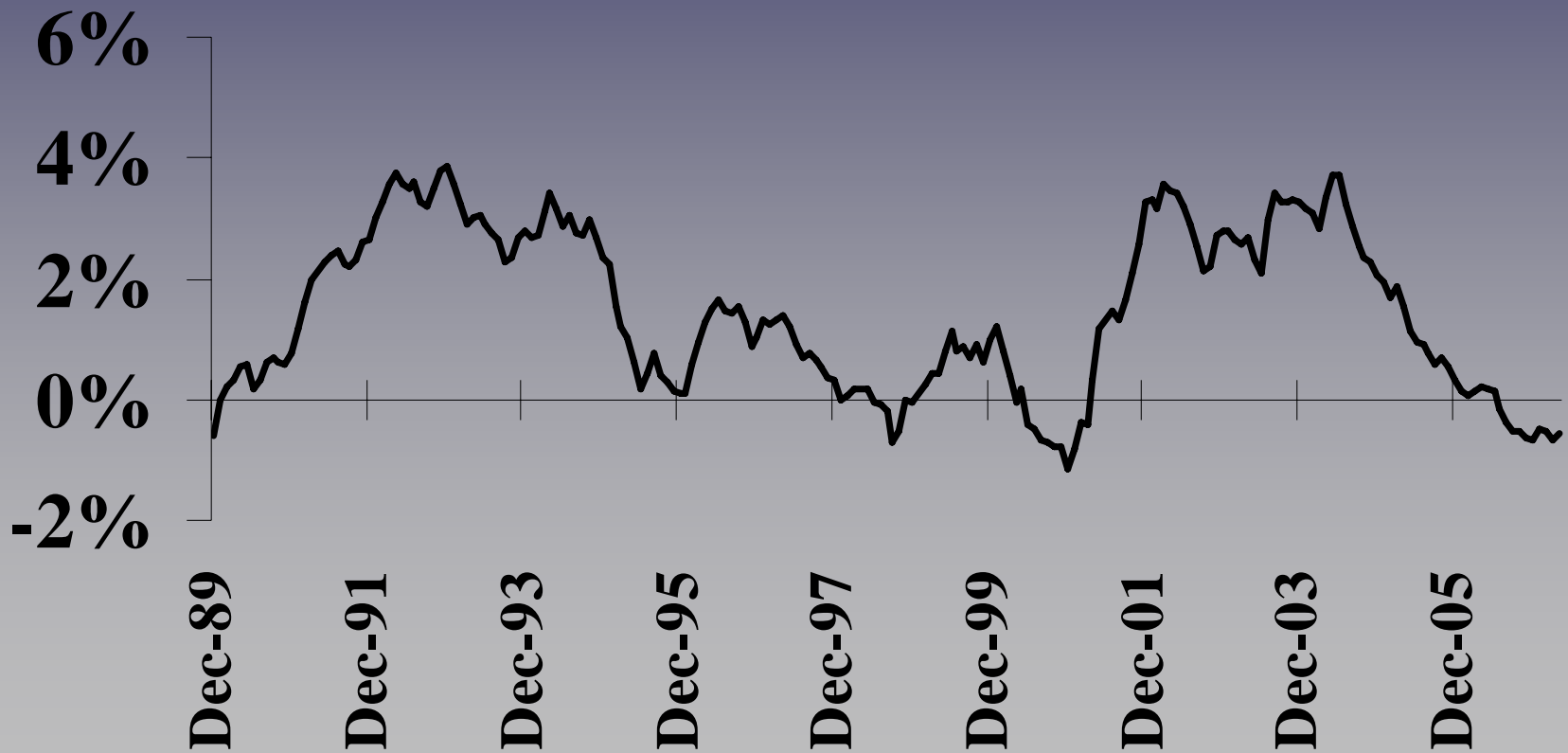


Inverted Yield Curve

INVERTED YIELD CURVE - PROBLEMS

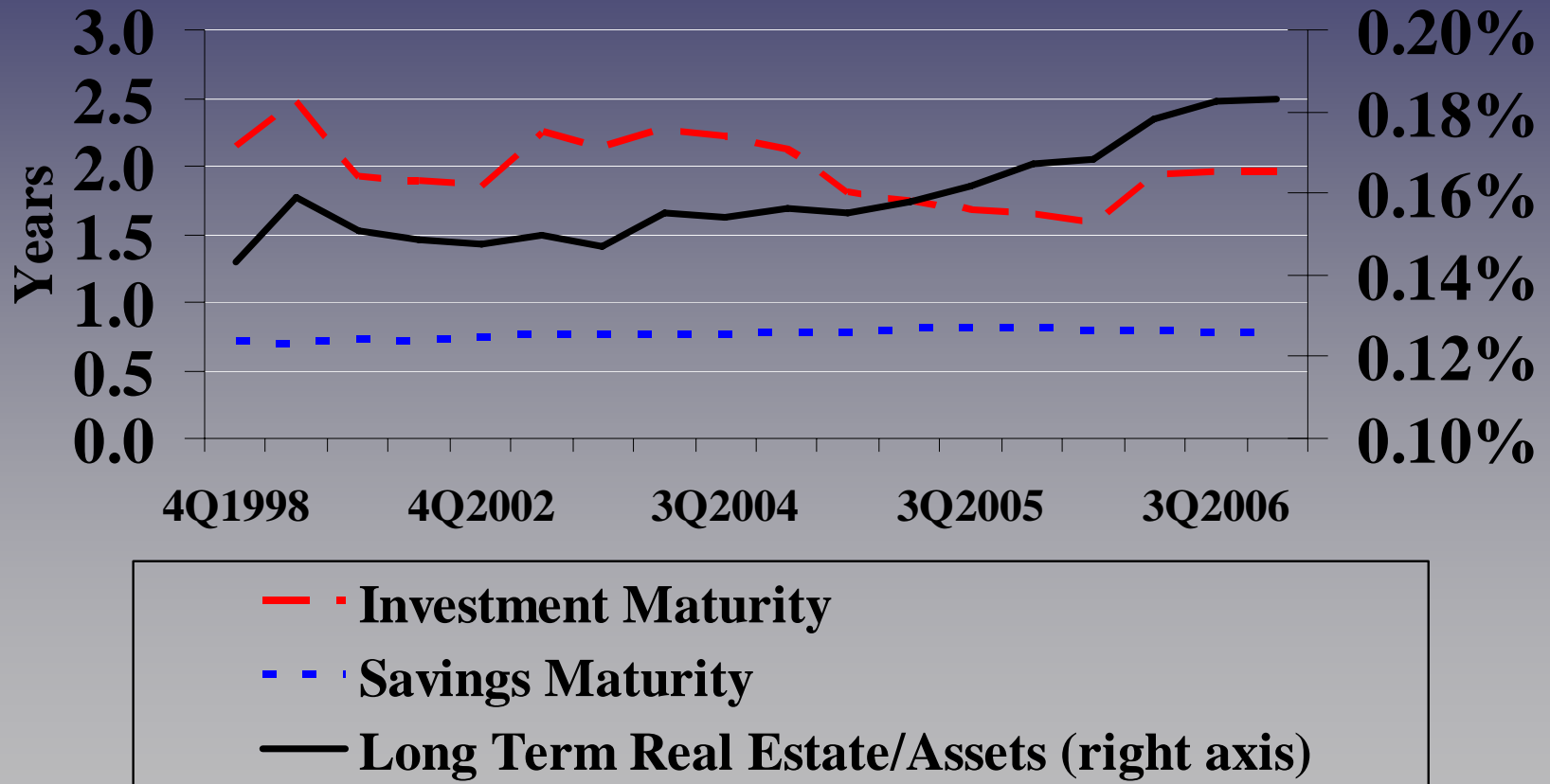
**Tun A. Wai, NAFCU
Chief Economist**

FED FUNDS RATE AND 10-YEAR T-NOTE



Source: Federal Reserve

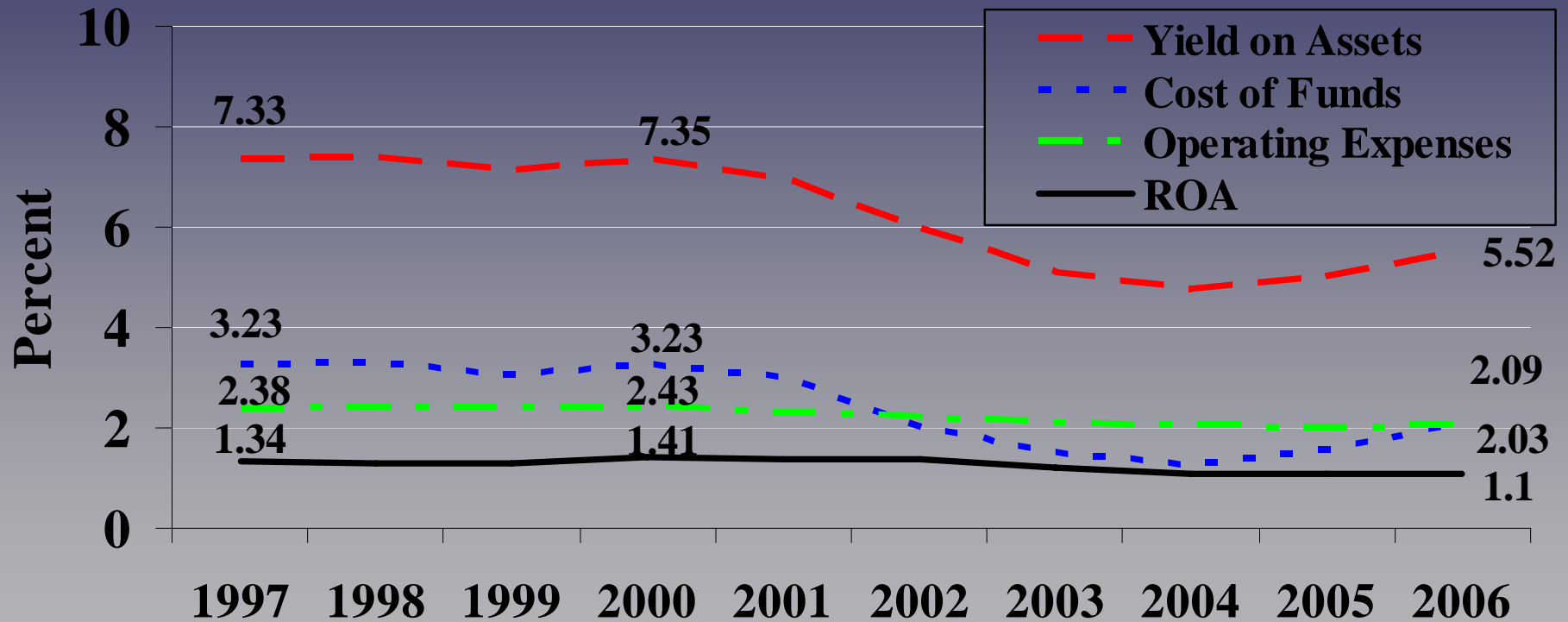
LOANS & INVESTMENTS MATURITIES



Long-term real estate = non-business real estate loans that will not mature, reprice or contractually refinance within 5 years.

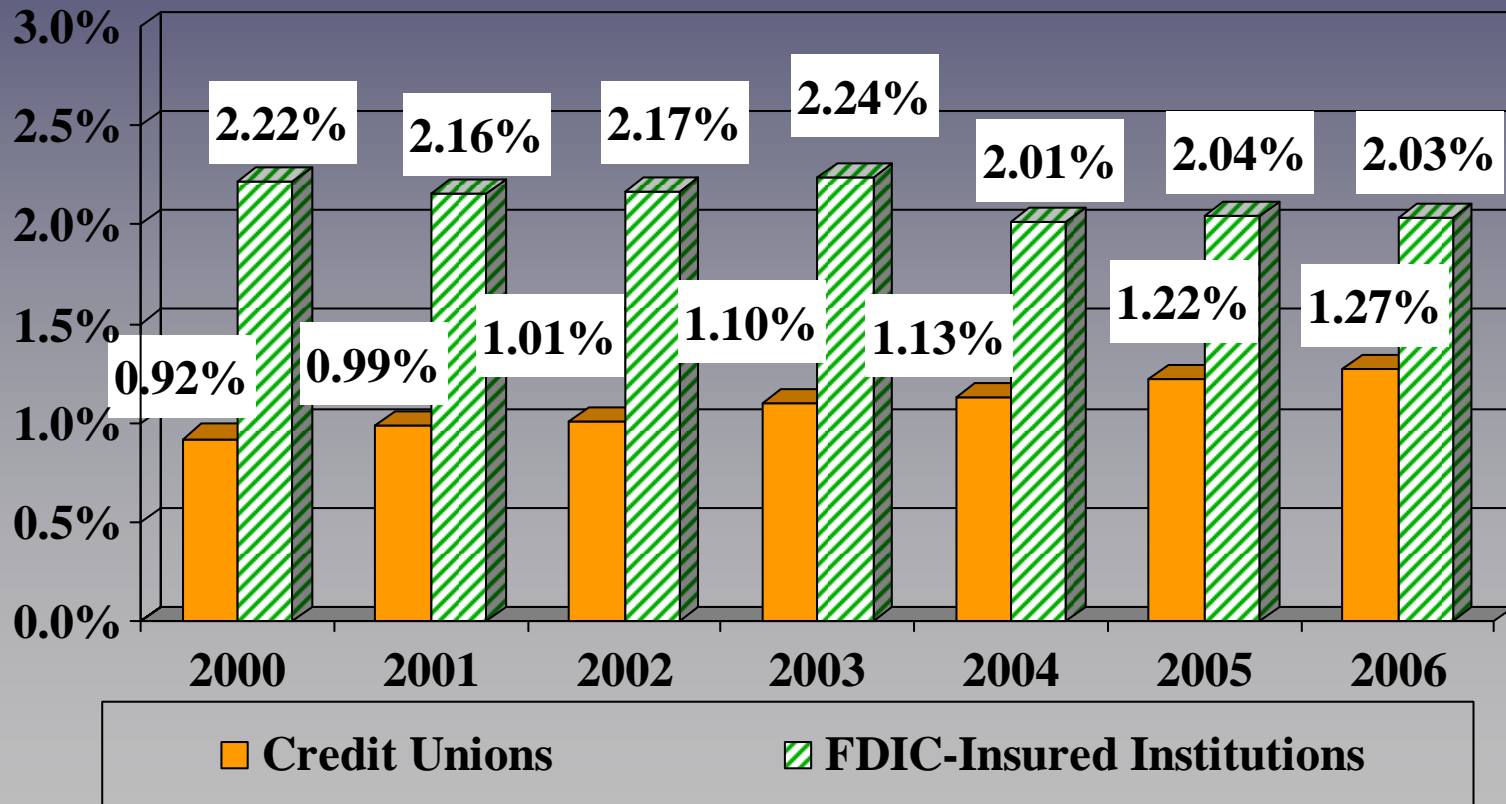
NET SPREADS

FICUs



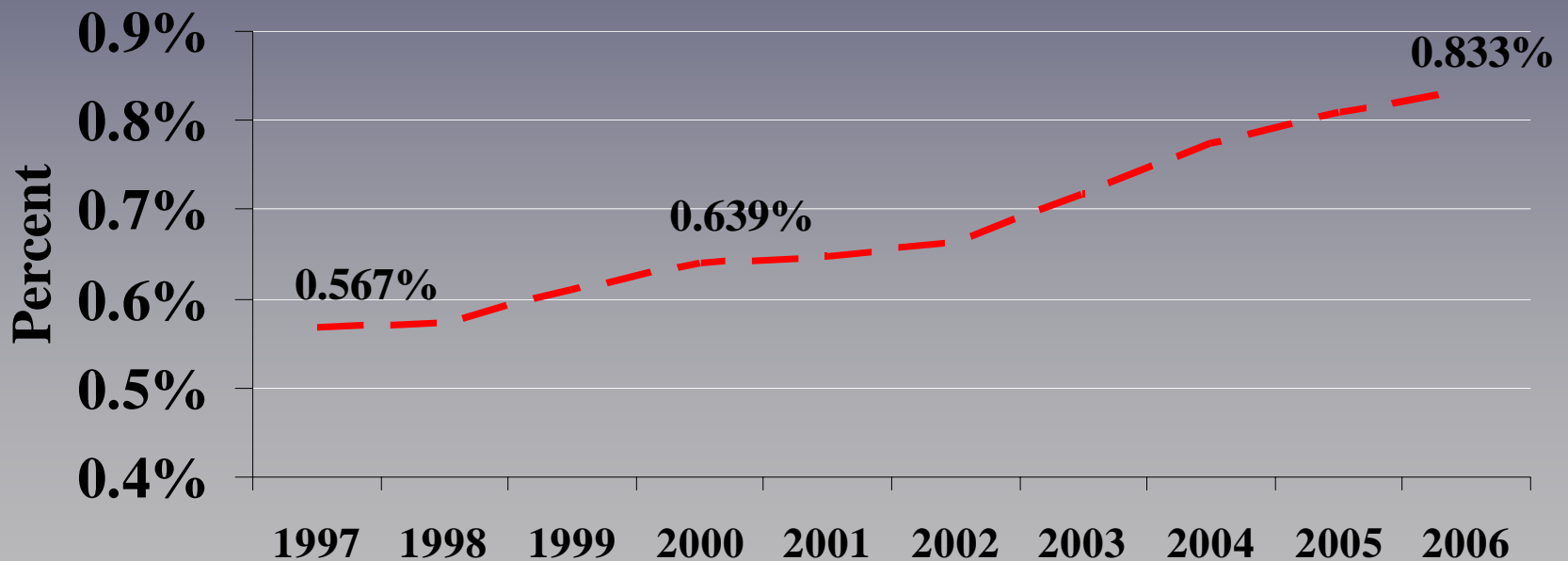
Source: NCUA applying "same store sales"

NON-INTEREST INCOME CREDIT UNIONS VS. BANKS



Source: NCUA & FDIC

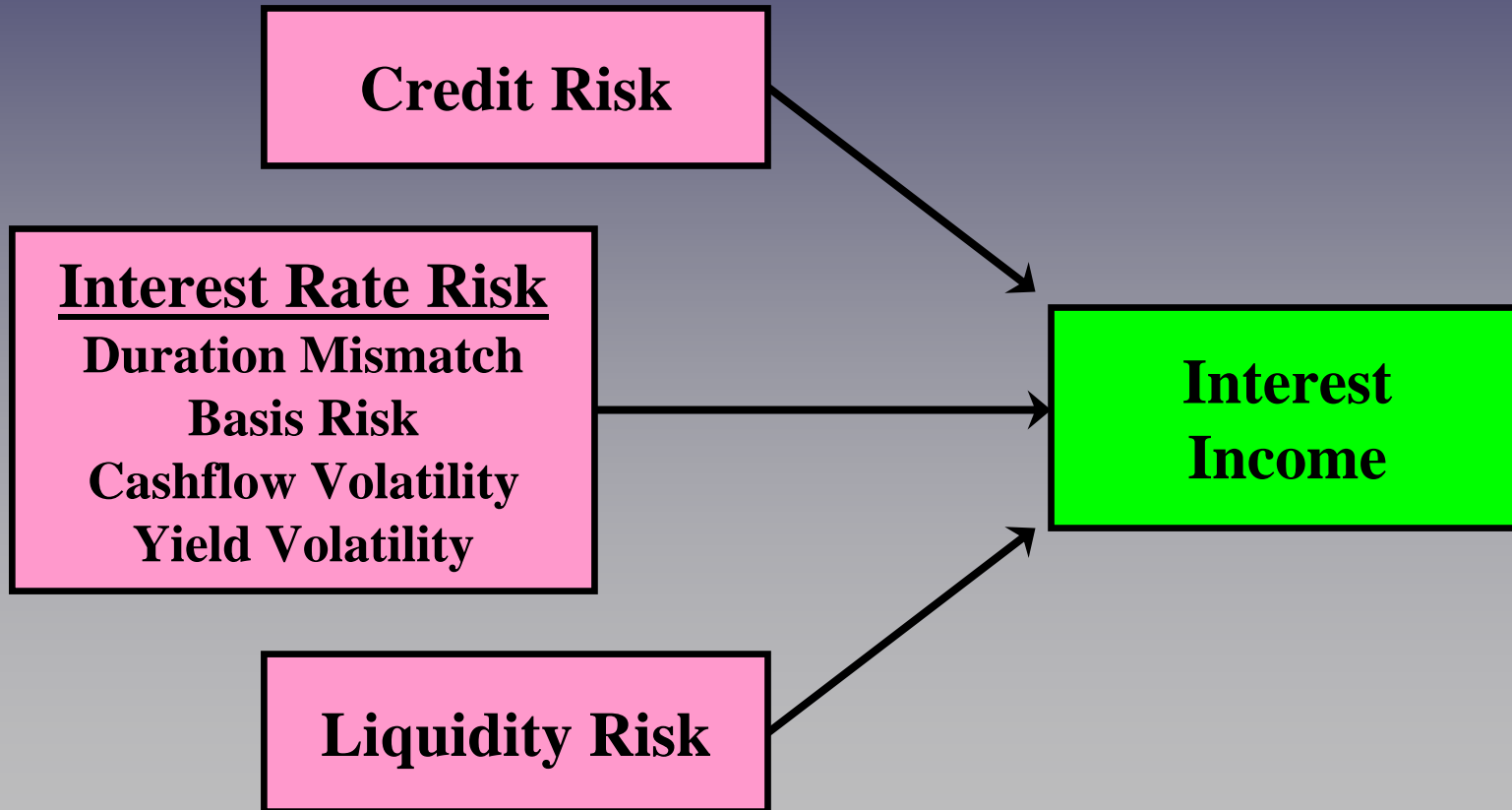
FEE INCOME AS PERCENT OF ASSETS FICUs



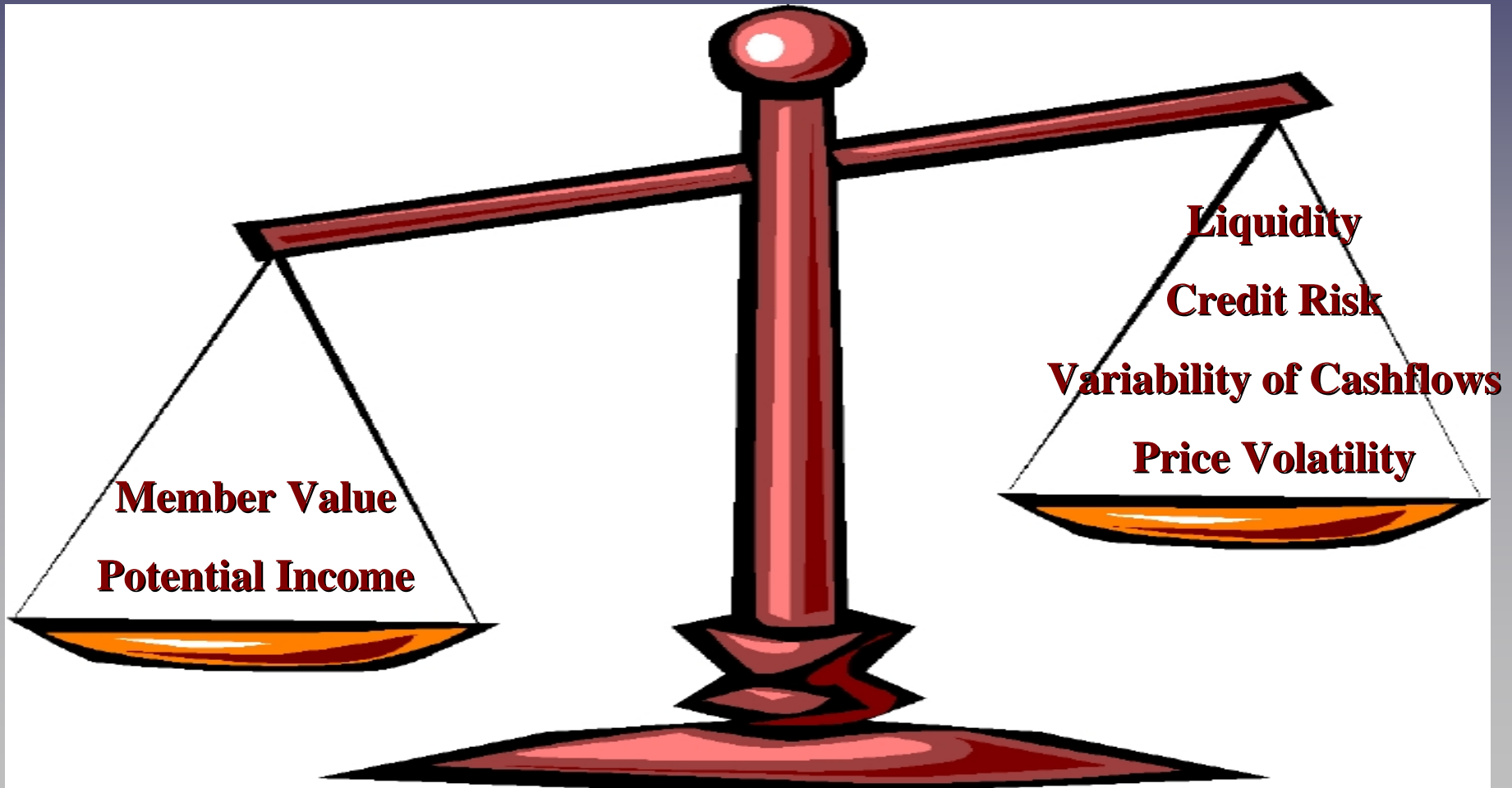
INVERTED YIELD CURVE - SOLUTIONS

**Bob Burrell, WesCorp
Executive Vice President & Chief Investment
Officer**

GETTING PAID TO TAKE ON RISK

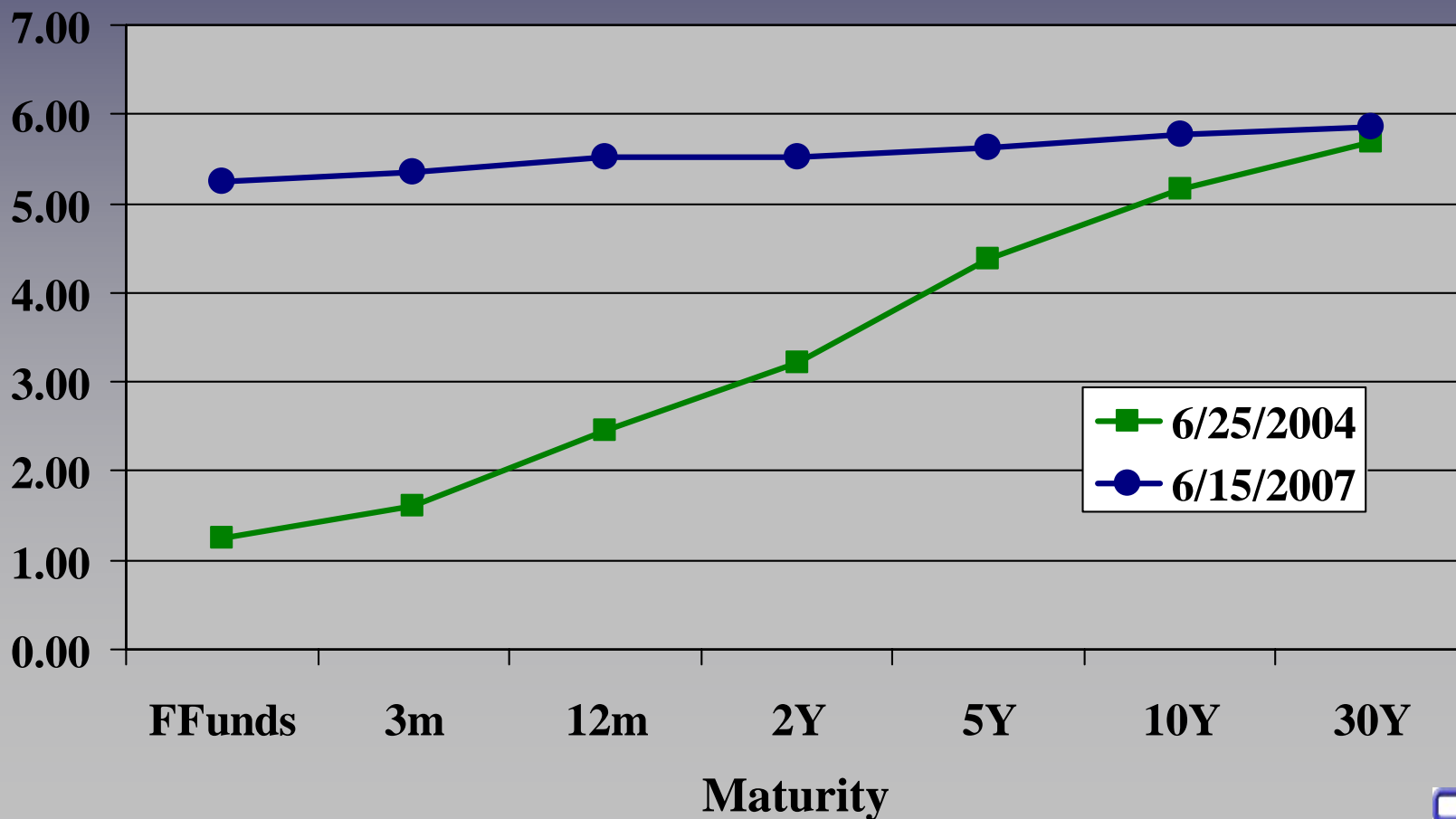


RISK/REWARD TRADE-OFF

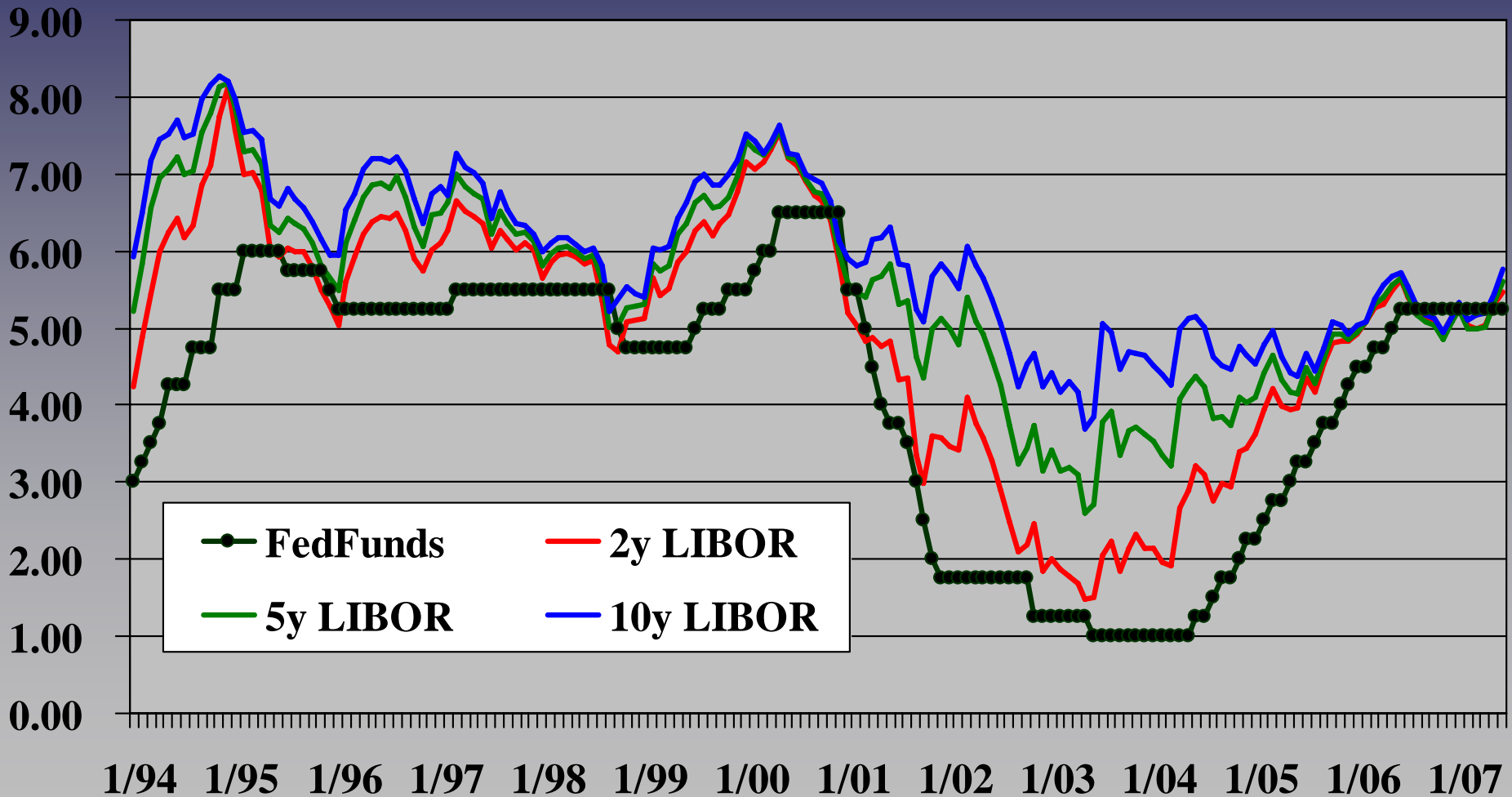


FLAT CURVE NEGATES THE CARRY TRADE

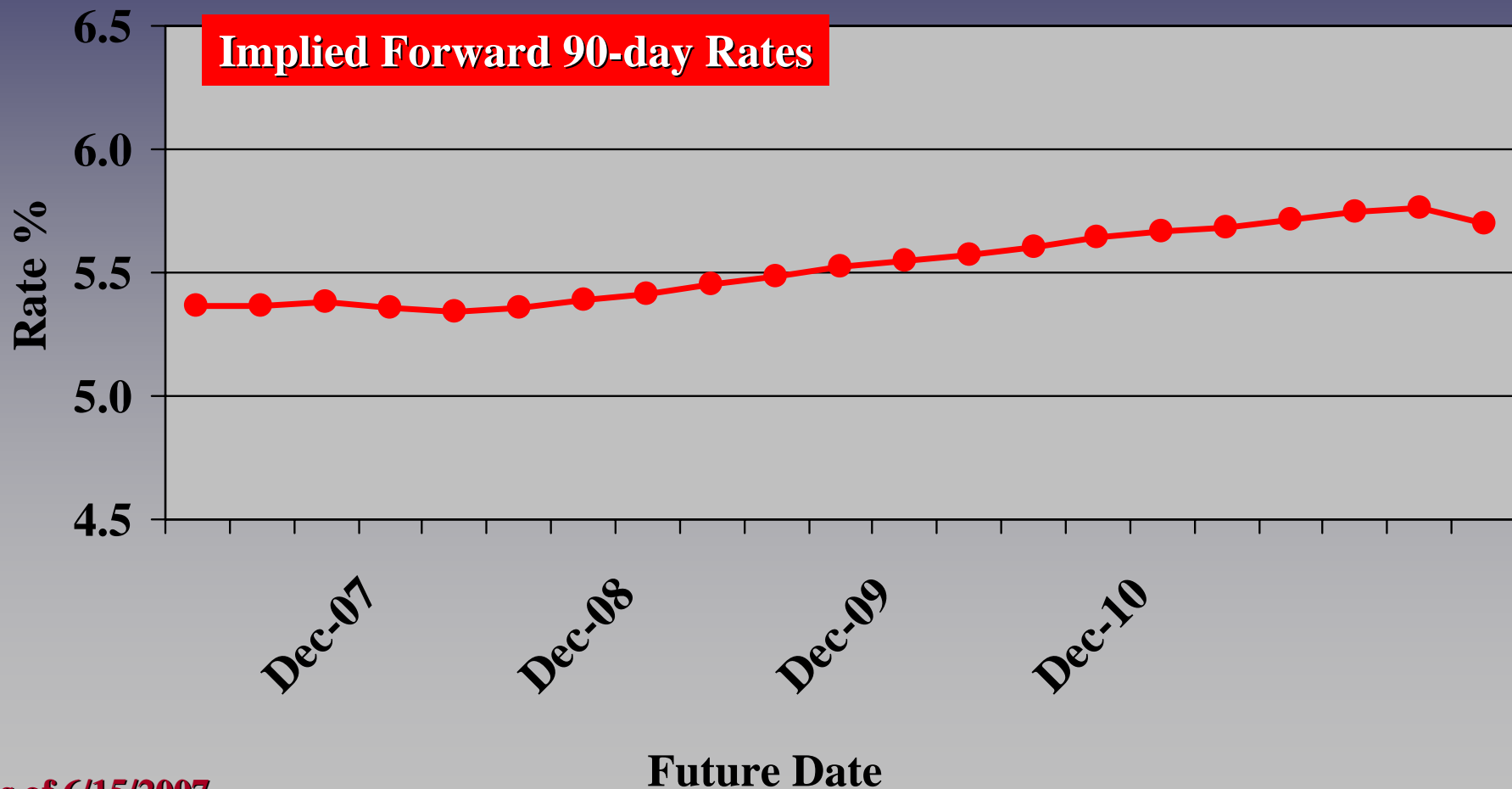
Swap Curve Yields - Percent



A FLAT CURVE IS UNUSUAL!



YOU CAN POSITION AGAINST THE CURVE!



As of 6/15/2007

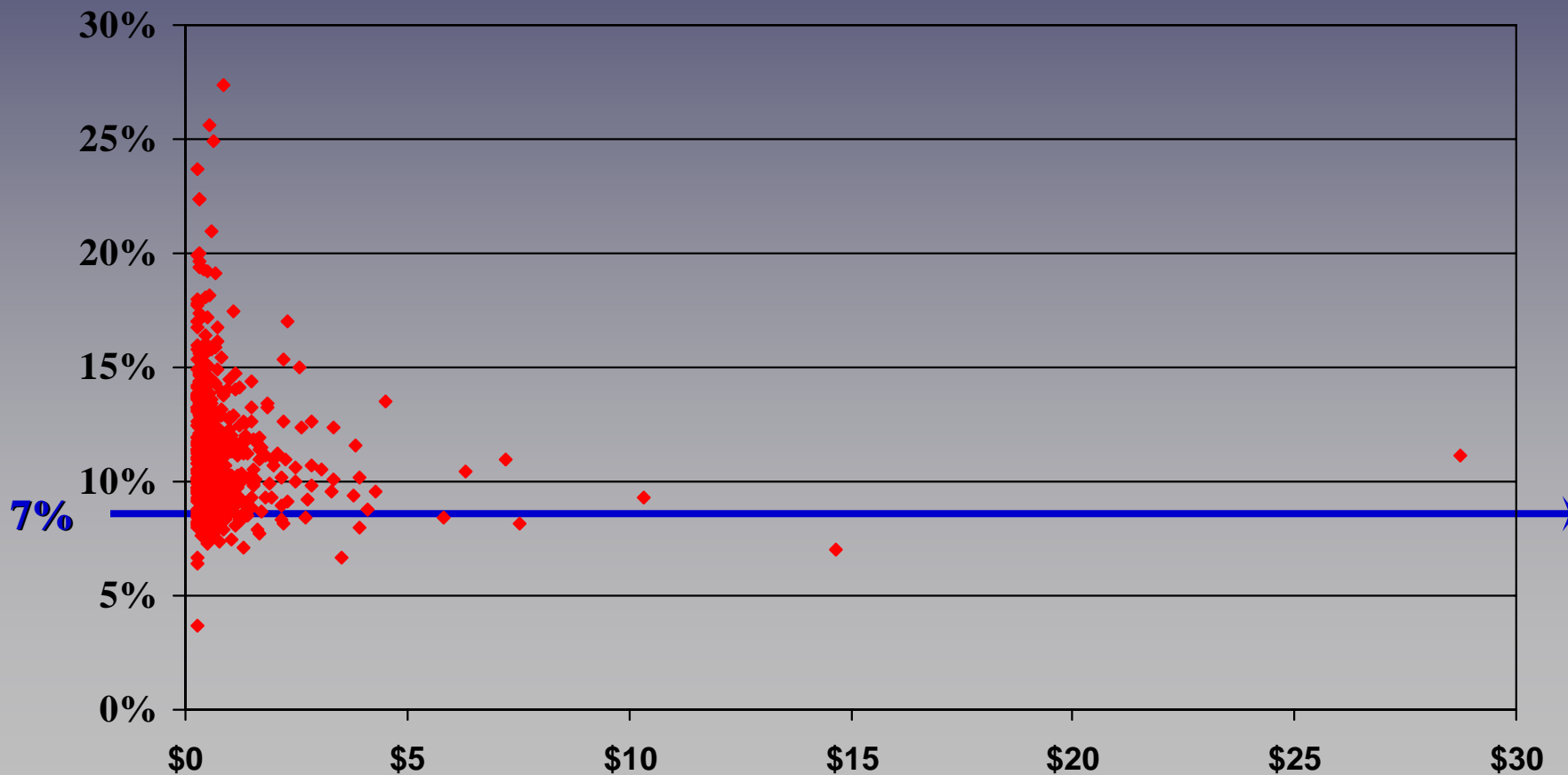
IT IS EASY TO STRUCTURE RISK

- **PSA Floater @ LIBOR + 25 Bps**
Benchmarked to 2006 FNMA 6.50% originations
- **3-Year Step Up @ 5.60% → 6.10% → 6.60%**
Callable after 1-Year
- **5-Year Callable @ 6.15%**
Callable after 1-Year
- **2-Year Extender @ 5.25%**
At CU discretion

WE HAVE ROOM TO LEVERAGE

FICU's \geq \$250 Mln Assets

Reserves/Assets



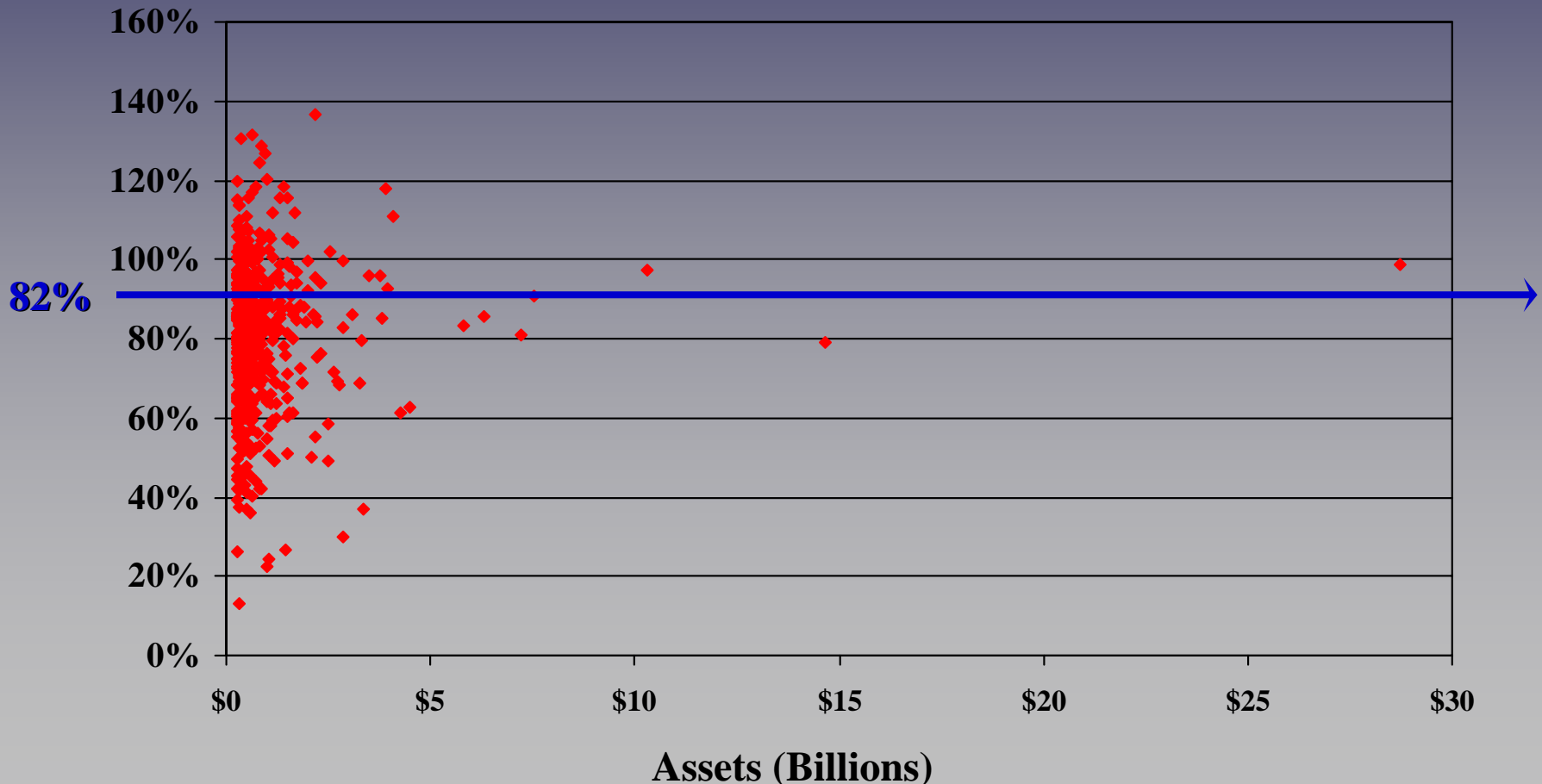
As of 3/31/2007

Assets (Billions)

SOME CU'S HAVE TOO MUCH LIQUIDITY!

FICUs \geq \$250 Mln Assets

Loans / Shares

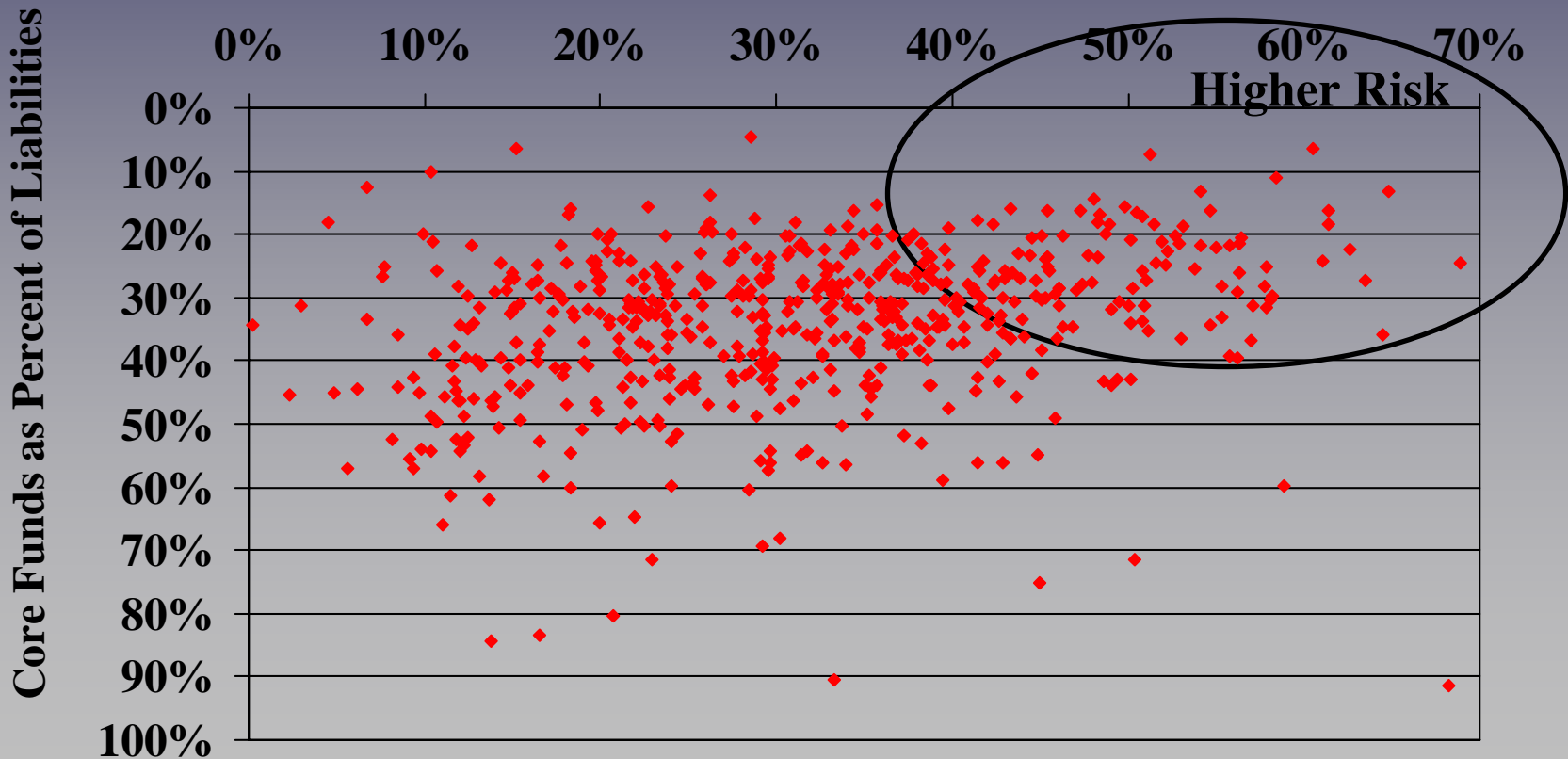


As of 3/31/2007

INTEREST RATE RISK IS FAIRLY MODEST AT MOST CU'S

FICUs \geq \$250 Mln Assets

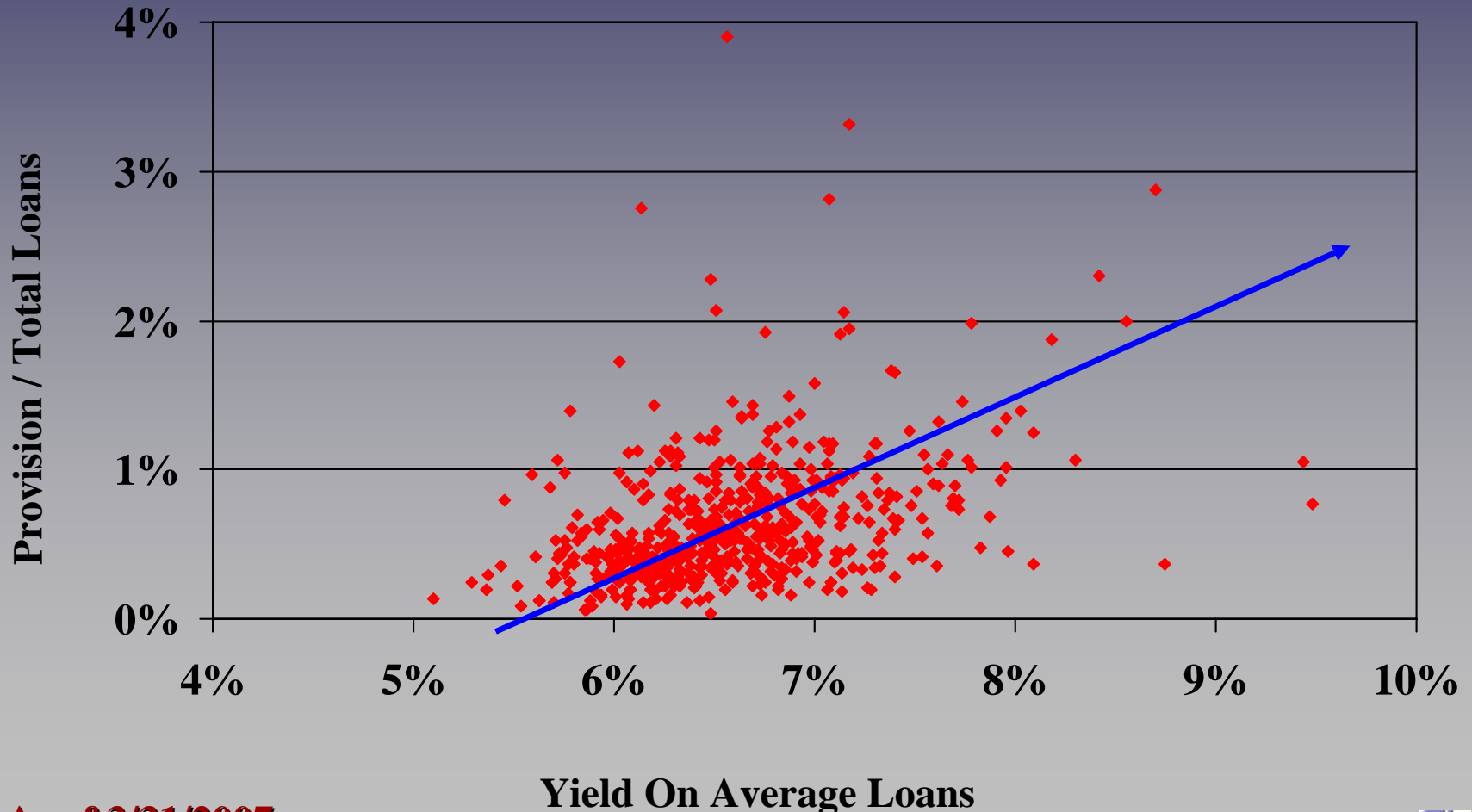
Fixed Rate Mortgages / MBS as Percent of Assets



As of 3/31/2007

CREDIT EXPOSURES ARE ALSO MODEST!

FICUs \geq \$250 Mln Assets



As of 3/31/2007

...Credit Union Liquidity



Future Funding Sources

FUTURE FUNDING SOURCES - PROBLEMS

**Bruce Fox, Southwest Corporate
Executive Vice President & Chief Investment
Officer**

FUTURE FUNDING SOURCES - PROBLEMS

- Core funding is declining as a percent of aggregate funding
 - Members are more informed due to access to financial information
 - Members seeking better performance (rates) on deposits (more rate sensitive)
 - Competition for deposits has increased from non-traditional sources (e-banks, brokerage accounts)
 - Majority of credit union share growth has been in higher cost share certificates
 - Credit unions experiencing a higher relative cost of funds due to change in funding mix deposits (i.e. larger % in certificates)

FUTURE FUNDING SOURCES - PROBLEMS

- Core funding is declining as a percent of aggregate funding (cont.)
 - Higher cost of funds will pressure already declining net interest margins
 - Slower membership growth is contributing to declines in core deposits

FUTURE FUNDING SOURCES - PROBLEMS

- Access by credit unions to long-term funding sources will be required as asset maturities lengthen
 - Mortgage lending should continue to dominate credit union lending activity in the foreseeable future
 - Credit union liabilities will become more interest rate sensitive as core deposits decline
 - Most credit unions maintain a conservative risk profile and can therefore manage additional interest rate risk -- at what point will credit unions need to mitigate rate risk?

FUTURE FUNDING SOURCES - PROBLEMS

- Efficient, robust loan participation market is limited
 - Credit unions with strong lending programs that originate high quality loans will seek to sell loan participations to credit unions with excess liquidity
 - Loan participations should provide a funding source for credit unions that originate MBLs and large commercial real estate loans to diversify single borrower concentration risk

FUTURE FUNDING SOURCES - PROBLEMS

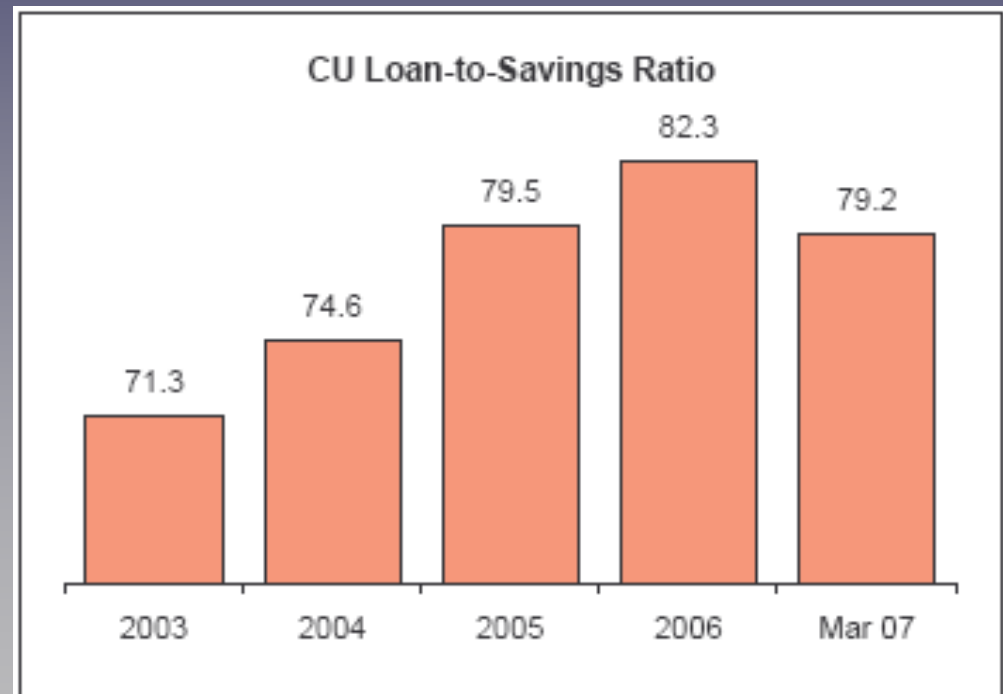
- Access by credit unions to capital markets is limited
 - Credit unions originating larger MBLs will need to manage their concentration risk to a single borrower
 - Access to secondary markets for liquidity and borrower concentration limits
- Credit union membership growth is declining

FUTURE FUNDING SOURCES - SOLUTIONS

**Eli Vazquez, American Airlines FCU
Senior Vice President & Chief Financial Officer**

FUTURE FUNDING SOURCES - SOLUTIONS

- Higher loan to share ratios have presented increasing funding challenges for some credit unions

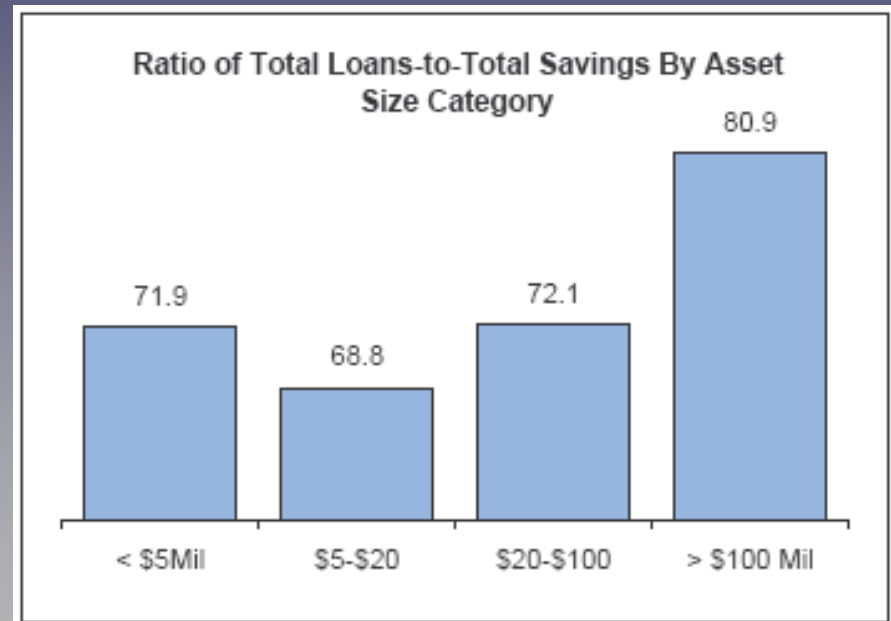


Source: CUNA Economics & Statistics

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FUTURE FUNDING SOURCES - SOLUTIONS

- Funding challenges vary by credit union asset size
 - Liquidity constraints more pronounced among larger credit unions
- Capacity exists in many credit unions to add loan participations



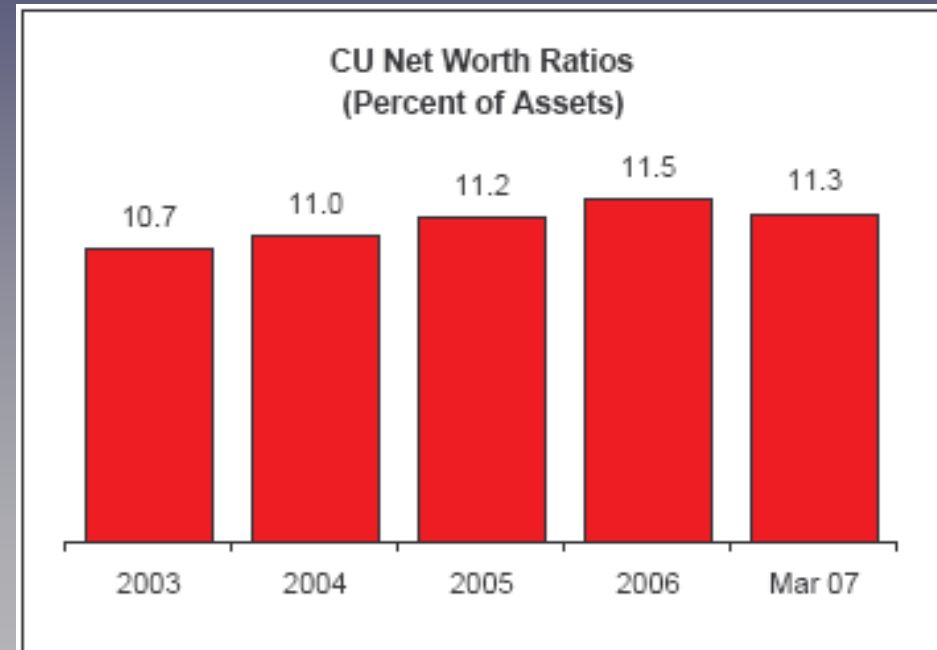
Source: CUNA Economics & Statistics

FUTURE FUNDING SOURCES - SOLUTIONS

- Use secondary markets to sell loans
 - Participations
 - Direct or through CUSOs and corporate credit unions
 - Securitization
- Fund growth by borrowing from:
 - Corporate credit unions
 - FHLB advances / matched funding

FUTURE FUNDING SOURCES - SOLUTIONS

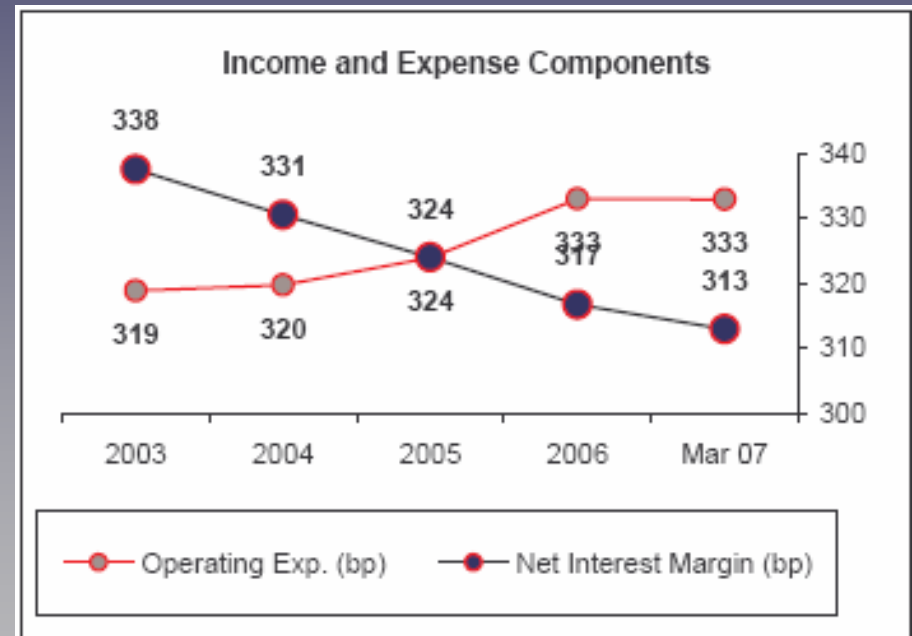
- Price deposit products competitively
- Capital is used to:
 - Ensure sound ALM
 - Fund future expansion
- Return excess capital to members
 - Value pricing on deposits will attract funds



Source: CUNA Economics & Statistics

FUTURE FUNDING SOURCES - SOLUTIONS

- Reverse rising trend in operating expense ratio
- Operating efficiently provides a margin with which to price products competitively and to invest in value added services that attract more deposits and members



Source: CUNA Economics & Statistics

FUTURE FUNDING SOURCES - SOLUTIONS

- Minimize operating costs through:
 - Automation
 - Increased credit union cooperation
 - CUSOs
 - Pooled resources and purchasing
 - Shared branch and ATM networks
 - Strategically focus on sound and efficient expansion strategies
 - Build around your core competencies

FUTURE FUNDING SOURCES - SOLUTIONS

- Promote savings through broad member education
 - generates incremental funds and fulfills our credit union mission of promoting habits of thrift
 - “Share Builder” programs
 - Link lending and savings products
 - Promote retirement savings through IRAs / tax refunds
- Equity linked share certificates
- Novel features on share draft accounts
- Attract new members

...Credit Union Membership Issues



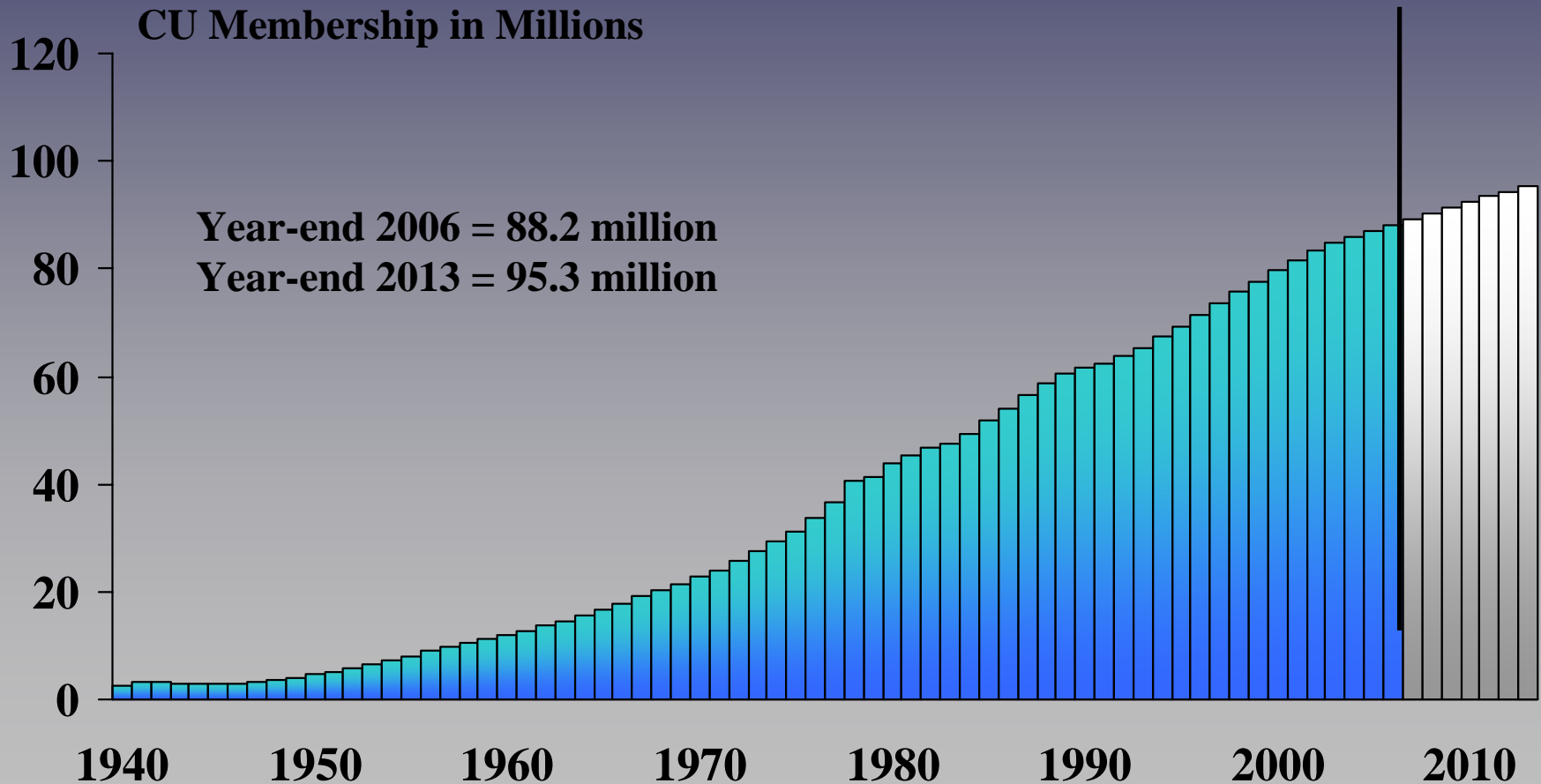
Attracting New Members

OUR GREATEST STRATEGIC CHALLENGE

Relevance

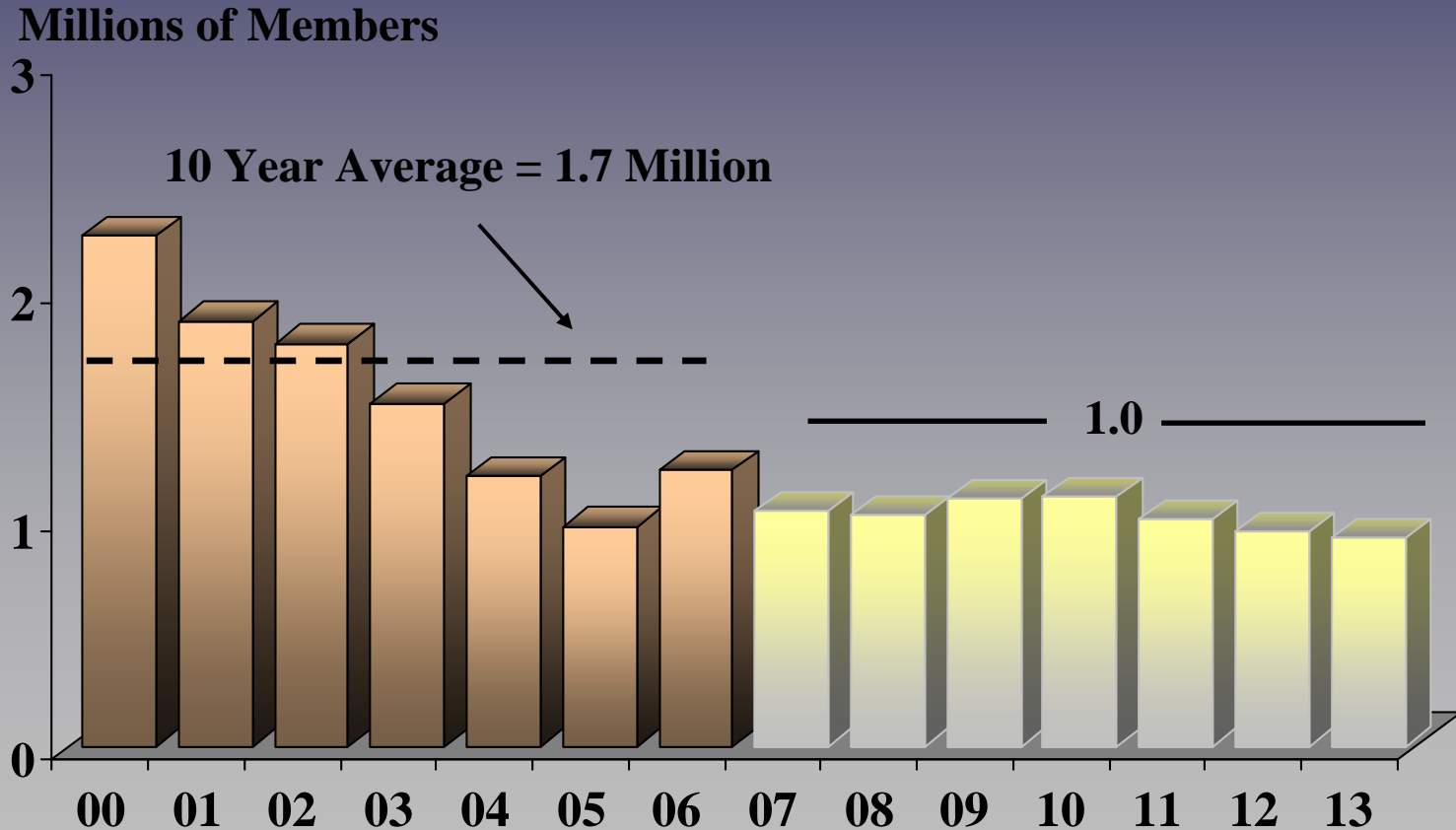
Dave Colby, CUNA Mutual Group - Chief Economist
Bruce Beaudette, Sunmark FCU – President/CEO

MEMBERSHIP TREND LOOKS SOLID



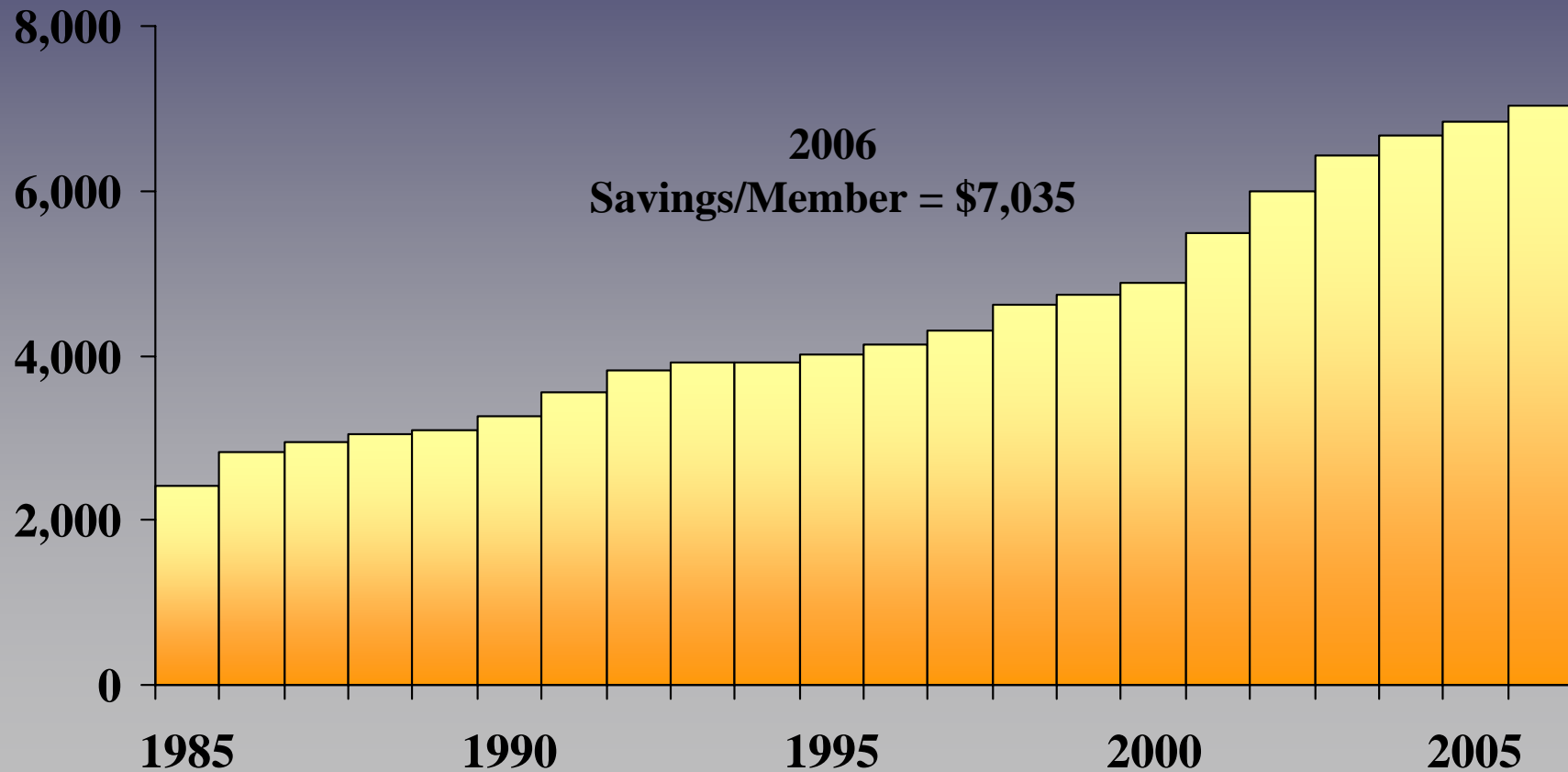
Source: CUNA Economics & Statistics and CUNA Mutual 2007 Strategic Planning Forecast

MEMBERSHIP A CLOSER LOOK

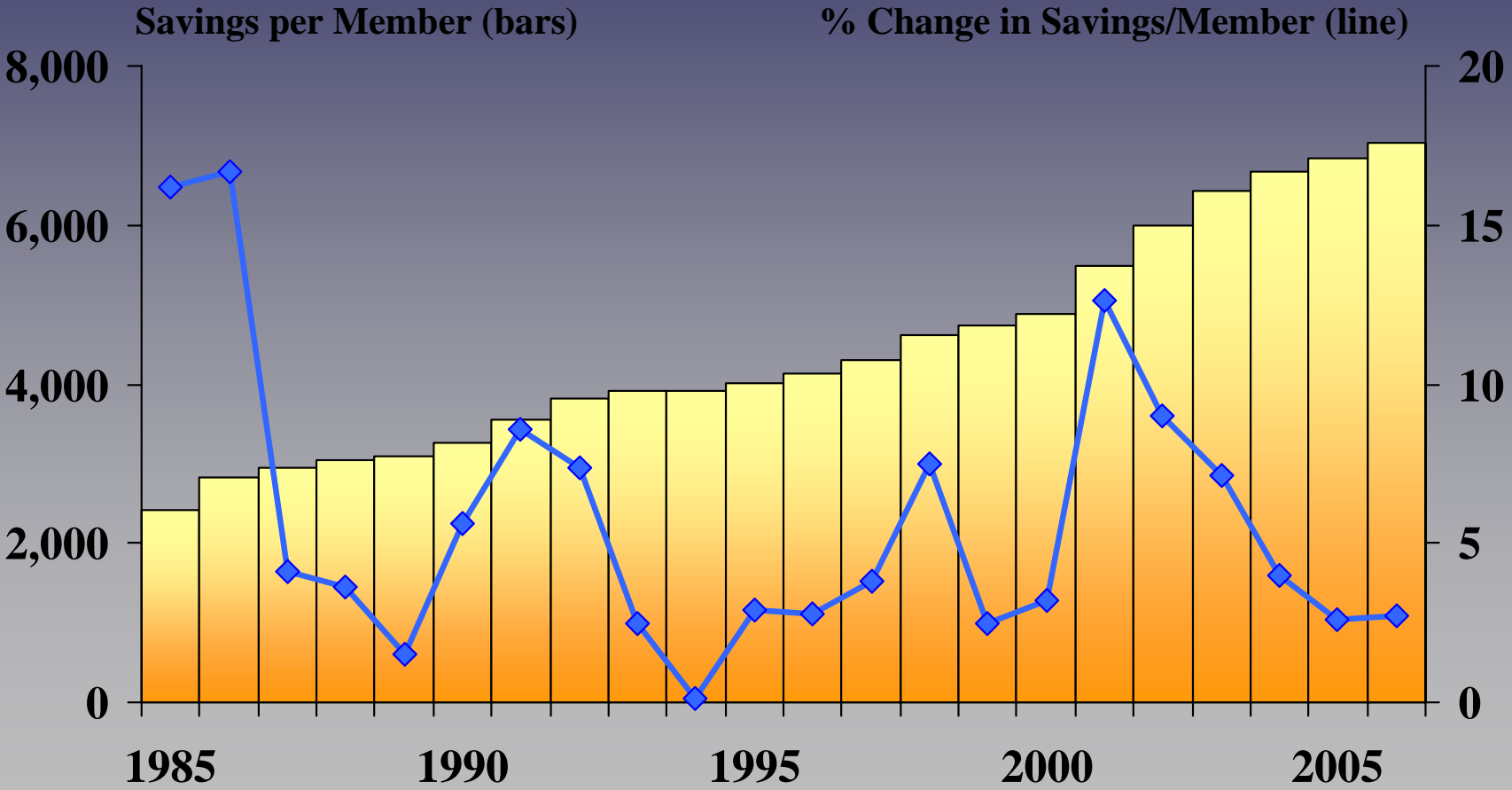


MEMBER RELATIONSHIP SAVINGS

Savings per Member (bars)

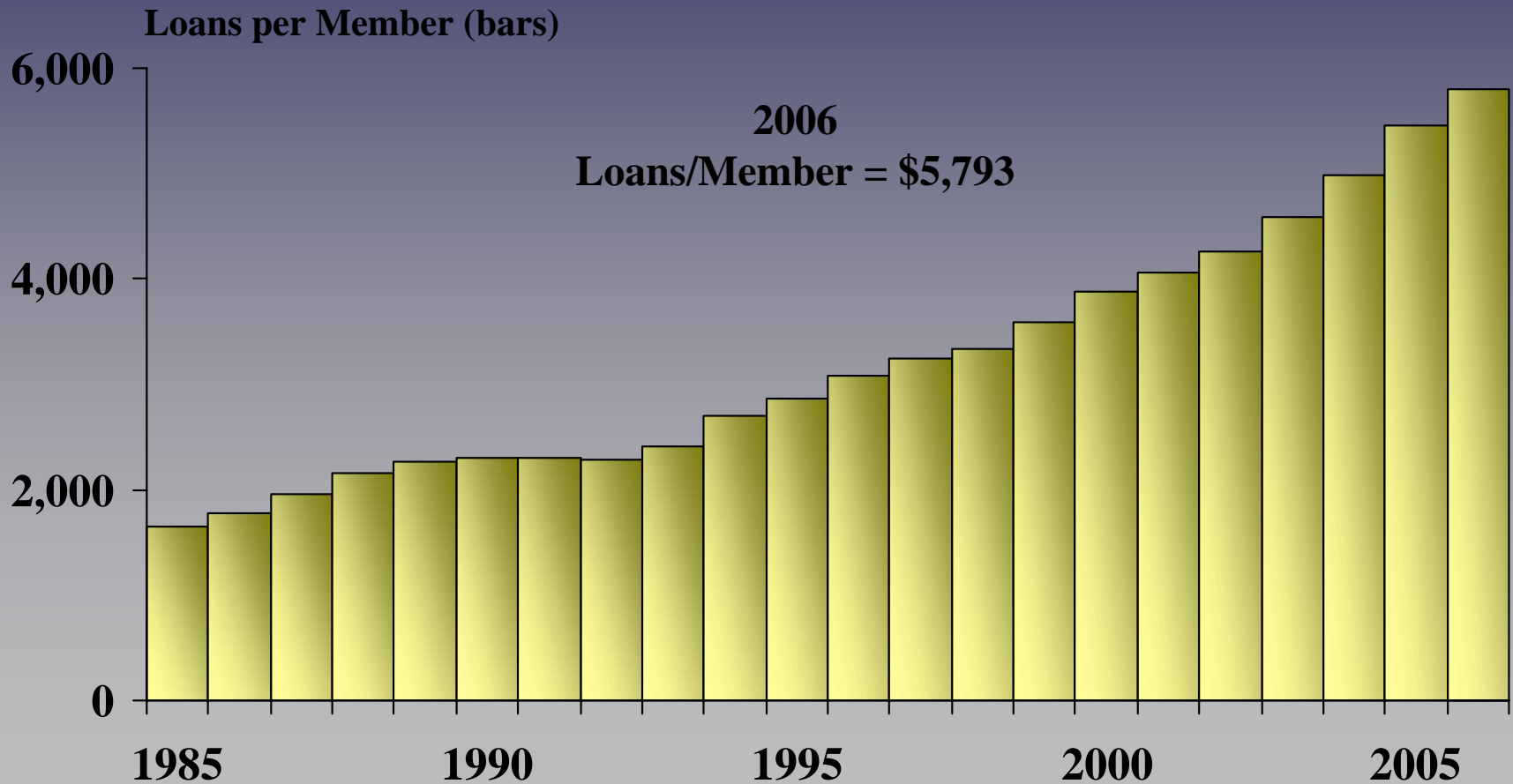


MEMBER RELATIONSHIP SAVINGS

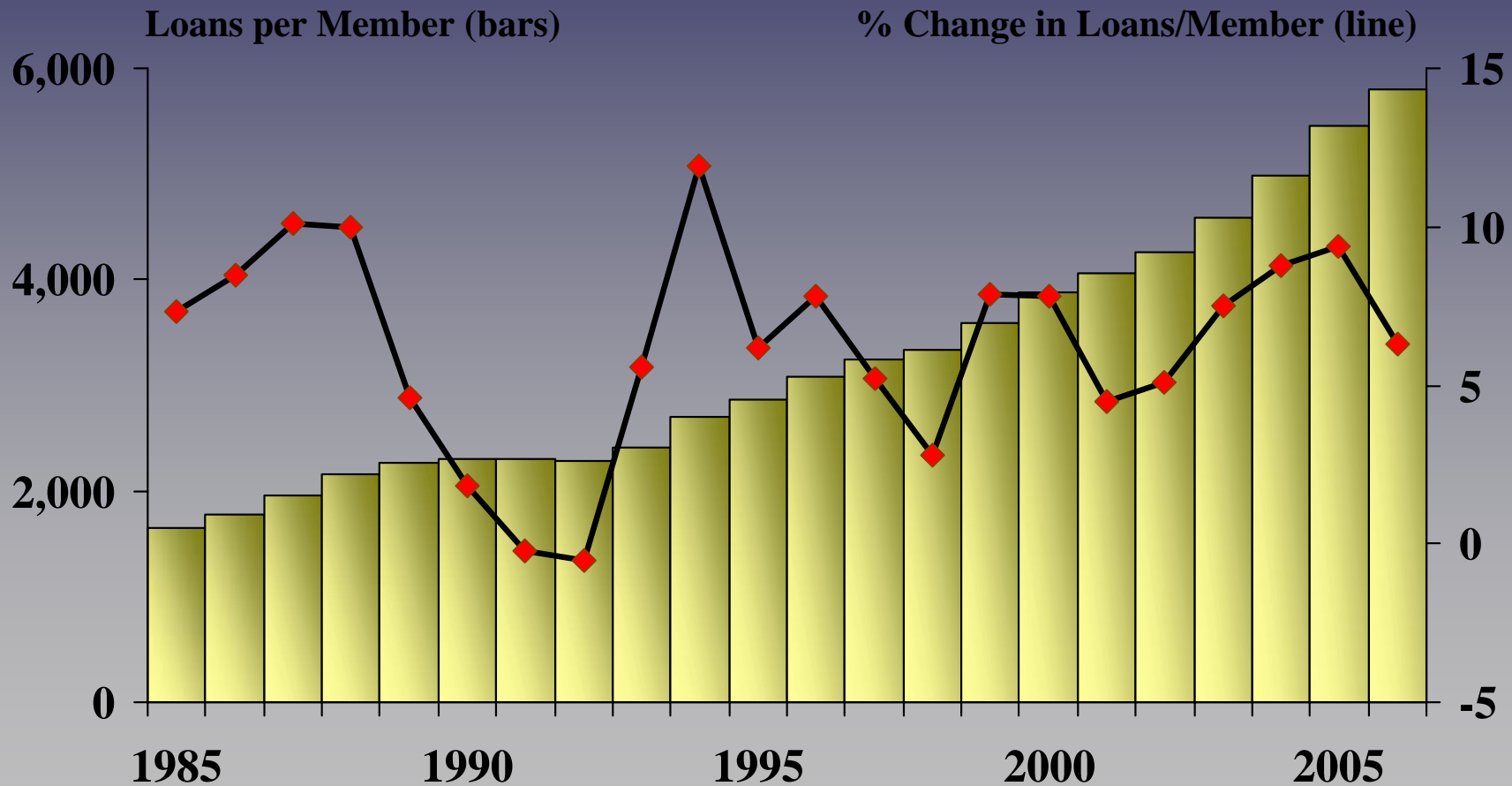


Source: CUNA Economics & Statistics and CUNA Mutual 2007 Strategic Planning Forecast

MEMBER RELATIONSHIP BORROWING



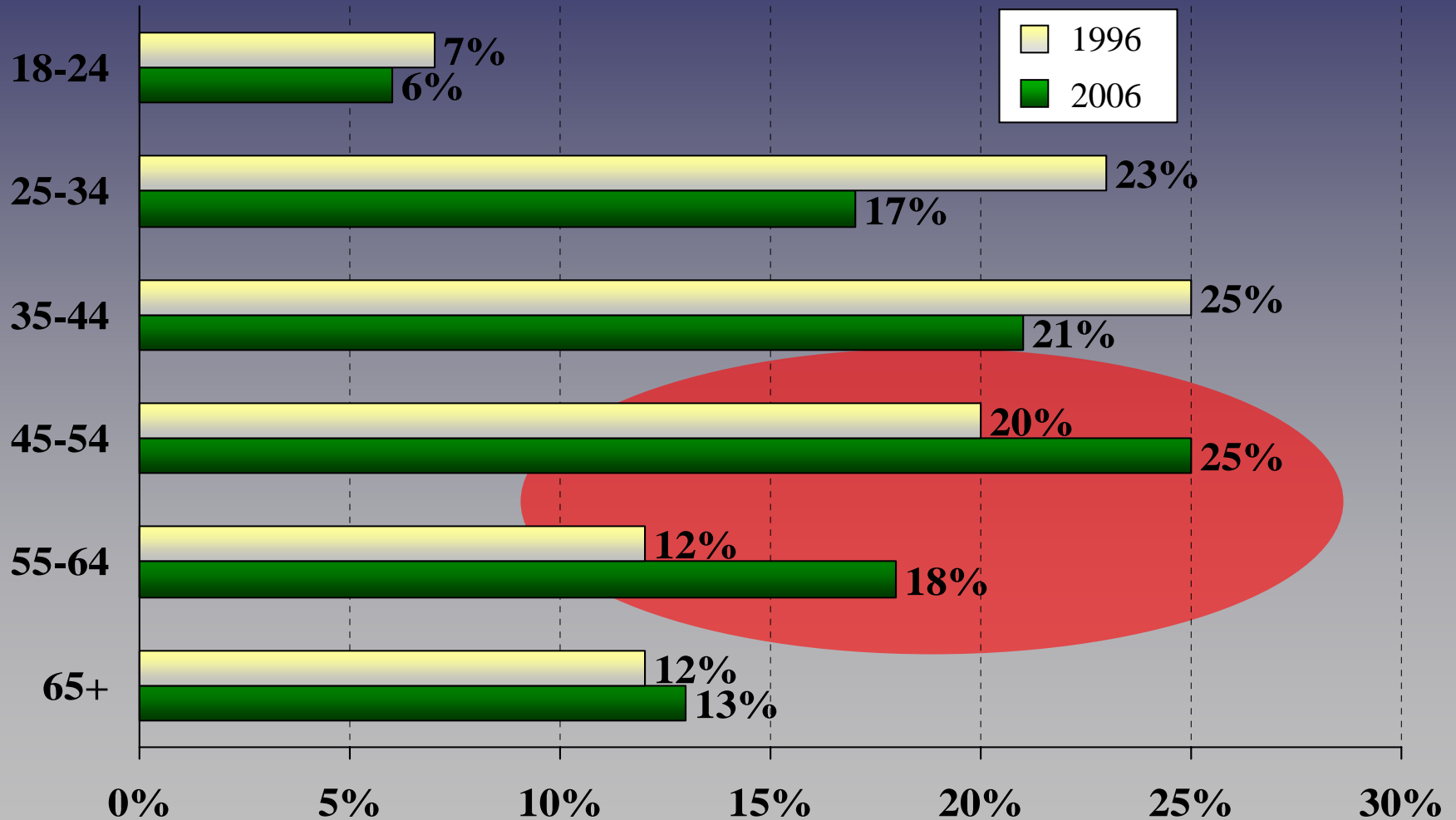
MEMBER RELATIONSHIP BORROWING



Source: CUNA Economics & Statistics and CUNA Mutual 2007 Strategic Planning Forecast

CU MEMBER AGE DISTRIBUTION

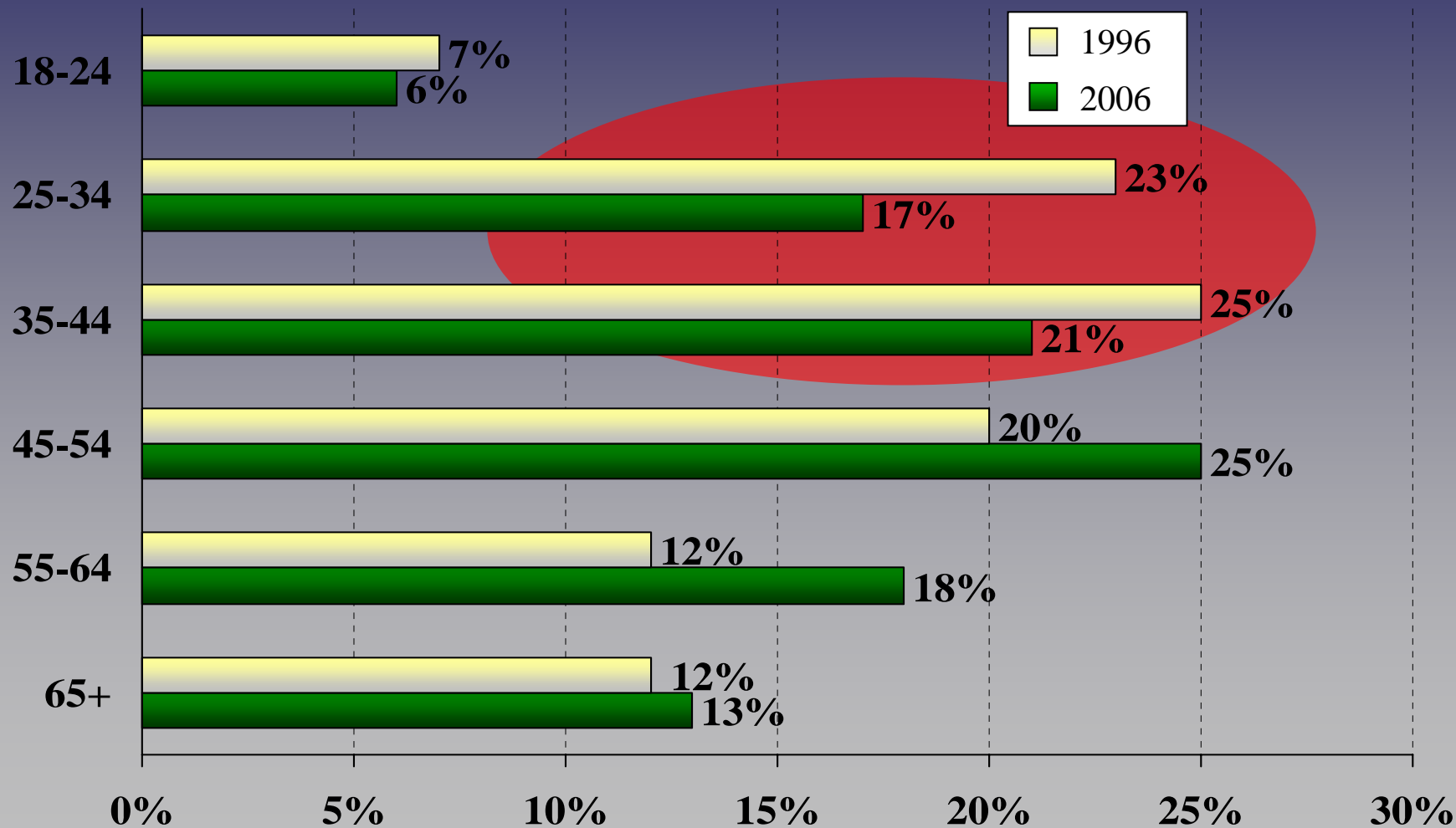
1996 - 2006



Source: CUNA'S 2006-2007 National Member Survey

CU MEMBER AGE DISTRIBUTION

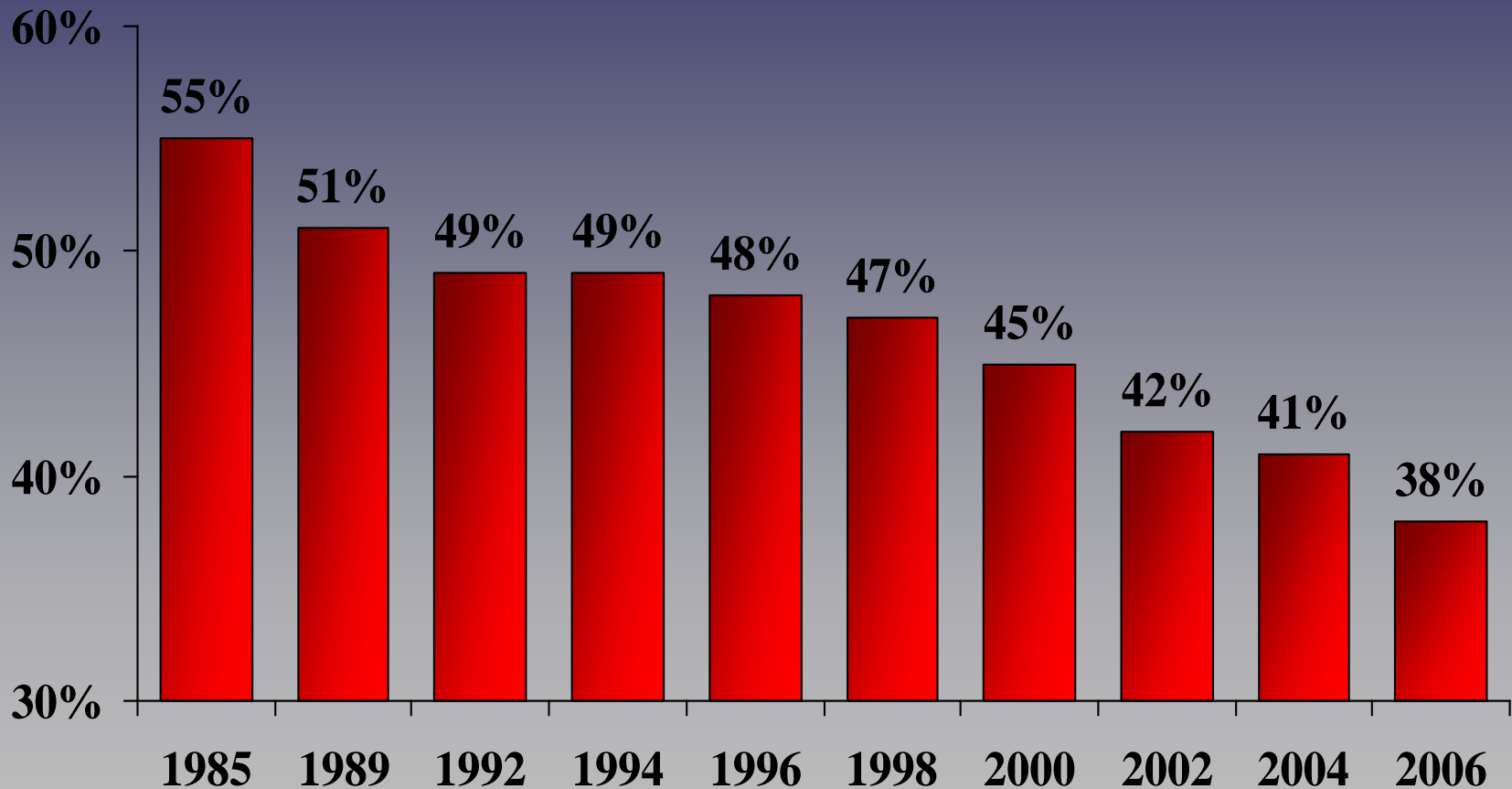
1996 - 2006



Source: CUNA'S 2006-2007 National Member Survey

AGE 24 TO 44 – 1985 TO 2006

Peak Borrowing Years – Declining Share of Members



Source: CUNA National Member Survey Reports and CUNA Member Statistics

MEMBER RELEVANCE IN A COMMODITY MARKET

- Why will they stay?
- Why will they come?
- What are we doing?

MEMBERSHIP GROWTH STRATEGIES

- Beware of Indirect Lending:
 - May be inflating growth numbers
 - Great for short term member growth
 - Little impact long term/ even negative
 - So hard with retention & cross sells

MEMBERSHIP GROWTH STRATEGIES

- Expanded Charters (caveats)
- Community Business Partners
- Mergers
- Acquisitions
- Youth Market
- Retention Strategies

MEMBER SAVINGS STRATEGIES

- Online Direct
- Share “Steals”
- Hot Money Segmentation

MEMBER LOAN STRATEGIES

- Outbound Calling
- Loan “Steals”
- Young Adult Market
 - 1st Time Auto Buyers Program

MEMBERSHIP AGE PROBLEM

- Need to focus heavily on Youth and Young Adult markets
- Find new ways to reach these markets
 - Blogs
 - ipod downloads
 - Create younger “face”
- Focus groups
- Work with schools

MEMBER RELEVANCE

- Why will they stay?
 - Retention strategies, providing added value, creating “stickiness”
- Why will they come?
 - Differentiation strategies
- What are we doing?
 - Not enough!

SUMMARY



- **Despite a flat yield curve, CU balance sheets are well positioned capitalize on other opportunities to boost earnings.**
- **Future funding sources should continue to evolve and meet the changing funding needs of credit union system.**
- **No magic membership bullets.**

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