



DECEMBER 7, 2009

NAFCU 2009 REPORT ON CREDIT UNIONS



National Association of Federal Credit Unions • www.nafcu.org

Board of Governors of the Federal Reserve System



Ben Bernanke: Chairman of the Board of Governors and the Federal Open Market Committee. He was sworn in on February 1, 2006. His four-year term as Chairman ends January 31, 2010 and his term as a member of the Board ends January 31, 2020. Dr. Bernanke has served the Federal Reserve System in several roles. He was a member of the Board of Governors of the Federal Reserve System from 2002 to 2005; a visiting scholar at the Federal Reserve Banks of Philadelphia (1987-89), Boston (1989-90), and New York (1990-91, 1994-96); and a member of the Academic Advisory Panel at the Federal Reserve Bank of New York (1990-2002).



Donald Kohn: Vice Chairman of the Board of Governors. His four-year term as Vice Chair began June 23, 2006, while his Board term ends on January 31, 2016. He has served as a Board member since August 5, 2002. Before becoming a member of the Board, he served on its staff as Adviser to the Board for Monetary Policy (2001-02), Secretary of the Federal Open Market Committee (1987-2002), Director of the Division of Monetary Affairs (1987-2001), and Deputy Staff Director for Monetary and Financial Policy (1983-87). He also held several positions in the Board's Division of Research and Statistics.



Kevin Warsh: Member of the Board of Governors. His term expires January 31, 2018. He began his term on February 24, 2006. From 1995 to 2002, Mr. Warsh was a member of the Mergers & Acquisitions Department of Morgan Stanley & Co., in New York, serving as Vice President and Executive Director. Prior to his appointment to the Board, Mr. Warsh served as Special Assistant to the President for Economic Policy and as Executive Secretary of the National Economic Council from 2002 until February 2006.



Elizabeth Duke: Member of the Board of Governors. Her term expires January 31, 2012. She began her term on August 5, 2008. Previously she was an Executive Vice President at Wachovia Bank, and an Executive Vice President at SouthTrust Bank. Earlier in her career, Ms. Duke was President and Chief Executive Officer of Bank of Tidewater, based in Virginia Beach, Virginia. Prior to her appointment to the Board, Ms. Duke was Senior Executive Vice President and Chief Operating Officer of TowneBank, a Virginia-based community bank.



Daniel Tarullo: Member of the Board of Governors. His term expires January 31, 2022. He took office on January 28, 2009. Before becoming a member of the Board, Dr. Kroszner was Professor of Law at Georgetown University Law Center. He also worked in several senior staff positions during the Clinton Administration, including Deputy Assistant to the President for Economic Policy and Assistant to the President for International Economic Policy. Prior to serving in the Clinton Administration, he was Chief Counsel for Employment Policy on the staff of Senator Edward Kennedy.

Board of Directors of the National Association of Federal Credit Unions



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Chair
Region V Director
Nevada
Federal Credit Union
Las Vegas, NV
Asset Size: \$805M
Members: 85,928
FOM: Community



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Director-at-Large
Webster First
Federal Credit Union
Webster, MA
Asset Size: \$465M
Members: 33,270
FOM: Community



Michael J. Parsons
Treasurer
Region I Director
First Source
Federal Credit Union
New Hartford, NY
Asset Size: \$251M
Members: 29,789
FOM: Community



Ed Templeton
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Director-at-Large
SRP
Federal Credit Union
North Augusta, SC
Asset Size: \$532 M
Members: 93,222
FOM: Community



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Endicott, NY
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Members: 122,273
FOM: Community



Shelley B. Clarke
Director-at-Large
Goldenwest
Federal Credit Union
Ogden, UT
Asset Size: \$715M
Members: 75,121
FOM: Multi-Occupational



Cutler Dawson
Director-at-Large
Navy
Federal Credit Union
Merrifield, VA
Asset Size: \$39,902M
Members: 3,310,914
FOM: Defense



Robert L. Marquette
Director-at-Large
Members 1st
Federal Credit Union
Mechanicsburg, PA
Asset Size: \$1,725M
Members: 158,440
FOM: Multi-Occupational



Randy M. Smith
Region IV Director
Randolph-Brooks
Federal Credit Union
Live Oak, TX
Asset Size: \$3,465M
Members: 294,516
FOM: Multi-Occupational



Charles W. Thomas
Region II Director
Mid-Atlantic
Federal Credit Union
Germantown, MD
Asset Size: \$243M
Members: 21,768
FOM: Community



Larry T. Wilson
Region III Director
Coastal
Federal Credit Union
Raleigh, NC
Asset Size: \$2,198M
Members: 194,507
FOM: Multi-Occupational

2009 REPORT ON CREDIT UNIONS FOR THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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¹ This is material presented at a meeting between the NAFCU Board and the Board of Governors of the Federal Reserve System on December 7, 2009.

Abbreviations

ACH	Automated Clearing House
APR	Annual Percentage Rate
ATM	Automated Teller Machine
CARD	Credit Card Accountability, Responsibility and Disclosure Act
CFPA	Consumer Financial Protection Agency
CRA	Community Reinvestment Act
FCU	Federal Credit Union
FDIC	Federal Deposit Insurance Corporation
FHLB	Federal Home Loan Bank
FICU	Federally Insured Credit Union
FOM	Field of Membership
HEA	Higher Education Act
HMDA	Home Mortgage Disclosure Act
HOEPA	Higher Education Opportunity Act
HELOC	Home Equity Line of Credit
HUD	Housing and Urban Development
NAFCU	National Association of Federal Credit Unions
NCUA	National Credit Union Administration
NCUSIF	National Credit Union Share Insurance Fund
ROA	Return on Average Assets
TILA	Truth in Lending Act

PREFACE

The National Association of Federal Credit Unions (NAFCU), founded in 1967, is headquartered in Arlington, Virginia and is the only trade association that exclusively represents the interests of federal credit unions before the federal government and the public. Membership in NAFCU is direct; there are no state or local leagues, chapters or affiliations standing between NAFCU members and their association.

NAFCU's Membership

NAFCU has approximately 800 members, including around 775 of the nation's most innovative and dynamic federal credit unions (FCUs) with various and diverse membership bases and operations. NAFCU takes pride in representing many smaller credit unions with relatively limited operations as well as many of the largest and most sophisticated credit unions in the nation. In fact, 80 out of the 100 largest FCUs are NAFCU members. NAFCU represents 63.8 percent of total FCU assets and 57.5 percent of all FCU member-owners.

In addition, NAFCU membership includes several state-chartered credit unions that were formerly federally chartered credit unions and chose to retain their NAFCU membership. NAFCU members include federally chartered corporate credit unions as well. Among all corporate credit unions, NAFCU represents 90.2 percent of total corporate assets and 80.4 percent of the members of corporate credit unions.

The Credit Union Universe

Federally Chartered Credit Unions

Federally chartered credit unions, or FCUs, obtain their charters from, and are regulated by, the National Credit Union Administration (NCUA). Their member shares (deposits) are insured by the National Credit Union Share Insurance Fund (NCUSIF), which is administered by the NCUA. As of June 2009, there were 4,783 FCUs, with assets of \$478.1 billion and a membership base of 49.5 million.

Federally Insured Credit Unions

All FCUs are required to be insured by the NCUSIF. State-chartered credit unions in some states are required to be federally insured while others may elect to be insured by the NCUSIF. The term "federally insured credit unions" (FICUs) refers to both federally and state-chartered credit unions whose accounts are insured by the NCUSIF. Thus, FCUs are a subset of FICUs. As of June 2009, there were 7,691 FICUs, with assets of \$870.1 billion and a membership base of 89.7 million.

Privately Insured Credit Unions

Private primary share insurance for state-chartered credit unions has been authorized in some states; currently there are privately insured credit unions operating in

nine states.² There is only one private insurance company (American Share Insurance (ASI) of Dublin, Ohio) offering credit unions primary share insurance, and only one other private insurer (Massachusetts Share Insurance Corporation) offers excess deposit insurance coverage.

Corporate Credit Unions

Corporate credit unions are “credit unions for credit unions.” Corporate credit unions provide investment products, advisory services, item processing and loans to their members. As of June 2009, there were 28 corporate credit unions with assets of \$101.6 billion.

NAFCU Research

NAFCU devotes a good deal of institutional resources to keeping its finger on the pulse of members’ operations by surveying its membership regularly. In this report, we reference two research instruments:

Flash Report

NAFCU’s *Flash Report* survey is sent out to approximately 150 NAFCU-member credit unions monthly and then compiled into a report with updates on our members’ financial data plus their responses to questions on a special monthly topic.

Federal Reserve Report

NAFCU’s *Federal Reserve Meeting Survey* is an annual assessment of NAFCU members that covers topics we believe will be of use in compiling this report. Survey data was collected as of September 25, 2009, for this report.

² The nine jurisdictions where state-chartered credit unions have obtained primary private insurance are Alabama, California, Idaho, Illinois, Indiana, Maryland, Nevada, Ohio, Texas. Approximately 17 other states have statutory provisions permitting private insurance pending regulatory approval.

Research Products

Visit www.nafcu.org/DidYouKnow to access all of these incredible benefits!

- **Daily Rates**

Online comparison of bank and credit union loan and savings rates updated daily.

- **Economic Forecasts**

Macroeconomic and credit union indicators forecast. (Percent Seasonally Adjusted Annual Rates)

- **Flash Report**

Monthly data on the financial performance of credit unions and economic analysis.

- **Macro Data Flash**

Concise, one page analysis of the most important consumer-oriented U.S. economic indicators posted to the NAFCU web site the day the indicators are released.

- **KFRAS and OEAs**

Individualized comparative analysis of key financial ratios and operating expense ratios based on your credit union's most recent NCUA 5300 Call Report data.

- **Capital Management Tools**

- Average risk-weighted net worth calculator – estimate change in your risk-weighted net worth ratio after 5 years.
- NCUA's proposed PCA calculator – determine what your PCA classification will be.
- Net worth calculator – determine your net worth in 10 years.
- 2009 Premium Calculator – determine your 2009 NCUSIF and Corporate Stabilization premium.

- **Issues Watch**

Credit union management teams face numerous financial services issues in today's dynamic economic environment. Find articles on these issues from experts around the country.

CREDIT UNION FINANCIAL CONDITION

- During the first half of 2009, FICUs' total annualized share growth (16 percent) outpaced total annualized loan growth (1.4 percent), resulting in a loan-to-share ratio of 77.5 percent.
- FICUs' return on average assets (ROA) increased from a negative 0.03 percent to an annualized 0.28 percent during the first half of 2009, with asset growth increasing to an annualized 14.5 percent and net income surging by an annualized 994.9 percent.
- FICUs' total net worth level fell from 10.6 to 10 percent during the first six months of 2009, with 96.6 percent of all FICUs staying above the "well capitalized" level of 7 percent.
- FICUs' first mortgage loans outstanding expanded by 3.2 percent during the first half of 2009, while first mortgage loans granted year-to-date surged by an annualized 57.9 percent. At the end of June 2009, first mortgage loans outstanding accounted for 167 percent of total loan growth.
- FICUs' total loan delinquency ratio increased from 1.4 to 1.6 percent during the first six months of 2009, while the total net charge-off ratio increased from 0.8 to 1.2 percent. The bankruptcy ratio for all FICUs decreased slightly from 0.5 to 0.4 percent over the same time period.

General Financial Condition

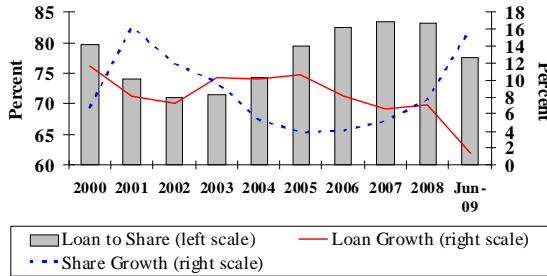
Credit unions are some of the most conservatively run financial institutions in the country. While they were not part of the problem that caused the turmoil in the financial markets, their financial condition has nonetheless been affected in various ways, particularly with regard to delinquencies, charge-offs, mortgage portfolios and liquidity issues. In addition, as with most other financial institutions, credit unions were forced to tighten their lending standards as a response to the conditions in the financial markets.

NAFCU's 2009 *Federal Reserve Meeting Survey* asked participating credit unions about the steps they have taken over the past 12 months in response to the financial crisis. A vast majority of credit unions indicated that they reduced dividend rates (86.5 percent). Almost two-thirds stated that they cut travel and/or training expenses (63.2 percent) and tightened lending standards (62.7 percent). Almost half of the responding credit unions increased their marketing efforts (47.2 percent), while about one-third increased their fee income (34.2 percent) and over one-quarter reduced the number of full-time employees (28.5 percent). Only 14.5 percent indicated that they raised capital targets as a response to the financial crisis.

During the last recession in 2001, FICUs saw a spike in their share growth due to the "flight to safety" (Chart 1). In 2001 and 2002, share growth outpaced loan growth by

a wide margin, a trend that was reversed during the boom period that started in 2003. The same trend has been seen since the beginning of the current recession in December 2007, suggesting another “flight to safety.” As of June 30, 2009, total shares at FICUs

Chart 1
Trends in FICU Loan and Share Growth



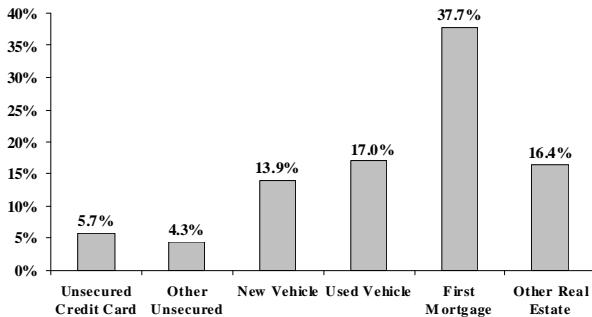
Source: NCUA Financial Performance Report

expanded by an annualized 16 percent, while total loans grew by an annualized 1.4 percent. This compares to share growth of 7.7 percent and loan growth of 7.7 percent in 2008. The resulting loan-to-share ratio of 77.5 percent, however, was still above its 2001 and 2002 levels, but almost 6 percent lower than last year. The higher inflow of shares when compared to loan growth caused total FICU investment portfolios to increase by 24.9 percent during the first half of 2009, after increasing by 9.8

percent in 2008. The strongest investment category during the first half of 2009 was investments with maturities from one to three years, which grew by 29.9 percent after increasing by 22.6 percent in 2008. Investments with maturities from three to five years grew by 15.4 percent, after being the strongest-growing category with 31.8 percent in 2008. FICU investments with maturities of one year or less were the second-fastest-growing category with 26 percent and made up the bulk (54.3 percent) of all FICU investments.

As far as the composition of the FICU loan portfolio is concerned, as of June 30, 2009, the biggest share of total loans came from first mortgage real estate loans with 37.7

Chart 2
Share of Total Loans



Source: NCUA Financial Performance Report

percent (Chart 2). While there were only minor changes in the composition of the loan portfolio when compared to 2008, the contribution to overall loan growth changed significantly. After contributing 70.4 percent to total loan growth in 2008, first-mortgage loans were responsible for 167 percent of total loan growth in the first half of 2009. At the same time, the amount of first-mortgage loans sold to the secondary market surged by an annualized 216.5 percent during the first half of 2009.

This shows that credit unions are carefully balancing their mortgage risk between holding first-mortgage loans in their portfolio and selling them to the secondary market. For example, credit union mortgage loans delivered to Fannie Mae under the NAFCU-Fannie Mae alliance continued to show huge increases in mortgage lending in July 2009, with the volume of total loan deliveries through July 2009 seeing a 282 percent increase over

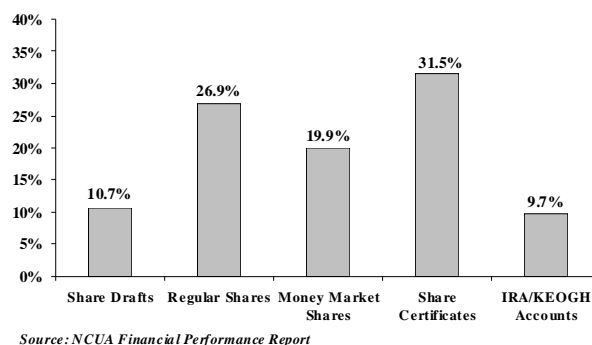
the same timeframe in 2008. The year-over-year total number of loans delivered under the NAFCU-Fannie Mae alliance rose 228 percent as of July 2009. As in 2008, first-mortgage loans continued to be the fastest-growing loan category during the first half of 2009, though at a much slower rate of 3.2 percent (2008: 14.5 percent). New-vehicle loans, on the other hand, declined the most by 2.8 percent, subtracting 57 percent from total loan growth.

Share certificates made up the biggest part of total shares and deposits with 31.5 percent as of June 30, 2009 (Chart 3). As in the case of the loan portfolio, the composition of total shares and deposits stayed fairly similar to the previous year. In terms of growth, however, share certificates only contributed 10 percent to total share growth after being responsible for 20.8 percent of total share growth in 2008. At the same time, regular shares contributed the most to total share growth during the first half of 2009 with 35.5 percent, closely followed by money market shares, which contributed 32.4 percent.

FICUs' total ROA increased from a negative 0.03 percent in 2008 to an annualized 0.28 percent during the first half of this year. While total FICU asset growth picked up from 7.5 percent in 2008 to an annualized 14.5 percent as of June 30, 2009, total net income rose from a negative \$260.9 million in 2008 to \$1.17 billion during the first half of this year. This number includes the NCUSIF stabilization expense of \$2.45 billion as of June 30, 2009. Without this expense, net income would have been \$3.62 billion. Interest income, which made up 71.6 percent of gross income, declined by an annualized 3.9 percent during the first half of this year, while non-interest income expanded by an annualized 67.4 percent. This compares to 1.7 percent and 1 percent growth, respectively, for 2008. Interest expenses, accounting for 37.1 percent of total expenses, dropped by an annualized 17.4 percent, while non-interest expenses declined by an annualized 4.7 percent. In 2008, interest expenses fell by 6.7 percent and non-interest expenses rose by 13.3 percent. In addition, provisions for loan and lease losses increased by an annualized 31.2 percent in 2009 after surging 119 percent in 2008. During the first half of this year, credit unions' average yield on loans declined from 6.6 percent in 2008 to an annualized 6.3 percent, while the average yield on investments dropped from 3.9 percent to an annualized 2.8 percent.

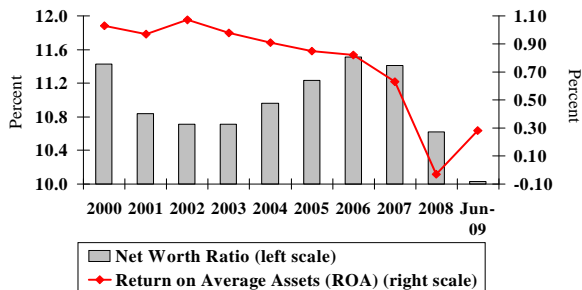
As a comparison, FDIC-insured institutions' ROA decreased from 0.08 percent in 2008 to an annualized 0.04 percent during the first half of this year. Asset growth declined from 6.2 percent in 2008 to an annualized negative 7.8 percent as of June 30,

Chart 3
Share of Total Shares and Deposits



2009. Net income dropped by an annualized 0.5 percent after falling 94.8 percent in 2008.

Chart 4
FICUs Net Worth Ratio and ROA



Source: NCUA Financial Performance Report

During the first six months of 2009, total FICU asset growth significantly outpaced net worth³ growth, resulting in the total net worth ratio decreasing from 10.6 percent at the end of last year to 10 percent. This compares to the peak net worth ratio of 11.5 percent at the end of 2006 (Chart 4). As of June 2009, 96.6 percent of all FICUs were considered “well capitalized” (i.e., they maintained a total net worth ratio of at least 7 percent in accordance with the Prompt Corrective Action (PCA) system as established by NCUA). This was slightly down from the 97.8 percent as of December 2008. At the same time, the number of FICUs classified as under-capitalized (i.e., possessing a net worth ratio of less than 6 percent) increased slightly from 1 percent to 1.5 percent. The remaining 1.9 percent of FICUs were classified as adequately capitalized, with net worth ratios between 6 percent and 7 percent, up from the 1.2 percent at the end of 2008.

The absence of a risk-based capital system for PCA continues to restrain some credit unions from expanding their field of membership during times of high asset growth and/or earnings compression as is currently the case. Using the average June 2009 net worth ratio and ROA for FICUs of 10.03 percent and 0.28 percent respectively, a credit union could grow its assets by just 2.83 percent each year without incurring a decline in its net worth ratio. During the first six months of 2009, 81.3 percent of all FICUs experienced annualized asset growth of more than 2.83 percent.

NAFCU also believes that the current financial crisis has shown the need for credit unions to be able to raise capital from their members as a secondary source of capital instead of only being able to count retained earnings as part of their net worth. Capital issues are further discussed in Chapter 2.

Mortgage Activity

Credit unions’ first-mortgage lending has slowed down significantly this year. Through June 2009, first mortgage loans outstanding grew by 3.2 percent to \$214.7 billion, after expanding by 14.5 percent in 2008. The majority of FICUs’ first-mortgage loans outstanding are fixed-rate loans (60.5 percent); however, 14.8 percent of the first-

³ The term “net worth” with respect to any insured credit union means the retained earnings balance of the credit union, as determined under generally accepted accounting principles. With respect to a low-income credit union, it includes secondary capital accounts that are uninsured and subordinate to all other claims against the credit union, including the claims of creditors, shareholders and the National Credit Union Share Insurance Fund. See 12 USC § 1790d (o) for more information.

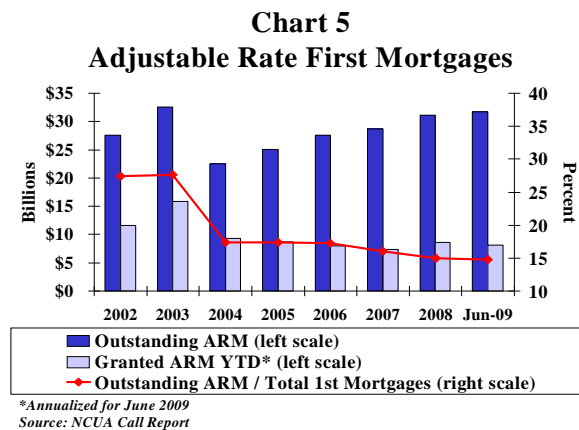
mortgage loans are adjustable-rate first mortgages. This has only slightly changed compared to 2008. Total first-mortgage loans granted year-to-date during the first half of 2009 increased by 57.9 percent from \$69.7 billion in 2008 to an annualized \$110.1 billion, with 84.1 percent of those loans being fixed-rate loans and 7.3 percent adjustable-rate loans. This compares to percentages of 67.4 and 12.3, respectively, for 2008. Based on first mortgage loan originations, FICUs' percent of the total market increased from 4.6 percent as of December 2008 to 5.3 percent as of June 2009.

Chart 5 shows that during the first six months of 2009 the amount of outstanding adjustable-rate first mortgages increased by 1.9 percent from \$31.2 billion at the end of 2008 to \$31.8 billion. Meanwhile, the amount of adjustable-rate first mortgages granted through June 30, 2009 fell by 6.1 percent from \$8.6 billion to \$8.1 billion on an annualized basis.

The ratio of adjustable-rate first mortgages outstanding to total first mortgages outstanding dropped sharply from 27.7 percent at the end of 2003 to 17.4 percent in 2004 and remained at approximately that level through the end of 2006. Since then, the ratio has slowly declined to 14.8 percent as the amount of adjustable-rate first mortgages outstanding grew at a much slower rate than total first mortgages outstanding. Total fixed-rate first mortgages outstanding grew by 5.7 percent from \$122.8 billion at the end of 2008 to \$129.8 billion during the first half of 2009. At the same time, total fixed-rate first mortgages granted through June 30, 2009 increased by 97.2 percent from \$46.9 billion in 2008 to \$92.6 billion on an annualized basis.

At the end of June 2009, total first mortgage loans outstanding comprised 37.7 percent of total loans and 24.7 percent of total assets, while total real-estate secured loans outstanding comprised 54.1 percent of total loans and 35.4 percent of total assets. As of June 30, 2009, 71.4 percent of all FICUs had real estate accounts, a slight increase from the 71 percent in 2008. Data from NAFCU's 2009 *Federal Reserve Meeting Survey* showed that 52.4 percent of the respondents' credit unions have seen an increase in mortgage originations in 2009 when compared to the same period last year. In addition, survey respondents indicated that, on average, 47.9 percent of their credit union's loans granted as of June 2009 have come from refinancing.

NAFCU's 2009 *Federal Reserve Meeting Survey* also asked member credit unions if their first-mortgage loan portfolio included interest-only mortgage loans, 40-year mortgage loans and payment-option loans. Only 7.9 percent of this year's survey participants responded that they offer interest-only mortgage loans, a significant drop from last year's 14.4 percent. Credit unions that offered 40-year mortgages fell from 23.2 percent last year to 18.4 percent, while only 2.2 percent of this year's survey



respondents answered that they offered payment-option loans, slightly up from the 2 percent in last year's survey.

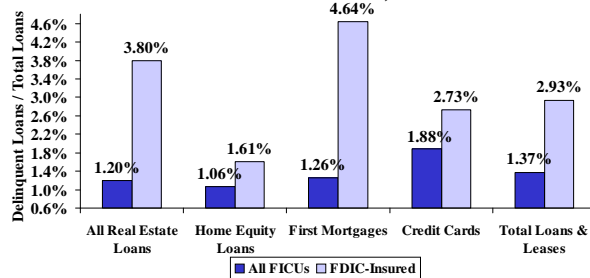
The amount of first-mortgage loans sold to the secondary market surged by 216.5 percent on an annualized basis during the first half of 2009, after growing by 23.8 percent in 2008. The ratio of first-mortgage loans sold to the secondary market year-to-date to all first-mortgage loans granted year-to-date also surged from 27.7 percent at the end of 2008 to 55.5 percent as of June 30, 2009. Credit unions that participated in NAFCU's 2009 *Federal Reserve Meeting Survey* indicated that, on average, 72.8 percent of their first mortgage loans outstanding could be sold to the secondary market. In addition, 35 percent of the respondents indicated that all of their mortgage loans could be sold to the secondary market.

Credit Quality/Standards

The overall quality of the asset portfolios held by FICUs remains relatively solid, particularly when compared to other financial institutions. FICUs have, however, experienced some deterioration in their overall credit quality and tightened some of their lending standards. The delinquency rate among FICUs was 1.6 percent in June 2009, up from the 1.4 percent in December 2008

and well above the 0.68 percent reported at the end of 2006 (Charts 6a and 6b). The credit card delinquency ratio increased from 1.9 percent at the end of 2008 to 2 percent as of June 30, 2009, while the total real estate delinquency ratio climbed from 1.2 percent to 1.6 percent over the same time period. The net charge-off ratio in June 2009 increased from the 0.9 percent level reported in December 2008 to 1.2 percent on an annualized basis. At the same time, the credit card net charge-off ratio surged from 2.8 percent to an annualized 4.2 percent, while the net charge-off ratio for total real estate loans increased from 0.3 percent to an annualized 0.5 percent.

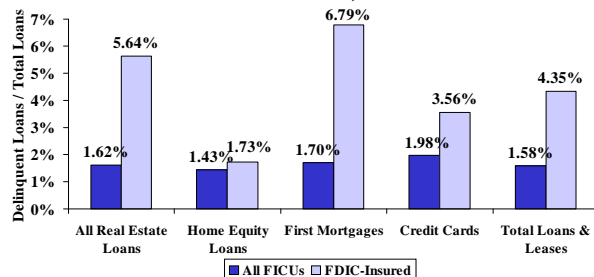
Chart 6a
Delinquency Ratios*
As of December 31, 2008



*Note: Credit union delinquencies are reported as 2 months or more past due, while FDIC delinquencies are reported 90 days or more past due.

Source: NCUA Call Report & FDIC Quarterly Bankine Profile

Chart 6b
Delinquency Ratios*
As of June 30, 2009



*Note: Credit union delinquencies are reported as 2 months or more past due, while FDIC delinquencies are reported 90 days or more past due.

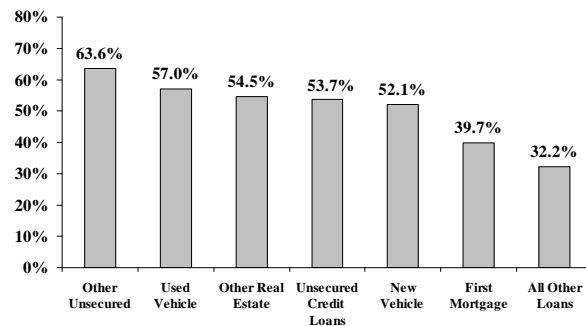
Source: NCUA Call Report & FDIC Quarterly Bankine Profile

exception of the delinquency ratio for home equity loans. The delinquency rate⁴ for FDIC-insured institutions was 4.4 percent in June 2009, up from the 2.9 percent in December 2008. The credit card delinquency ratio increased from 2.7 percent at the end of 2008 to 3.6 percent as of June 30, 2009, while the total real estate delinquency ratio climbed from 3.8 percent to 5.6 percent over the same time period. The net charge-off ratio for FDIC-insured institutions in June 2009 increased from the 1.3 percent level reported in December 2008 to 2.2 percent on an annualized basis. At the same time, the credit card net charge-off ratio surged from 5.4 percent to an annualized 8.8 percent, while the net charge-off ratio for total real estate loans increased from 1 percent to an annualized 1.7 percent.

The 2009 mid-year ratio of loans subject to bankruptcy divided by total loans for FICUs declined from 0.5 percent at year-end 2008 to 0.4 percent. This was, however, still a significant jump from the year-end 2006 bankruptcy ratio of 0.2 percent. Data from NAFCU's September *Flash Report* indicated that the bankruptcy ratio among NAFCU members increased by 19 basis points from 0.21 percent in January 2009 to 0.4 percent in July 2009. The average for the whole seven-month period from January to July 2009 was 0.32 percent. After a strong drop in FICU members that filed for bankruptcy in 2006 to 117,170 (-65.8 percent), that number increased significantly by 34.9 percent and 44.1 percent in 2007 and 2008, respectively. During the first half of 2009, 162,625 FICU members had already filed for bankruptcy, which equals an annualized increase in filings of 42.7. This resulted in year-to-date charge-offs due to bankruptcy in the amount of \$713.7 million as of June 30, 2009, an annualized increase of 44.6 percent compared to 2008. In 2008, loans charged off due to bankruptcy surged by 76.6 percent.

According to data from NAFCU's 2009 *Federal Reserve Meeting Survey*, almost two thirds of the responding credit unions have tightened their lending standards in the past 12 months (62.7 percent). This compares to 54.9 percent of survey respondents' credit unions tightening their lending standards in the 12 months prior to NAFCU's 2008 *Federal Reserve Meeting Survey*. The loan category that has been tightened the most was other unsecured loans with 63.6 percent (Chart 7). Last year's survey showed other real estate loans with 71.4 percent as the loan category that had been tightened the most. In addition, respondents stated that rising delinquencies and charge-offs were, by far, the most common cause for the tightening of lending standards (88.4 percent). Examples of other causes were

**Chart 7
Tightened Loan Standards**



Source: NAFCU's 2009 Federal Reserve Meeting Survey

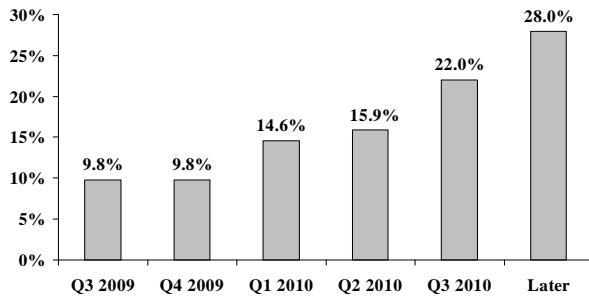
⁴ Credit union delinquencies are reported as two months or more past due while FDIC delinquencies are reported 90 days or more past due.

declining property values, funding source constraints, matching market competitors, risk mitigation and general economic conditions.

While over half of NAFCU's 2009 *Federal Reserve Meeting Survey* respondents stated that they did not know whether their credit union has made any loans to members who have been turned down by other lenders in the past year, almost all of the remaining respondents (90.8 percent) confirmed that they have made such a loan. Most commonly, the type of loan involved was used vehicle loans (73.4 percent), followed by new vehicle loans (64.6 percent), other unsecured loans (46.8 percent), first mortgage loans (31.6 percent), other real estate loans (29.1 percent), unsecured credit card loans (22.8 percent), member business loans (19 percent) and all other loans (4.1 percent).

After an increase of 105.4 percent in foreclosed real estate during 2008, foreclosed real estate assets for all FICUs were up by 35.7 percent during the first half of 2009. Total foreclosed and repossessed assets increased by 22.2 percent from \$1.026 billion at the end of 2008 to \$1.241 billion as of June 30, 2009. This compares to a surge of 72 percent during 2008. NAFCU's 2009 *Federal Reserve Meeting Survey* asked whether responding credit unions had seen an increase in real estate foreclosure notices and actual real estate foreclosures among members during the previous 12 months. While 58.3 percent indicated that their credit union has seen such an increase in foreclosure notices, 53.5 percent saw an increase in actual foreclosures. The positive aspect of this problem is, however, that more than two-thirds of the responding credit unions also stated that they have helped member(s) forestall a foreclosure during the last 12 months (72 percent). In addition, 64.3 percent of the survey respondents' credit unions have seen an increase in loan modifications over the past 12 months, while only 1.6 percent have seen a decrease.

Chart 8
Quarter with Highest Number of Mortgage Loan Resets



Source: NAFCU's 2009 *Federal Reserve Meeting Survey*

Over half of NAFCU's 2009 *Federal Reserve Meeting Survey* respondents indicated that they have mortgages in their portfolio that will reset within the next 12 months. The majority of these mortgages (28 percent) will reset after the third quarter of 2010 (Chart 8). However, only one-fourth of the survey participants stated that they have seen an increase in applications for loan modifications from members that are facing resets on their mortgage loans during the past 12 months (24.9 percent).

Liquidity

Even though credit unions are more limited in their access to liquidity than other financial institutions, they have several options at their disposal. As of June 2009, 12.7 percent of all FICUs were a member of the Federal Home Loan Bank (FHLB). In

addition, 40.3 percent of NAFCU's 2009 *Federal Reserve Meeting Survey* respondents indicated that they have used FHLB's financial products and services over the past 12 months. On the other hand, only 5.3 percent of all FICUs have filed an application to borrow from the Federal Reserve Discount Window as of June 30, 2009, and a mere 12.1 percent of NAFCU's 2009 *Federal Reserve Meeting Survey* participants stated that they are planning to file an application over the next 12 months.

For many financial institutions with mortgage loan portfolios, the secondary market is an important source of liquidity. As shown in the section on mortgage activity found in this chapter, survey respondents indicated that they can sell, on average, 72.8 percent of their first mortgage loans outstanding to the secondary market. Furthermore, 17.6 percent of all credit unions offer participation loans, and 27.5 percent of NAFCU's 2009 *Federal Reserve Meeting Survey* respondents indicated that their credit union is planning to increase the number of participation loans over the next 12 months.

The maximum amount that a FICU was entitled to borrow under all established lines of credit was, on average, \$16.3 million as of June 30, 2009. This was slightly up from the \$16.1 million at the end of 2008. In addition, almost a quarter of NAFCU's 2009 *Federal Reserve Meeting Survey* respondents indicated that they are planning to increase their credit union's total line of credit over the next 12 months (22.1 percent).

Another important source of liquidity for natural-person credit unions is corporate credit unions. Even though corporate credit unions today offer a wider array of products and services to natural-person credit unions, they are still the primary source of liquidity and wholesale funding for most credit unions. As of June 2009, approximately 80.6 percent of FICUs had invested \$2 billion as membership capital at corporate credit unions. This was a significant decrease from the 87.4 percent of FICUs that had \$2.53 billion invested as membership capital at corporate credit unions at the end of 2008. As of June 2009, there were 28 corporate credit unions with total assets of \$101.6 billion, an increase of 10.2 percent in total assets from year-end 2008. At mid-year, the largest corporate credit union was Western Corporate with \$19 billion in assets, and the smallest corporate credit union was LICU Corporate with \$3.8 million in assets. US Central Corporate Federal Credit Union, which functions in the capacity of the corporate credit union for the other corporate credit unions, had \$31.5 billion in assets as of June 2009, a decrease of 3.8 percent compared to 2008. It should be noted, however, that on March 20, 2009, NCUA placed U.S. Central and Western Corporate under conservatorship. The maximum amount that a FICU was entitled to borrow under all established lines of credit at a corporate credit union was, on average, \$5.7 million as of June 30, 2009. NAFCU's 2009 *Federal Reserve Meeting Survey* asked participating credit unions whether they are planning to increase their credit union's total line of credit at corporate credit unions over the next 12 months, which only 7.3 percent of the respondents confirmed. This was very likely a result of the recent problems in the corporate credit union system that resulted in the aforementioned NCUSIF stabilization expense of \$2.45 billion as of June 30, 2009.

EFFECTS OF LEGISLATION AND FEDERAL RESERVE REGULATIONS ON CREDIT UNION OPERATIONS

- **NAFCU supports the creation of a Consumer Financial Protection Agency (CFPA) for entities that are not federally regulated.**
- **NAFCU members support capital reform for credit unions.**
- **NAFCU members support easing member business lending limitations, which would enable credit unions to further assist in the recovery of the nation's economy.**
- **NAFCU members support a decreased regulatory burden for Regulation Z credit disclosures.**

Credit Unions and Congress

Policymakers, like the nation's consumers, have expressed how important credit unions are to the nation's economic health. Congress continues to recognize that credit unions in large part are not responsible for the financial crisis and current economic environment.

The financial crisis has accelerated calls for financial regulatory reform and Congress is currently considering legislation to revamp the financial regulatory framework, which includes the creation of a Consumer Financial Protection Agency (CFPA). The CFPA would implement and oversee consumer protection regulations, and rulemaking authority of consumer protection issues would be transferred from the functional regulators and the Federal Reserve to this new agency.

NAFCU supports the creation of a CFPA for those entities that are not federally regulated; however, we do not believe that a CFPA's authority should extend to federally regulated depository institutions such as federally insured credit unions. Credit unions are more heavily regulated than other financial institutions, and there are many consumer protections already built into the Federal Credit Union Act (such as a usury ceiling and a prohibition on pre-payment penalties). Giving the new agency authority to regulate and examine credit unions that are already regulated by the NCUA would add an unnecessary regulatory layer and increase compliance costs for credit unions. These additional burdens would lead to diminished services to credit union members.

While credit unions did not cause the current crisis, they have not been immune to it. As a sector, they have experienced historic and unprecedented levels of losses and impairments to capital, even though their capital position in the aggregate remains strong. The NCUSIF, which insures deposits in FCUs and most state-chartered credit unions up to \$250,000, has been absorbing its largest losses ever primarily due to losses at the two largest corporate credit unions. Until recent changes to the law, unlike other deposit

insurance funds, however, the NCUSIF was statutorily required to be recapitalized within the same year as its equity ratio falls below one (1) percent. Therefore, assessments on the nation's credit unions were contemplated earlier this year in order to sufficiently recapitalize the NCUSIF.

Congress, recognizing the devastating impact this would have on credit unions, created a temporary corporate credit union stabilization fund as part of the Helping Americans Save Their Homes Act of 2009. NCUA has used its authority under the new law to institute a plan under which federally insured credit unions would be assessed over a seven-year period. NAFCU worked alongside NCUA supporting the change in law and deeply appreciates the strong and timely action taken by Congress and NCUA.

The creation of the corporate credit union stabilization fund, however, is only a part of what credit unions need to continue to realize their mission of meeting their members' needs. Access to liquidity is, and will continue to be, the other critical component. NAFCU believes that it is imperative that credit unions have multiple sources of liquidity and that the Federal Reserve's discount window should be one of those sources. NAFCU stands ready to work with the Federal Reserve to make sure that credit unions have access to the liquidity as needed.

Credit unions stand ready to help improve the current economic environment, but they continue to face some challenges and restrictions in doing so, including an arbitrary member business lending cap (MBL) that was imposed on federal credit unions in 1998. Currently, federal credit unions' member business lending limit is capped at 12.25 percent of total assets or 1.25 times net worth. Reps. Paul Kanjorski (D-PA) and Ed Royce (R-CA) introduced H.R. 3380, the *Promoting Lending to America's Small Business Act*, which would increase the member business lending cap to 25 percent of assets. The bill would also exempt business loans under \$250,000 from the cap. Finally, the legislation would exempt loans made to not-for-profit religious organizations and loans made in underserved areas from the cap. NAFCU supports the legislation as there is an obvious need among small businesses for loans. In fact, a recent study by the Federal Reserve Bank of Atlanta identified a real need for more small business loans. The report found that as financial institutions increased their size through mergers, they did less small business lending. We also support a continuation of the 90 percent guarantee on Small Business Administration loans since the guaranteed portion does not count towards the cap.

Credit union business lending is not a threat to other financial institutions, despite what some bankers may claim. In fact, a 2001 Treasury Report concluded, "Business lending is a niche market for credit unions. Overall, credit unions are not a threat to the viability and profitability of other insured depository institutions. In certain instances, however, credit unions that engage in member business lending may be an important source of competition for small banks and thrifts..." Many credit unions are well-capitalized and stand ready to help America's small businesses. However, the out-of-date MBL cap continues to serve as a barrier for credit unions that wish to provide more small business loans.

In addition, NAFCU strongly opposes any extension of Community Reinvestment Act (CRA) requirements to credit unions. NAFCU believes that credit unions, by virtue of their charters, already serve their communities well by providing provident credit. Furthermore, CRA was placed on banks as a punitive measure for redlining, and there has never been any evidence of credit unions engaging in such practices. Additionally, the Home Mortgage Disclosure Act (HMDA) data supports NAFCU's belief that CRA is unnecessary for credit unions, while also demonstrating that credit unions were not a cause of the subprime crisis (See Chapter 4). Implementing a CRA system for credit unions would unnecessarily add to their already considerable regulatory burden and would not improve credit unions' services to their members.

NAFCU is also concerned with recent efforts to limit interchange fees. Two different bills have been introduced in the House this year. The first proposal, sponsored by Rep. John Conyers (D-MI), would grant merchants an exemption from antitrust law, allowing merchants to discuss and decide among themselves what price they are willing to pay to accept credit and debit cards. Absent the exemption provided by the legislation, such collusion would be a blatant violation of antitrust law. A second proposal would amend the Truth in Lending Act (TILA) and empower the Federal Trade Commission to promulgate regulations regarding interchange fees that it determines are unfair or deceptive. NAFCU opposes both measures.

The current electronic payment system works exceedingly well, balancing the benefits to merchants and the costs to financial institutions of maintaining the network. Legislation targeting interchange fees will increase the cost of transactions without providing any benefit to consumers. Interchange fees are similar to any other cost of doing business. This is an issue between two large, sophisticated sectors – the financial services industry and the retail industry. Accordingly, NAFCU believes this issue is best left to the market. There is little need for congressional action to protect these two parties.

Capital Reform: Secondary Capital and Risk-Based Capital Reform

The current crisis has illuminated the need for secondary capital sources for credit unions. With the exception of low-income designated credit unions, credit unions can only count retained earnings as capital in determining their net worth. NAFCU believes that credit unions should be able to raise capital from their members as a secondary source of capital. We believe that a change to the restrictions on credit unions to raise capital would not only provide an effective and appropriate option for credit unions that seek to shore up their capital, but is also consistent with the cooperative and mutual principles under which credit unions exist and operate.

NAFCU has also long supported a risk-based capital regime for credit unions. While all credit unions are created to meet the needs of their members, their risk portfolios range dramatically depending on their members' needs and requirements. As such, within the stringent legal and regulatory limits, some credit unions engage in riskier activities than others. We believe the level of capital required should not be the same

across the board; rather, it should be consistent with risk portfolios. As such, we support a risk-based capital regime under which capital with less risk has more weight than capital with greater risk.

Regulation Z

The increasing burden posed by Regulation Z is one of the industry's primary concerns. Since July of last year, the Federal Reserve Board (Board) has finalized five rules amending Regulation Z. Additionally, the Board proposed two comprehensive new rules covering closed-end loans and home equity lines of credit (HELOCs). Further, the most recent proposal implementing the *Credit Card Accountability, Responsibility and Disclosure Act* (CARD Act) spanned more than 840 pages. Simply put, it is very difficult for institutions of any size to keep up with the sheer number of changes to Regulation Z. NAFCU understands the Board's obligation to implement legislation passed by Congress. Nonetheless, we are hopeful that the Board will take care, where possible, to minimize the disruption and the operational burdens created by the sheer volume of changes to Regulation Z.

The CARD Act

NAFCU is concerned with a number of issues involving the Board's regulations and proposed regulations regarding the CARD Act. Most controversially, the CARD Act amended TILA to require statements to be mailed at least 21 days before the payment due date for all open-end loans. The credit union industry found the 21-day notice requirement particularly burdensome due to its practice of sending combined statements to members. As you know, Congress has clarified that this provision only applies to credit cards and not to all open-end credit plans. Nonetheless, credit unions still face enormous burdens in complying with the broad changes in the CARD Act.

NAFCU appreciates that the Board has recognized the CARD Act included an unreasonably short effective date. NAFCU and its members strongly oppose moving up the effective date for any provisions included in the January 2009 Regulation Z Rule (74 Fed. Reg. 5244 (January 29, 2009)) that are not directly affected by the CARD Act. In its most recent proposal, the Board indicated it was considering moving up the effective date for all provisions in the January Rule to February 22, 2010, in order to match the effective date for the CARD Act. Given the considerable changes to Regulation Z that credit unions already must comply with by February 22, we strongly encourage the Board not to move up the effective date for unrelated issues included in the January Rule.

The Higher Education Opportunity Act

NAFCU supports the *Higher Education Opportunity Act* (HEA) and its emphasis on ensuring clear and accurate disclosures. The Board's regulation implementing the act, however, is particularly bothersome in one specific matter. The regulation requires lenders examining a multipurpose or signature loan to provide HEA disclosures if it discovers that the prospective borrower intends to use some of the proceeds for qualified education expenses. Alternatively, the lender could simply turn down the loan. NAFCU finds the two alternatives troubling. On the one hand, the prospective borrower may

effectively turn a multipurpose loan into a qualified education loan with all the corresponding requirements. On the other hand, a lender who is not in the business of providing student loans finds its lowest cost alternative to be simply turning down an otherwise acceptable loan application. Accordingly, NAFCU asks that the Board reconsider its decision to apply the HEA requirements to multipurpose loans.

Closed-End Lending

NAFCU commends the Board and Federal Reserve staff for conducting a comprehensive review of Regulation Z. The complexity of the issues demands that the landmark changes to Regulation Z are made with great care. NAFCU's comment letter to the Board regarding its recent comprehensive proposal to amend Regulation Z as it applies to closed-end, home-secured loans outlines our concerns relative to the proposal. Nonetheless, we wanted to take this opportunity to present a few specific concerns. First and foremost, the final rule should be as specific as possible regarding exactly what fees should and should not be included in the definition of "finance charge." While regulated institutions often prefer flexibility, this is a situation where bright lines would be helpful. Along those same lines, NAFCU is skeptical of including any taxes within the definition of finance charge. Given that the taxes are levied by a third party, it seems unreasonable to include the cost as part of the finance charge as that term is intended to reflect the cost of credit. Furthermore, the term should not include any voluntary fees instigated by a third party as it would be unreasonable to require the lender to track such fees.

HELOCs

In addition, NAFCU has provided comments on the Board's proposed rule to amend its rules in Regulation Z regarding HELOC.

On the proposed changes to the HELOC rules, we would like to take this opportunity to encourage the Board and the Federal Reserve staff to consider revising the proposed timing requirements related to advance notices to change in terms. Additionally, we urge the Board to scale back on the amount of disclosures required to be provided to borrowers at application, at account opening and throughout the life of the loan. The volume, we believe, could lead to the unintended consequence of consumer confusion.

Overdraft Protection Programs

The Federal Reserve is reviewing comments from a proposal earlier this year to amend Regulation E relative to overdraft protection. One of the primary issues the Board is considering is whether to require an opt-in disclosure for overdraft protection. NAFCU believes that the best approach to this issue would be to require members to opt in, provided credit unions can continue providing the service to existing customers. Under this system, all future members would have to affirmatively opt in to receive overdraft protection. However, current members who use the program would not see their service disrupted and be given the opportunity for a one-time opt-out. Requiring credit unions to receive an affirmative opt-in for existing customers would, we believe, be unduly

burdensome and also potentially harmful to members who benefit from the service and who may not respond to a notice requesting their assent.

NAFCU also urges the Board not to allow institutions to continue providing overdraft on an “all-or-nothing” basis. Many credit unions’ automated payment processing systems do not have the capability to distinguish between an ATM withdrawal, a debit card purchase, a check or an ACH payment. Consequently, a final rule that requires credit unions to provide overdraft protection for only certain payments would create a costly burden as many credit unions would either need to reconfigure software systems or change to a new system in order to distinguish between each type of payment.

As Congress continues to review legislation to codify policy regarding overdraft programs, NAFCU urges the Board to recognize that these programs provide consumers with a valuable tool to manage their finances.

CREDIT UNION SERVICE TO MEMBERS AND USE OF FEDERAL RESERVE SERVICES

- Electronic service offerings by credit unions continue on an upward trend.
- More than half of credit unions have members performing electronic financial services via automated teller machines (ATMs), audio response systems and the Internet.
- Credit unions continue to use many Federal Reserve services, which is indicated by increasing usage in nearly 40 percent of those services over the past year.
- NAFCU members view the majority of Federal Reserve services as competitively priced.

Serving members remains the most important aspect of credit union operations, and credit unions' ability to take advantage of improved technology to provide financial services continues to expand.

Electronic Financial Services

Similar to last year, this year's report reflects that the most common online service offered by FICUs is account balance inquiry, with 67.9 percent of FICUs indicating that they currently offer this service. This is an increase from the 66.3 percent reported last year. As credit unions grow and become more technologically savvy and these technologies become more affordable, the array of electronic financial services offered to members continues to increase.

The percentage of credit unions offering electronic financial services has increased for 13 of the 16 electronic services, with the largest jumps in bill payment and e-statements (Table 1).

Table 1
Financial Services Offered Electronically by Credit Unions

Online Service Offered	Provided in 2008	Provided in 2009
Account Aggregation	4.9%	5.6%
Account Balance Inquiry	66.3%	67.9%
Bill Payment	44.9%	48.6%
Download Account History	52.2%	55.0%
Electronic Cash	2.8%	2.9%
Electronic Signature Services	1.7%	2.4%
e-Statements	38.0%	43.8%
Internet Access Services	9.6%	11.2%
Loan Payments	58.4%	58.6%
Member Application	25.2%	25.0%
Merchandise Purchase	5.3%	5.3%
New Loan	40.2%	39.2%
New Share Account	14.4%	15.3%
Share Account Transfers	63.8%	65.4%
Share Draft Orders	54.6%	54.4%
View Account History	63.0%	65.2%

Source: NCUA June 2008 & 2009 Call Reports.

Approximately 65 percent of FICU members use Internet home banking to perform financial services (Table 2). Those FICUs providing Internet home banking hold 97.6 percent of total credit union assets. ATMs at credit unions saw a slight usage increase (1.5 percent).

Table 2
How Do Your Members Access/Perform Electronic Financial Services?

Electronic Service	Percentage of Institutions		Percentage of Assets	
	2008	2009	2008	2009
Audio Response/Phone-Based	54.6%	55.6%	95.8%	96.3%
Automatic Teller Machine (ATM)	60.8%	62.3%	96.9%	97.0%
Home Banking Via Internet Website	62.7%	65.0%	97.3%	97.6%
Kiosk	4.2%	4.8%	23.4%	24.7%
Other	2.3%	2.2%	5.1%	4.3%

Source: NCUA June 2008 & 2009 Call Reports.

Federal Reserve Services

The Federal Reserve is an important partner in enabling credit unions to deliver services to members such as FedLine Advantage and Automated Clearing House (ACH) Receipts. In addition, many credit unions obtain Federal Reserve services indirectly through arrangements with other institutions such as corporate credit unions. According to NAFCU's 2009 *Federal Reserve Meeting Survey*, NAFCU-member credit unions continue to utilize many Federal Reserve services (Table 3). The most widely used Federal Reserve service was ACH Receipts (58.6 percent), followed by Currency Orders (52.4 percent) and FedLine Advantage (46.1 percent). The least used service was Direct Mainframe Access (7.2 percent).

NAFCU members who indicated use of a service were also asked to indicate if they were utilizing those Federal Reserve services in an increasing, constant or decreasing manner. Credit unions indicated the largest declining usage in the following services: Cash Letters for Paper Deposits (17.6 percent), Check Inclearings (13 percent) and Coin Deposits (4.1 percent). Cash Letters for Paper Deposits and Check Inclearings also experienced the largest decline last year. The services with the largest increases in credit union usage were ACH Receipts (35.8 percent), ACH Originations (23.3 percent), Cash Letters for Image Deposits (21.2 percent) and FedLine Advantage (17.1 percent).

NAFCU members were also asked to rate the Federal Reserve services on a scale of one to five with five indicating an "excellent" rating (Table 3). Among all the services rated, 11 received an "above average" rating (median rating of four), including Customer Help Services. Thirteen of the services were rated a three (average).

None of the services had a median rating below a three. Comparing the results of NAFCU's 2009 *Federal Reserve Meeting Survey* with the 2008 survey shows a continued

Table 3
NAFCU Members' Usage of Federal Reserve Services

Federal Reserve Service	Declining Usage	No Usage Change	Increasing Usage	Credit Union Usage	Median Service Rating: 1 to 5*
Currency Deposit	3.6%	28.5%	6.7%	38.8%	3
Coin Deposit	4.1%	31.1%	8.8%	44%	3
Currency Orders	3.1%	38.9%	10.4%	52.4%	3
Coin Orders	2.6%	35.8%	5.7%	44.1%	3
Cash Letters – Paper Deposits	17.6%	9.8%	2.6%	30%	3
Cash Letters – Image Deposits	3.6%	10.4%	21.2%	35.2%	3
Check Inclearings	13%	22.3%	6.2%	41.5%	3
Foreign Check Services	3.6%	17.1%	2.1%	22.8%	3
FedImage Services^	3.1%	15%	3.6%	21.7%	3
Check 21 Enabled Services**	2.6%	14.5%	14%	31.1%	4
FedLine Direct	1.6%	17.1%	6.7%	25.4%	4
ACH Originations	1%	19.7%	23.3%	44%	4
ACH Receipts	0.5%	22.3%	35.8%	58.6%	4
Fedwire Funds Services	1%	27.5%	16.6%	45.1%	4
Fedwire Securities Services	0.5%	10.9%	5.7%	17.1%	4
National Settlement Services	1%	10.4%	2.1%	13.5%	4
Direct Mainframe Access^	1%	5.7%	0.5%	7.2%	3
FedLine Command	0.5%	7.3%	2.1%	9.9%	3
FedLine Advantage	1%	28%	17.1%	46.1%	4
FedLine Web Services	1%	28.5%	13.5%	43%	4
Automated Voice Response System**	2.1%	14.5%	3.1%	19.7%	3
Fed Discount Window	0.5%	9.8%	2.1%	12.4%	4
Customer Help Services	1%	36.3%	5.7%	43%	4
Educational Seminars	1.6%	29%	8.3%	38.9%	3

Source: NAFCU's 2009 *Federal Reserve Report Survey*.

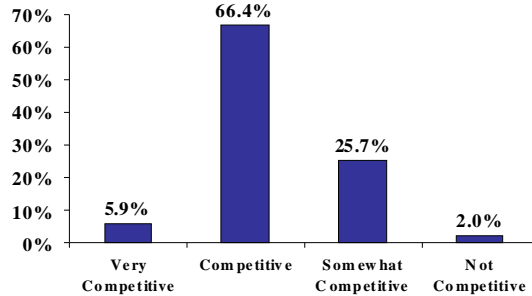
*5 = Excellent **Changed since 2008 survey ^New in the 2009 survey

satisfaction with the services used. Last year, there were 10 services with a median rating of four or above average. A change in the labeling of two of the services between the

2008 and 2009 surveys may have affected these ratings slightly. Also, two services were added to the 2009 survey: Direct Mainframe Access and FedImage Services.

Three services that the Federal Reserve already offered under the same label in 2008 improved their rating (Fedwire Securities Services, National Settlement Services and Fed Discount Window), while two saw a rating decrease (FedLine Command and Educational Seminars). Fifteen services saw no change in their rating. NAFCU-member credit unions were also asked to indicate an overall rating of the competitiveness of Federal Reserve Services (Chart 1), as well as a rating of the competitiveness of specific services. The specific services with the most competitive price rating mentioned were Currency Orders and Fedwire Funds Services. The services with the least competitive price rating mentioned were Check Processing and Currency Orders.

Chart 1
Overall Rating of Federal Reserve Services



Source: NAFCU's 2008 Federal Reserve Report Survey

Overall, credit unions are very satisfied with the pricing of Federal Reserve services, with 98 percent of the survey respondents indicating that Federal Reserve services are priced “somewhat” to “very” competitively. Over 72 percent of the survey respondents indicated that the Federal Reserve prices for their credit union’s services were “competitive” or “very competitive,” down from around 80 percent last year.

FEDERAL CREDIT UNIONS ASSIST LOW- AND MODERATE-INCOME PEOPLE

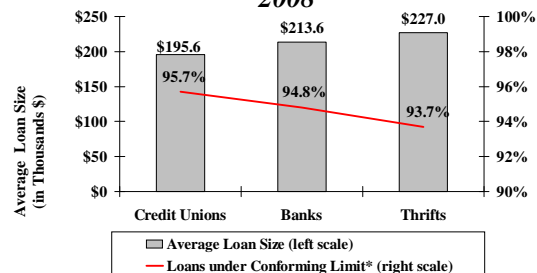
- Credit unions have a lower average dollar amount of real estate loans than other types of lending institutions, according to 2008 HMDA data.
- Credit unions have a significantly lower percentage of “high-priced” real estate loans when compared to other lending institutions.
- The number of low-income designated credit unions⁵ is increasing.
- Credit unions are adding underserved areas⁶ to their fields of membership at a slower pace than previous years.

Credit unions remain a vital resource for helping members improve their financial situation. They continually provide important financial services to a diverse field of membership (FOM). Credit unions serve different ethnicities, ages and socio-economic groups. Serving low- and moderate-income members has been, and remains, a priority for credit unions even though credit unions are not required to do so under any legislative or regulatory requirements. Credit union services are especially important in the current, tough economic environment, and NAFCU believes credit unions are part of the solution.

Mortgage Lending to Low- and Moderate-Income Members

One indication that credit unions are serving members of low and moderate income can be found in the annual Home Mortgage Disclosure Act (HMDA) data that covered 91.5 percent of all mortgage loans outstanding among credit unions during 2008 (a strong indication that this is a fairly complete picture of credit union mortgage lending). According to this data, credit

Chart 1
Approved 1-4 Family Real Estate Loans
2008



* Standard Conforming Limit 2008 was \$417,000 and High Cost Limits were higher in Certain Areas.

Source: Federal Financial Institutions Examination Council HMDA Data

⁵ A “low-income designated credit union” is a credit union in which the majority of its members, or the majority of residents in the community the credit union serves, make less than 80 percent of the average wage for all wage earners as established by the Bureau of Labor Statistics or have an annual household income that falls at or below 80 percent of the median household income for the nation as established by the Census Bureau. 12 C.F.R. §§ 701.1, 701.34

⁶ An underserved area is a local community, neighborhood or rural district that is an “investment area” as defined in section 103(16) of the Community Development Banking and Financial Institutions Act of 1994 (12 USC § 4703(16)). 12 USC § 1759(c)(2). Examples of investment areas include an area where at least 20 percent of the population is living in poverty; an area where the unemployment rate is at least 1.5 times the national average; or an area meeting the criteria for economic distress as established by the Community Development Financial Institutions Fund (CDFI) of the US Department of Treasury.

unions tended to make smaller mortgage loans than other financial institutions and had a higher percentage of mortgage loans with low- and moderate-income borrowers.

Among all mortgage loans approved in 2008 for 1-4 family homes, the average loan made by banks was larger than the average loan made by credit unions by over 9 percent, while the average loan made by thrifts was larger than those made by credit unions by more than 16 percent (Chart 1).

Table 1
Approval Rate,⁷ All Mortgage Loans⁸

	All Applicants		White Applicants		Minority Applicants	
	Applicant Income		Applicant Income		Applicant Income	
	Less than \$40,000	\$40,000 or More	Less than \$40,000	\$40,000 or More	Less than \$40,000	\$40,000 or More
2008						
Credit Unions	70%	85%	72%	87%	52%	73%
Banks	55%	68%	59%	70%	40%	54%
Thrifts	63%	73%	65%	75%	50%	62%
2007						
Credit Unions	73%	87%	75%	89%	56%	75%
Banks	57%	69%	60%	72%	44%	57%
Thrifts	66%	73%	70%	75%	53%	64%
2006						
Credit Unions	75%	89%	78%	91%	58%	79%
Banks	61%	75%	64%	77%	49%	66%
Thrifts	63%	73%	66%	75%	51%	65%

Source: Federal Financial Institutions Examination Council HMDA Data

Further, the percentage of credit union borrowers (approved 1-4 family purchase loans) with incomes of less than 80 percent of the Housing and Urban Development (HUD) median family income for the area is higher among credit unions (25.9 percent), as compared to the total for banks and thrifts (24.7 percent). This means that credit

⁷ Approvals equal loans originated plus loans approved but not accepted as a percent of all loan applications approved and denied. Minority applicants include those who identified themselves as Native American, Asian/Pacific Islander, Black or Hispanic.

⁸ All loans include home purchases, home improvements, refinancings and those where race information is reported for the mortgage loan.

unions have a greater percentage of their loans going to lower income populations than banks and thrifts, even though banks and thrifts are subject to the Community Reinvestment Act (CRA).

In addition, credit union mortgage loan approval rates continue to exceed those of banks and thrifts (Table 1). The loan approval rate, rather than the proportion of total loans granted to low- and moderate-income applicants, is the best indicator of credit unions providing service to such applicants because it is not biased by the smaller number of loans found at credit unions.

In 2008, the HMDA data collected included information on the interest rates charged on mortgage loans. This information was collected to compare the difference between the mortgage loan annual percentage rate (APR) and the applicable Treasury

Table 2
2008 Approved 1-4 Family Purchase Loans
Percentage of Approvals with Rate Spreads $\geq 3\%$ ⁹

2008	All Approvals (with race data)		White Approvals		Minority Approvals	
	Applicant Income		Applicant Income		Applicant Income	
	Less than \$40,000	\$40,000 or More	Less than \$40,000	\$40,000 or More	Less than \$40,000	\$40,000 or More
Credit Unions	4.8%	2.4%	4.6%	2.3%	7.1%	2.4%
Banks	13.5%	7.6%	13.5%	7.6%	13.9%	8.0%
Thrifts	14.1%	8.1%	13.6%	7.7%	16.7%	10.5%
2007						
Credit Unions	3.70%	1.80%	3.60%	1.80%	4.40%	2.10%
Banks	14.70%	9.50%	13.70%	8.80%	20.80%	13.70%
Thrifts	24.80%	20.60%	22.70%	19.00%	34.70%	28.40%
2006						
Credit Unions	3.70%	2.20%	3.60%	2.20%	4.70%	2.40%
Banks	22.50%	18.10%	20.40%	16.30%	34.20%	27.70%
Thrifts	27.60%	26.70%	24.30%	24.20%	42.80%	38.10%

Source: Federal Financial Institutions Examination Council HMDA Data

⁹ Approvals equal loans originated plus loans approved but not accepted. The rate spread is the difference between the APR of the loan and the applicable Treasury security yield of a comparable period of maturity. The rate spread is only reported if it is equal to or greater than 3 percentage points for first-lien loans and 5 percentage points for subordinated-lien loans. Minority approvals include loans to applicants who identified themselves as Native American, Asian/Pacific Islander, Black or Hispanic.

security yield. This was the fourth year this information was collected. If the difference between the mortgage loan APR and Treasury security yield was less than 3 percentage points for a first-lien loan and less than 5 percentage points for a subordinated-lien loan, there was no reporting requirement.

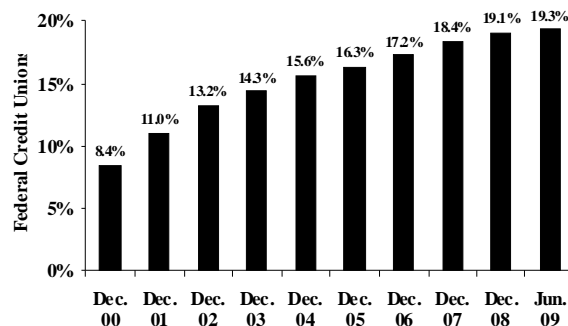
Credit unions had a significantly smaller percentage of loans that had to be reported compared to banks and thrifts, not only with respect to all mortgage approvals but also to applicants that had incomes of less than \$40,000 and those of minority status (Table 2).

Compared to banks and thrifts, credit unions approved real estate loans that were smaller in size, approved a greater percentage of conforming real estate loans, had a greater percentage of real estate borrowers with less than \$40,000 in income and granted fewer real estate loans charging 3 percentage points or more above the Treasury benchmark. Such data show, rather convincingly, that credit unions continue to serve low- and moderate-income members very well.

Low-income credit unions

Another indication that credit unions serve low- and moderate-income members can be seen by the increasing number of FCUs that are designated as low-income credit unions (Chart 2). As a result of this low-income designation, these FCUs strive to provide greater access to much-needed financial services to persons of low- and moderate-income levels. NCUA has made significant efforts to ensure credit unions are aware that they may qualify for the low-income designation.

Chart 2
Low-Income Designated
Federal Credit Unions



Source: NCUA Call Report

It is important to recognize that low-income credit unions have been given some regulatory incentives by the government as a result of their designation. For example, these credit unions are permitted by statute to have secondary capital and are able to accept non-member savings. In addition, some participate in various government programs for low-interest funding and technical assistance in an effort to enhance their services to members in financial need.

Addition of Underserved Areas

FCUs continue to add underserved areas to their FOMs, providing another sign that they are serving low- and moderate-income members. Since NCUA limited such expansions to multiple-group institutions in June 2006, in response to a suit by the banking industry, FCUs have continued to add underserved areas but at a markedly slower rate (Chart 3).

For 2009, 24 underserved areas, representing 2.4 million people, are projected to be added to credit union FOMs (Chart 3). Last year, 11 underserved areas were added, representing 2 million people. By contrast, during the period from 2001 to 2005, the average annual number was 278 underserved areas and 23.4 million potential members added.

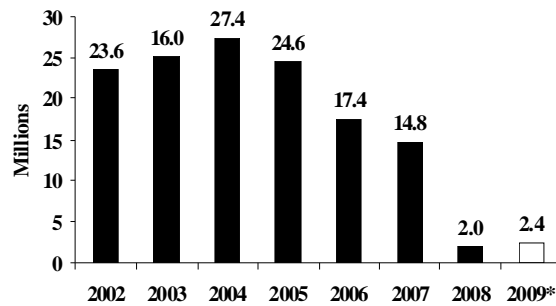
Since NCUA placed a limitation on underserved area expansions in 2006, the loan growth among credit unions with underserved areas has been slower than the universe (Chart 4). Prior to 2006, FCUs that added underserved areas as part of their FOMs saw consistently higher loan growth than the loan growth experienced by all FCUs. In 2005, the loan growth for credit unions that added underserved areas tapered off to levels comparable to those of the FCU community. By 2006, FCUs that added underserved areas experienced slower loan growth than all FCUs. Clearly, the NCUA limitation had a significant impact on credit unions adding underserved area and making loans to these communities. Credit unions would be doing much more lending in these areas if such restrictions were not in place.

Conclusion

Not only do credit unions approve a higher percentage of all real estate loans to their members, but they also charge lower interest rates and fees than banks and thrifts. Credit unions would also add more underserved areas if the limitation restricting the addition of underserved areas to multiple-group credit unions was lifted. Also, low-income designated credit unions are increasing in number and are taking advantage of the many government programs to help them serve low-income members.

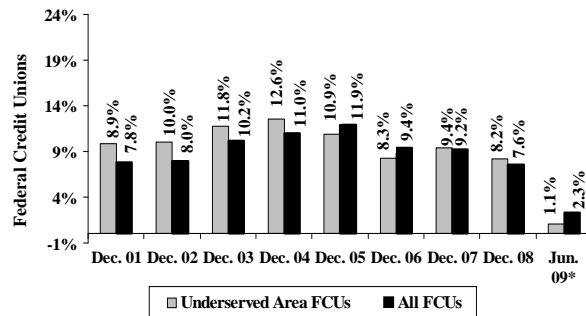
Credit unions continue to serve low- and moderate-income members well. NAFCU believes that further evidence of credit union services to those of lesser income is unnecessary in the face of such compelling evidence of service to America's underserved population.

Chart 3
Potential Underserved Member-Owners Added to FCU Membership



*Projected Figure
Source: NCUA

Chart 4
Loan Growth Trends Underserved Areas FCUs vs. All FCUs



Note: The numbers are based on same-store sales.
Source: NCUA

*Annualized Figure

CONCLUSIONS

Credit Union Financial Condition

Credit unions, while not part of the problem, have been affected in various ways by the turmoil in the financial markets, though to a lesser degree than other financial institutions. They have been experiencing strong share growth as a result of a “flight to safety” since the beginning of the recession in December 2007, a trend that is expected to continue into the first half of 2010. By the end of next year, loan growth is expected to outpace share growth again. Despite the effect that the financial crisis had on their bottom line, credit unions maintain a small but steady market share, are well-capitalized, and continue to provide their members with high-quality, low-cost products and services. Specifically, credit unions’ first mortgage lending remains sound as a result of conservative lending practices and, consequently, credit unions continue to steadily extend their market share of total first mortgage loan originations.

Effects of Legislation and Federal Reserve Regulations on Credit Union Operations

Credit unions face unprecedented compliance burdens due to changes to lending laws and accompanying regulations promulgated by the Federal Reserve this year. The changes to Regulation Z alone are crippling to our smaller members in particular. Credit unions stand ready and able to provide credit to our nation during this economic crisis but are being forced to limit programs due to limited resources.

Credit Union Service to Members and Use of Federal Reserve Services

Credit unions continue to provide their members with an array of electronic services, and members are using these services with greater frequency. ACH Receipts, ACH Origins, Currency Orders and FedLine Advantage are the most commonly used Federal Reserve services. Federal Reserve services continue to be rated highly by NAFCU survey respondents with 11 of 24 services receiving an “above average” rating. Ninety-eight percent say that the Federal Reserve prices these services from “somewhat competitive” to “very competitive.”

Federal Credit Unions Assist Low- and Moderate-Income People

Credit unions continue to provide important financial services to low- and moderate-income members, but expansion of credit union services into “underserved” areas has been limited because NCUA set restrictions in response to bank industry litigation. The number of low-income designated credit unions continues to expand. Among real estate loans, credit unions have a higher percentage of approved loans to low- and moderate-income people than other financial institutions. More significantly, credit unions have a substantially smaller proportion of “high-priced” loans to low- and moderate-income borrowers than other types of lending institutions. NAFCU believes that further evidence of credit union services to those of lesser income is unnecessary in the face of such compelling evidence of service to America’s underserved population.