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presents a complimentary event

1st Quarter TRENDWATCH

Data for March 31, 2014

Call Dates: May 22 & 23, 2014

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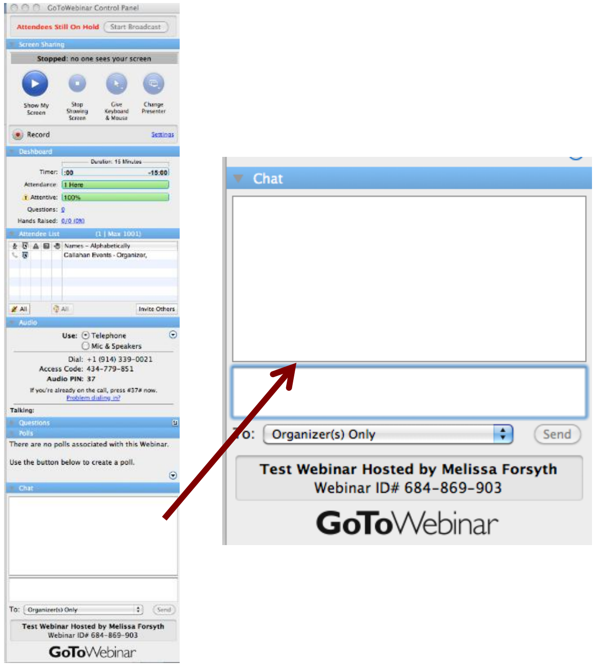
http://www.callahan.com/wp-content/uploads/2014/02/4q13TW.pdf

We are recording today's event for on-demand viewing.

We Encourage Questions!!!



Use the **Questions Box** located on the right side of the screen, to type your comments or questions.

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Fundamentals of Fixed Income – *A complimentary investment education series brought to you by TRUST*

Mortgage Backed Securities: Looking Underneath the Hood – *June 10th at 1pm EST/10am PST*

Portfolio Management– *July 15th at 1pm EST/10am PST*

Visit www.trustcu.com for more details or to register.

Upcoming Leadership Webinars

- June 3rd – ***Converting a Complete Card Portfolio to EMV***
- June 11th – ***Setting Up an EMV Structure Now***
- June 24th – ***Tips for Becoming a Realtor's Go-To Lender***

Contact us at support@Callahan.com for more information.

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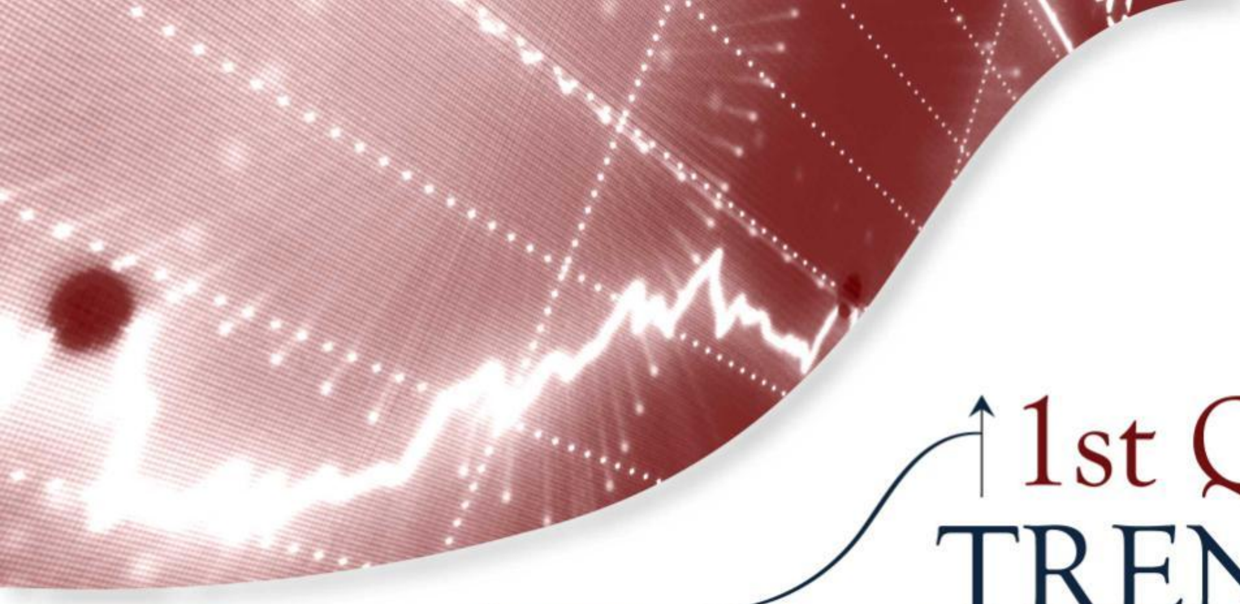

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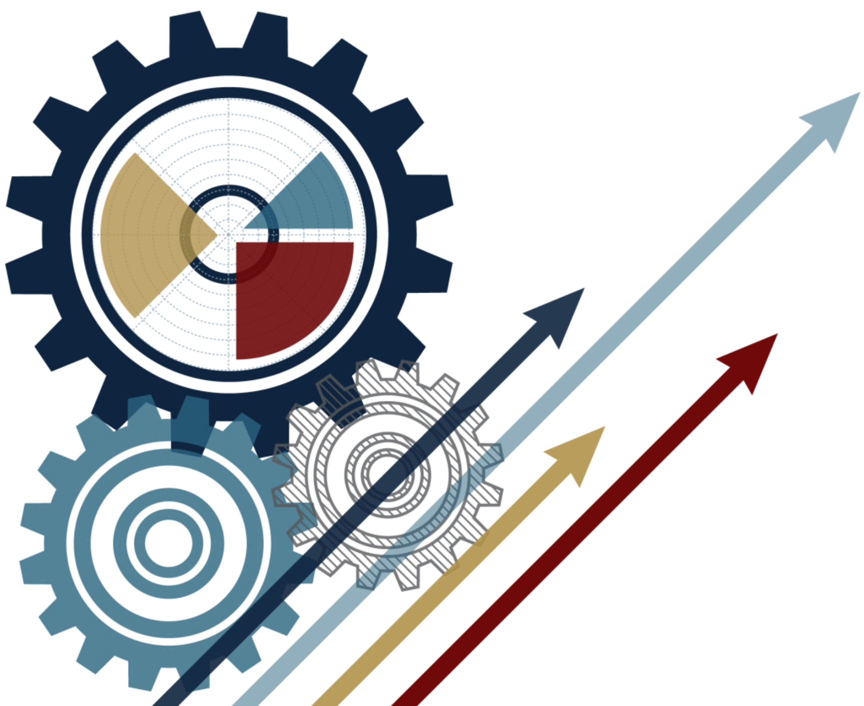

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Agenda

Economic Outlook

Scott Gilbert, Vice President, Goldman Sachs

1Q 2014 Credit Union Trends & Key Issues

“Cooperative Strong”

Chip Filson, Chairman, Callahan & Associates

Jay Johnson, Executive Vice President, Callahan & Associates

The Capital Debate: “A Tool, Not a Rule”

Doug Fecher, President & CEO, Wright-Patt Credit Union

Beavercreek, OH

Scott Gilbert, Vice President
Goldman Sachs Asset Management

Economic Outlook:

- Will economic momentum build in 2014?
- What and when are the Fed's next steps?
- Should we expect more interest rate movement in the second half of the year?

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QUESTIONS?

If you have a question or comment, please use the chat box.

Consumer Lending Leads Strong Loan Growth

1. Consumer loan originations are highest ever for 1Q
2. Auto loan portfolio tops $200 billion
3. First mortgage lending slows but market share rises

The U.S. Credit Union Industry at March 2014

	As of 3/31/14	12-mo. Growth 1Q 2014	12-mo. Growth 1Q 2013
Assets	$1.11T	4.2%	5.4%
Loans	$661.7B	8.9%	4.8%
Shares	$957.2B	3.8%	5.1%
Investments	$405.4B	-2.7%	5.0%
Capital	$123.1B	4.4%	6.9%
Members	98.5M	2.9%	2.1%

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Source: Callahan's Peer-to-Peer Analytics

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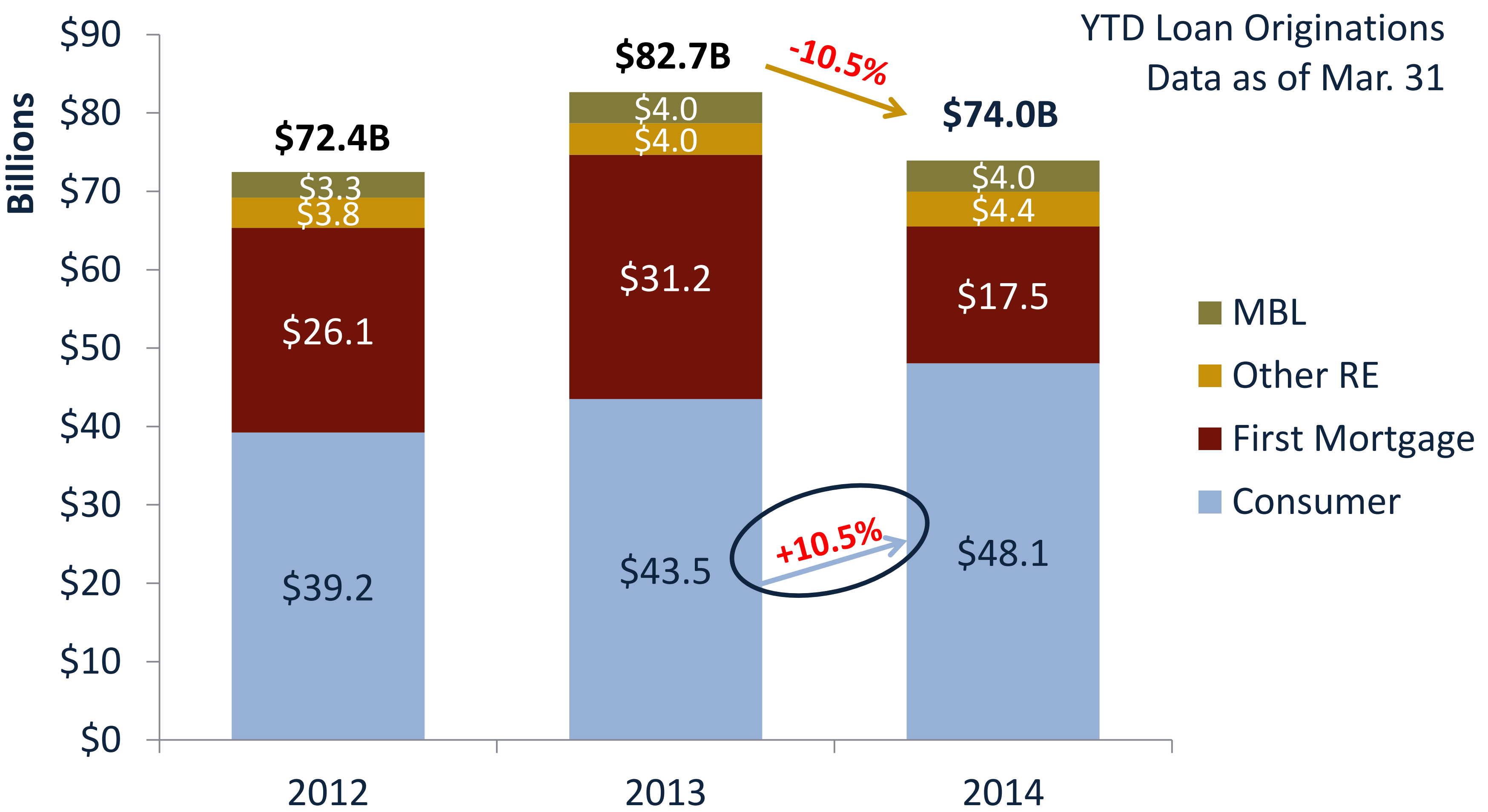
Up 11% from 1Q 2013, consumer loans drive credit union lending activity



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Source: Callahan's Peer-to-Peer Analytics

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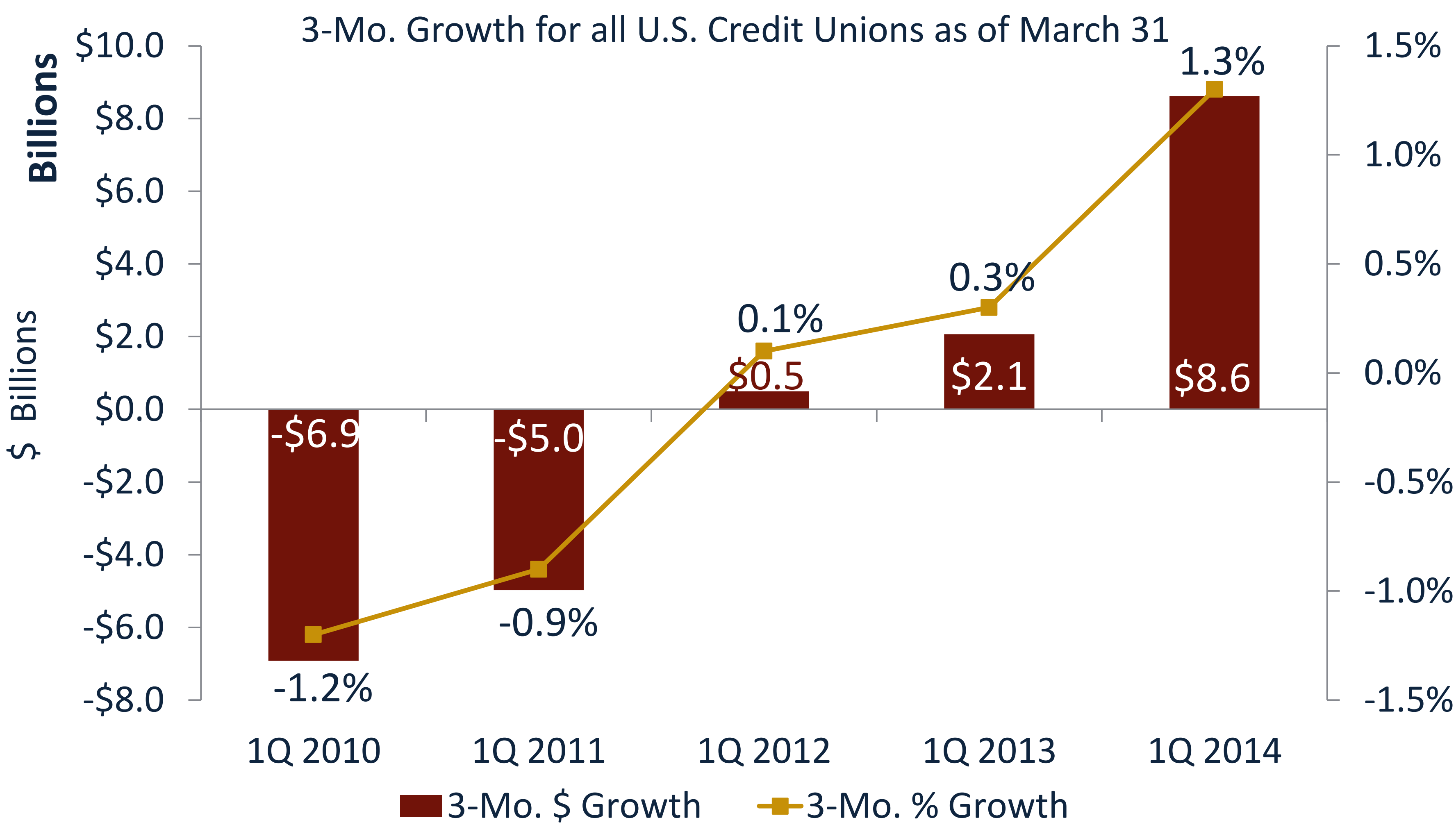
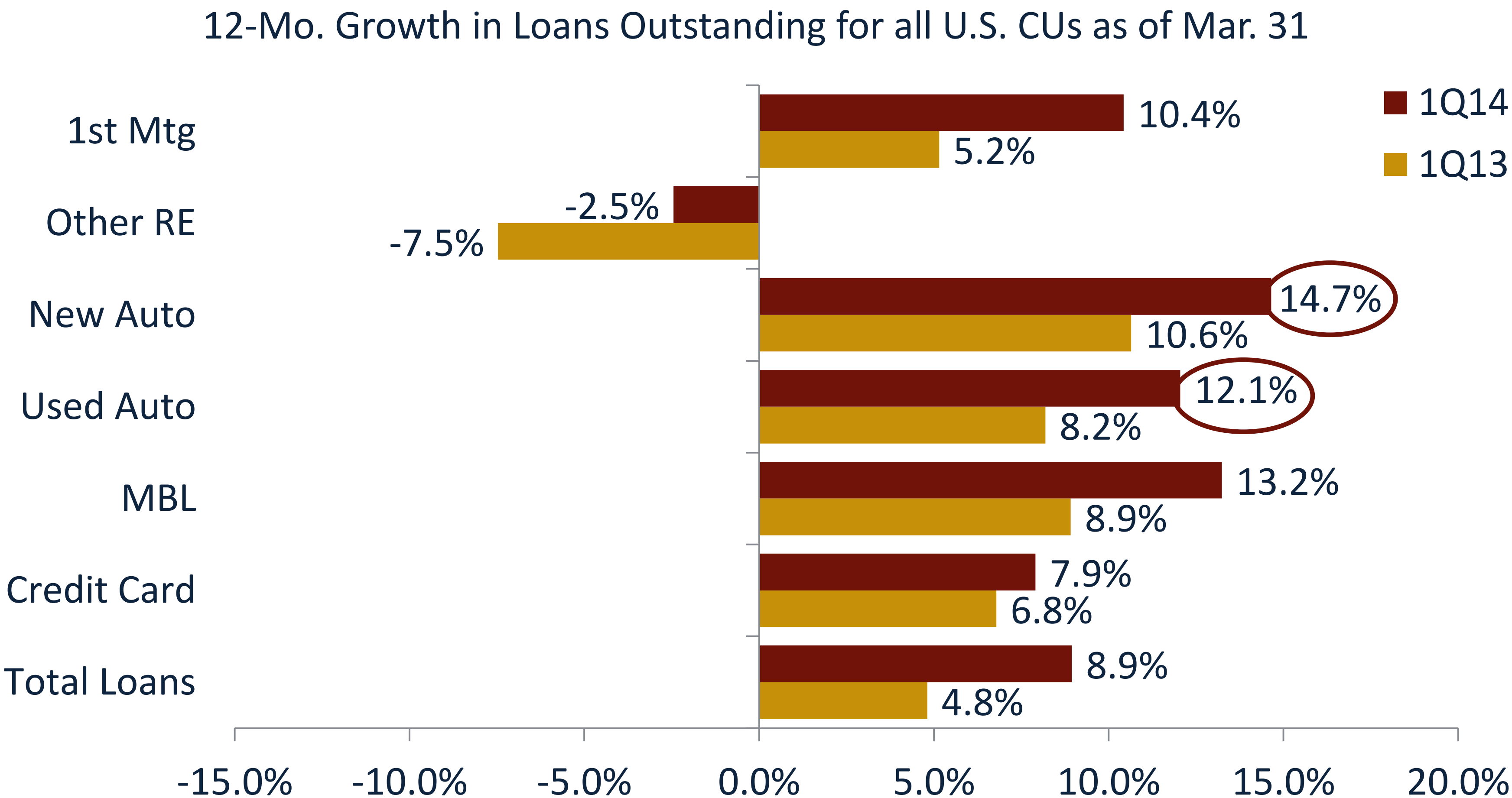
First quarter growth in outstanding loans is the fastest since 2004??



Source: Callahan's Peer to Peer Software

Auto loans lead accelerating portfolio growth



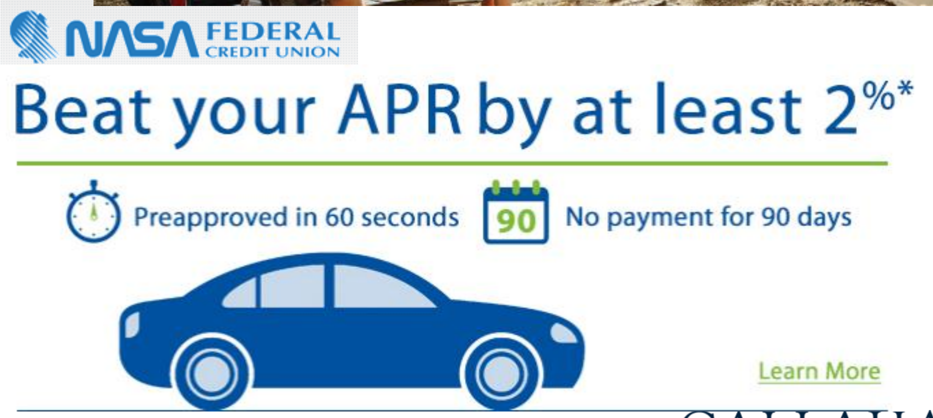
Source: Callahan's Peer-to-Peer Analytics

Auto loan balances are up over 20% in 3 states

Top 5 States by 12-mo. Auto Loan Growth			
Rank	**State**	**Auto Loan Growth**	**Auto Loans Outstanding**
1	Rhode Island	33.8%	$540,667,649
2	Idaho	23.9%	$1,924,432,979
3	Arkansas	21.2%	$922,332,353
4	Florida	19.5%	$9,812,359,863
5	Arizona	18.4%	$3,517,542,527

Source: Callahan's Peer-to-Peer Analytics

Auto loans are a core CU product



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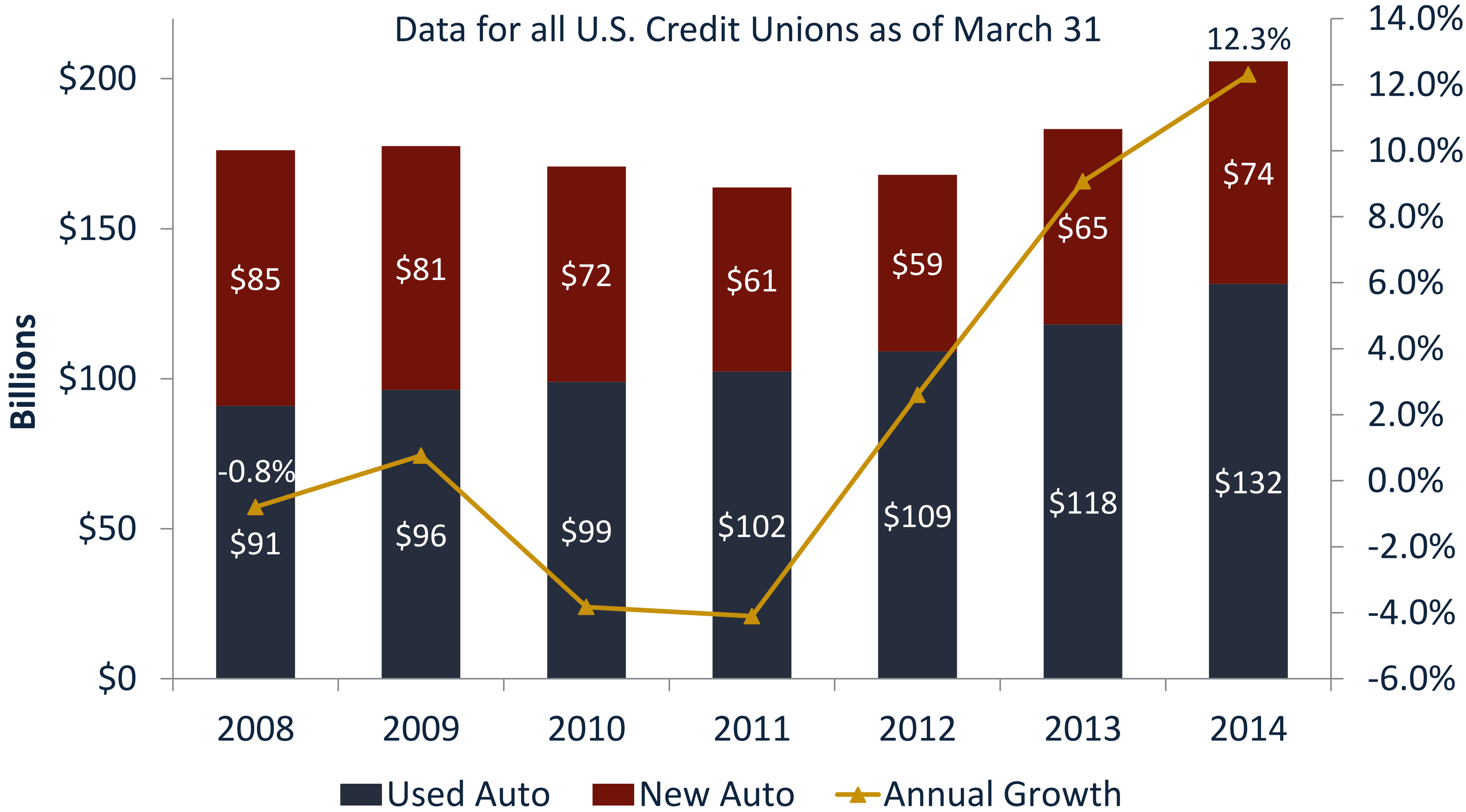
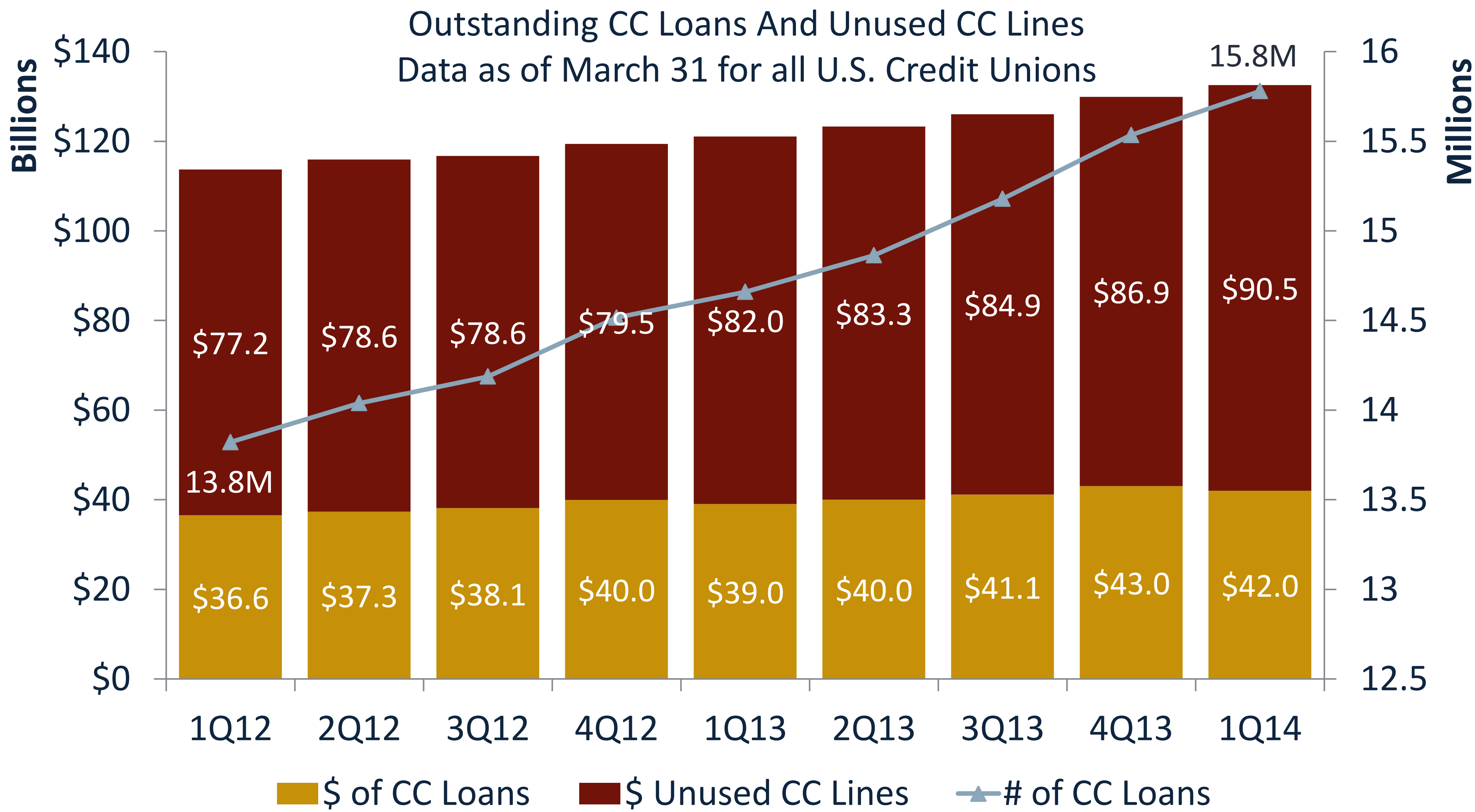
Refinancing has been a key factor in portfolio growth in recent years



Source: Callahan's Peer-to-Peer Analytics

Credit unions have added 2 million active credit card accounts in the past two years



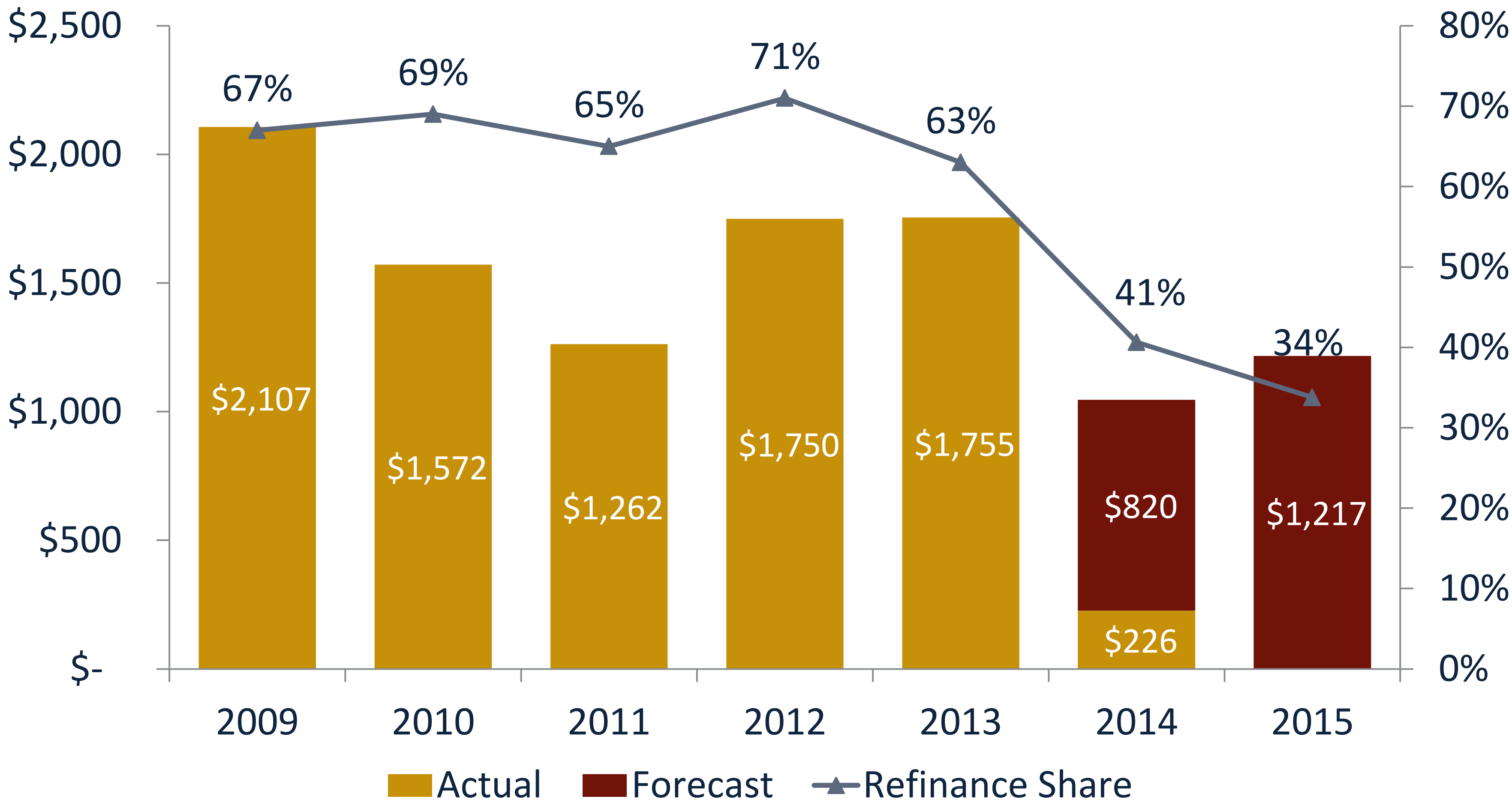
Source: Callahan's Peer to Peer Software

Some states are posting double-digit growth in card balances

Top 5 States by 12-mo. Credit Card Balance Growth			
Rank	State	Credit Card Balance Growth	Credit Card Balances Outstanding
1	North Carolina	23.0%	$785,232,548
2	Idaho	19.3%	$148,035,055
3	Vermont	14.5%	$101,714,031
4	Virginia	12.6%	$11,052,075,982
5	Indiana	12.1%	$422,062,615

Source: Callahan's Peer-to-Peer Analytics

U.S. mortgage lending volume projected to decline 40% in 2014 as refinances wane



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Source: Mortgage Bankers Association

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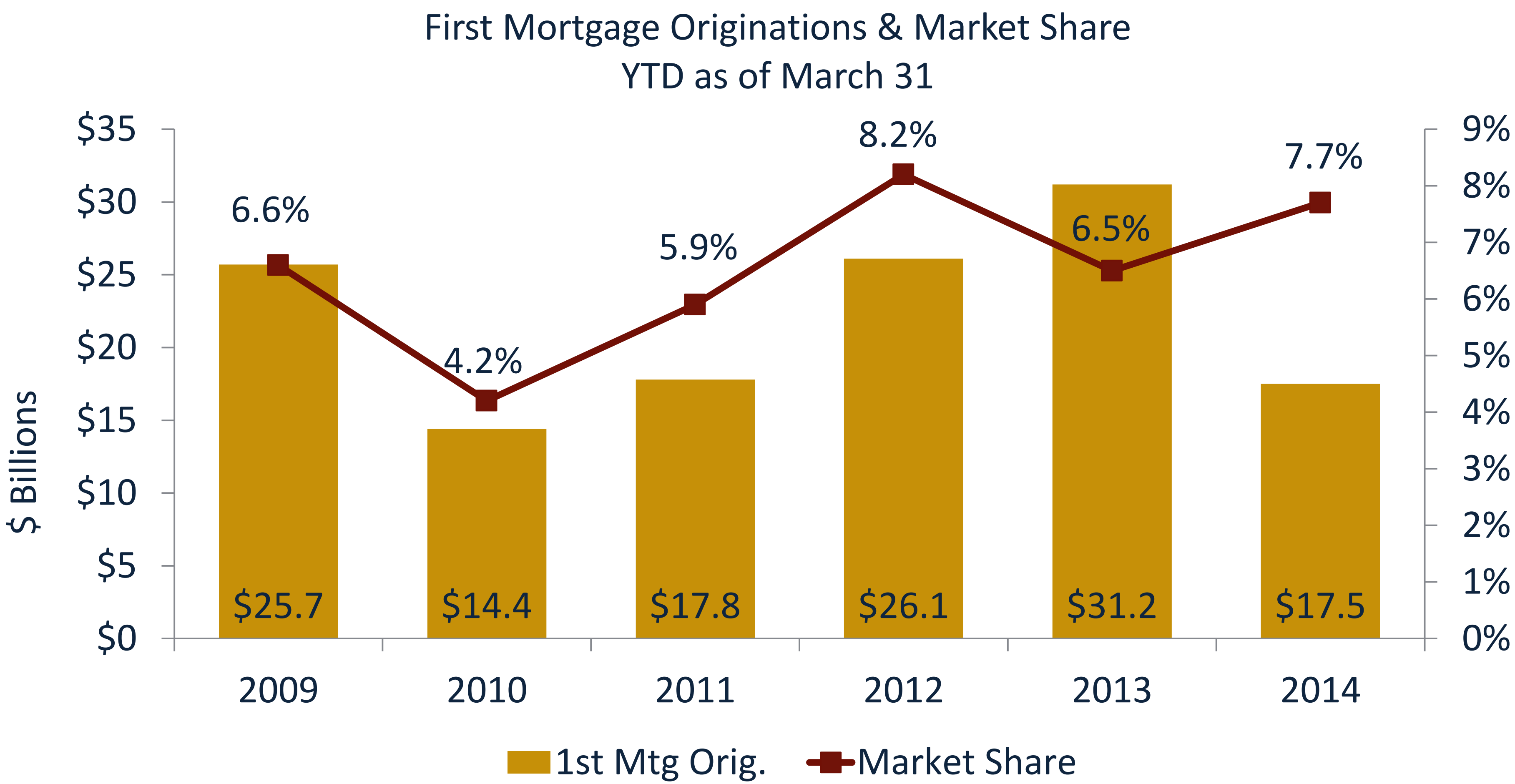
Credit union 1st mortgage lending market share continues to trend up



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Source: Callahan's Peer-to-Peer Analytics, Mortgage Bankers Association

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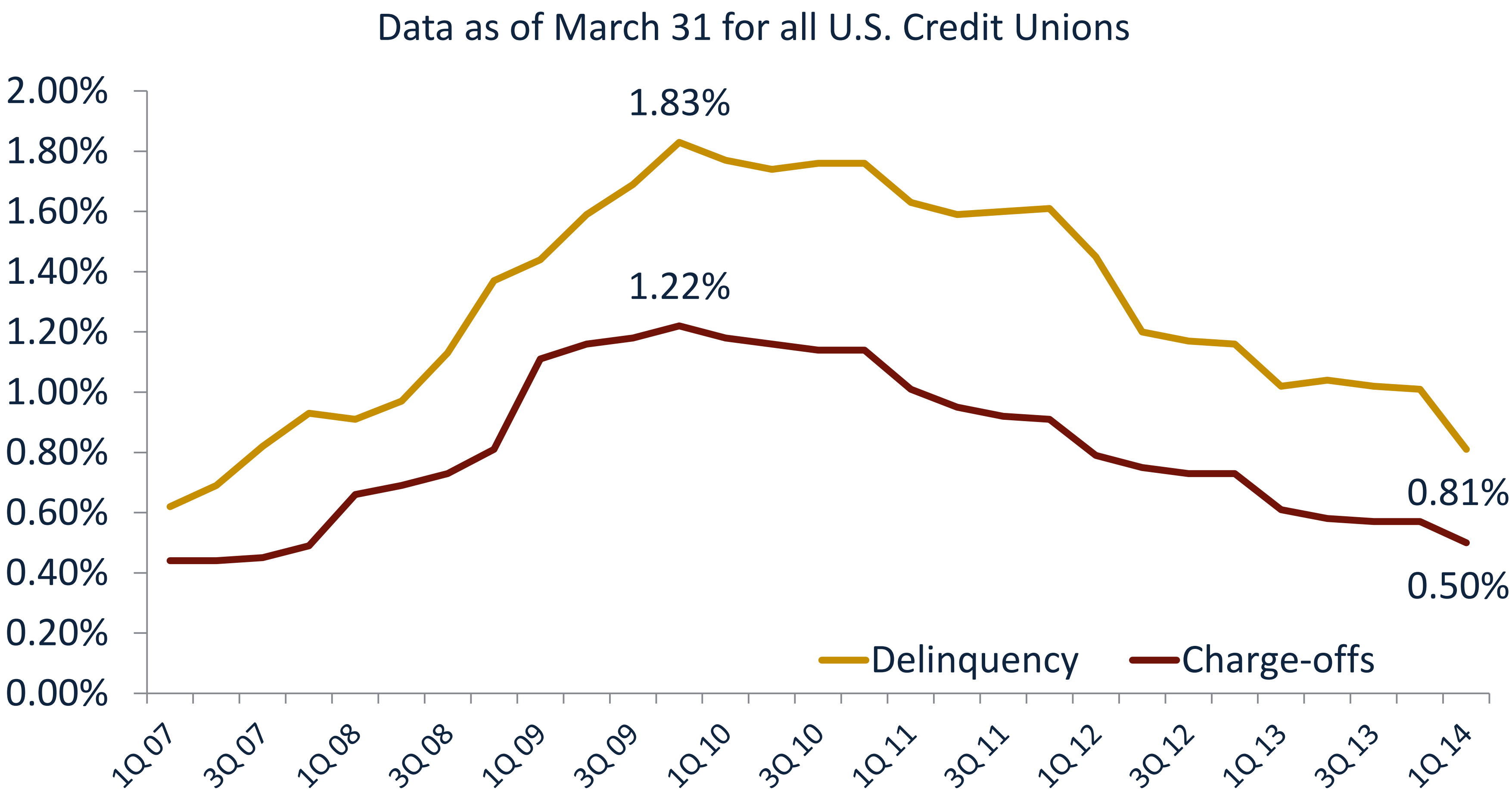
Delinquency and net charge-off rates lowest since 1Q 2008

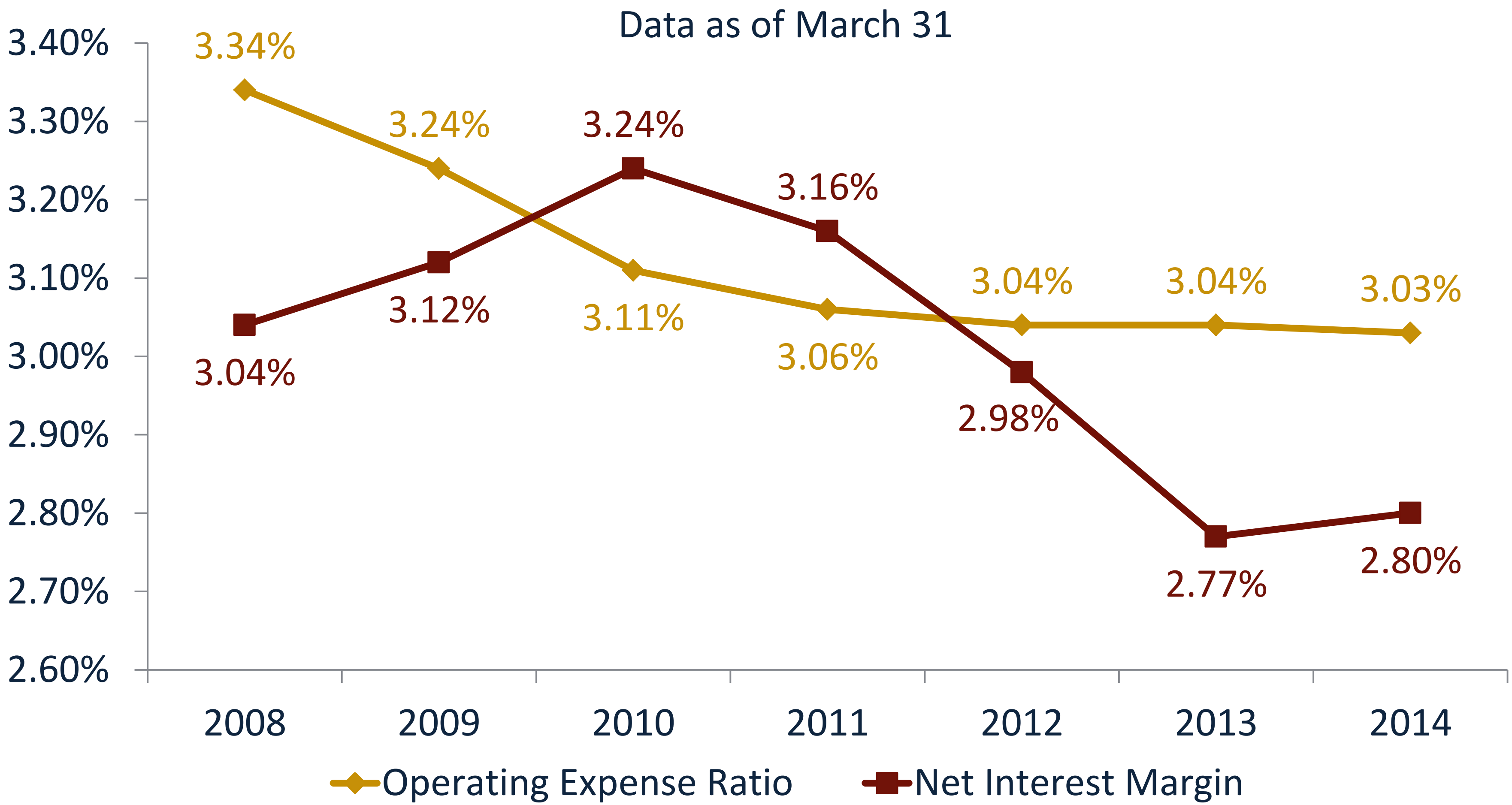


Source: Callahan's Peer-to-Peer Analytics

Revenue Rises as Higher Loan Balances Drive Interest Income

- Net interest margin increases versus 2013
- Non-interest income lower as 2014 begins
- Capital base continues to strengthen

Net interest margin rose to start 2014 as loan growth picked up



Source: Callahan's Peer-to-Peer Analytics

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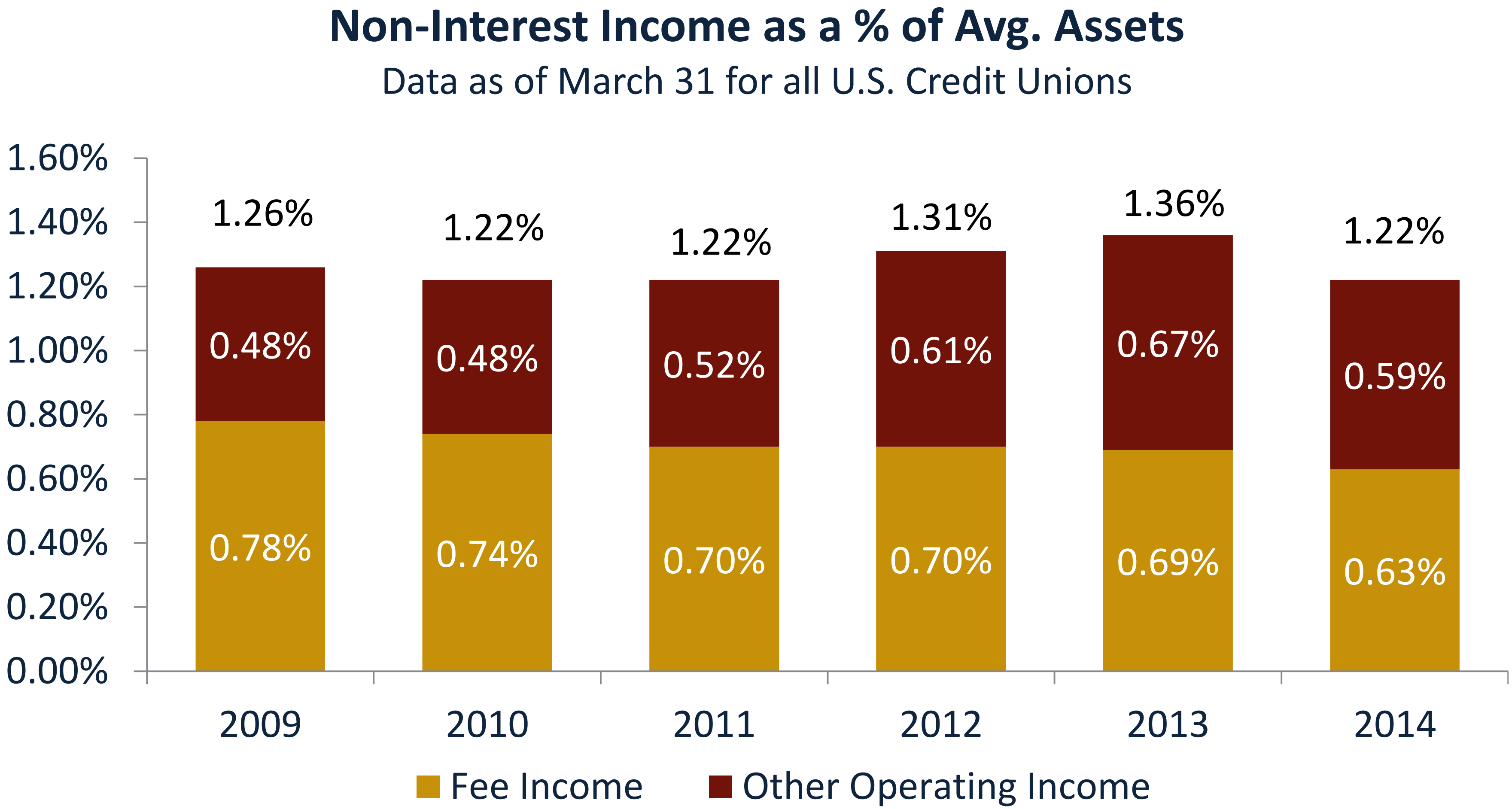
Both components of non-interest income are below 1Q 2013 levels



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Source: Callahan's Peer-to-Peer Analytics

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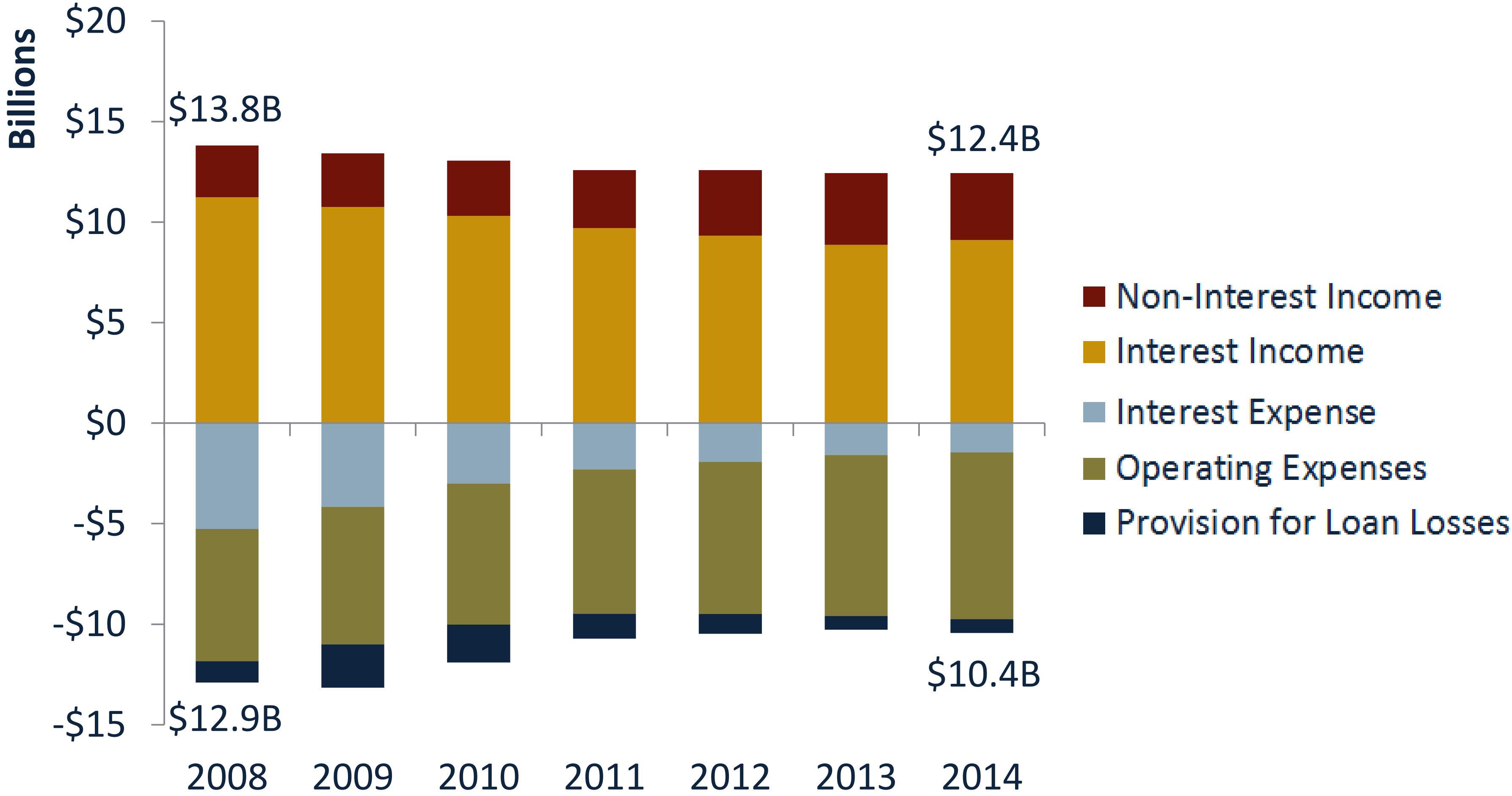
Income and expense dynamics have changed



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Source: Callahan's Peer-to-Peer Analytics

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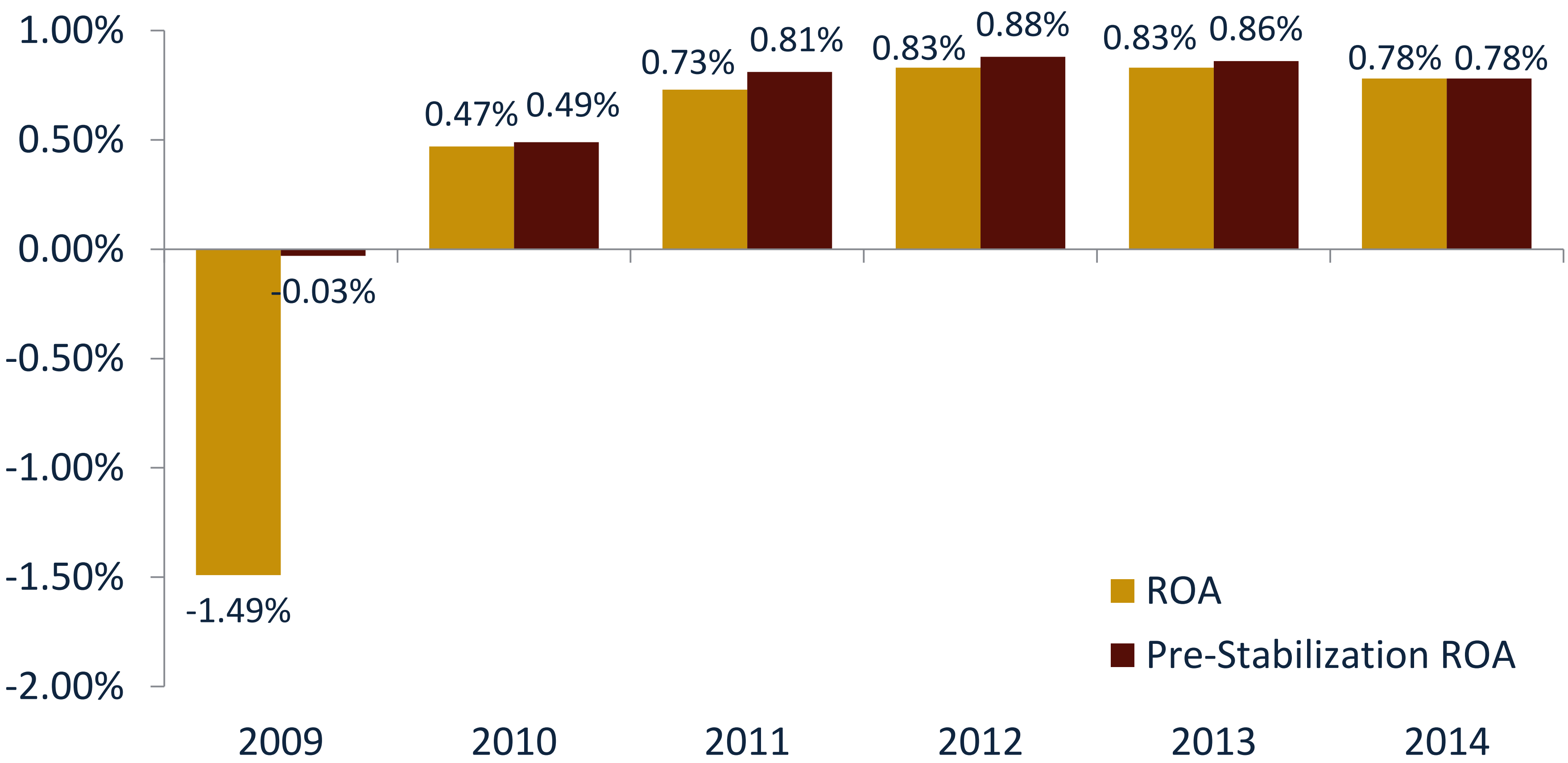
Return on assets is lower in 2014…

Data for all U.S. Credit Unions as of March 31



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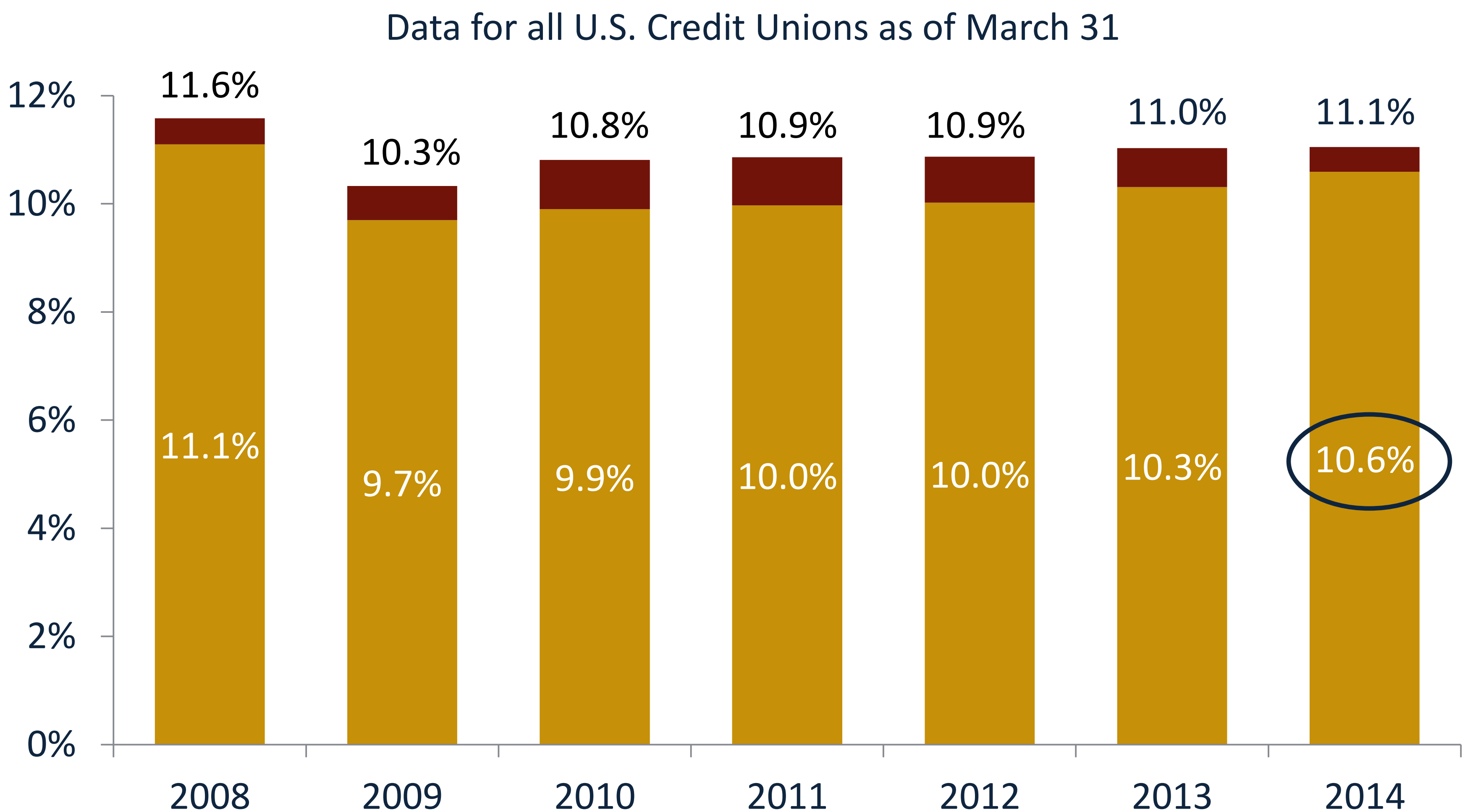
…But net worth and total capital ratios improve



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Source: Callahan's Peer-to-Peer Analytics

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THE CAPITAL DEBATE

NCUA's Risk-Based Capital Proposal: The Current Context

- 198 page proposal issued by NCUA board at Jan. 23, 2014 meeting
- 90-day comment period ends May 28 - no extension
- Amends 7 sections of the Federal Credit Union Act
- Applies to Credit Unions > $50 million in assets
  - All deemed "complex"
- Goal: make credit unions' rules consistent and comparable with OCC, FDIC, Fed banking rules, and Corporate capital requirements
- Effective 18 months from publication of final rule
- Over 887 comments submitted from 479 institutions
- Letter signed by more than 320 members of Congress expressing concerns with the proposal

Replaces existing risk-based net worth requirement with risk-based capital ratio

A Tool, Not a Rule

Doug Fecher, President & CEO
Wright-Patt Credit Union
Beavercreek, OH

As of Mar 14		12-mo. Growth
Assets	$2.8B	6.7%
Loans	$1.9B	21.2%
Shares	$2.4B	6.7%
Members	275,053	11.0%
Loans/Shares:		77%
ROA		1.26%
Net Worth/Assets		11.0%
CUSO ownership interests		9

myCUmortgage®
A credit union owned mortgage service provider

Serves 190 CUs in 20 states

Wright-Patt CREDIT UNION, INC.

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Credit unions are different by design

- No other class of financial institution has been as resilient to risk as credit unions
- Lack of profit motive, a mission of service, and cooperative ownership are all reasons for this
- We need a different way of measuring and accounting for risk than the Basel-style methods used by for-profit banks
- We need a method that balances the best interests of members with the safety of their money, and recognizes CUs as unique, cooperative institutions formed to serve members on a not-for-profit basis

Rule fails to "Take into account the unique structure of credit unions"

- The proposed rule will fundamentally change the way we make future decisions
- Managing "capital at risk" becomes a priority, much like a for-profit banking institution
- Members will see less value because of the need to hold more capital against routine assets
  - Higher fees, lower dividend rates, fewer services, higher lending costs and less lending
- The use of Basel-style, RBC calculations did not reduce risk on bank balance sheets, did not prevent losses, and caused banks to curtail lending during the crisis

Credit Union vs Bank Performance: 2007-2013

	Losses per $1,000		Institution Failures	
	NCUSIF	FDIC	CUs	Banks
2007	$0.33	$0.05	--	--
2008	$0.47	$4.19	22	25
2009	$0.86	$6.67	28	140
2010	$0.97	$3.38	37	157
2011	-$0.67	$1.26	16	92
2012	-$0.09	$0.38	21	51
2013	-$0.06	$0.20	17	24
Totals	$0.26	$2.30	141	489

8.8x

3.5x

Wright-Patt CREDIT UNION, INC.

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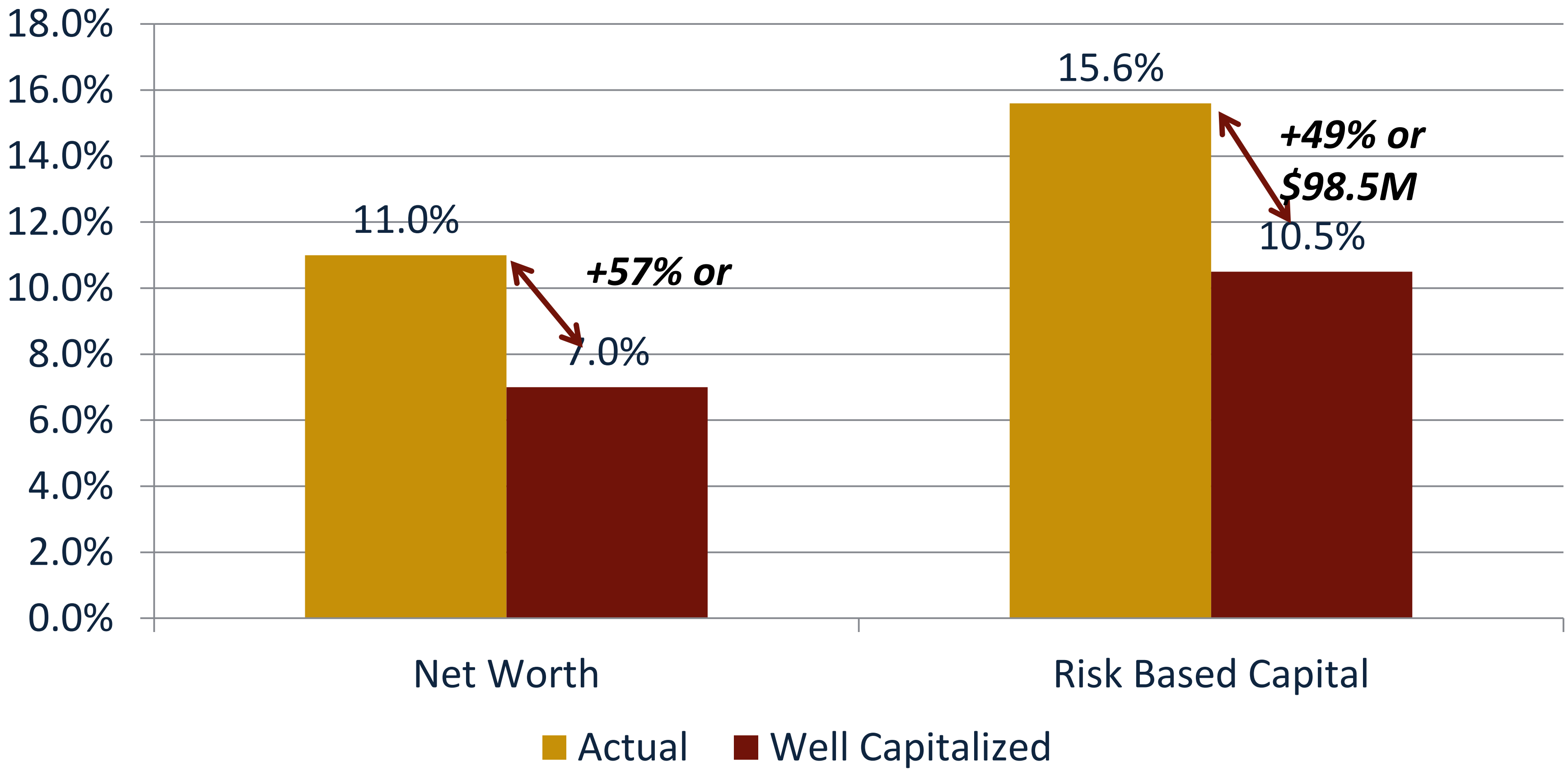
WPCU as of March 31, 2014: Less "cushion" under RBC versus Net Worth



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Our recommendation: *Include an RBC model calculation as part of NCUA's exam process rather than a long, complicated and onerous rule*

- Similar to NCUA requirements for other types of modeling such as for interest rate risk testing
- Can be used by examiners and CU boards to identify "potential risk" instead of assuming to quantify "actual risk" based on a single formula
- Allows for a dialogue between examiners and CU boards/managers
  - Example: If investments are concentrated with a WAL of 5-10 years, can show that the investments are floating rate
  - If management is unable to show adequate risk mitigation, examiners can use existing tools (CAMEL, DORs, LUAs, etc.)

Five Fundamental Issues with Risk-Based Capital

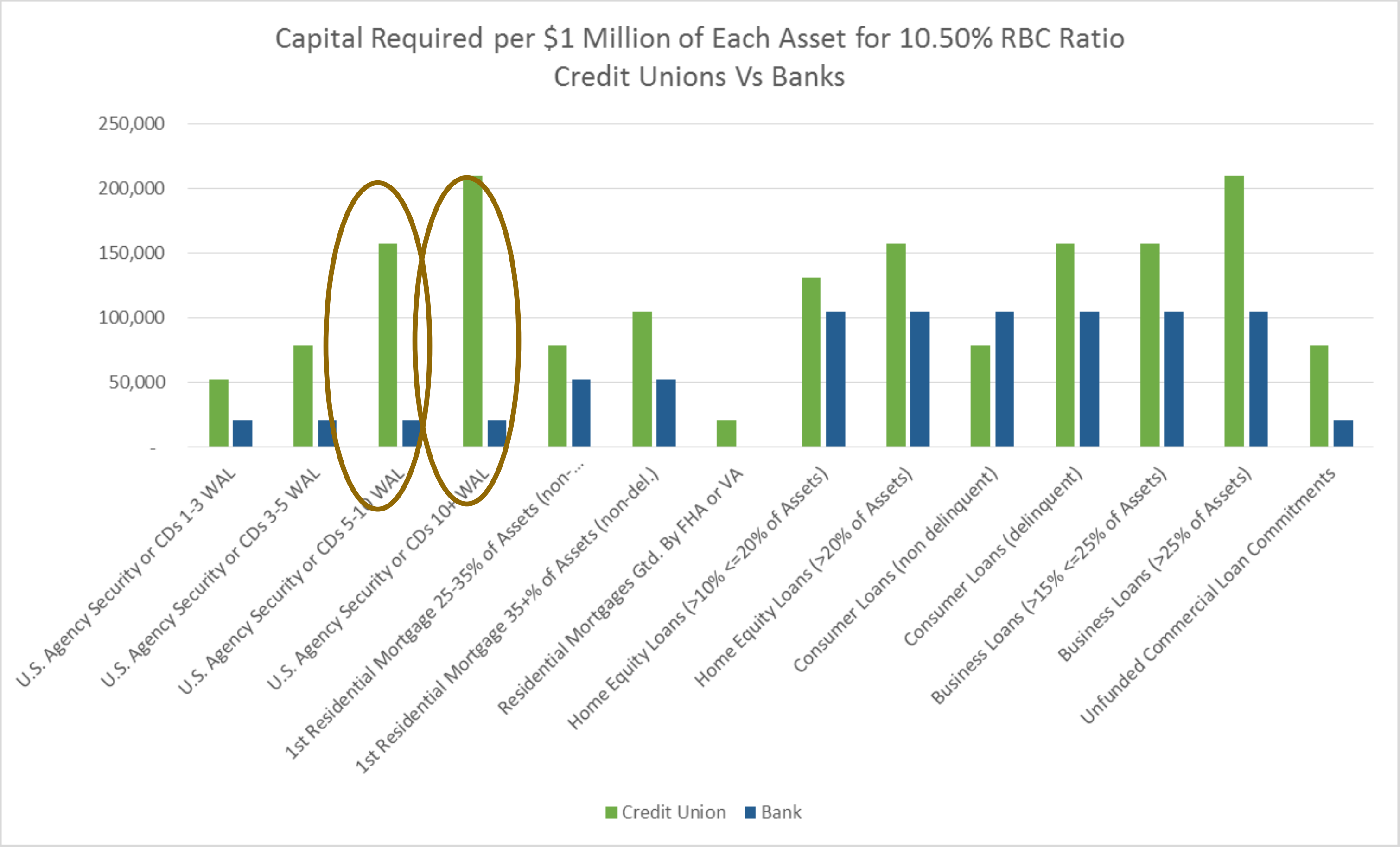
- The risk weightings
- A single, national capital formula rests on multiple assumptions
- The current system works
- Metsger: RBC brings better performance
- Banking regulators adopt simple leverage ratio capital rules

"I believe in RBC but NCUA's weightings are not right."

- Most CUs reserve based on their experience with asset risk
- NCUA formulas not based on factual analysis
- More onerous than banks
  - Competitive disadvantage
- Hundreds of suggestions to improve
  - Can't all be right or wrong

Bottom line: What works locally does not "scale up" to a single national formula

$ Capital Required: Credit Union vs. Bank - Differences Greatest For Investments



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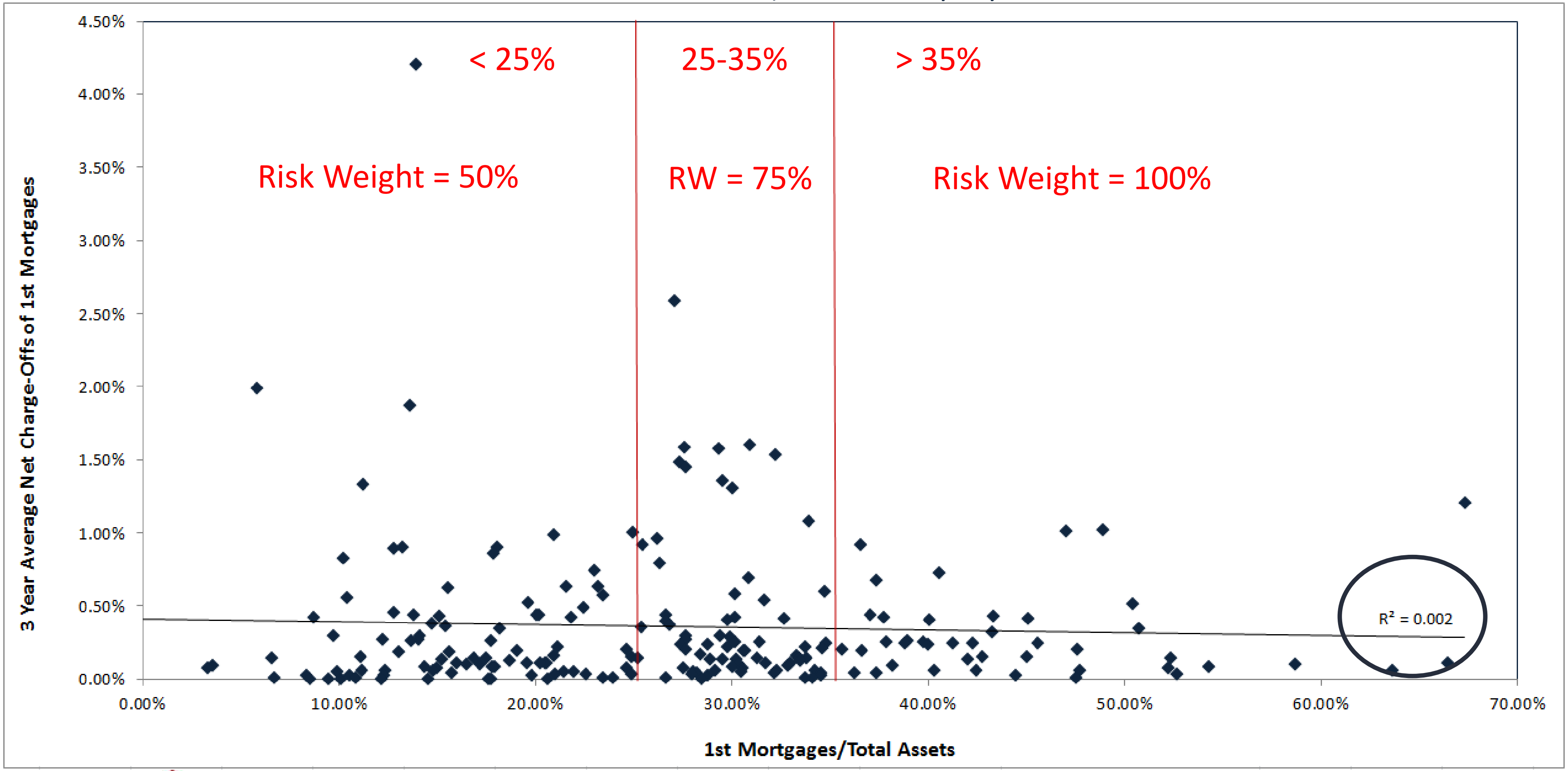
A single, national capital formula rests on multiple assumptions

- Rule addresses IRR, concentration and credit risk with assumptions about each
- Reflects current environmental assessments, e.g. "historically low rates"
- Requires multiple calculations to try to mirror real world complexity
- Single formula does not include all risk management factors

Bottom line: One size capital formula does not fit <u>all</u> situations and circumstances

Example 1: Losses on 1st mortgages decline as they are higher percentage of assets, not increase as required in RBC weighting

% of Net Losses on 1st Mortgages (2011-2013) vs. 1st Mortgages as % of Assets (YE 2013)
Data for CUs > $1B as of 12/31/13



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Source: Callahan's Peer-to-Peer Analytics

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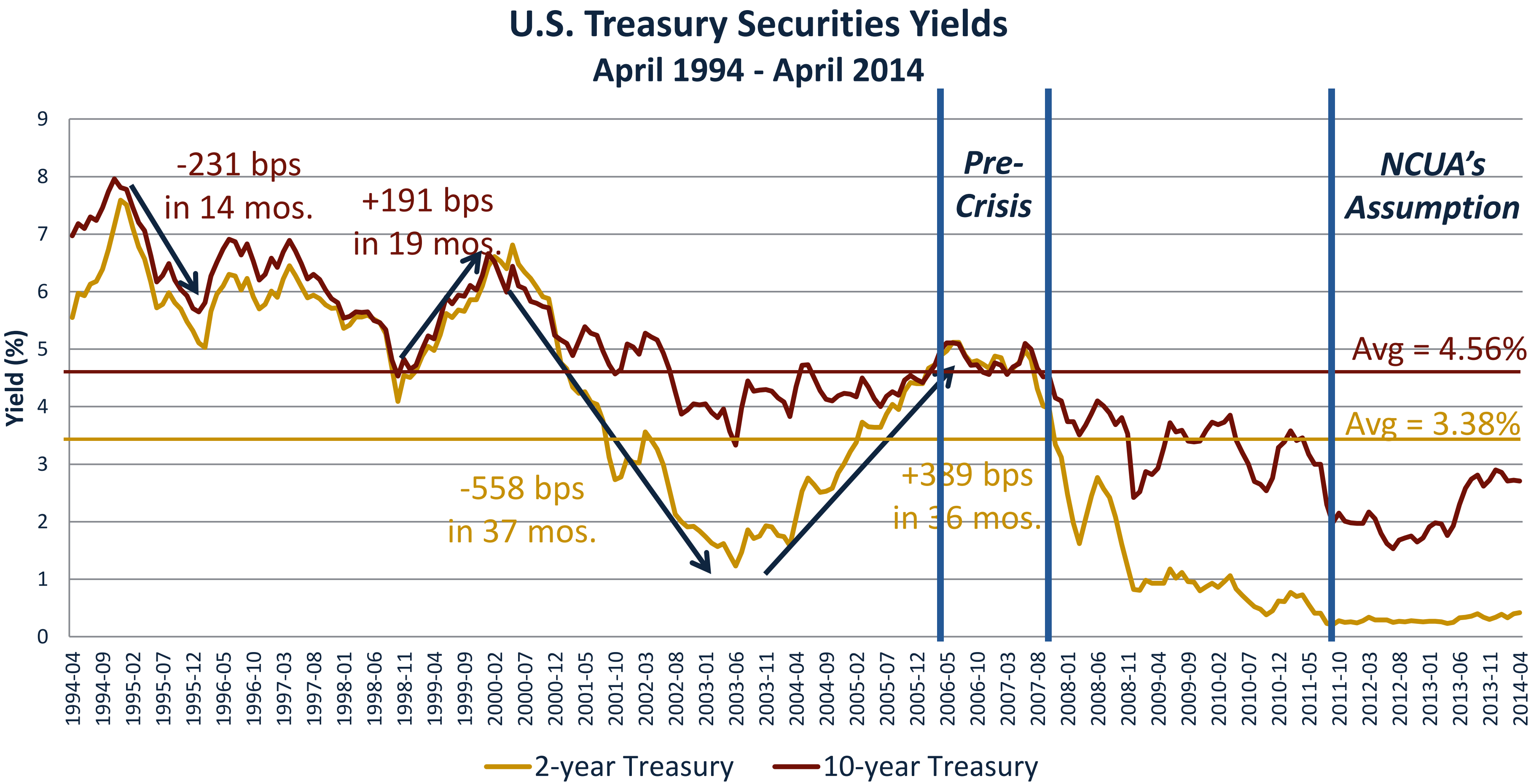
Econ 101: Interest rates move in cycles



What credit unions are saying…

"The NCUA Board has stated in several documents that a "one-size-fits-all" approach is not prudent yet applying arbitrary risk-weightings for capital requirements, as this rule proposes, is just that. We ask that the NCUA Board abandon the entire proposed rule and allow the current risk-based net worth requirement structure to remain in place."

Brad Houle, President

What credit unions are saying…

"(The rule) attempts to homogenize the industry and will restrain growth opportunities, limit services to members, reduce the value proposition of credit union membership, and diminish the role of the credit union board of directors.

I get that NCUA is fixated on interest rate risk in this historically low rate environment. What I don't get is that NCUA has drafted a rule that so poorly addresses interest rate risk by using one metric, one side of the balance sheet, and one interest rate environment."

Carol Adler, President

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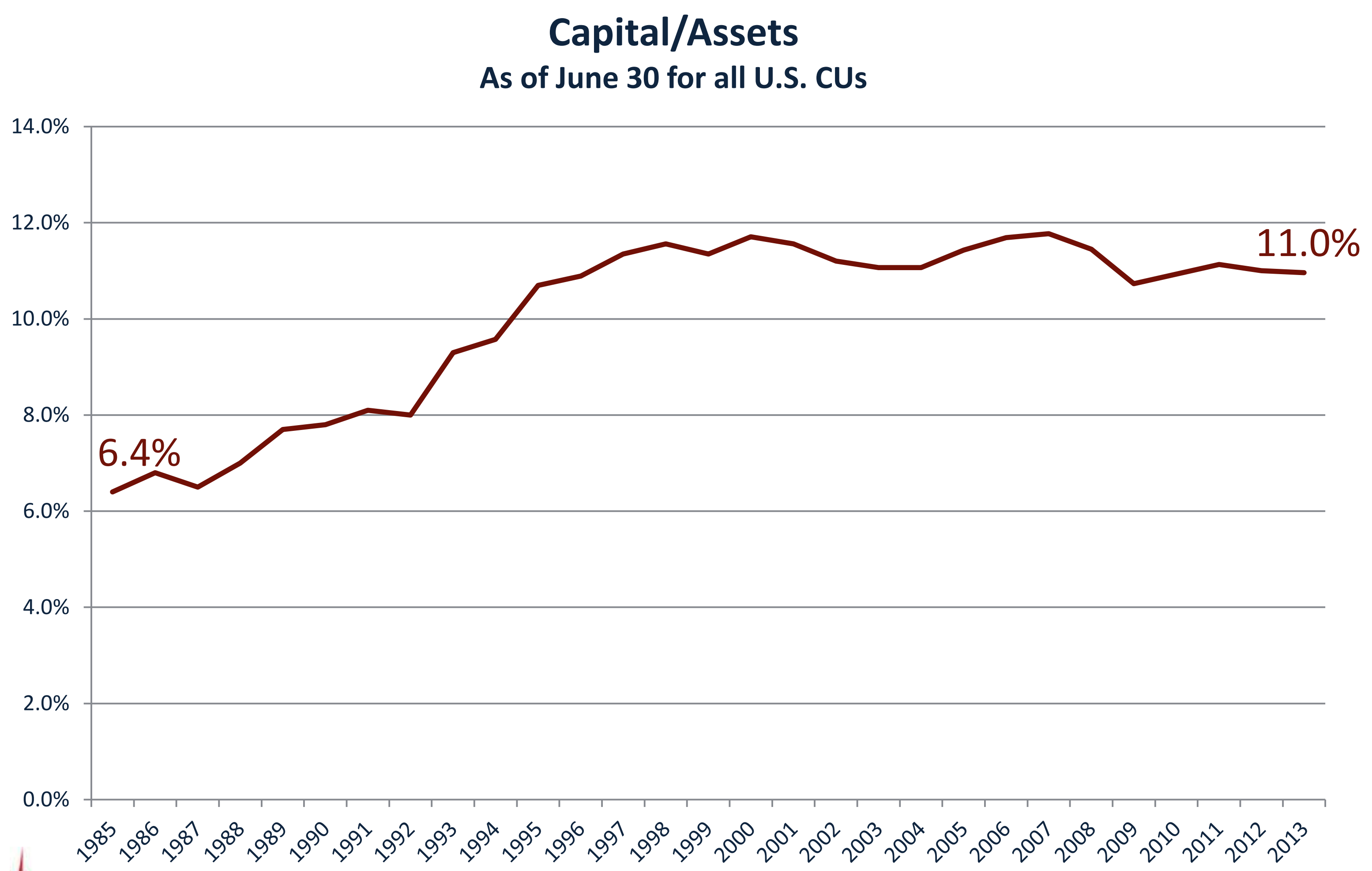
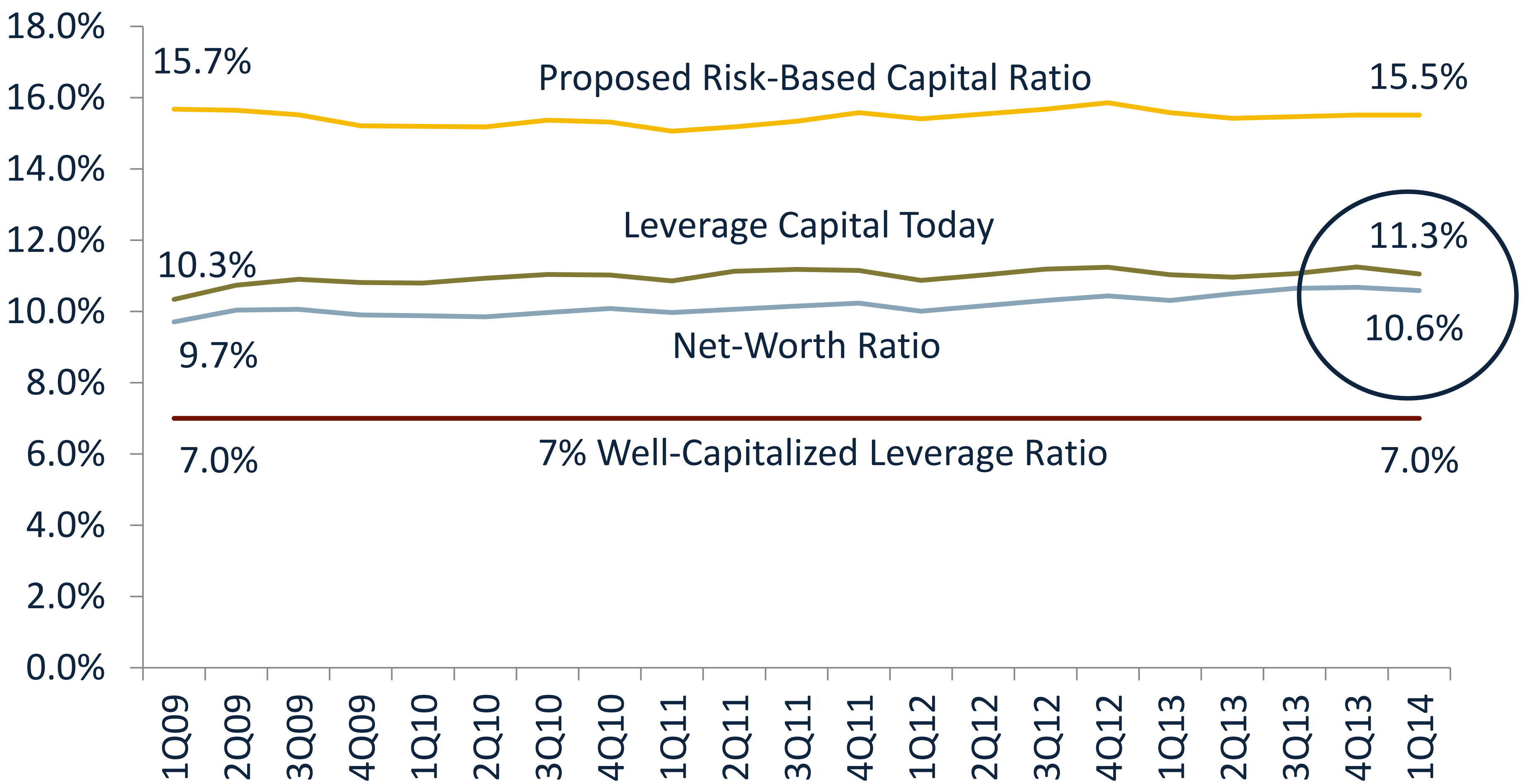
THE CURRENT SYSTEM WORKS

Credit unions have steadily built a strong capital base



Credit unions have built and sustained adequate levels of capital throughout the Great Recession (2008-2013)



Source: Callahan's Peer-to-Peer Analytics

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What credit unions are saying…

"Please keep in mind that credit unions under NCUA supervision soundly weathered the worst economic recession in decades…As a whole the national credit union movement lost 158 basis points by the end of 2009, and in 45 months (Sept 2013) 107 basis points of that lost capital (67.72%) had been recovered, all while dealing with asset growth of 19.3%...The current methodology of building, maintaining and rebuilding capital obviously works when you consider the history of this movement."

David Skilton, SVP/CFO

Altier CREDIT UNION™

METSGER: RBC BRINGS BETTER PERFORMANCE

Metsger: RBC brings better performance

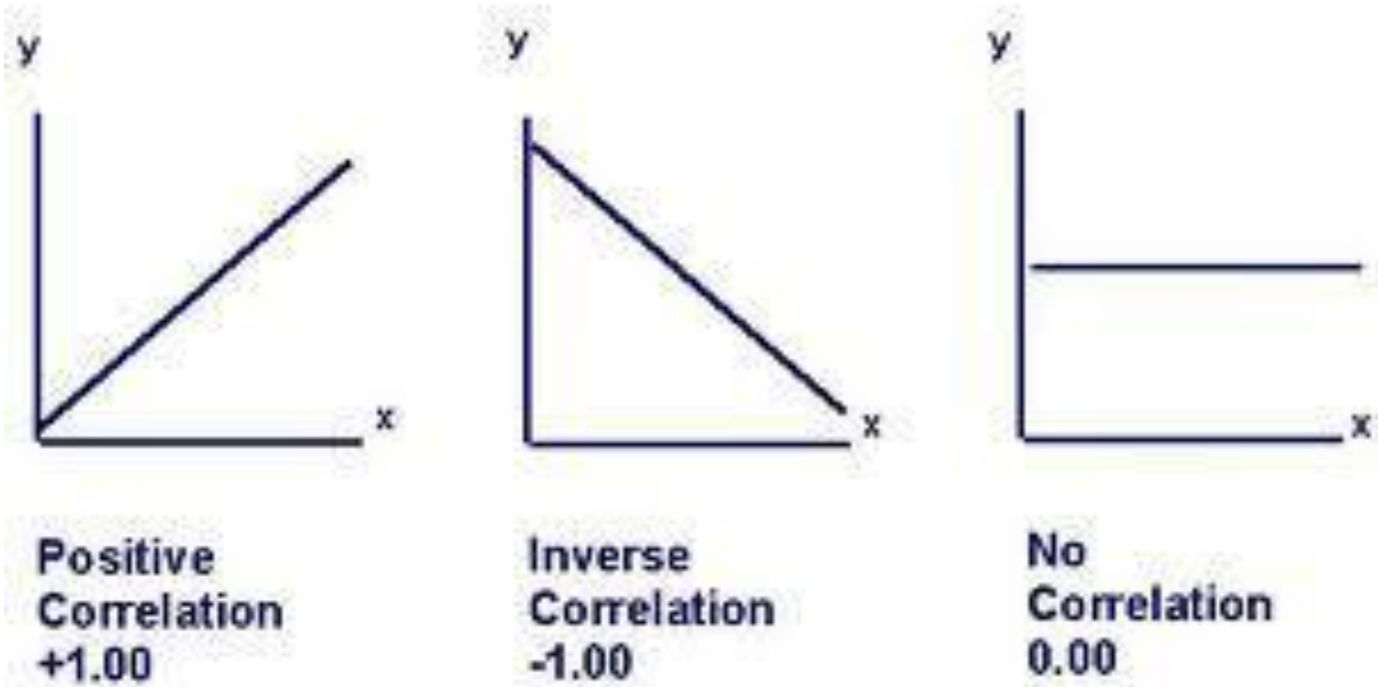
Metsger said he asked NCUA staff to review performance data from the last five years for credit unions with more than $100 million in assets. Specifically, staff applied the proposed risk-based capital rule and compared the 100 credit unions that had the most and least resulting capital.

"The results are eye opening," Metsger said Friday in a speech before the Tennessee Credit Union League.

They had more than twice the asset, loan and share growth and more than four times the membership growth, he said.

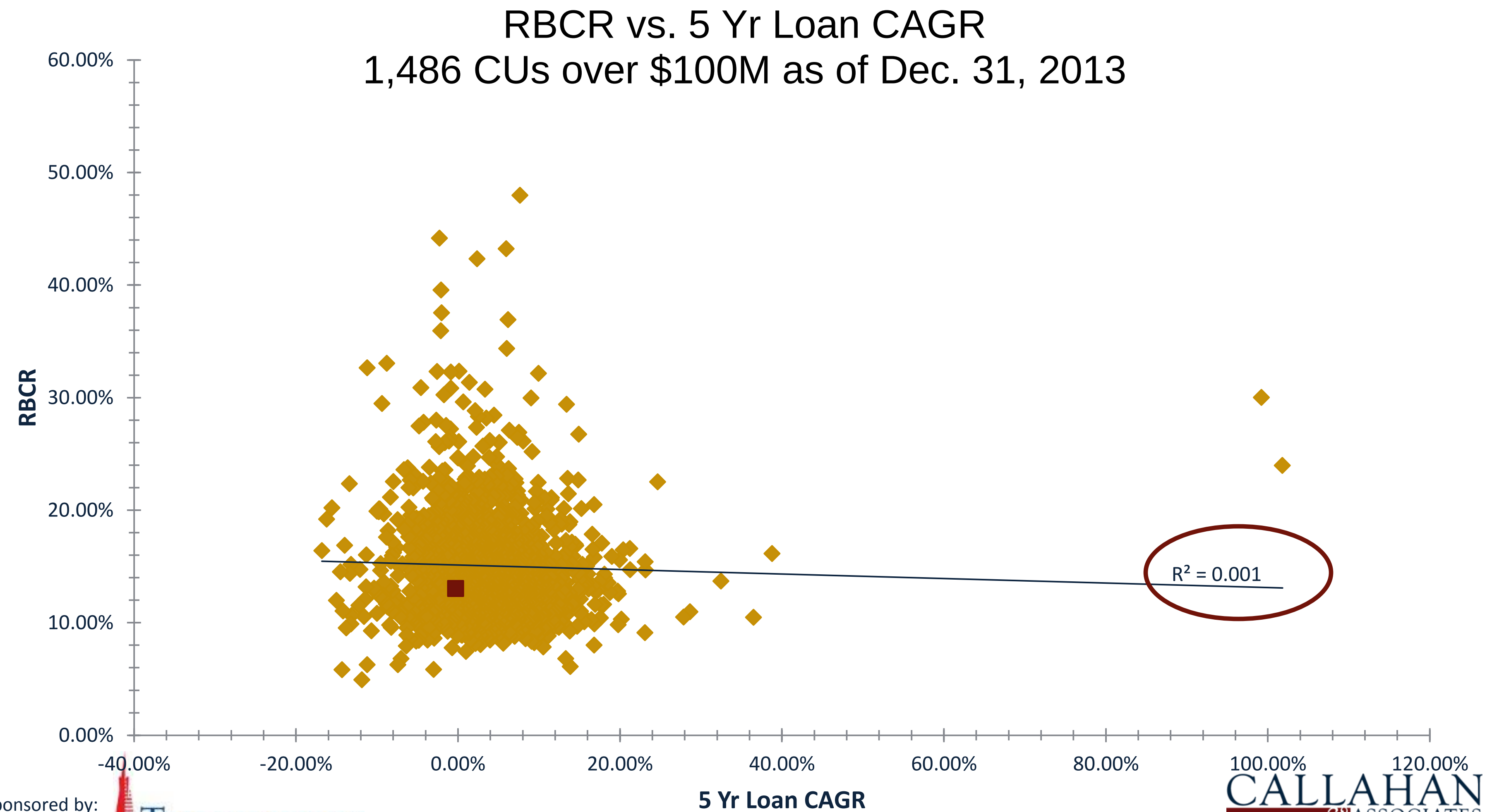
Credit Union Times, May 16, 2014

Understanding Correlation

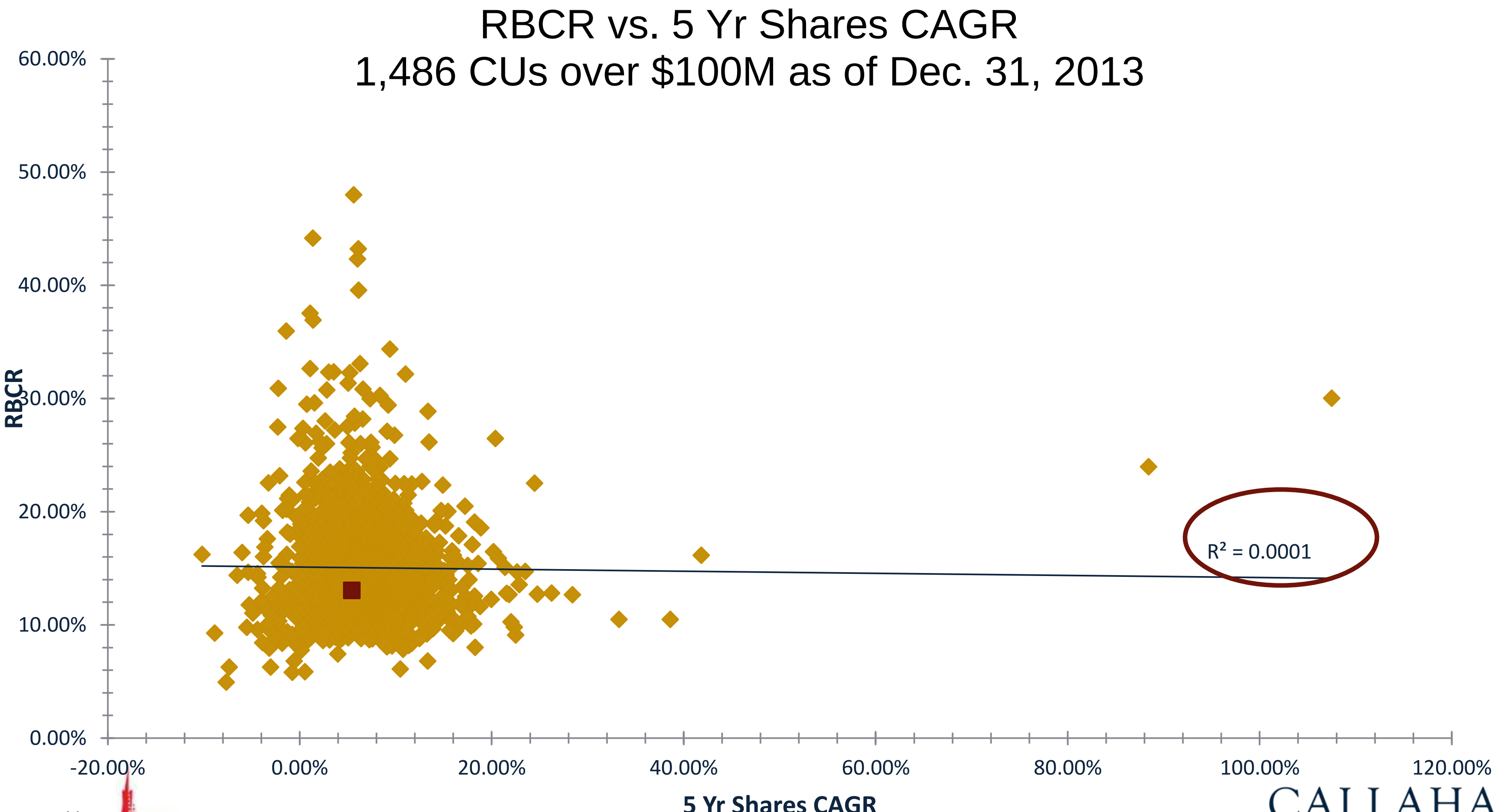


Correlation coefficient variation

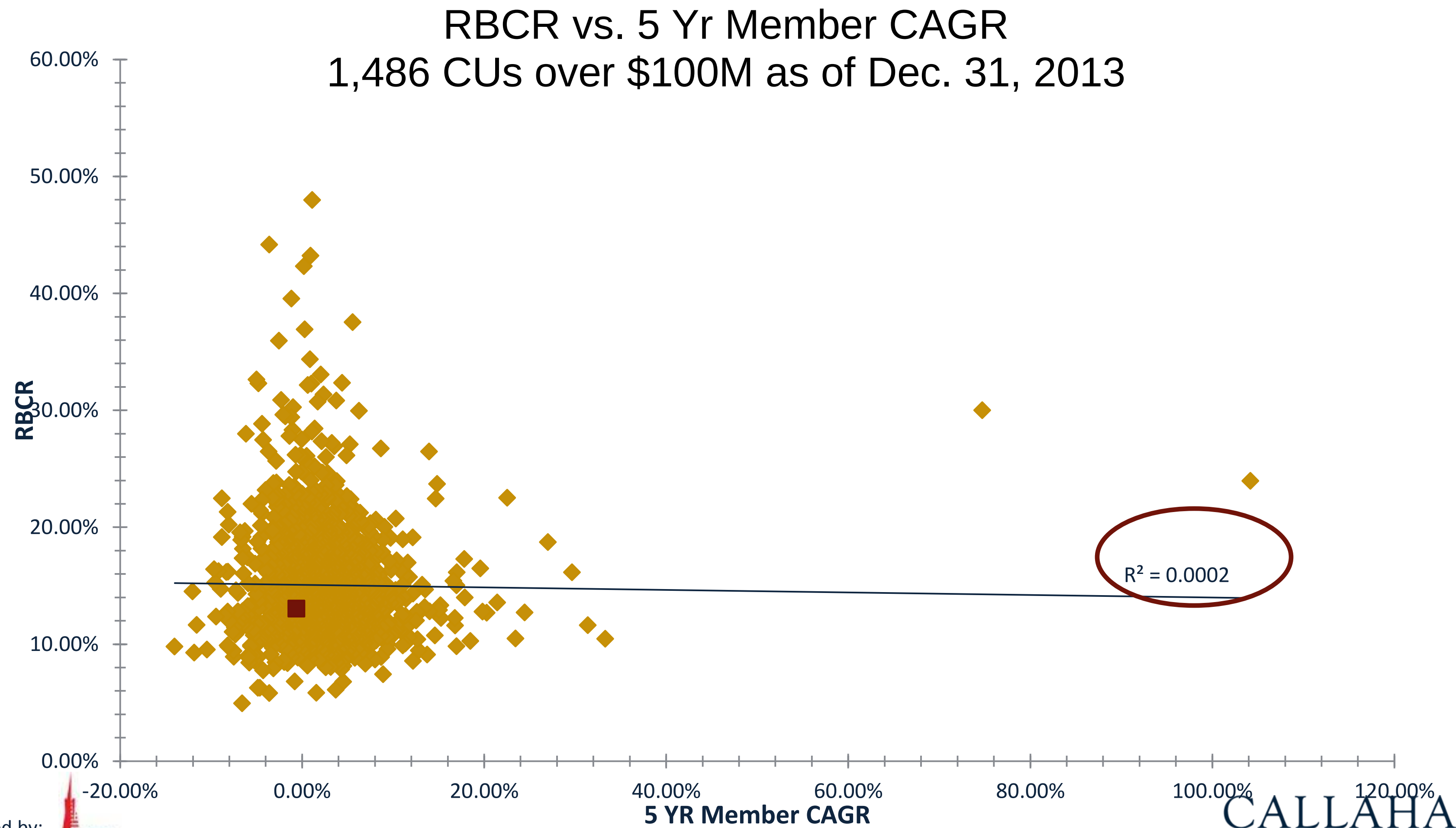
No correlation between RBC and 5-year compound loan growth rate



No correlation between RBC and 5-year compound share growth rate



No correlation between RBC and 5-year compound member growth rate



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An observation…

"The error range of Metsger's distortion runs from 10% on the low end to 500% on the high end, depending on the CU performance parameter measured. This shocking display of the NCUA's mathematical distortion should tell every CU CEO to oppose this rule, resulting in either a) its withdrawal, or b) the industry's insistence that an independent appeal process be built into the rule to limit the exercise of NCUA's subjective judgment."

BANKING REGULATORS ADOPT SIMPLE LEVERAGE RATIO CAPITAL RULES

"A Better Alternative to Capital Rules" - Speech by Thomas Hoenig, Director FDIC, Sept. 14, 2012

- "The poor record of Basel I, II and II.5 is that of a system fundamentally flawed…It turns out our Basel capital rules protected no one: not the banks, not the public and certainly not the FDIC…The complex Basel rules hurt, rather than helped, the process of measurement and clarity of information."
- "An alternative: capital must be simple, understandable and enforceable. The measure that best achieves these goals is the tangible equity to tangible asset ratio. It does not tier the measure into any number of refined levels. This is not government ex-ante endorsement of risk assets or capital allocations…It provides a consistent and comparable measure across firms."
- "Conclusion: Basel III will not improve the outcomes for the largest banks…nor improve the condition of small and medium sized banks. It continues an experiment that has lasted too long."

Cooperative capital works

- Cooperative strength not founded on “financial capital” but on member-owner support
- Reserving “process” from revenue reflects operational reality – no external capital
- 100+ years of experience setting prudent levels in all economic cycles
- Balances system stability and member needs – especially in a crisis
- Real issue in a crisis is <u>liquidity</u> not <u>capital</u> – need a cooperative safety net
- Debate is useful – CUNA’s May 1982 “Report of National Credit Union Capitalization Commission”

Make your voice be heard!

There are three ways for anyone to comment on the NCUA's proposed risk-based capital rule:

The Quickest and Easiest: Just one click

Email: Send an email to

Subject line: NCUA Risk-Based Capital Proposed Reg

Fax: (703) 518-6391 Attn: Mr. Gerard Poliquin, Secretary, NCUA Board

Mail: (snail mail)

Mr. Gerard Poliquin
Secretary, NCUA Board
1775 Duke Street
Alexandria , Va. 22314-3428

Ref: NCUA Risk-Based Capital Proposed Reg

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One lucky survey respondent will win a Starbucks gift card.

We believe everyone deserves a better financial future. We make products that help you fulfill your member's vision for a better tomorrow. They count on us to help them make the things that matter. Things like peace of mind, a college education, or a successful retirement. Because even in trying times, we stand by a simple idea. We do what we say we're going to do. We've done it for over 100 years, and we'll keep delivering on our promises – so we can keep making the things that make Tomorrow better.

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