

# CU-ALM REPORT

APRIL 2011

VOLUME 8, ISSUE 1


## ECONOMIC OUTLOOK FOR 2011

A mixed outlook at best, but probably worth taking into consideration. For credit unions, the CUNA Economic Group publishes an extensive forecast on CUNA's website, <http://CUNA.org/econ>. This forecast is free, it's available, and is credit union specific. If your ALCO and board of directors are not already receiving an economic forecast, this would be a good start. Additionally, local and regional forecasts are often provided free by states, local governments, universities, large banks, and business groups. A few minutes spent on Google will usually result in success.

Here is a synopsis of the March 2011 CUNA forecast for the remainder of 2011.

- Economic growth—3.05%
- Core inflation for 2011—1.5%
- Unemployment—8.65%
- Of key interest are interest rates

—CUNA sees short-term rates remaining unchanged until the 4<sup>th</sup> quarter of 2011, when they expect a 21 bp upward rate move.

—10-year Treasuries, which were near 3.5% for the first quarter, are forecasted by CUNA to reach 4.1% by year-end. The Treasury Yield Curve will remain steep throughout the year. With a steep yield curve, credit unions should be able to put some vitality back into their net interest spread. 

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## MARK H. SMITH INC. ANNOUNCES FREE WEBINAR TRAINING FOR VOLUNTEERS

We are pleased to assist credit union volunteers in complying with NCUA's new requirement to receive training with regard to the credit union's financial statements. We are offering 2 free 60-minute webinars presented specifically for volunteers.

- **Balance Sheet 101 for Volunteers:** This webinar will provide an introduction to the basic components of the balance sheet including loans, investments and fixed assets; borrowed funds from financial institutions, shares and deposits borrowed from members, and net worth (capital). Basic balance sheet ratios will be presented and explained.
- **Income Statement 101 for Volunteers:** This webinar will provide an introduction to the basic aspects of the income statement including: Loan income, investment income, fees and other revenue, operating expenses, provision for loan loss, and net income. Basic ratios will be demonstrated and explained.

To participate, you will need to register in advance and have access to a high-speed internet connection. Feel free to connect from your home, if that is convenient for you. A schedule for our volunteer webinars is found on our website ([www.MarkHSmith.com](http://www.MarkHSmith.com)).

Attendees will receive a confirmation e-mail from us which can be used to verify their attendance at the webinar. 

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## BUDGETING FOR ROA

If you have read our newsletters or attended our seminars or webinars in the past, you know the importance we place in operating the credit union in a pragmatic and businesslike manner. In 2011 and going forward, it will be more important than ever to do so.

Return on Assets (ROA) is a measure of profitability that almost everyone is familiar with. It is the gold standard for measuring operating efficiency. Almost all credit unions have a guideline or goal with respect to ROA. But, the ROA is the bottom line—without a roadmap to get there, most will never reach the goal. Here are some ideas that might be helpful.

**Dollars or Basis Points**—It doesn't matter if you use forecasted dollar amounts for your budget or if you use basis points in a spread-analysis format. The most important thing about budgeting is the process. Use whichever works for you. Perhaps the greatest planner of all is General Dwight D. Eisenhower. He planned the Normandy Invasion in WWII. Ike always argued that the plan often turned out useless, but the planning process was priceless.

**Balancing Your Budget**—If you do a personal budget, you know that it must balance. The spending and saving components of your budget have to equal the income component. Believe it or not, we occasionally see credit union budgets that don't add up. When you look at your budget, whether it be in dollars or basis points, add the revenue items, subtract the expense items and the sum should be your forecasted net income or forecasted ROA.

Now onto the components of your operating budget.

**Net Interest Income (NII)** is a very significant component of ROA. Credit unions are financial institutions. The majority of their revenue and much of their expense comes from interest income and interest expense. Our experience is that many credit unions do not focus on managing to a goal with NII. This is a serious mistake. Because of its magnitude and impact on ROA, NII is crucial and needs to be aggressively managed.

**Non-Interest Income (Fees)**—Fee income is an integral part of credit union profitability for most credit unions. Credit unions have traditionally resisted fees. Please note, however, this tradition began when credit unions had 700 bp in their net interest spread. Today, most have about half of that or less! Unless you have a unique circumstance such as very low operating expenses, fee income will need to be strong in order to maintain profitability.


**Loan Loss Expense (PLL)** has risen to be a major component of profitability, but is beyond the scope of this article. It goes without saying that loan losses need to be aggressively controlled.

**Share Insurance Premiums** are back with us for the foreseeable future. They need to go into your budget.

**Operating Expenses** are an area where most credit unions have become somewhat proficient in managing; nevertheless, we see operating expenses all over the map. Some of that is reflective of the level of service provided to members. Some of it is regional. Nevertheless, management should continue its effort to minimize operating expense when prudent.

Finally, let's talk about what your ROA should be for 2011. The answer is, of course, it depends. A few of you are still achieving ROAs over 100 bp. Most are not. In some regions, operating losses are still common. We suggest that you set a realistic expectation for the current year and budget to that. Going through the process of budgeting NII and the other components of the budget, will be helpful in achieving a realistic expectation for ROA. In 2010, some of our clients actually budgeted for negative ROA. Not a pleasant prospect. But better to be realistic and deal with it than not.

**CU-ALM REPORT** is a publication of Mark H. Smith Inc. that contains opinions, articles, and insight into many facets of credit union operations. At times it offers suggestions in the decision-making process. We are not registered investment advisers and our suggestions tend to be general in nature. While we are happy to share our insights and thoughts with our readers, it is important to understand that the responsibility for implementing the ideas or strategies suggested in these pages rests solely with the credit union's management.

In March 2011, we presented a webinar in our Swimming With the Sharks Series entitled "Budgeting and Managing for Return on Average Assets (ROA)." The webinar expands on the budgeting process summarized here. A recording of the webinar is available on our website ([www.MarkHSmith.com](http://www.MarkHSmith.com)). Click the button on the front page. There is no charge. 

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## CLIENTS' CORNER

*ALMPro*® TRAINING WEBINARS

Beginning in April 2011, Mark H. Smith Inc. will offer webinars specifically produced for users of the *ALMPro*® Report. Others having an interest in *ALMPro*® are also invited to attend. The webinars will utilize the *ALMPro*® Report and provide training and perspective on the analysis contained therein.

Each webinar will feature one panel of the *ALMPro*® Dashboard. We will explain the synoptic presentation on the Dashboard and then take you deep into the corresponding section of your *ALMPro*® Report. Nonclient attendees may use the sample report found on our website. We are planning on about 60 minutes for the webinar.

The first webinar is scheduled for April 27<sup>th</sup>. We invite you to attend. You can register on the website. As always, there is no charge. ☞

## NEW LIQUIDITY AND FUNDING GUIDANCE IS FINALIZED BY NCUA

In August of 2010, NCUA issued Letter to Credit Unions 10-CU-14 which outlines liquidity and funding guidance for all federally chartered and insured credit unions. We anticipate that most state regulators will adopt this guidance and apply it in general terms to their respective state charters, even if not federally insured.

The liquidity guidance is the outcome of the liquidity crisis which began several years ago. Sheila Bair, Chair of the FDIC, indicated that most banking failures in 2008 and 2009 were liquidity- or funding-related rather than credit-related. In 2008, it was the wholesale-funding resources that dried up, leaving banks without ongoing funding to support their balance sheets. Hence, bank failures, related counterparty failures, and TARP.

Credit unions are awash in liquidity for the moment. But, there will come a time in the future when circumstances will evolve and credit unions must be prepared to manage liquidity. The new liquidity guidance issued in NCUA's Letter to Credit Unions 10-CU-14, August 2010, sets forth specific requirements that credit unions must meet. For many, the impact will be minimal. But for some, there is significant work to do.

The full Letter to Credit Unions is available at <http://www.ncua.gov/letters/2010/CU/10-CU-14.pdf>. In order to assist credit unions in understanding and complying with the new liquidity and funding guidance, Mark H. Smith Incorporated offers two liquidity webinars on April 13<sup>th</sup>, 2011. **Liquidity 101** is an updated introduction to liquidity risk. **Liquidity 201** is intermediate liquidity risk and covers cash-flow analysis and stress testing. You can register for the webinars on our website, [www.MarkHSmith.com](http://www.MarkHSmith.com). Our webinars are always free and without obligation.

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# NOW AVAILABLE

## *ALMPro® Plus!*

Mark H. Smith Incorporated is now offering an enhanced version of *ALMPro®* called *ALMPro® Plus*. The current version now in use will be called *ALMPro® Classic*.

*ALMPro® Classic* will continue the reporting level which most clients receive at the present time. We recognize that many clients consider this basic level to be very adequate for their needs and have no interest in an upgrade. We are committed to continue providing this basic level of service.

*ALMPro® Plus* is an enhancement to the *Classic* level of *ALMPro® Service*. *Plus* retains the same format, but with additional analyses sequenced into the *Report* and *Dashboard*.

The three major components of *Plus* may be purchased individually or grouped together at a discount. A fee schedule and a sample *Plus Report* are available on our website.

*ALMPro® Plus* adds the following features to *ALMPro® Classic*

➤ **Enhanced Shock Scenarios**

- 100, 200, and 300 basis points up and down

➤ **Enhanced Liquidity Analysis and Forecast**

- Assistance in Adopting Liquidity Policy
- 12-Month Cash Flow Forecast
- Liquidity Stress Tests
  - Liquidity Coverage Ratio (LCR)
  - Net Stable Funding Ratio (NSFR)
- Assistance in Adopting a Contingency Funding Plan (CFP)

➤ **Written Executive Summary**

Provides a synopsis of the credit union's IRR and liquidity risk positions. Each panel of the *Dashboard* receives a short written summary. Suggestions and recommendations are offered when appropriate.

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