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Must Reads

LITIGATION

Vensure an Embarrassment?

The NCUA and Vensure FCU continue to slug it out in court.

The NCUA contends Vensure had long questionable history.

Vensure counter charged that NCUA conserved it out of embarrassment.

As of this writing, U.S. District Judge Rosemary Collyer is scheduled to hear oral arguments and perhaps deliver a decision in Vensure Federal Credit Union's attempt to stave off NCUA's conservatorship of its operations.

But no matter how the decision comes down, the agency and the credit union have already traded significant blows through their retracted legal filings in the case.

The NCUA conserved the \$4.7 million credit union on April 15, just hours after its largest account holder had its account seized **▲22**

MEMBERS

Upgrade Brings Outcry

A system upgrade at the \$1.5 billion Bakersfield, Calif.-based Kern Schools Federal Credit Union caused frustration early this month among some members who claimed they could neither access their accounts nor reach service representatives for help.

However, the credit union and the NCUA said that members were fully warned of the upgrade and no problems occurred during the conversion.

To help prepare members for its switch from a legacy system to Fiserv Inc.'s XP2 core processing platform, the CU provided information via mailed upgrade kits and conversion handbooks, e-messages, an online system preview, YouTube videos and in-branch fliers and signage, CEO Steve Renock said. Members were also told to update **▲21**



THE BUDGET

Will Taxes Be the Death of The Credit Union Charter?

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If credit unions were subject to income taxes, they would lose a key part of what makes them unique, but experts are divided as to whether it would create a

stampede of bank conversions.

"Being taxed would cause a real difficult adjustment for some credit unions. They'd have to increase efficiencies, at the very least. But it is not at all clear that they would conclude that changing over to a bank would be better for their members,"

said Janice Hollar, a former credit union CEO who is now senior vice president of RP Financial LC. The Virginia-based consulting firm works with banks and credit unions on strategic planning, mergers and business plans.

"A credit union that is **▲20**

REGULATION

Charge Against NCUA: 'Extremism'

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GREENBELT, Md. — Saying that the NCUA and other regulators are marching toward "regulatory extremism," the leader of a movement aimed at pressuring Congress to make changes to the NCUA outlined the extent of his frustrations with the status quo.

"We are pleading with members of the [congressional] committees to place curbs on unregulated

regulators who issue unreasonable regulations," said Alcoa Tenn FCU President/CEO David Proffitt, the coordinator of the Committee on the Declaration of Grievances, during a May 9 speech at the Metropolitan Area Credit Union Management Association.

"Credit unions are being regulated into mediocrity or regulated out of existence," Proffitt said. "We need regulators who have a business sense, who are member oriented and un-

derstand marketing."

Proffitt said the major purpose of the effort is to get lawmakers to provide greater oversight of and direction to the NCUA. He said the agency and the regulators who promulgate rules such as the Bank Secrecy Act need to be subject to greater checks and balances.

And he added that only Congress can perform that function.

Proffitt said 71 credit union leaders have signed his declaration, but that he hadn't received any **▲22**

MEMBERS UNITED

NCUA IG Sprays Blame Far and Wide

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Everybody messed up. Poor investment decisions by executives and volunteers and inadequate oversight by the NCUA were the key factors in the heavy losses at Members United Corporate Federal Credit Union that caused the NCUA to have to conserve it, the agency's Officer of Inspector General concluded.

"Specifically, management and the board's inadequate oversight resulted in Members United purchasing significant holdings of private-label mortgage-backed se-

The report concluded that 'stronger and timelier supervisory action regarding Members United's concentration in mortgage-backed securities could have resulted in a reduced loss to the TCCUSF.'

curities, many of which were later downgraded to subprime..., that exposed the credit union to excessive amounts of financial risk," according to the report.

The NCUA conserved Members United last September and liquidated it in October.

As of Feb. 1, it had cost the Temporary Corporate Credit **▲20**



Trailblazers 40 Below

A recognition program highlights the achievements of young executives in the credit union industry. First up: Brent Dixon. **▲6**

Forum Focus

A new feature offers debates on important industry topics. This week: Are branches essential? **▲10**



Taxes

CONT. FROM PAGE 1

The Rundown
▲ As the Obama administration and Congress look for revenue, taxing credit unions is yet again on the table.
▲ CUs would have instruments available to them to defer some of their tax payments.
▲ It's not clear if being taxed will cause a rush to conversions.

happy with the services it offers its members would have less incentive to switch. The biggest factor in deciding on a conversion would be how the credit union's business model has matured," she added.

Insurance costs for credit unions, especially financially healthy ones, could be lower if they became banks because banks aren't having to pay for the corporate credit union losses and because the FDIC's insurance is risk-based, Hollar noted.

CUNA Chief Economist Bill Hampel projects that over the next 11 years, insurance costs will be slightly lower for banks than for credit unions.

He projects that during that time, the average FDIC assessment will be 6.7 basis points of a financial in-

During the next two years, credit union assessments are likely to be significantly higher than those for banks, Hampel said, because of the way the corporate credit union repayment plan is structured.

stitution's assets, while the average NCUA assessment will be 7.7 basis points of assets.

The NCUA assessments are likely to only go toward paying off the loan from the Treasury Department that was used to rescue the corporate credit union system, starting in 2009. CUNA isn't projecting any assessments for the NCUSIF during that time period.

For this year, the NCUA has advised credit unions to budget for 20-35 basis points' worth of additional assessments. The agency estimates between zero and 10 basis points for the NCUSIF and between 20 and 25 basis points for the Temporary Corporate Credit Union Stabilization Fund.

During the next two years, credit union assessments are likely to be significantly higher than those for banks, Hampel said, because of the way the corporate credit union repayment plan is structured. CUNA projects that the NCUA assessment will be 19.1 basis points this year and 12.1 basis points next year, compared with the FDIC assessments of 7.6 basis points for both years.

There isn't a legislative proposal to tax credit unions, but it could be in the mix as part of an effort to raise revenue and reform the tax structure, in part by eliminating what are called "parlance tax expenditures" in Washington.

Bank lobbyists have said if credit unions are taxed, they would drop their opposition to raising the cap on member business loans and to credit unions being allowed to raise supplemental capital.

"We wouldn't object because credit unions and banks would be on a level [tax] playing field," said ABA Chief Economist Keith Leggett.

But John McKechnie, a former NCUA official who now lobbies for financial institutions, doubts bankers will keep their word.

"Why should we believe anything banks say about credit unions?" McKechnie said. "They want credit unions to eat their vegetables first and then have dessert. Banks are trying to lure credit unions into a trap."

Alan Theriault, president of CU Financial Services, which helps credit unions convert to banks, said depending on how Congress structures the taxation of credit unions, there would likely be a phase-in period and credit unions could defer some taxes.

"If you go from a non-taxed entity to a taxable entity, you generate a deferred tax asset which might give you a tax shelter for a few years. So you can't just put a mathematical percentage to your earnings to get to your tax liability. Things like charitable contributions and depreciation would come into play," he said.

Theriault said that being a bank would be a competitive advantage for some financial institutions because of poor consumer awareness of credit unions. He added that because credit unions aren't FDIC-insured, they have to offer lower loan rates because the public is often confused about the safety of financial institutions that aren't FDIC-insured. CUNA's Hampel disagrees and counters that the cooperative model is a competitive advantage for credit unions.

"Members are better off in a cooperative model where the management and board are primarily concerned with member-owners rather than worrying about shareholders who aren't always the same as customers. That means better rates," he said.

The tax exemption has been in place since the Federal Credit Union Act was passed in 1934. Ever since, banks have fought it by portraying it as providing an unfair competitive advantage. ■

Members

CONT. FROM PAGE 1

The Rundown
▲ The NCUA's Inspector General concluded that the management and board of Members United Corporate Credit Union didn't pay adequate attention to concentration risks.
▲ The management and board were too influenced by outside rating agencies and didn't do enough due diligence.
▲ NCUA examiners didn't identify risks early enough and suggest remedies but were hampered by inadequately regulations.

Union Stabilization Fund \$400 million.

The report concluded that the Warrenton, Ill.-based credit union's management didn't establish proper concentration limits, relied too

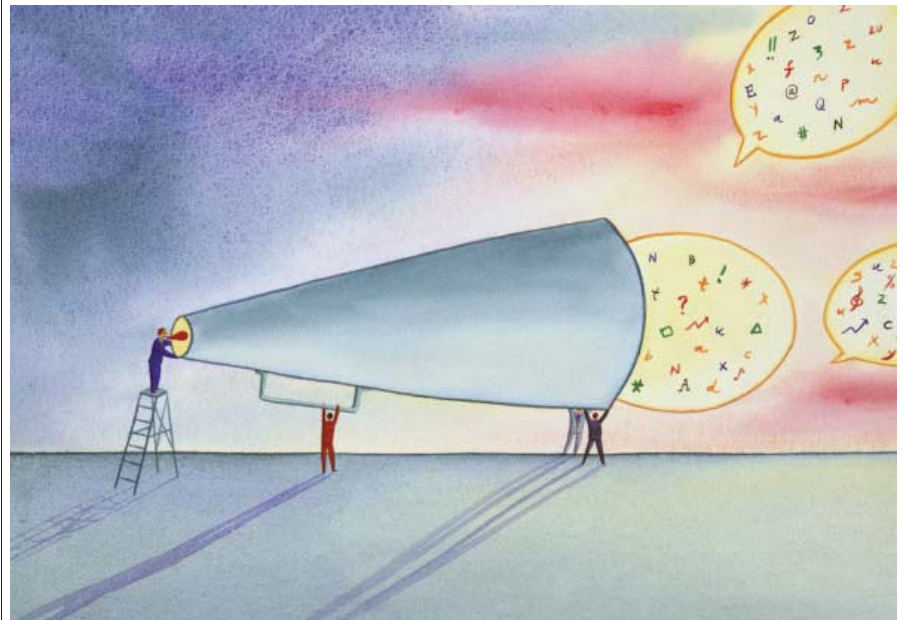
The reported noted that Members United's CEO Joseph Herbst was on U.S. Central's board and should have known of the concentration in mortgage-backed securities. Members United lost \$308.2 million from its investments in U.S. Central as of Feb. 28.

Members United's management failed to understand the credit risks associated with investments in complex instruments and didn't establish "prudent sector concentration limits," according to the report.

The report also concluded that "stronger and timelier supervisory action regarding Members United's concentration in mortgage-backed securities could have resulted in a

The report concluded that the Warrenton, Ill.-based credit union's management didn't establish proper concentration limits, relied too heavily on rating agencies, didn't properly monitor credit risk exposure and relied on the corporate credit union structure to provide financial strength and liquidity.

rate credit unions. He added that the agency is exploring whether to develop additional risk-monitoring



heavily on rating agencies, didn't properly monitor credit risk exposure and relied on the corporate credit union structure to provide financial strength and liquidity.

In 2009 and 2010 the NCUA conserved five corporate credit unions because of extensive losses from their investments in mortgage-backed securities: Constitution Corporate FCU, Members United Southwest Corporate FCU, U.S. Central Corporate FCU and Western Corporate FCU.

Members United had as much as \$6.5 billion invested in U.S. Central, and this represented indirect exposure to the mortgage-backed securities that U.S. Central invested in.

"Members United, when determining concentration limits in mortgage-backed securities, did not consider this indirect exposure," the report concluded.

reduced loss to the TCCUSE?"

The report noted that NCUA examiners didn't identify and require corrective action until May 2008, by which time there had already been severe losses. There had been no supervisory concerns raised in 2007 even though there had already been severe losses.

However, the report noted that some of the NCUA's shortcomings in this area were the result of the agency not having "appropriate regulatory support, such as specific investment concentration limits" that might have addressed the concentration risk issues.

In response, NCUA Executive Director David Marquis wrote that the recent set of changes to the corporate credit union regulations approved by the NCUA board are aimed at preventing a recurrence of many of the problems at Members United and the other corpo-

cedures to help examiners identify changes in a corporate credit union's risk exposures.

In addition, he noted that the corporate credit union rule approved by the NCUA board requires a majority of corporate credit union board members to come from natural person credit unions in order to avoid potential conflicts stemming from having too many corporate credit union executives on the board of top-tier corporates such as U.S. Central.

Last September the NCUA agency approved a series of rules that take effect this year on the corporates. And last month, the board approved another set of regulations that include mandatory risk-management committees at all corporate credit unions, recorded votes on all board actions and mandatory disclosure of any compensation received from a corporate CUSO. ■

NEXT STEPS
READ the IG's report & new corporate regulations at ncua.gov



Herbst



Marquis