Understanding Key Ratios for the Credit Union Volunteer

Lee Fogle, Chief Executive Officer
Duke University Federal Credit Union
March 2, 2011
 Agenda

• Overview
• Financial Report Ratios
• ALM and Investments
• NCUA Camel Ratios
• Risk Management Ratios
• Strategic Scorecard Ratios
• Summary
Overview
What is a Key Ratio?

• A Key Ratio is a number, expressed in percentages, that is used as a guideline to measure Credit Union Performance.

• Financial Soundness, Risk, and Strategic Direction of the Credit Union can be measured by ratios.

• Ratio computation and utilization may be different for each Credit Union.
Why do we have Key Ratios?

- To benchmark performance
- To set goals and direction
- To measure progress toward those goals
- To measure safety and soundness
How do we Benchmark?

1. Strategy
2. Business Plan
3. Budget
4. Peer
Who uses Key Ratios?

1. CEO, CFO, Management
2. Finance Committee (ALCO)
3. Board of Directors
4. Examiners
Financial Report
Ratios
Credit Union Balance Sheet

ASSETS
(we own)
• Cash
• Investments
• Loans
• Fixed assets

LIABILITIES
(we owe)
• Deposits
• Notes payable
• Reserves
• Undivided Earnings
Income and Expense Statement

INCOME (we earn)
- From loans
- From investments
- Fees
- Other Income

EXPENSE (we pay)
- Dividends
- Salaries / benefits
- Travel & conference
- Office occupancy
- Office operations
- Educ. & promotional
- Prof & outside services
Capitalization Ratios

- **NET WORTH TO ASSETS** - Regular reserves + Undivided Earnings / Assets

- **DELINQUENCY TO LOANS** - Loans reported over 60 days past due / Loans

- **CHARGEOFFS TO LOANS** - Charge Offs - Recoveries / Loans
Growth

- **ASSET GROWTH** - Current Assets - Prior Year-end Assets / Prior Year-end Assets
- **LOAN GROWTH** - Current Loans - Prior Year-end Loans / Prior Year-end Loans
- **MEMBER GROWTH** - Current members - Prior Year-end Members / Prior Year-end Members
- **LOANS TO DEPOSITS** - Loans / Deposits
- **BORROWERS TO MEMBERS** – Members with Loans / Members
Spread Table

+ ASSET YIELD
- (COST OF FUNDS)
  = NET INTEREST MARGIN
- GROSS EXPENSE
+ OTHER INCOME
- (NET EXPENSE)
- (PROVISION FOR LOAN LOSSES)

= RETURN ON ASSETS (Loss)
Spread Table Ratios

- **ASSET YIELD** - Interest on Loans and Investments / Average Assets
- **DIVIDENDS** - Cost of Funds / Average Assets
- **NET INTEREST MARGIN** - Asset Yield – Cost of Funds / Average Assets
- **GROSS EXPENSE** - Operating expense excluding Provision for Loan Losses / Average Assets
- **OTHER INCOME** - Other Operating Income / Average Assets
- **NET OPERATING EXPENSE** - Operating expense less other income / Average Assets
- **PROVISION FOR LOAN LOSSES** - Provision for Loan Losses / Average Assets
## Monthly Financial Ratios Report

**DUKE UNIVERSITY FEDERAL CREDIT UNION**
**KEY RATIOS**
**2/28/2011**

### Capitalization

<table>
<thead>
<tr>
<th></th>
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</tr>
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<tbody>
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<td><strong>NET WORTH/ASSETS</strong></td>
<td>0</td>
<td>0.00</td>
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<tr>
<td><strong>LOAN/DEPOSIT</strong></td>
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<tr>
<td><strong>DELINQUENCY/LOANS</strong></td>
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<td>0.00</td>
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<tr>
<td><strong>CHARGE-OFFS/LOANS</strong></td>
<td>0</td>
<td>-</td>
<td>-</td>
<td>0.00</td>
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### Growth % (annualized)

<table>
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<tbody>
<tr>
<td><strong>ASSETS</strong></td>
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<td>0.00</td>
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<tr>
<td><strong>LOANS</strong></td>
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<td>0.00</td>
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<tr>
<td><strong>MEMBERS</strong></td>
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<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
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</table>

### Spread Table (Annualized)

<table>
<thead>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSET YIELD</strong></td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td><strong>DIVIDENDS</strong></td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td><strong>EXPENSE “minus PLL”</strong></td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td><strong>Other income</strong></td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
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<tr>
<td><strong>Expense net other income</strong></td>
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<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td><strong>Provision for Loan Loss</strong></td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td><strong>RETURN on ASSETS</strong></td>
<td>0</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
</tbody>
</table>
Trend Analysis

- vs. Strategy
- vs. Projections
- vs. Prior year
- vs. Peer
- vs. Budget

Be sure to ask Questions!
ALM and Investments
### ALM/ Investment Policies

<table>
<thead>
<tr>
<th>ALM &amp; Investment Policies</th>
<th>As of 10/31/2010</th>
<th>Within Policies</th>
</tr>
</thead>
<tbody>
<tr>
<td>FCCCU credit line</td>
<td>Not to exceed 200% of the CU's equity capital based on actual debt</td>
<td>0%</td>
</tr>
<tr>
<td>Income Simulation</td>
<td>35 bp given 300 +/- shock (Semi-annual basis)</td>
<td>0bps</td>
</tr>
<tr>
<td>NEV</td>
<td>NEV ratio to be &gt; 4%; max decline limited to no more than 50% of CU's base NEV for +/- 300 bp shifts in market rate (Semi-annual basis)</td>
<td>0%</td>
</tr>
<tr>
<td>Lending</td>
<td>First mtg balance on loans &gt; 5yr life limited to 100% of CU's equity cap</td>
<td>0%</td>
</tr>
<tr>
<td>Lending</td>
<td>Holding of total real estate loans (regardless of type) limited to 500% equity cap</td>
<td>0%</td>
</tr>
<tr>
<td>Liquidity</td>
<td>Liquidity ratio &lt; 95%; if &gt; 95%, then Liquidity Plan must be adopted -[plan adopted August 2006]</td>
<td>0%</td>
</tr>
<tr>
<td>Investments</td>
<td>Various investment types have weighted avg life restrictions; see policy</td>
<td>Yes</td>
</tr>
<tr>
<td>Investments</td>
<td>All other investments cannot have fair values decline by %s when shocked +/-300bps; see policy and note policy variances</td>
<td>Yes</td>
</tr>
<tr>
<td>Investment Policy</td>
<td>Policy conditions adhered</td>
<td>Yes</td>
</tr>
<tr>
<td>Max exposure to Corp CU limited to 400% of CU's equity capital</td>
<td>0%</td>
<td>Yes</td>
</tr>
<tr>
<td>Net worth</td>
<td>Above 8%</td>
<td>0</td>
</tr>
</tbody>
</table>
Camel Ratios
NCUA “CAMEL” Rating System

A performance evaluation system concentrating on the five critical areas of a credit union's operations.

• **COMPONENTS**
  - C = capital adequacy
  - A = asset quality
  - M = management
  - E = earnings
  - L = asset/liability management
  - (S = sensitivity to market risk?)
NCUA “CAMEL” Rating System

1. **Strong performance** - consistently provides for safe and sound operations.

2. **Satisfactory performance** - provides for safe and sound operations.

3. **Flawed Performance** - is to some degree flawed and is of supervisory concern.

4. **Poor performance** - is of serious supervisory concern.

5. **Unsatisfactory performance** - is critically deficient and in need of immediate remedial attention.
CAMEL “C”

CAPITAL ADEQUACY

An analysis of the strength of the credit union's Net Worth position and its ability to withstand losses to assets.

- Net Worth/ Assets
- Delinquent Loans/ Net Worth
- Solvency Evaluation
CAMEL “A”

ASSET QUALITY

An analysis of the soundness of the assets of the credit union and the effect the "classified assets" will have on the financial condition of the credit union.

- Delinquent Loans/ Loans
- Charge-offs/ Loans
- Delinquent Loans/ Assets
MANAGEMENT

An analysis of the credit union's management performance in operating the credit union within accepted practices and in a safe and sound manner.

- Business Plan Ratios
- Financial Performance Ratios
- Expense Ratios
CAMEL “E”

EARNINGS

An analysis of all components related to income and expenses and of the overall operation of the credit union to be able to cover expenses and still grow Net Worth.

• Return on Assets
• Yield on Loans
• Yield on Investments
• Operating Expenses/ Gross Income
CAMEL “L”

ASSET/ LIABILITY MANAGEMENT

Identification, monitoring, and control of interest rate sensitivity, reliance on short-term, volatile sources of funds, and availability of assets readily convertible into cash.

- Long-Term Assets/ Assets
- Loans/ Deposits
- Cash + Short-term Investments/ Assets
- Deposits and Borrowing/ Earning Assets
Risk Management Ratios
What is Risk Management?

- **RISK** is the potential that events may have an adverse impact on Net Worth.

- **ENTERPRISE RISK MANAGEMENT** is a total risk management process taking an entity-wide view of a variety of risks and its potential impact. (Is coming soon if not already.)

- **NCUA Risk Focused Exam**
Seven Major Risks:

1. Credit
2. Interest Rate
3. Liquidity
4. Compliance
5. Transaction
6. Strategic
7. Reputation
1. **Credit Risk** - The risk of non-payment
   - Delinquent Loans/Loans
   - Charge-offs/Loans

2. **Interest Rate Risk** - The risk of changes in value due to fluctuating interest rates
   - Long-Term Assets/Assets
   - Loans/Deposits
The Seven R’s

3. **Liquidity Risk** - The risk of selling investments or borrowing in the current market
   - Cash + Short-term Investments/Assets
   - Long-Term Assets/Assets

4. **Compliance Risk** - The risk to earnings due to the violation of non-conformance with laws, rules, and regulations.
   - Exams
   - Audits
5. **Transaction Risk** - The risk of fraud and operational inefficiencies
   - Audits
   - IT testing

6. **Strategic Risk** - The risk of changes on earnings or Net Worth from adverse business decisions.
   - Net Worth Trends
   - Return on Assets Trends
   - Charge-off Trends
The Seven R’s

7. **Reputation Risk** - The risk of negative publicity on an institution’s business.
   - Word of Mouth by Members
   - Concern of Sponsors
   - Legal or Press Concerns
Strategic Scorecard Ratios
Balanced Scorecard Strategies

• **Membership** - our owners as consumers
• **Learning and Growth** - our people and our service
• **Internal Business** - technology and efficiency
• **Financial** - ability to grow
Member/ Owners as Consumers

- **Asset Growth** – Member satisfaction level measured by dollar amount of business brought to the Credit Union.
- **# Services per Member** – Member satisfaction level measured by increasing relationships.
- **Accounts Opened** – New relationships measure, growth by word of mouth.
Our People and Our Service

- % Members Very Satisfied - by % of membership answering the survey.
- % Member Propensity to Recommend - by % of membership answering survey.
- Average Years Financial Institution Experience - skill and job expertise of Staff and Management.
Efficiency and Technology

• **Staff versus Peer** – Efficiency measurement, FTE staff per $1 million in assets.

• **E-Services uptime** - Efficiency measurement, hours down vs. operational, i.e. up-time.

• **Services per Staff** – Efficiency measurement, total # of primary services identified as core divided by number of FTEs.
Financial Ability to Grow

- **Return on Assets** – Safety and soundness measurement, indicates net income to be retained as Net Worth.

- **Net Worth** – Indicates undivided earnings and reserves available at any given time to withstand a financial crisis.

- **Loans to Deposits** - Measures growth and income potential.
Summary
It is our responsibility to:

• Review Trends
• Set Goals
• Monitor Trends
• And to ask questions!
Do’s and Don’t of Key Ratios

1. Don’t look too closely
2. Do use as Guideline
3. Do add Common Sense
4. Don’t rely totally on Peer
5. Do use as a Trend Indicator
6. Do use for Planning/Strategy
Only Two Ratios Really Needed!

1. Net Worth
2. Member Satisfaction