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The New View From the Top of the Corporate Heap

After the NCUA seized Members United FCU and Southwest Corporate FCU, the playing field changed dramatically in the corporate system. Now, the title of largest corporate must carry an asterisk that separates corporates under the NCUA's management from those running independently.

That leaves two previously mid-sized corporates that may now make the claim of largest independently managed corporate: the $3.7 billion Corporate America CU and the $3.5 billion Mid-Atlantic Corporate FCU.

By HEATHER ANDERSON

CORPORATE AMERICA CU

Corporate America has more than $100 million in Tier One capital on the books and reported a nearly 3% core capital ratio and 0.59% retained earnings ratio on its August 5310 report. CEO Thomas Bonds said that provides his Irondale, Ala.-based corporate with a "stable platform" from which to offer services to CUs shopping around for a new corporate.

Service continuity should not worry members of any corporate, he said, as the NCUA has done a good job of protecting consumers whose transactions are ultimately processed by any of the five corporates currently under conservatorship. However, he said credit unions "disenchanted" with their corporate should consider Corporate America.

BONDS

"We aren't pillaging members or saying anything bad about other corporates, but we do offer a good, solid, financially sound alternative," he said.

Although Corporate America's membership ranks have grown by more than 50% in the last 12 months, Bonds said he's not concerned about growing too quickly as members are voluntarily purchasing perpetual contributed capital at a sufficient level to support growth.

In fact, Corporate America currently does not plan to require new members to contribute any membership capital.

"Membership capital is worthless," Bonds said. "The way the regs are written it can be ratcheted up but not down. It's not like the Federal Home Loan Bank, where if your deposits go down the capital is refunded."

Bonds wouldn't rule out requiring PCC contributions from members but said if such a requirement were implemented, it would be a "little itty bitty amount" based on usage.

Corporate America is targeting southern states to increase market share and will introduce a full suite of proprietary balance sheet management tools, including asset-liability management modeling and investment advisory services, in coming months. Currently, those services are available to members through a third-party vendor.

Additionally, the corporate doesn't have any legacy assets on its books. "Unquestionably, we're pretty confident about the future," Bonds said.

MID-ATLANTIC CORPORATE

Jay Murray, CEO of the $3.5 billion Mid-Atlantic Corporate, said his Middletown, Pa.-based institution has a retained earnings ratio of 0.20% and 4.28% total capital. Mid-Atlantic also has agreements from members to convert membership capital accounts to PCC to meet core capital ratio requirements before they are implemented by the NCUA, he said.

Mid-Atlantic's current objectives are twofold: rebuild retained earnings and ramp up back-office support functions for members. This will allow Mid-Atlantic to spend more time assisting members, implementing marketing plans and business development strategies, and rebuilding capital while accounting for the NCUSIF and corporate assessments.

The corporate also will help credit unions manage compliance expense and take a more strategic approach to ALM, treating it less like an NCUA requirement and more like a strategic plan. Mid-Atlantic will continue to offer ALM using third-party modeling and strategic planning through its partially owned CUSO.

MURRAY

Although Mid-Atlantic has picked up a few new members over the past year, Murray said he's found most credit unions are still waiting to see business plans submitted by their current corporates before making the decision to convert.

"We've been to several meetings where credit unions have indicated they are starting the due diligence process and just want to know what we have to offer," he said. "We will have the opportunity to pick up more members in coming months."

The corporate will stick to the Mid-Atlantic region when pursuing new members and convey the message that "we're here and available, if you're interested in knowing more."

Mid-Atlantic never purchased any private label securities.

Although the eastern Pennsylvania corporate is relatively close to the failed Constitution Corporate, for which NCUA is currently soliciting bidders, Murray isn't anxious to acquire its assets because they don't include any capital.

He explained, "Even to pick up market share geographically, you have to look at any efforts and decide at what cost it will take to make those things happen. If you don't have a current relationship in an area, it will take time and effort to build them. Everything comes at a cost, and we don't have the money in the checkbook like we used to."

Mid-Atlantic has reduced expenses by $2 million annually by reducing staff and hopes to lease out empty space in its headquarters building to generate more revenue. The corporate will also continue to reduce infrastructure costs for its bill pay system solution, iPay, and will continue to look for additional opportunities to save on operating expenses with the product and generate more economies of scale for members.

THE FATE OF U.S. CENTRAL

Also on the list of Mid-Atlantic's short-term projects, as well as other so-called pass-through corporates, is determining the fate of U.S. Central's core processing, payment processing and other core services. Murray attended an Association of Corporate Credit Unions meeting Oct. 13 in which the fate of U.S. Central was a primary topic.

"Until now, U.S Central has not been allowed to construct plans and give us real numbers," he said. Now that the new corporate regulations and legacy asset plan are out, corporates are looking at pieces of U.S. Central's operation to find common ground and efficiencies.

Although Bonds said Corporate America doesn't rely much upon U.S. Central services, he would be interested in buying into a surviving CUSO. However, He expressed concern that CUSO could someday be sold to an trade organization or bank. Or, the NCUA could decide to sell U.S. Central assets to the highest bid-

(Please see New View, page S-8)

GUEST OPINIONS

Five and Ten: Top Questions to Ask Yourself and Your Next Corporate

No sooner had the reports gone out about the NCUA's actions last month to help define the future of the corporate system than natural person credit unions began analyzing what to do next. What had been speculation over the past 18 months was now becoming an actual decision facing every credit union in America. Within the next 12 months, credit unions will make the call–will there be a corporate system, what will be its business model, and will my credit union do business with and invest in a corporate?

Dennis Dollar is the principal partner at Dollar Associates LLC in Birmingham, Ala. He can be reached at 205-991-1525 or ddollar@dollarassociates.com

Our clients began asking us to help them draft questions to ask the corporate credit unions that will be coming to them over the next few months in an effort to keep their business, secure their business or solicit their investment in the corporate's future. Due diligence efforts were already kicking into gear as they tried to find out what entity would continue to offer them the best services at the best pricing with the best prospects for a long-term future relationship. Whether that is inside the corporate network or outside the industry, decisions needed to be made and alternatives needed to be analyzed.

As most of our clients are already well underway with this process, Credit Union Times asked for a list of the top 10 questions a natural person credit union should ask its next corporate. (Our apologies to David Letterman.)

But before we get to that, first consider these five questions for your institution in evaluating marketplace options:

1. How much of back office activity is my credit union willing to assume in-house so that I can make my relationship work with a new service provider, and how much back office work does my credit union, based upon our internal level expertise, feel is most efficient to contract out to a qualified third party–whether it be a corporate or another entity?

2. If I need a line of credit, where would my CU best be in a position to obtain one, and what would be the cost and terms?

3. What additional resources will I need to add and what will be the cost if my credit union brings services previously provided by my corporate in-house, and if my credit union cannot handle the services in-house, are there other providers that can meet the expectations of my credit union in terms of actual credit union market expertise and ability to provide turn-key solutions to a credit union?

4. Is there sufficient benefit in continuing to use the services of a corporate to offset the risk of future losses in light of the hit my credit union has taken in the cooperative structure through my past investment in a corporate? Does the cooperative philosophy of the credit union movement matter enough to me to even consider supporting the corporate network again?

5. I may be angry at the losses I have taken in the name of corporate stabilization, but what is in the strategic best interest of my credit union going forward? If I am not willing to invest capital in a corporate, am I willing to invest in a CUSO to provide the same services? Which option has the least risk? Which has the most upside?

Then dive into the top 10 questions for your next potential corporate partner:

1. If your business model is to remain a freestanding corporate, what does your business plan look like and how can you assure me that losses of my investment will not happen again under the new model?

2. What new infrastructure will you need to meet the requirements of the new corporate rule and how will it be financed?

3. What capital investment will be required of my credit union, and will you plan on requiring a membership fee before I can utilize your services?

4. What will be the fee structure and costs to my credit union for your products and services?

5. Will you be able to provide my credit union with access to a line of credit?

(Please see Top Questions, page S-8)

Question: Will you consider recapitalizing your bridge corporate?

I would have to take it to the board, but personally, I would, with a lot of careful consideration. I would have to see that the people in charge are actually credit union people.

Lorene Crucian, Asst. Manager
$4.2 million Houston Musicians FCU
Houston, Texas
Southwest Bridge Corporate FCU member

We have no problem with it whatsoever; but, our board members don't feel the same as we do. We are not suffering because they have run their credit union conservatively, and it's been hard for them to foot the bailout for everybody else. But, I worked here back in the 80s when we struggled and Southwest Corporate kept us afloat. They gave us a line of credit during that period, and as we made payments we could turn around make loans to members. Each day we would put up a sign with our daily loan limit to members, all thanks to Southwest Corporate's help. We went through some really bad times back then and they were there for us. It's hard for to us to get upset at them when they were following advice from people who were supposedly in the know.

Benita Huskey, Chief Financial Officer
$51 million Cooperative Teachers CU
Tyler, Texas
Southwest Bridge Corporate FCU member

Yes, I would consider recapitalizing the WesCorp if they came up with a compelling business plan, given new regulations NCUA has put forward. Now they have two years to figure out what it is they are going to do.

Jack Fallis, CEO
$340 million Global CU
Spokane, Wash.
Western Bridge Corporate FCU member

It depends upon what plan they come up with. There hasn't been anything put out there yet; they are just now getting a committee formed. But yes, I am interested, however, I would need to see the plan first.

Doris Small, Manager
$10 million Fort Smith Teachers FCU
Fort Smith, Ark.
Southwest Bridge Corporate FCU member

Yes. Certainly, we would need a concurrence from the board. It would obviously depend upon the level, the pricing structure, and whatever other changes come about, and would have to be the most secure and reasonable thing for us to do. It certainly wouldn't be an automatic yes.

Steve Devan, CEO
Grossmont Schools FCU
$80 million
El Cajon, Calif.
Western Bridge FCU member

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Investing in the Future of Credit Unions

By JOYCE MOED

Independent income brokerage firms are seeing a surge in business, but it's one that comes with mixed feelings, one firm said.

"The credit union system has surplus funds to invest–more than in recent years, and it's not flowing into the corporate system," said Charlie Felker, managing director of regulatory affairs for First Empire Securities. "[Credit unions] are looking for alternatives. They are investing more, and directing into capital markets, and the way you do that is through a fixed-income broker. We are obviously benefiting from this, but not necessarily the way we like to benefit from this. We are not particularly happy that the credit union system is under this kind of stress. We have mixed feelings about it. Yes, we like the additional clients and the additional business, but we don't like to see the credit union system having additional stress. And there could be more depending on the losses that come out of the corporates."

FELKER

First Empire Securities, in Hauppauge, N.Y., which offers fixed-income brokerage, already has numerous clients that invest in the capital markets through them, Felker said.

"And there are other fixed income brokerages that credit unions would have access to," he said. "That market has been there for years, and many credit unions have invested in capital markets for years. It's not new."

What is new, Felker noted, is that more credit unions are moving away from their corporates and investing directly in the capital markets.

"It became very apparent about two years ago when the trouble in the corporate credit union system became apparent," Felker said. "Corporates had already been losing market share over time, but it accelerated, certainly when the troubles became clear. It has increased over those two years."

During these past two years, First Empire has opened a lot of new accounts, Felker said.

"We offer many of the same services [as the corporates]," he said. "We offer investment advisory services. We offer liability analysis, portfolio analysis¬–many of the same services that corporates have provided. We have competed with corporates for many years. It's not that we are providing more services. It's the structural change in the competitive marketplace. It's sort of a game-changer, where you had a major competitor who is not a competitor anymore. A major competitor is evacuating from the market."

Felker predicted this is a permanent change. "I think we're going to go from the present 29 corporates probably down to five to seven, and I think they will function more as regional facilities," he said. "But I don't think they will be broadly competitive as investment vehicles. They may provide liquidity, and they may provide investment advisory–many of the same services we provide. But they will have difficulty as investment providers. They won't be able to pay the same amount of return as they did in the past. It's going to be hard for them to compete broadly speaking, and that apparently is the outcome NCUA seeks.

"And of course there is another issue there, too. If you have written off your membership capital and you are receiving assessments, how likely would it be that your credit union would want to write another check to buy some more capital? I think that's going to be a very tough sell. I just don't see it."

CBNS, a full-service brokerage dealer and adviser in Overland Park, Kan. that serves credit unions almost exclusively, said most of its clients are seeking short-term, bullet securities, "something with a fixed maturity, where there is a call option embedded in the bond," said Brian Hague, president/CEO. "Yields are so low."

Hague said CBNS is not seeing a huge difference in its business but suspects it will see more.

LASS

"One of the services we supply is bond accounting," he said. "For all of our bond accounting clients, close to a half-billion dollars was placed in corporate credit union certificates. Going forward, we don't expect to see that money invested in corporate credit unions. When those mature, we expect to see increase in securities."

Right now, a lot of credit unions are sitting on the sideline due to the low yield, Hague said. But this October is still the best October CBNS has seen since 2004, "because there's a ton of liquidity out there," Hague said. "Credit unions are getting flooded with deposits. An unprecedented amount has come out of mutual funds. People are hunkering down, so to speak, and not racking up the credit card debt and trying to increase their saving rate, and they want to park their money somewhere safe. Their members are flooding them with deposits but nobody is borrowing. At a time like this they have to earn a return to pay their members something and cover operating costs, and they have no choice but to invest it."

HAGUE

Hague said that CBNS began to see the increase in March, and it continued through spring and summer.

"And the summer months are usually slow because credit unions tend to write more loans in the summer," he said. "But through the summer, although it did slow down from the spring, pretty much every month this summer was the best [since 2004]."

Hague expects that to continue. "Everybody talks about the new normal," he said. "I don't believe it's the new normal. I believe it's my dad's normal when people lived within their needs. People saved maybe 10% of their income. I think those days are here to stay for a while. That's good for our business."

Less competition from corporate deposits is good for CNBS' business. "We're seeing a number of those credit unions come to us," Hague said. "We're definitely seeing a pick-up in new accounts and seeing a pickup in interest and advisory services."

We are very sensitive that it would not be good for corporate credit unions if natural person credit unions would withdraw funds from corporate credit unions.

John Lass, senior vice president of strategy and business development for CUNA Mutual Group, said that CUNA Mutual has three key points in mind when it comes to the corporates. First, managing credit union investments is not new for CMG. Second, it only manages investments more than 365 days.

He added, "The third point is that we are very sensitive that it would not be good for corporate credit unions if natural person credit unions would withdraw funds from corporate credit unions. We are cognizant of the need of letting NCUA work through the process."

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CU Broker-Dealers Cry Foul on ISI Legacy Asset Sales

By HEATHER ANDERSON

Broker-dealers that serve credit unions are bristling as they have been left out of legacy asset offerings. U.S. Central FCU's wholly owned subsidiary, CU Investment Solutions, Inc. has been named the single access point for credit unions.

BLEVINS

D. Henry Blevins, managing director of the Credit Union Group at Little Rock, Ark.-based Crews & Associates, compared the single access point to a "good ol' boys system," saying credit unions that don't have an existing relationship with a pass-through corporate or ISI must become new clients to access NCUA Government Notes.

"The only time I can get them is when they hit the secondary market, if someone re-offers them," he said. Blevins said he hasn't received many calls from credit union clients, because at press time the issuance was still new and most credit unions didn't know the details yet. However, Blevins said his trading desk had heard the bonds were already "heavily oversold."

"This is more like a private placement than a public offering," he said.

Andrew McGeorge, senior portfolio strategist for Kansas City-based CNBS, once owned by U.S. Central, agreed with Blevins, saying a single source for bonds is unusual given the size of the deal.

"There are many agency issues that come every day that can only be purchased from one dealer at issuance, but these tend to be smaller deal sizes," he said. CNBS is also shut out of the deal, he said, with no ability to buy the bonds from Barclays and send them on to credit unions.

John McKechnie, NCUA director of public and congressional affairs, stated, "It is not unusual, and in fact is relatively customary. The only 'customized' aspect was to have a point of contact specific to credit unions to have, under securities laws, their questions answered and to have a broker that would ensure they were treated fairly and as a conduit to Barclays."

The first issuance of the NCUA Guaranteed Notes backed by legacy assets, some $4 billion expected to close Oct. 25, were made available to investors through Barclays and four selling groups with access to credit unions provided through ISI. At press time, the unofficial price for the floating rate bonds was 40 basis points over Libor.

McKechnie said the NCUA is using a syndicate to sell the NGNs and rotating participation of brokers on each transaction. The offerings will be conducted on a "fixed economics" basis, he said.

Underwriting fees will be 2.9 basis points on securitization proceeds. As sole book-runner and structuring agent, Barclays will receive 70% of economics on all transactions. The remaining 30% economics will be split equally among the two co-managers–Wells Fargo and JP Morgan on the initial transaction–and the group of selling group members. Each co-manager will receive 10% of economics.

MCGEORGE

Selling group members will be rotated for each transaction with the exception of ISI participating in all transactions. Loop Capital Markets, CapitalOak Securities, Williams Capital Group and ISI are the four selling groups for the first transaction, which closed Oct. 25. The 10% allocation for the selling group members will include an 8% fixed economics split equally among the four selling group members and a 2% incentive fee which is not assigned.

"The plan is to rotate among major broker-dealers for co-managers and to do so with those major players who have the experience, credentials and customer base to make for a most successful sale," McKechnie said.

McGeorge worked for Barclays Capital before joining CNBS and said Barclays has some latitude regarding how the bonds are distributed.

"It's not entirely clear how credit union orders will be processed," he said. "Are we at the front of the line? Do we get partial fills of our orders depending upon how oversubscribed the deal is? Do we get the dregs? It's not clear."

However, McGeorge said Barclays would be "idiotic" to try to influence distribution of funds, giving existing clients more favorable bonds in order to maximize profits because of the government contract.

"No amount of love from (Pimco's) Bill Gross could offset the reputation risk they would face by not handling the deal fairly," he said.

McKechnie said the NCUA will "rotate through an appropriate number of premier firms" in future issuances and plans to also include some smaller regional firms while keeping the selling group to a reasonable number.

MCKECHNIE

"There is a need to keep this process manageable," he said.

Both Blevins and McGeorge said at 40 basis points over the one-month Libor, the investments are a fairly good deal although not something credit unions would normally buy.

Blevins called it "as good as any other government guaranteed bond."

McGeorge said the bonds have the same credit risk as Ginnie Mae floating rate collateralized mortgage obligations, but the NGNs have the advantage of a hard stated final maturity of 10 years and an extra 10 basis points of yield. The 10-bp advantage is similar to the price the FDIC put on its legacy assets-backed bonds, which were offered at Libor plus 55 bps compared to Ginnie Mae's floating rate CMOs at 45 bps over Libor at the time.

However, McGeorge cautioned credit unions that the bonds do have liquidity risk. If cash-strapped investors are forced to sell the bonds, they may have to accept a price well below intrinsic value.

"However, if credit unions are sitting on a lot of cash, have little prospects for lending picking up, and don't think they'll need to cash to redeem members' deposits, the floating-rate NGNs could make sense," he said. "Just be aware that the secondary liquidity of the bonds is quite uncertain."

Series I-A of the initial issuance–worth $3.5 billion–will feature the floating rate. The remaining $500 million in Series II-A will be a fixed-rate investment. McGeorge advised against the fixed-rate purchase, saying the potential reward is so limited it didn't justify the required pre-purchase due diligence.

McGeorge also said he is advising clients to wait for future issuances to get the best deal.

"It's not unreasonable that the spread between NGNs and Ginnie Mae CMO floaters will widen as the months go by as the demand for the paper gets filled," he said.

According to Barclays investor marketing materials, both the floating and fixed-rate notes in the initial issuance are backed by U.S. Central-owned, private label residential mortgage-backed securities. All will mature Oct. 7, 2020. Denominations of the offering will be $10,000 each.

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New View

(Continued from page S-3)

der to recover corporate losses. Both scenarios could result in systems no longer regulated by the NCUA, which Bonds said poses a threat to consumers.

"Everybody wants their hands in U.S. Central's payment system platform for different reasons," he said. "Everybody believes they can do it better, and I don't think there is any mischievousness involved here; however, its crucial payment systems remain in the hands of a regulated entity. When NCUA is not in control of payment systems that touch consumers, you have to wonder what they're there for."

BUTKE

Bonds did say he "has a lot of confidence in the people sitting around that [NCUA] boardroom table."

Murray anticipated future plans for U.S. Central to be released within the next 90 days, and resolution of U.S. Central's core services within six months.

THE REST OF $3 BILLION CLUB

Close behind Corporate America and Mid-Atlantic are three corporates with approximately $3 billion in assets: Corporate One FCU, Southeast Corporate FCU and Central Corporate Credit Union.

Corporate One, which fell from $3.4 billion in assets in July to just under $3 billion as of August 31, will ride a wave of robust earnings into the future, CEO Lee Butke told Credit Union Times. Corporate One reported a nearly 1% retained earnings ratio as of Aug. 31 and currently earns approximately $1 million per month, which Butke said covers 80% of operating expenses.

"When we think back upon the rhetoric of what was right and wrong with corporates, if you aren't covering your expenses with fee income, you'll be forced to take risk on your balance sheet. There are only two sides to that equation," he said.

Corporate One's brokerage service is a big fee producer and, Butke said, any modern corporate should have a good brokerage offering. The Columbus, Ohio-area corporate, which pioneered the popular SimpliCD service, currently has $1.5 billion in outstanding off-balance sheet assets under management.

"This new NCUA model says corporates should be good off-sheet asset managers, and we already do that," he said.

Corporate One is also benefitting from embracing technology before the economy crashed by making "tough decisions" soon after Check 21 was introduced, eliminating paper processing from its product line.

"We use a lot of technology to make ourselves efficient," he said. "We build and make things, adapt and modify tools already available in the market place, and it's reflected in our efficiency numbers. These things are already bought and paid for."

Butke said he hears a lot of challenges to the corporate system to improve efficiency.

"That's a promise our current members already know we can deliver," he said.

While Corporate One does have private label securities still on its books, Butke said Clayton modeling has already taken aggressive write-downs on losses, and $1 million per month in core earnings "goes a long way" to cover OTTI exposure. Additionally, many private label investments held by Corporate One are performing well.

"The real definition of legacy assets has to do with terms like mezzanine and option-adjusted ARMs," he said. "Just because it's private doesn't mean it's bad."

Butke said an Oct. 14 meeting with Scott Hunt, NCUA's director of the office of corporate credit unions, boosted his confidence that the NCUA will allow Corporate One to continue to manage its private label securities rather than sell them immediately at a loss.

Corporate One has some interest in acquiring Constitution Corporate's assets, Butke said, but not if such an acquisition would dilute his corporate's efficiency or capital. "We owe that to our current members," he said.

Top Questions

(Continued from page S-4)

6. Are you in a position to generate sufficient earnings to build the capital necessary under the new corporate regulation and can you still be competitive in your pricing?

7. If you do not raise the necessary capital to comply with the new regulation, what is your fall back plan?

8. Do you have skilled investment and risk management professionals on staff to remain in compliance with the new regulation but still provide top quality products and services at a competitive price?

9. Do you have the infrastructure in place with regards to technology, risk management, modeling, investment, brokerage, etc. to create real value in the future, and how do you plan to pay for this infrastructure going forward?

10. Do you have the skill and credibility to continue to bring new business and conversions to your products sufficient to remain a long-term player in the corporate credit union network and how can you validate this?

The bottom line is, while there were some who predicted that the entire corporate system would fail and all 27 corporates would be put into conservatorship well before now, a number of corporates have come through this debacle un-conserved and undeterred. They plan to be survivors, perhaps even thrive under the new corporate regulation. Whether their plans come to fruition will be determined by natural person credit unions that either bring them their business and investments–or not. The future of the corporate network is in the hands, not of the regulator, but of the natural person credit unions of America.

CUs need to do their homework and make the best decision for their institution. It is quite likely that there will indeed be corporates that survive and even prosper in the new environment. Note that of the 22 corporates that were not conserved by the NCUA, several never impaired any member capital.

Remember that corporate credit unions were originally created because the banking industry and others did not want to serve natural person credit unions. A real concern exists among many credit unions about losing the internal industry option that corporates provide and being totally at the mercy of competitors for a significant number of essential services.

Without question, all options should be carefully considered and the time is now to do so. We are encouraging our clients to begin the serious due diligence process now and to be open to all possibilities for the services they need. But every credit union should be mindful that, as a result of NCUA's recent action on legacy assets and the new corporate rule, the corporate option should not been taken off of the table. A corporate relationship may not be right for every CU going forward, but automatically discounting the potential value of a revitalized and capitalized corporate system may not be wise either. Ask the tough questions. If the corporate soliciting your business cannot answer them satisfactorily, move on. However, if the corporate can meet your needs but needs your support and commitment to do so, it would not be a good business decision to say no if indeed there is more value to your individual credit union by saying yes.