



CREDIT WORTHINESS

FINANCIAL SOUNDNESS REPORT

VOLUME 11, ISSUE 4

FOURTH QUARTER 2010 REPORT

Retain this report as part of the credit analysis under Regulation 703

Executive Summary

Missouri Corporate Credit Union's (MCCU) Credit Worthiness Report is published quarterly. It is intended to provide member credit unions with current information on the financial soundness of MCCU and to help you in meeting regulatory requirements.

As noted in MCCU's previous 2010 quarterly *Credit Worthiness Reports* and in the 2010 audited financial statements (for more information: www.mocorpcu.coop), MCCU has suffered losses resulting from the depletion of its investments in U.S. Central Corporate Federal Credit Union (U.S. Central) that have left MCCU with very little retained earnings and capital ratios below the regulatory minimum required levels, similar to other corporate credit unions in the United States. On September 24, 2010, the NCUA approved new regulations which would allow MCCU and other corporate credit unions to operate with capital levels below the current required capital levels, with plans for increasing capital in future years.

Even though MCCU's capital is less than the regulatory minimum, the manner in which the funds are matched and invested well positions MCCU to meet the liquidity demands of its member credit unions.

Here is a recap of the financial highlights for the fourth quarter:

❑ **Assets remained fairly constant** throughout the fourth quarter of 2010. Members' overnight borrow-

ings from MCCU had a see-saw effect in the first and third months of the fourth quarter and picked up at the end of the October at \$2,951,162 while term loans remained unchanged.

❑ **Capital – on the rise!** Total capital consists of \$798,612 in Retained Earnings and \$23,376,504 in Membership Shares as of December 31, 2010. Total capital ratio of 3.77% at the end of the fourth quarter was slightly higher than the 3.25% as of September 30, 2010.

❑ **Earnings for the fourth quarter were higher** due to a change in accounting for investment in a CUSO from the cost method to the equity method. The interest rate environment continued to remain uncharacteristically low and has caused further compression on spread. Net income for the year ended December 31, 2010 of \$798,612, was comparable to the same period as last year of \$789,841, when excluding the \$34,428,034 U.S. Central depletion and the \$146,690 NCUSIF stabilization expense.

❑ **Conservative investment strategies** continue to minimize MCCU's interest rate risk. As noted in Table 1, MCCU's NEV ratio for the month ended December 31, 2010, was 4.557% compared to the regulatory minimum of 2.00%. Shocking the portfolio up or down 300 basis points (*bps*) generated a maximum projected decline of only -8.691%. The regulatory maximum is 15.00%.

Assets Decrease

Assets decreased by 44.1% in the fourth quarter of 2010 compared to the same period last year. As of December 31, 2010, assets were \$501,014,375 compared to \$526,413,519 for the third quarter of 2010, a decline of 4.8%.

Due to potential big swings in total assets from month to month, corporate credit unions use moving daily average net assets (*MDANA*) as the denominator in most of the

TABLE 1

INTEREST RATE RISK

Interest Rate Scenario	NEV \$	% Change From Base	NEV Ratio %
+ 300 bps	22,086,945	- 8.691	4.211
Base	24,189,164	0.000	4.557
- 300 bps	24,189,164	0.000	4.557

capital ratios. Therefore, a lower MDANA will generate higher capital ratios. The overall decline in 2010 was intentional as MCCU stopped paying interest on its Overnight Account on May 1st with the desire to shrink the balance sheet and build retained earnings.

The respective month's DANA continued to plummet over the past seven months while the 12-month MDANA also trended downward. December 2010's DANA, decreased by \$366,391,392 or 42.8% compared to the same period last year, while December 2010's MDANA decreased by \$311,384,050 or 32.7% compared to December 2009.

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TABLE 2

	INVESTMENTS				
	Dec-10	Sep-10	Jun-10	Mar-10	Dec-09
U.S. Central Bridge Corporate FCU:					
Daily and Overnight Shares	6.7%	14.7%	13.6%	26.7%	14.0%
Community Investment Fund	1.1	1.1	1.1	0.9	0.7
Other Floating Rate Certificates	11.7	12.3	12.0	10.8	11.7
Fixed Term Certificates	41.6	49.3	52.0	41.2	48.5
Other:					
Interest Bearing Deposits	24.8	14.0	12.5	15.5	21.4
Shares & Share Certs of other fin inst	1.0	0.5	0.5	0.4	0.3
HTM – Agency Securities	0.0	0.0	0.0	0.2	0.4
AFS – Agency Securities	13.1	8.1	8.3	4.3	3.0
Asset Backed Securities	0.0	0.0	0.0	0.0	0.0
	100.0%	100.0%	100.0%	100.0%	100.0%

Asset/Liability Management

Under NCUA Regulation 704, which governs the operation of corporate credit unions, MCCU operates under the “Base” level of authority. “Base” level corporates are restricted to the most conservative Asset/Liability Management parameters outlined in the regulation.

Conservative Investment Strategy Limits Exposure to Interest Rate Changes

MCCU has long followed a conservative approach to investing. Investments made in MCCU by its member credit unions are closely matched in similar investments with the same maturity and options. Table 2 provides detail on MCCU’s investment portfolio over the last five quarters. Based on the NCUA’s desire to maintain liquidity within the corporate network so as not to put U.S. Central in a position to sell some of its toxic assets and recognize realized losses, MCCU kept the majority of its investable funds at U.S. Central during 2009.

In the latter part of 2009, MCCU began to invest in Agency Securities, of which approximately \$24,700,000 were pledged as collateral to the Federal Reserve Bank of St. Louis, in accordance with the daily settlement agreement therewith. MCCU does not hold any toxic assets (“legacy assets”) and therefore, does not expect to gen-

erate any future losses related to investments. MCCU’s Agency Securities classified as “available-for-sale” are subject to mark-to-market adjustments as part of the equity section within the Balance Sheet. As such, there is a line item on MCCU’s financial statements for Accumulated Other Comprehensive Income which is entirely comprised of unrealized gains and losses on available-for-sale securities.

NCUA Regulation 704.8 limits corporates to a minimum NEV Ratio of 2.00%. For “Base” level corporates, the NEV cannot decline more than 15.00% when the portfolio undergoes an interest rate shock test of plus or minus 300 bps.

The NCUA defines NEV as “the fair value of assets minus the fair value of liabilities.” The NEV ratio is calculated by dividing NEV by “the fair value of assets.” MCCU’s base case NEV for the month ended December 31, 2010, was \$24,189,164 or 4.557% compared to \$24,417,007 or 4.518% as of September 30, 2010 (see Table 1). There is a moderate change in MCCU’s NEV Ratio when the portfolio is shocked up or down 300 bps. The regulation limits the decline to 15.00%, and in MCCU’s case, the maximum projected decline is –8.691%. This percentage change has fluctuated as MCCU continues to look for investment opportunities outside of U.S. Central.

MCCU Capital

NCUA Regulation 704 allows corporate credit unions to include as capital their Reserves, Undivided Earnings and Membership Shares, provided Membership Shares have a minimum three (3) year withdrawal notice. Since MCCU’s membership shares have a three-year notice requirement, they can be counted as capital under the regulation. In June, October and December of 2009, and in October 2010, MCCU received such notices of withdrawal from members, some of which related to mergers at the member credit union level, and have begun to amortize their respective Membership Shares in compliance with the regulations. The amortized portion of Membership Shares is no longer counted towards capital. The amortized amounts continue to share in the same risks as Membership Shares that have not been put on notice.

As of December 31, 2009, MCCU had depleted all of its capital investment in U.S. Central which totaled \$43,949,882. As a result, all of MCCU’s Reserves, Undivided Earnings, Members’ Paid-in Capital and approximately 10% of Membership Capital Share Deposits were needed to offset the losses recorded at the end of 2008 and throughout 2009.

As of December 31, 2010, MCCU had \$798,612 in Undivided Earnings and \$23,376,504 in Membership Capital Share Deposits. Total capital therefore was \$24,175,116. As noted previously, because the assets of corporate credit unions tend to fluctuate significantly, corporate credit unions’ capital-to-asset ratios are calculated using a twelve (12) month “moving” DANA formula. Using this regulatory formula, MCCU’s capital-to-asset ratio as of December 31, 2010, was 3.77%, which was slightly higher than the previous quarter’s 3.25%.

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TABLE 3

MISSOURI CORPORATE CREDIT UNION BALANCE SHEET

	(audited)		(unaudited)
	December 31, 2010	2009	September 30, 2009
ASSETS			
Cash & Uncollected Deposits	\$ 21,774,888	\$ 27,057,132	\$ 24,020,108
Loans, Net of Participations Sold	6,178,975	8,499,953	8,592,519
Investments:			
Interest Bearing Deposits	116,632,877	183,973,613	68,697,596
U.S. Central FCU	287,825,029	642,603,968	380,564,398
HTM – Outside U.S. Central FCU	—	3,600,000	—
AFS – Outside U.S. Central FCU	61,676,320	25,426,815	39,699,134
Other	5,236,534	2,597,000	2,845,000
Total Investments	<u>471,370,760</u>	<u>858,201,396</u>	<u>491,806,128</u>
Other Assets	1,689,752	2,797,224	1,994,764
TOTAL ASSETS	<u>\$ 501,014,375</u>	<u>\$ 896,555,705</u>	<u>\$ 526,413,519</u>
LIABILITIES & MEMBERS' EQUITY			
Liabilities:			
Future Dated Deposits	\$ 21,134,109	\$ 26,313,497	\$ 23,909,951
Other Liabilities	1,086,979	2,004,996	1,358,630
Total Liabilities	<u>22,221,088</u>	<u>28,318,493</u>	<u>25,268,581</u>
Members' Equity:			
Daily Shares	217,505,213	381,864,016	188,726,365
Share Certificates	236,649,000	462,388,824	287,882,107
Membership Shares, Amortized Portion	681,053	117,935	483,126
Total Shares	<u>454,835,266</u>	<u>844,370,775</u>	<u>477,091,598</u>
Membership Shares, Net of Amortization	23,376,504	23,939,622	23,574,431
Reserves	—	—	—
Undivided Earnings	798,612	—	479,240
Paid-in Capital	—	—	—
Total Capital	<u>24,175,116</u>	<u>23,939,622</u>	<u>24,053,671</u>
Accumulated Other Comprehensive Income	(217,095)	(73,185)	(331)
Total Members' Equity	<u>478,793,287</u>	<u>868,237,212</u>	<u>501,144,938</u>
TOTAL LIABILITIES & MEMBERS' EQUITY	<u>\$ 501,014,375</u>	<u>\$ 896,555,705</u>	<u>\$ 526,413,519</u>

NCUA informed the corporates on April 29, 2009, that their respective capital ratios as of November 30, 2008 will be used for purposes such as computing member credit unions' lines of credit and determining earnings retention requirements. MCCU's capital ratios as of November 30, 2008 were as follows:

- Retained Earnings Ratio 3.39%
- Core Capital Ratio 4.45%
- Total Capital Ratio 7.34%

Since the Retained Earnings Ratio as of November 30, 2008 was above 2.00%, MCCU is not subject to the earnings retention requirement even after recording the U.S. Central capital depletion. The November 30, 2008 capital ratios will sunset at the one-year anniversary of the final corporate regulation (*i.e.*, October 20, 2011).

On November 19, 2009, NCUA proposed new regulations which would allow MCCU and other corporate credit unions to operate with capital levels below the current required capital levels, with plans for increasing capital in future years. On September 24, 2010, the NCUA issued final corporate regulations which establish three standards that a corporate credit union must satisfy in order to meet its capital requirement: a leverage ratio of 4.0%, a tier 1 risk-based capital ratio of 4.0% and a total risk-based capital ratio of 8.0%. The final corporate regulation phases in these requirements over time with milestones at the one-year, three-year, six-year and ten-year anniversary of the date published in the Federal Register (*i.e.*, October 20, 2010).

In order to comply with these final capital requirements, MCCU will need to minimize dividend payments, raise additional capital and/or raise fees on products and services. On the expense side, MCCU has always operated in a very lean manner and has always enjoyed low operating expenses compared to other corporate credit unions. MCCU management plans to continue to monitor operating expenses, but with expenses already as low as they are, cutting expenses beyond what has already been cut may not be an option.

Also on September 24, 2010, the NCUA announced its plan to isolate those non-agency residential mortgage-backed securities on conserved corporate credit unions' balance sheets that in essence would shield member credit unions' new capital from future actions (*i.e.*, other than temporarily impaired (OTTI) losses). **As of December 31, 2010, MCCU did not hold any such assets in its investment portfolio.**

Conservative Investment Portfolio

As of December 31, 2010, 61.1% of MCCU's investments were in U.S. Central Bridge. The remaining 38.9% was invested in overnight interest-bearing deposits at the Federal Reserve Bank of St. Louis, Agency Securities and certificates of deposit with other financial institutions (*SimpliCD*). Within U.S. Central, MCCU's investments consist of 41.6% in term certificates, 11.7% in floating rate certificates, 6.7% in Overnight Accounts, and 1.1% in Community Investment Funds (*see Table 2*).

U.S. Central

As part of the NCUA Board's plan to resolve ongoing problems with a handful of corporate credit unions and to reform the corporate system under a stronger regulatory framework, the NCUA finalized the new corporate regulation, announced its plan to deal with "legacy assets"

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and established bridge corporate credit unions to conduct essential activities of the conserved corporate credit unions to facilitate payment and settlement services. On October 1, 2010, U.S. Central was converted to U.S. Central Bridge Corporate Federal Credit Union (*U.S. Central Bridge*).

NCUA stated that bridge corporate credit unions have a limited life of 24 months so as to allow for uninterrupted services during this transition period. Under the final corporate rule, the three-tiered system within the credit union movement (*with U.S. Central Bridge and the concept of a wholesale corporate credit union will no longer exist by September 30, 2012*). No assurance can be provided that the period of existence for any bridge corporate credit union may be shorter than 24 months.

Since MCCU's capital in U.S. Central has been totally depleted by the end of 2009, MCCU is not subject to any further OTTI investment losses in U.S. Central Bridge's portfolio.

Earnings Consistent With Low Rate Environment

MCCU's net earnings for the year ended December 31, 2010, were \$798,612 or \$34,583,495 more than the same period last year (see Table 4). Excluding the U.S. Central capital depletion of \$34,428,034 and the NCUSIF Replenishment of \$146,690 from prior period net income, the net earnings for the year of 2010 were \$8,771 or 1.1% more than the same period last year. Net interest

TABLE 4

MISSOURI CORPORATE CREDIT UNION INCOME STATEMENT

	For The Year Ended December 31,	
	2010	2009
Loan Income	\$ 606,492	\$ 1,133,808
Investment Income	6,341,563	12,470,794
Total Interest Income	6,948,055	13,604,602
Interest & Dividend Expense	5,136,185	11,415,632
Net Interest Income	1,811,870	2,188,970
Net Realized Gains (Losses) on Financial Instruments	295,370	194,657
Depletion of U.S. Central Corporate FCU Capital	—	(34,428,034)
Operating Expenses	2,179,911	2,401,122
Fee & Other Income	562,749	660,646
Equity in Earnings from CUSO	308,534	—
Net Income (Loss)	\$ 798,612	\$ (33,784,883)

income for the year ended December 31, 2010, was \$377,100 less than for the same period in 2009, and operating expenses were less by \$221,211. Fee income and other income were down \$97,897 compared to last year's numbers (*primarily due to NCUSIF pass-back and recapitalization recorded as Other Income in June 2009*). MCCU changed accounting for its investment in a corporate CUSO from the cost method to the equity method in December 2010. As such, MCCU recognized \$308,534 in income as its pro-rata share of the CUSO's earnings. Going forward, MCCU will record its pro-rata share of CUSO's earnings on a monthly basis. Management continues to monitor operating expenses.

The cost-of-funds as a percentage of interest income averaged 73.9%

for the year ended December 31, 2010. This is lower than the 83.9% for the same period in 2009 due to management and the board's desire to begin to rebuild retained earnings in order to comply with certain milestones regarding earnings within three, six and ten years after issuance of the final rule.

Loan Demand Decreased

Loan demand for overnight borrowings were light, but fairly consistent in the beginning of the fourth quarter of 2010 and increased somewhat at the end of October, while term loans remained unchanged. The total loans of \$6,178,975 as of December 31, 2010 were 27.3% lower than the same period last year.

In order to better match liquidity needs and build retained earnings, MCCU began charging two basis

TABLE 5

MISSOURI CORPORATE CREDIT UNION STATEMENT OF RESERVES, UNDIVIDED EARNINGS AND PAID-IN CAPITAL

	Reserves	Undivided Earnings	Paid-in Capital	Accumulated	
				Other Comprehensive Income	Total
Balance as of December 31, 2009	\$ —	\$ —	\$ —	\$ (73,185)	\$ (73,185)
Net Income	—	798,612	—	—	798,612
Change in valuation of AFS debt securities	—	—	—	(143,910)	(143,910)
Balance as of December 31, 2010	\$ —	\$ 798,612	\$ —	\$ (217,095)	\$ 581,517

TABLE 6

MISSOURI CORPORATE CREDIT UNION
INVESTMENTS OUTSIDE U.S. CENTRAL – DETAIL DECEMBER 31, 2010

	Maturity Date	Rating	CUSIP	Par Value	Amortized Cost	Fair Value
Investment Securities – HTM						
				\$ —	\$ —	\$ —
				\$ —	\$ —	\$ —
Investment Securities – AFS						
FFCB	12/09/11	AAA	31331G6D6	2,000,000	2,000,000	2,009,196
FHLB	01/19/11	AAA	3133XWQ28	5,000,000	5,000,149	5,000,387
FHLB	02/01/13	AAA	3133XWR84	2,000,000	2,000,000	2,002,014
FFCB	03/30/15	AAA	31331JJJ3	700,000	698,634	703,274
FHLB	07/18/14	AAA	313371A55	200,000	200,000	197,455
FFCB	10/19/15	AAA	31331JT45	3,000,000	3,000,000	2,930,217
FHLB FLOAT	10/26/18	AAA	313371JJ6	10,000,000	10,000,000	9,999,901
FHLB	10/27/15	AAA	313371DL7	3,500,000	3,500,000	3,436,045
FCCB	10/25/13	AAA	31331JV67	2,000,000	2,000,000	1,983,144
FHLB	11/24/14	AAA	313371NR3	3,500,000	3,500,000	3,447,556
FHLB	11/15/12	AAA	313371K96	2,000,000	1,999,532	1,994,504
FFCB	12/01/14	AAA	31331J3D3	2,000,000	1,995,099	1,983,123
FHLMC	12/03/12	AAA	3134G1ZN7	3,000,000	3,000,000	2,994,927
FHLB	12/22/15	AAA	3133722L7	3,000,000	3,000,000	2,983,251
FNMA VAR	12/03/12	AAA	31398A6V9	10,000,000	10,000,000	9,999,997
FNMA	12/30/13	AAA	31398A7A4	8,000,000	8,000,000	8,006,181
FNMA	12/30/13	AAA	3136FPY92	2,000,000	2,000,000	2,005,148
				61,900,000	61,893,415	61,676,320
				\$ 61,900,000	61,893,415	61,676,320

CREDIT WORTHINESS

FINANCIAL SOUNDNESS REPORT

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2055 Craigshire Drive
St. Louis, MO
63146-4009

Phone: 1-800-826-5228
Fax: 1-314-542-1347
www.mocorpcu.coop

Chris McCreary
Chairman

Ron Miller
Secretary-Treasurer and
ALCO Committee Chairman

Dennis J. DeGroot
President/CEO

For more information concerning
the contents of this report
call: 1-800-826-5228

points, annually, on members' line of credit amount at the end of January 2011. In anticipation of the new fee, members reduced their lines of credit from a high of \$861 million in November 2010 to \$353 million in January 2011.

Should the need for liquidity arise, MCCU has in place two sources; a \$175,000,000 advised line-of-credit with U.S. Central Bridge and a \$100,000,000 Federal Funds

discretionary line of credit with an unaffiliated financial institution which is fully guaranteed under the Temporary Corporate Credit Union Liquidity Guarantee Program (TCCULGP). Due to the direct matching strategy employed for investments, MCCU's investment maturities match their corresponding liabilities – which further enhance MCCU's liquidity position.

REQUIRED CREDIT ANALYSIS UNDER REGULATION 703

"Except for investments that are issued or fully guaranteed as to principal and interest by the U.S. government or its agencies, enterprises, or corporations or fully insured (including accumulated interest) by the National Credit Union Administration or the Federal Deposit Insurance Corporation, you must conduct and document a credit analysis of the issuing entity and/or investment before you purchase the investment. You must update the analysis at least annually as long as you hold the investment."

Retain this report as part of the credit analysis required under regulation 703

Reviewed by: _____ Date Reviewed: _____

Comments: _____

