



CREDIT WORTHINESS

FINANCIAL SOUNDNESS REPORT

VOLUME 11, ISSUE 3

THIRD 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 2009 audited financial statements (click here www.mocorpcu.coop) MCCU has suffered losses resulting from the depletion of its investments in U.S. Central 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. The NCUA issued new final regulations on September 24, 2010 to allow MCCU and other corporate credit unions to operate under new capital levels they would have to meet within one year after the final rule's publication in the Federal Register (i.e., October 20, 2011).

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 third quarter:

❑ **Assets intentionally declined** throughout the third quarter of

2010. Members' overnight borrowings from MCCU were consistent in the first and third months of the third quarter and picked up significantly at the end of the August at \$9,429,940 while term loans remained unchanged.

❑ **Capital – a bit on the rise!** Total capital consists of \$479,240 in Retained Earnings and \$23,574,431 in Membership Shares as of September 30, 2010. Total capital ratio of 3.25% at the end of the third quarter was slightly higher than the 2.88% as of June 30, 2010.

❑ **Earnings for the third quarter were stable** considering how interest rates continued to remain uncharacteristically low and have caused further compression on spread. Net income for the nine months ended September 30, 2010 of \$563,696, excluding the \$84,456 NCUSIF expense accrual, was significantly less than the same period as last year of \$737,201, then when excluding the \$31,204,206 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 September 30, 2010, was 4.518% 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 - 6.299%. The regulatory maximum is 15.00%.

Assets Decrease

Assets decreased by 42.5% in the third quarter of 2010 compared to the same period last year. As of September 30, 2010, assets were \$526,413,519 compared to \$576,506,824 for the second quarter of 2010, a decline of 8.7%.

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 capital

TABLE 1

INTEREST RATE RISK

| Interest Rate Scenario | NEV \$ | % Change From Base | NEV Ratio % |
|------------------------|------------|--------------------|-------------|
| + 300 bps | 22,879,034 | - 6.299 | 4.282 |
| Base | 24,417,007 | 0.000 | 4.518 |
| - 300 bps | 24,417,007 | 0.000 | 4.518 |

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 four months while the 12-month MDANA also trended downward. September 2010's DANA, decreased by \$356,417,966 or 40.0% compared to the same period last year, while September 2010's MDANA decreased by \$191,977,739 or 20.6% compared to September 2009.

continued on page 2

continued from page 1

TABLE 2

INVESTMENTS

| | Sep-10 | Jun-10 | Mar-10 | Dec-09 | Sep-09 |
|--|--------|--------|--------|--------|--------|
| U.S. Central Federal Credit Union: | | | | | |
| Daily and Overnight Shares | 14.7% | 13.6% | 26.7% | 14.0% | 28.8% |
| Federal Funds Overnight | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Community Investment Fund | 1.1 | 1.1 | 0.9 | 0.7 | 0.7 |
| Member Paid-In Capital | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Membership Capital Shares | 0.0 | 0.0 | 0.0 | 0.0 | 0.4 |
| Other Floating Rate Certificates | 12.3 | 12.0 | 10.8 | 11.7 | 10.3 |
| Indexed Amortizing Certificates | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Fixed Term Certificates | 49.3 | 52.0 | 41.2 | 48.5 | 59.0 |
| Other: | | | | | |
| Interest Bearing Deposits | 14.0 | 12.5 | 15.5 | 21.4 | 0.5 |
| Shares & Share Certs of other fin inst | 0.5 | 0.5 | 0.4 | 0.3 | 0.3 |
| HTM – Agency Securities | 0.0 | 0.0 | 0.2 | 0.4 | 0.0 |
| AFS – Agency Securities | 8.1 | 8.3 | 4.3 | 3.0 | 0.0 |
| 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, all of which are 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 generate 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 September 30, 2010, was \$24,417,007 or 4.518% compared to \$24,327,968 or 3.502% as of June 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 –6.299%. 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, MCCU received such notices of withdrawal from members, mostly 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 September 30, 2010, MCCU had \$479,240 in Undivided Earnings and \$23,574,431 in Membership Capital Share Deposits. Total capital therefore was \$24,053,671. As noted previously, because the assets of corporate credit unions tend to fluctuate significantly, corporate credit unions’ capital-to-asset ratios

continued on page 3

continued from page 2

TABLE 3

MISSOURI CORPORATE CREDIT UNION
BALANCE SHEET

| | (unaudited) September 30, | | (unaudited) June 30, |
|--|------------------------------|-----------------------|-------------------------|
| | 2010 | 2009 | 2010 |
| ASSETS | | | |
| Cash & Uncollected Deposits | \$ 24,020,108 | \$ 22,828,200 | \$ 24,653,456 |
| Loans, Net of Participations Sold | 8,592,519 | 11,738,560 | 7,330,786 |
| Investments: | | | |
| Interest Bearing Deposits | 68,697,596 | 4,587,266 | 67,885,202 |
| U.S. Central FCU | 380,564,398 | 869,956,972 | 426,654,446 |
| HTM – Outside U.S. Central FCU | — | — | — |
| AFS – Outside U.S. Central FCU | 39,699,134 | — | 45,257,805 |
| Other | 2,845,000 | 2,349,000 | 2,845,000 |
| Total Investments | <u>491,806,128</u> | <u>876,893,238</u> | <u>542,642,453</u> |
| Other Assets | 1,994,764 | 3,969,081 | 1,880,129 |
| TOTAL ASSETS | <u>\$ 526,413,519</u> | <u>\$ 915,429,079</u> | <u>\$ 576,506,824</u> |
| LIABILITIES & MEMBERS' EQUITY | | | |
| Liabilities: | | | |
| Future Dated Deposits | \$ 23,909,951 | \$ 22,054,011 | \$ 23,886,777 |
| Borrowings Under Reverse Repo | — | — | — |
| Other Liabilities | 1,358,630 | 3,553,199 | 1,280,847 |
| Total Liabilities | <u>25,268,581</u> | <u>25,607,210</u> | <u>25,167,624</u> |
| Members' Equity: | | | |
| Daily Shares | 188,726,365 | 307,623,933 | 197,617,751 |
| Share Certificates | 287,882,107 | 554,969,191 | 329,163,366 |
| Membership Shares, Amortized Portion | 483,126 | 7,750 | 366,455 |
| Total Shares | <u>477,091,598</u> | <u>862,600,874</u> | <u>527,147,572</u> |
| Membership Shares, Net of Amortization | 23,574,431 | 26,682,650 | 23,691,102 |
| Reserves | — | — | — |
| Undivided Earnings | 479,240 | — | 442,867 |
| Paid-in Capital | — | 538,345 | — |
| Total Capital | <u>24,053,671</u> | <u>27,220,995</u> | <u>24,133,969</u> |
| Accumulated Other Comprehensive Income | (331) | — | 57,659 |
| Total Members' Equity | <u>501,144,938</u> | <u>889,821,869</u> | <u>551,339,200</u> |
| TOTAL LIABILITIES & MEMBERS' EQUITY | <u>\$ 526,413,519</u> | <u>\$ 915,429,079</u> | <u>\$ 576,506,824</u> |

are calculated using a twelve (12) month "moving" DANA formula. Using this regulatory formula, MCCU's capital-to-asset ratio as of September 30, 2010, was 3.25%, which was slightly higher than the previous quarter's 2.88%.

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.

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%.

As noted in the previous Credit Worthiness Report, the NCUA Board has indicated its understand-

ing that the proposed amendments to the capital regulations are complex and that many corporate credit unions would not meet the targets upon issuance of the final regulation. Instead of an immediate implementation, the NCUA has allowed a phase-in of the new capital requirements over a ten-year period of time. 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 September 30, 2010, MCCU did not hold any such assets in its investment portfolio.**

Conservative Investment Portfolio

As of September 30, 2010, 77.4% of MCCU's investments were in U.S. Central. The remaining 22.6% 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 49.3% in term certificates, 14.7% in Overnight Accounts, 12.3% in floating rate certificates, and 1.1% in Community Investment Funds (see Table # 2).

continued on page 4

U.S. Central Analysis

As a pass-through corporate, MCCU has a large percentage of its funds in U.S. Central and therefore, a credit worthiness analysis of MCCU should include a review of U.S. Central's financial performance. However, 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's portfolio. The latest financial statements for U.S. Central may be found at www.uscentral.org.

Earnings Consistent With Low Rate Environment

MCCU's net earnings for the nine months ended September 30, 2010, were \$479,240 or \$31,092,935 more than the same period last year (see Table # 4). Excluding the U.S. Central capital depletion of \$31,204,206 and the NCUSIF Replenishment of \$146,690 from prior period net income, and excluding the \$84,456 NCUSIF accrual from current net income, the net earnings for the nine months of 2010 were \$173,506 or 23.5% less than the same period last year. Net interest income for the nine months ended September 30, 2010, was \$245,953 less than for the same period in 2009, and operating expenses were less by \$155,252 (primarily due to NCUSIF Replenishment expense incurred in March 2009). Fee income and other income were down \$118,107 compared to last year's numbers (primarily due to NCUSIF pass-back and recapitalization

TABLE 4

MISSOURI CORPORATE CREDIT UNION INCOME STATEMENT

| | For The Nine Months Ended September 30, | |
|---|---|------------------------|
| | 2010 | 2009 |
| Loan Income | \$ 564,427 | \$ 927,403 |
| Investment Income | 5,232,075 | 9,883,321 |
| Total Interest Income | 5,796,502 | 10,810,724 |
| Interest & Dividend Expense | 4,346,815 | 9,115,084 |
| Net Interest Income | 1,449,687 | 1,695,640 |
| Net Realized Gains (Losses) on Financial Instruments | 290,449 | 192,912 |
| Depletion of U.S. Central Federal C.U. Capital | — | (31,204,206) |
| Operating Expenses | 1,675,256 | 1,830,508 |
| Fee & Other Income | 414,360 | 532,467 |
| Net Income (Loss) | \$ 479,240 | \$ (30,613,695) |

recorded as Other Income in June 2009). Management continues to monitor operating expenses.

The cost-of-funds as a percentage of interest income averaged 75.0% for the nine months ended September 30, 2010. This is lower than the 84.3% for the same period in 2009 due to management and the board's desire to begin to rebuild retained earnings in anticipation of a final rule on the proposed corporate Reg. 704, which would require corporate credit unions to reach 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 third quarter

of 2010 and increased significantly at the end of August, while term loans remained unchanged. The total loans of \$8,592,519 as of September 30, 2010 were 40.4% lower than the same period last year.

Should the need for liquidity arise, MCCU has in place two sources; a \$300,000,000 advised line-of-credit with U.S. Central 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.

TABLE 5

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

| | Reserves | Undivided Earnings | Paid-in Capital | Accumulated | Total |
|--|----------|--------------------|-----------------|----------------------------|-------------|
| | | | | Other Comprehensive Income | |
| Balance as of January 1, 2010 | \$ — | \$ — | \$ — | \$ (73,185) | \$ (73,185) |
| Net Income | | 479,240 | | | 479,240 |
| Change in valuation of AFS debt securities | | | | 72,854 | 72,854 |
| Balance as of September 30, 2010 | \$ — | \$ 479,240 | \$ — | \$ (331) | \$ 478,909 |

TABLE 6

MISSOURI CORPORATE CREDIT UNION
INVESTMENTS OUTSIDE U.S. CENTRAL – DETAIL SEPTEMBER 30, 2010

| | Maturity Date | CCUN Investment No. | CUSIP | Par Value | Amortized Cost | Fair Value | |
|------------------------------------|---------------|---------------------|------------|------------|----------------|------------|------------|
| Investment Securities – HTM | | | | | | | |
| | | | | \$ — | \$ — | \$ — | |
| Investment Securities – AFS | | | | | | | |
| | | | | \$ — | \$ — | \$ — | |
| FFCB 1.00 | 12/7/2011 | 12/07/11 | 5100001005 | 31331G4V8 | 3,000,000 | 3,000,000 | 3,003,109 |
| FFCB .875 | 12/9/2011 | 12/09/11 | 5100001004 | 31331G6D6 | 2,000,000 | 2,000,000 | 2,010,777 |
| FHLB .45 | 12/29/10 | 12/29/10 | 5100001008 | 3133XW3U1 | 5,000,000 | 5,000,000 | 4,999,370 |
| FHLB .375 | 01/19/11 | 01/19/11 | 5100001001 | 3133XWQ28 | 5,000,000 | 5,000,912 | 5,002,110 |
| FHLB 2.00 | 07/26/13 | 07/26/13 | 5100001012 | 3133XWQV4 | 2,000,000 | 2,000,000 | 2,010,393 |
| FHLB 1.84 | 02/01/13 | 02/01/13 | 5100001013 | 3133XWR84 | 2,000,000 | 2,000,000 | 2,008,322 |
| FFCB 2.95 | 03/30/15 | 03/30/15 | 0420001004 | 31331JJJ3 | 700,000 | 698,553 | 707,276 |
| FHLB VAR | 04/16/18 | 04/16/18 | 0420001005 | 3133XXW37 | 10,000,000 | 10,000,000 | 10,000,976 |
| FHLB VAR | 04/19/17 | 04/19/17 | 0420001001 | 3133XXWD5 | 10,000,000 | 10,000,000 | 9,956,800 |
| | | | | 39,700,000 | 39,699,465 | 39,699,133 | |
| | | | | 39,700,000 | 39,699,465 | 39,699,133 | |

CREDIT WORTHINESS

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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: _____

