

Town Hall Meetings



SOUTHEAST  CORPORATE

How Did We Get Here?

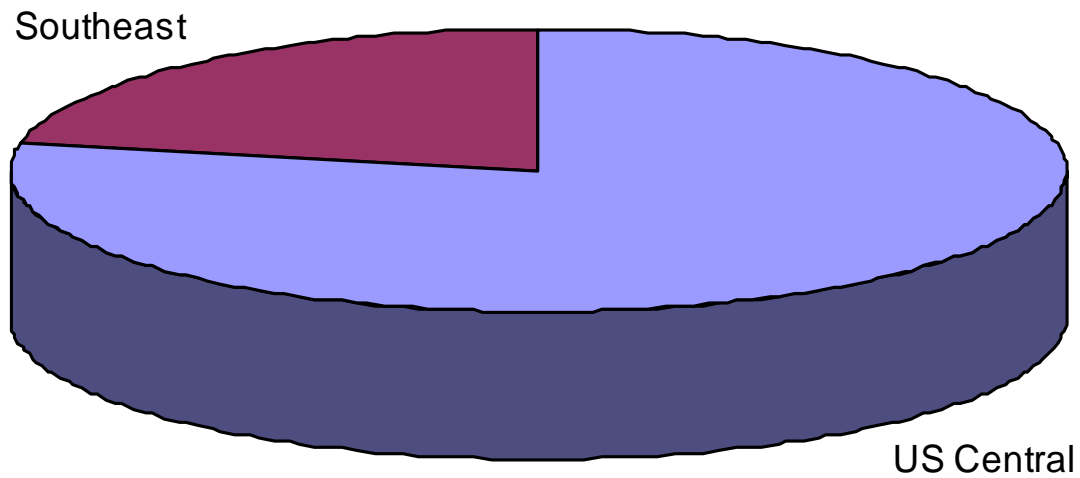
- Worst economic crisis since the Great Depression
- NCUA Conservatorship of U.S. Central and Western Corporate in March 2009
- Southeast lost entire capital investment in U.S. Central, totaling \$130.2 Million
- Despite a conservative investment risk posture, Southeast suffered impairments on its securities portfolio of \$41 Million
- NCUA regulation requires negative retained earnings be replenished from member capital
- Southeast member PIC of \$20.2 Million fully depleted and \$25.0 Million of MCS (approximately 27%)

Impact on Southeast's Capitalization (in Millions)

	<u>Original</u>	<u>12/31/09</u>
RUDE	\$121.0	\$0
PIC	\$20.2	\$0
MCS	\$92.7	\$67.7

Capitalization as of 12/31/09 was impacted by both \$130.2 Million in U.S. Central related charges and \$41 Million from Southeast's PMBS portfolio

Impairment Allocation

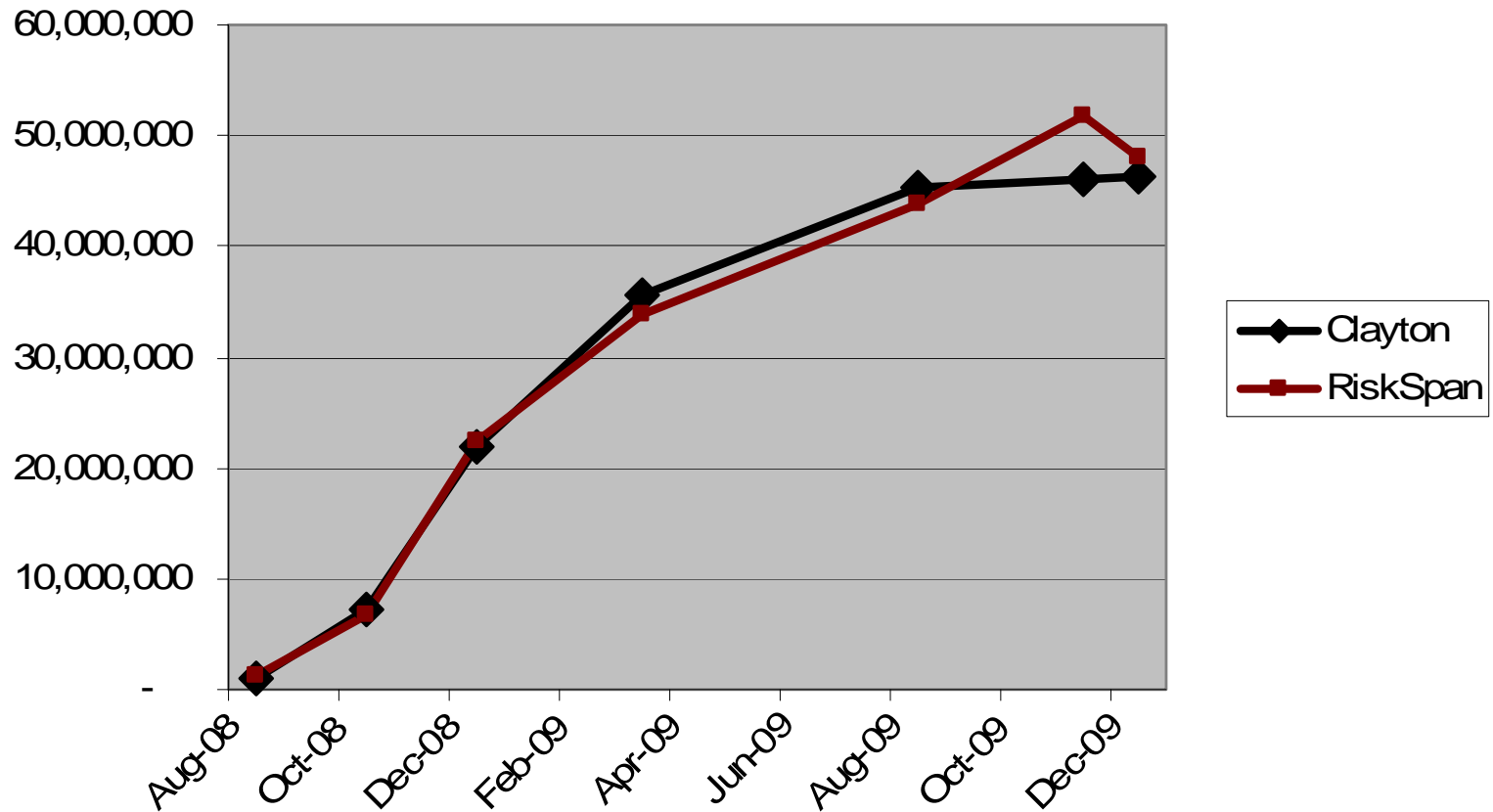


Where We Are Now

- Economic leveling off
 - Expect the worst is behind us now that we have reflected all U.S. Central losses and markets seem to be leveling off
- Our loss projections appear to be flattening according to outside analysis
- \$67.7 Million of Capital Remaining
- Budget has been cut back to 2005 levels

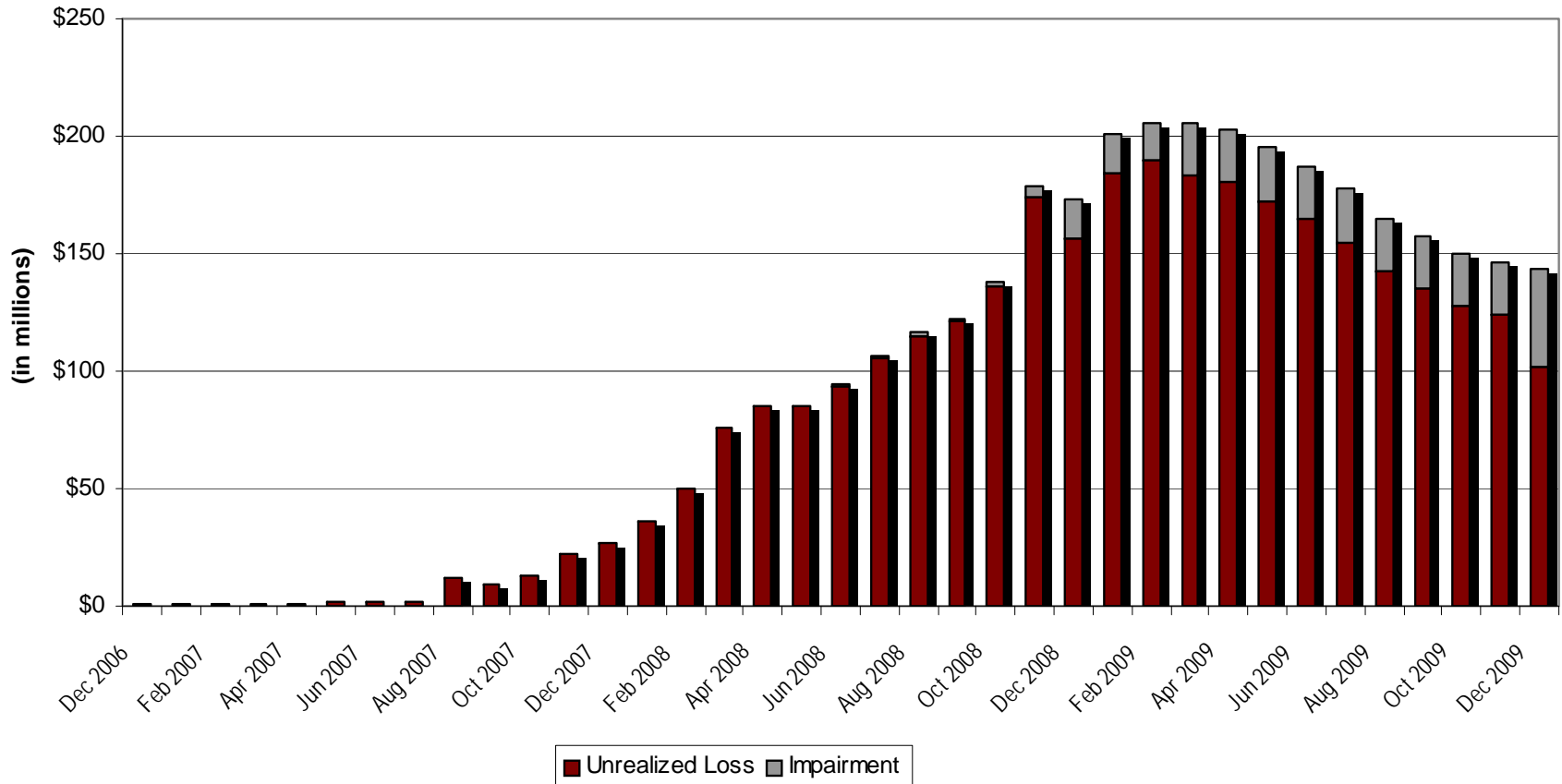
Third Party Portfolio Review

Aggregate Projected Principal Shortfalls



Loss Trends

Southeast Corporate FCU - Unrealized/Realized Losses



An Improving Economy

4th quarter positive economic signs:

- Surprising fourth quarter growth occurred even as inventories are further depleted
- Improved risk asset valuations help improve household and business balance sheets
- Consumer debt capacity improves
- Labor markets are beginning to stabilize



New Proposed Reg. 704

Why the Reg. Matters to YOUR CU

- **Unchanged** it will affect your earnings
- **Unchanged** it will affect your access to liquidity
- **Unchanged** it will affect your access to products & services
- **If changed** credit unions could get some of their depleted capital back
- **If changed** credit unions will remain competitive with banks

Issues with Proposed Regulation 704

- Depletion of Member Capital
- Plan for Legacy Assets
- Building Capital & Retained Earnings
- Early Redemption of Certificates
- Prompt Corrective Action (PCA)
- Credit Risk Management
- CUSO's
- Board Term Limits

Recommendations for Capital Depletion

- **ISSUE:** New Regulation requires permanent depletion of member capital to restore deficit retained earnings
- **RECOMMEND NCUA:** Allow depleted capital to be restored if projected losses ultimately overstate actual losses.

Capital Needs

Total Capital - 3 years after Reg. effective

- *Leverage ratio of 4.0 % or greater;*
- *Tier 1 risk-based capital ratio of 4.0 % or greater*
- *Total risk-based capital ratio of 8.0 % or greater*

Retained Earnings

- *Year 3 - 45 bps*
- *Year 6 – 100 bps*
- *Year 10 – 200 bps*

Contributed Capital

Contributed Capital

- Under New Reg. current MCS has no value as capital
 - Current MCS will be subordinate to PCC
- We will be asking members to convert capital to the new PCC relatively soon
- Without capital conversion Southeast could be under PCA in one year

Plan for Legacy Assets

ISSUE: Handling of the legacy assets

- A substantial issue with major impact that was not addressed in the proposed regulation.
- NCUA states that they will have a plan for handling the legacy assets before the final rule is released.

Building Retained Earnings

ISSUE: Requires 20 bps of earnings per year

- NCUA's earnings model is flawed
 - Model does not incorporate a cost of capital
 - Significant earnings assumed from private label student loan securities
- Accurate modeling takes earnings from 21 basis points to **negative** 3 basis points

Building Retained Earnings

ISSUE: Requires 20 bps of earnings per year

- NCUA's risk constraints are excessive
 - NEV tests for widening credit spreads and prepayment slowdowns
 - A/L weighted average life and duration mismatch constraints
- With current business model, unlikely to earn enough to meet the requirements

Member Impact

Unchanged, new Reg could result in:

- Negative impact to investment rates members can earn
- May significantly impact corporates' ability to meet members' liquidity needs
- Will result in higher fees and lower investment rates for credit unions

RECOMMEND NCUA: Revisit and revise
Asset Liability Management constraints

Member Impact

Early Certificate Redemptions

- Reg. prohibits current practice of redeeming outstanding certificates at a market rate, even if it is at a premium dollar price
 - Reduces competitive investment alternatives for credit unions
 - Penalizes members who may need the liquidity
 - Reduces system liquidity
 - Likely to impact member lines of credit
- **RECOMMEND NCUA:** Retain the current rule for certificate redemptions

Prompt Corrective Action Powers (PCA)

- Significant concerns regarding the level of discretionary supervisory powers implied in the Reg.
- Little guarantee of consistent application regarding what constitutes a “well” or “adequately” capitalized corporate due to level of discretionary authority
- Methods by which NCUA will ensure consistency in its approach to a subjective measurement are not stated.

Credit Risk Management

- Concentration limit is overly restrictive at 25% of capital or \$5 million
- Mid-size and larger corporates will not be able to find enough depository institutions that meet all the Reg's criteria

Credit Risk Management

- **RECOMMEND NCUA:** Alter the 25% single obligor investment limitation & allow a larger limit of 200% of capital on money market transactions with a term of 90-days or less. NCUA could also change this from a “limit” to a “guideline”

Corporate CUSOs

ISSUE: All CUSO's, even existing, must be re-approved by NCUA.

- No phase-in provided to allow existing CUSOs to continue.
- Corporate could be required to suspend the activities of their CUSOs until NCUA permission is received.
- CUs could lose competitive advantage if CUSOs have limited ability to invest in/offer services to support member needs.

RECOMMEND:

- NCUA review all existing corporate CUSOs and identify those who have a sufficient performance record and deem the CUSO's activities permissible, reducing the number needing permission to continue.
- Allow streamlined process for existing CUSOs to qualify as a permissible activity

Board Term Limits

ISSUE: Board terms limited to 6 years

- A stable and long-tenured Board is important as Boards maintain culture, values, and principles.
- It takes time for Board members to thoroughly understand a corporate's operations and govern well.

RECOMMEND: A 12-year term limit instead of 6 years

The Future

- Corporate Value Proposition
- Developing New Business Model
- Meet member needs
 - New ways to distribute best of breed products
- Leverage existing resources

The Future

- Build on Cooperative concept
- Strategic partnerships & collaboration
- Increase efficiencies via economies of scale
 - Shared back office functions
 - Shared new product development

Your Corporate

- Corporates were created to harness the collective strength of members for their mutual benefit.
- Members can continue to receive services from within the credit union movement, from entities they collectively own.

The Future

- A variety of opportunities
- Outsourcing to limit infrastructure costs
- Utilize and share the best of the best
- Strong governance & leadership