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Corporate CU Stabilization Plan's Impact on ASI-insured CUs

As the year began, most credit unions thought it would not likely be any better than 2008; and, many began their cost-cutting initiatives early in 2009. Clearly, few anticipated the magnitude of the losses that swamped the credit union system starting January 28, 2009, when NCUA first announced its risk of loss in the corporate credit union system. Federally insured credit unions were shocked by the amount of the loss -- \$4.7 billion -- and further dismayed by the fact they had to bear such a large charge to already strained net earnings.

Fortunately, the NCUA assessment to recapitalize the NCUSIF (0.51% of insured shares to \$100,000), and the 0.30% premium to be assessed to restore the NCUSIF to 1.30% of insured shares, had no effect on privately insured credit unions.

This remained true until March 20, 2009, when the NCUA Board moved to conserve the nation's two largest corporate credit unions, WesCorp and US Central. This unprecedented action caused the cost of NCUA's corporate credit union stabilization plan to climb to \$5.9 billion; in turn, increasing the total cost to federally insured credit unions by 18 basis points on insured shares to \$100,000, or from 81 basis points to 99 basis points. The cost of this stabilization plan will likely wipe out 2009's projected net earnings for many federally insured credit unions nationwide.

Unfortunately, as a result of the WesCorp conservatorship, all member credit unions must write-off their Member Capital Shares (MCS) and Paid-in-Capital shares (PIC) with WesCorp. Collectively, this amounts to the loss of approximately \$1.2 billion in credit union capital nationwide. Now federally insured credit unions not only face a 99 basis points recapitalization and premium assessment, but an additional write-down of a significant amount from their MCS and PIC shares at WesCorp as well.

The WesCorp write down also impacts privately insured credit unions. Our preliminary analysis shows that 44 of our primary insured credit unions have a total of \$36.9 million invested in WesCorp MCS and/or PIC share accounts. After writing these amounts off, the collective capital ratios of the affected privately insured credit unions fall from 10.76% to 10.08%. This loss of capital does not measurably affect our current level of monitoring of the subject credit unions.



The conservatorship of US Central could also impact privately insured credit unions since most corporate credit unions have MCS and PIC accounts with US Central, and these accounts are currently considered impaired. If the write down of a corporate credit union's investment in US Central depletes its respective retained and undivided earnings (RUDE), then derivatively, its natural person member credit unions may also have their respective MCS and PIC accounts partially or fully impaired.

Given this exposure to loss, we attempted to estimate the effect on privately insured credit unions in the unlikely event of all corporate credit unions failing because of the US Central conservatorship, in turn, impairing the MCS and PIC of all member credit unions, irrespective of who insures them. Under this "worst-case" scenario, the average net capital level of all privately insured credit unions would drop from 11.43% to 10.80%. This degree of loss, while material, would not dramatically change our current course of action with respect to those credit unions currently being closely monitored.

Over the short-run, privately insured credit unions need to carefully monitor the balance sheets of their respective corporate credit unions; assess their own risk of full or partial impairment; and, closely monitor NCUA's activity with respect to all corporate credit unions in the months ahead.

Insurance Fund Update



The recent announcements about the impairment of certain corporate credit unions' member capital and PIC capital shares illustrates the indirect exposure that all credit

unions can have to the sub-prime mortgage situation. Credit unions must continue to be vigilant against the "trickle down" effect of a variety of economic pressures in these troubling times.

Is There a Silver Lining for Credit Unions?

The severity of the current US recession, which began at the end of 2007, cannot be over emphasized, given: (1) the continued weak conditions in the banking system; (2) weaknesses in the US stock markets which recently dipped to 12-year lows; (3) falling home and other asset prices; and (4) the rising unemployment rate that may peak later this year or early in 2010 at double-digit levels not seen since 1975. Further, the US economy is projected by the Federal Reserve to contract by about 1.0% in 2009 (i.e., negative GDP) and consumer spending has dissipated to such low levels that the federal government stepped up with its recent \$787 billion fiscal stimulus package, two-thirds of which consist of government spending programs designed to help pick up some of the slack from the decline in consumer spending. Despite the government's efforts to rescue the economy with various bailouts since last fall and its attempts to jump-start an economic recovery through fiscal spending and historically low interest rates, when the recovery does finally occur, unlike past economic recoveries that tend to roar back, it will likely be slow to unfold and take several years, not months, to settle in at more normalized levels.

Despite the steep downturn of the US economy, there are a few recent economic and other trends that may actually give credit unions something to cheer about as 2009 unfolds. First, public sentiment towards banks is very negative while credit unions are still perceived as welcome beacons that serve their members and not the special interests of stockholders and management. In addition, the fact that credit unions have not needed to participate in the Troubled Assets Relief Program (TARP) has helped strengthen their image over that of banks.

Second, as a result of weak consumer sentiment towards spending, the US savings rate surged to 5% in January, the highest monthly increase in the savings rate since such records were first kept in 1959. What is significant about this is that

for a number of years the savings rate had been negative when consumers heavily leveraged their purchases during the last economic expansion. In addition, this phenomenal savings growth occurred during a period of historically low interest rates and should help credit unions attract low-cost deposits in the near-term for lending or investment. As a point of reference, in 2008, credit union shares nationally grew 7.7% while ASI insured credit unions grew on average about 5%. Reflecting the early 2009 national savings rate trend, we have seen a 5% nominal increase in share balances in the first two months of 2009 for those credit unions that report financial information to ASI monthly rather than quarterly.

Third, the timing of the recent steepening of the yield curve also bodes well for credit unions, providing opportunity to invest what should be plentiful levels of inexpensive funds at higher interest rates. For example, the benchmark spread between the two-year and the ten-year US Treasury yield has increased by 40 basis points (bp) from a 150 bp spread at the end of 2008 to 190 bp in late March 2009. Prior to the Federal Reserve's recently enacted program to purchase US Treasuries on the open market in order to keep interest rates down, the two-to-ten year US Treasury spread had widened to 200 bp or more. Credit unions may be entering a period over the coming year wherein the combination of share growth and higher interest spreads could result in stronger net interest margins in 2009.

Caution Should Still Prevail

Because of the significance of the US government fiscal stimulus package, the various bailouts underway in the financial markets and the Fed's efforts to increase money supply through its open market securities purchases, it is likely that these efforts will spawn inflationary pressures, perhaps by late 2010. It is easy to ignore thoughts of inflation today when there was no change in the consumer price index for the twelve months ended January 31, 2009. In fact, in the coming 3-4 months it is likely that the twelve-month inflation measures will be negative (deflation) due to the fact that food and energy prices are considerably lower today than a year ago.

As a result of low interest rates today and inflation expectations in the future, the next asset valuation bubble that may burst is the bond market. Should the yield curve continue to steepen so that the difference between the two-year and ten-year US Treasury yields increases well beyond the current 190-200 bp spread, it will be a signal of inflationary pressures on the horizon. Although credit unions should take advantage of the steep yield

curve today, they must also exercise some caution since inflationary pressures will eventually lead to higher interest rates, which could possibly rise faster than the re-pricing of a credit union's interest-earning assets, resulting in an ALM mismatch and downward earnings pressure. Further, a rising interest rate environment will erode bond prices. A steady-as-she-goes approach and sound ALM planning is still important as credit unions take advantage of the opportunities presented by the current yield curve.

Insurance Fund Update

Presented below are four key credit union ratios and four key insurance fund statistics as of December 31, 2008, compared with June 30, 2008 and December 31, 2007. The tables demonstrate that ASI and its insured credit unions have reported results that are comparable to the national averages, largely due to sound credit union management and ASI's tightened underwriting standards and heightened examination efforts over the past several years.

	December 31, 2008		June 30, 2008		December 31, 2007	
	ASI	Federally Insured (1)	ASI	Federally Insured (1)	ASI	Federally Insured (1)
Net Capital Ratio	11.43%	10.93%	11.26%	11.04%	11.24%	11.43%
Return on Assets	0.17%	0.31%	0.48%	0.52%	0.48%	0.64%
Delinquent Loans Ratio	1.52%	1.37%	0.96%	0.97%	0.95%	0.93%
Net Charge-off Ratio	0.64%	0.84%	0.52%	0.71%	0.54%	0.51%

(1) Source: NCUA website.

The ASI share insurance fund continues to exhibit sound financial condition and has never been more secure than it is now. We are pleased to report that 95% of our assets are held in cash and US Treasury and Government securities and that none of our assets are held in mortgage-backed or exotic securities. Further, the market value of our investment portfolio exceeds our recorded book value by over 2%. We are proud to report that ASI was able to implement a new, lower-cost primary pricing model at year end 2008 to benefit our members; yet we have not had to charge any special premiums or other assessments and we continue to report a very strong equity ratio of 1.48% at December 31, 2008, as shown in the table below.

	December 31, 2008		June 30, 2008		December 31, 2007	
	ASI	NCUSIF (1)	ASI	NCUSIF (1)	ASI	NCUSIF (1)
Primary Equity Ratio	1.48%	1.27%	1.49%	1.24%	1.35%	1.29%
No. of Problem CUs as Percent of Total CUs (2)	1.85%	3.47%	2.45%	3.07%	2.41%	2.60%
Shares of Problem CUs as Percent of Total Shares (2)	1.30%	2.70%	0.40%	1.37%	0.26%	1.04%
Loss Reserves to Insurance-in-Force (basis points)	6.0bps	4.6bps	5.7bps	5.6bps	4.6bps	3.8bps

(1) Source: NCUA website and/or calculated from data from the NCUA website.

(2) Problem credit unions are defined as those credit unions with a CAMEL/CAE rating of 4 or 5.

Although credit unions in general, and ASI's primary insured credit unions specifically, have little or no direct exposure to many of the problems plaguing the financial markets, avoiding the direct impact of the sub-prime mortgage mess, credit unions may still be vulnerable to losses - case in point, the recent announcement concerning impairment of member capital accounts at corporate credit unions caused by mortgage securities losses.

Looking forward, continued tight credit conditions between consumers and banks and other lenders will likely result in credit unions seeing an increase in loan demand from consumers that are denied access to credit by banks; however, a portion of this loan demand will likely represent weak credit relationships that would best be avoided. Credit unions should continue to be vigilant against the

expected fallout from the current economic conditions and the impact on their members and their operations caused by higher unemployment and escalating loan delinquency rates. This can best be accomplished by maintaining stronger than normal operations and safe and sound lending and collections programs.

In conclusion, we believe that the ASI insurance fund provides its credit unions with a strong, high-quality, reasonably priced program that is established so as to always be around for its members regardless of changes in economic conditions.

FTC's Second Attempt at Rulemaking

The Federal Trade Commission (FTC) recently issued a supplemental notice of proposed rulemaking for public comment that directly affects privately insured credit unions. Principally, the proposed rule sets into regulation the exact language of action taken by the US Congress in October 2006 when it passed the Financial Services Regulatory Relief Act of 2006 (FSRRA).

The original form of the FTC's rulemaking dates back to March 16, 2005, when the FTC issued long-awaited rules implementing the consumer disclosure provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) -- a law that all of our member credit unions knew had lacked much-needed guidance in the form of regulations since its enactment in December 1991.

ASI, its insured credit unions and numerous credit union leaders challenged the March 2005 proposal, submitting over 160 comment letters. The FTC took pause and asked Congress to correct many of the confusing provisions of FDICIA so that reasonable rules could be developed. ASI's management and its team of legislative experts worked hard throughout 2005 and 2006 to secure passage of Section 505 of FSRRA resolving almost all of the FDICIA provisions that had caused consternation among our member credit unions and those credit unions converting to private insurance or merging with a privately insured credit union.

In reviewing the newly proposed rules, ASI has only one concern. **Section 320.4 – Disclosures in Advertising and on its Premises** of the proposed rule, which states in part that:

“(a) Required Disclosures. Depository institutions lacking federal deposit insurance must include clearly and conspicuously a notice disclosing that the institution is not federally insured: (1) at each station or window where deposits are normally received, its principal place of business and all its branches where it accepts deposits or opens accounts (excluding automated teller machines or point of sale terminals), and on its main Internet page....” [Emphasis added.]

While we felt we had successfully argued the point that “all its branches” meant only those branches actually owned by the privately insured credit unions, the FTC, in its preamble to the supplemental notice of proposed rulemaking, counters with a statement that: “...the fact that the shared facility may not be owned by the ...privately insured institution or may not be subject to FTC jurisdiction does not control the ability of the institution itself to ensure that the disclosures are made.”

In other words, despite the language of the proposed rule and FSRRA, the FTC seems to want to require that privately insured credit unions post the “This institution is not federally insured” signage in shared branch facilities owned by a federally insured credit union. Since this requirement would be almost impossible to enforce or implement, the entire credit union system should take exception to the FTC's interpretation.

To this end, in April, ASI will be sending a request for comment to all privately insured credit unions, credit union system leaders and others to refute the FTC's interpretation of what constitutes “all its branches.” In addition, we believe there is strong argument that the black letter of the law would suggest that the phrase “all its branches” means just those owned, leased or under the direct control of the privately insured credit unions.

For instructions as to how to submit a comment on the FTC's interpretation of this particular issue, please go to Policyholder Login at www.americanshare.com.



Exams of ASI/ESI Completed

ODI Exam Completed

The Ohio Department of Insurance (ODI) recently completed its five-year statutory financial statement examination of ASI and ESI for the period ended December 31, 2007. The companies are pleased to announce that the ODI reported positive results in the recently completed examinations, and that the ODI's reports revealed no findings on either company.

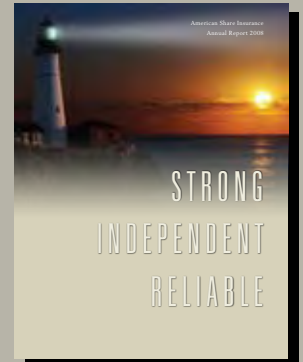
ASI/ESI Vice President-Finance and Treasurer Curt Robson stated, "Over the last 15 years ASI and ESI have enjoyed the recognition as a top-tier insurance company in the eyes of the Ohio Department of Insurance, which is the result of the companies' history of sound operations and adherence to regulatory requirements."

By Ohio law and National Association of Insurance Commissioners (NAIC) guidelines, most insurance companies are required to have a

statutory examination performed by the insurance department of their state of domicile. The last ODI statutory examination conducted on ASI/ESI was for the five-year period ended December 31, 2002.

Annual Audits Completed

The annual audits performed of ASI and ESI financial statements as of December 31, 2008 by Deloitte & Touche, LLP have been completed and the 2008 annual reports were distributed in March. Electronic versions of the annual reports and consumer financial statements are available in the Policyholders section of the ASI and ESI websites.



ASI Annual Meeting Set for April 22nd



Paul Simons

The 2009 Annual Meeting of Participating Credit Unions of American Mutual Share Insurance Corporation (ASI) is scheduled for 11:00 a.m. on Wednesday, April 22. The meeting will be held at the ASI corporate office in Dublin, Ohio. During the meeting the election of two directors to the ASI board will be announced. The candidates up for election to the board are Paul

Simons, CEO of Credit Union 1 (Illinois) and J. Stewart Fuller, CEO of Monterey Credit Union (California), both incumbents.



J. Stewart Fuller

Along with the 2008 ASI annual report that was mailed in March, primary insured credit unions received the notice, proxy and ballot for the board election. Member credit unions are reminded to complete and return their proxy and ballot for the corporation's board member elections before the Annual Meeting date, April 22, 2009.

ASI/ESI Update Meetings Set for April and May

The past year has been one of the most volatile in decades for all aspects of the financial services industries... credit unions included. It has been over 25 years since we last witnessed a prolonged recession with the levels of unemployment and economic downturn that we are experiencing today. Furthermore, it has been as many years since we last saw the number of bank failures we have seen in just the past nine months. And, never before has the magnitude of the losses to the FDIC or NCUA been so great.

Fortunately, ASI has weathered the storm better than most, principally because of sound investment management of the fund's assets, the strength of our insured credit unions and effective risk-based monitoring and examination practices that have been basic tenets of ASI for years.

The ASI management team has arranged to provide our members a full review of the fund's 2008 activity and forecast for 2009 at regional information sessions closely linked to specific state credit union league annual conventions. ASI president, Dennis Adams, and other

executive officers will be offering an overview and answering questions about ASI's primary share insurance and ESI's excess share insurance programs at meetings open to its members and other interested credit union executives. The schedule for the next set of meetings is:

- Illinois CU League's Annual Convention – April 17, 2009
4:30 p.m. to 6:00 p.m. at the Chicago Hilton and Towers – Williford Room C – Third Floor
- Ohio CU League's Zenith '09 – April 23, 2009
4:00 p.m. to 4:50 p.m. at the Cleveland Convention Center
- Idaho CU League's Annual Meeting – May 22, 2009
3:30 p.m. to 4:30 p.m. at the Doubletree Hotel
Boise-Riverside – Northstar Room

Invitations will be sent to executives of all credit unions insured by ASI or ESI. Additional information can be found at www.americanshare.com. We hope to see your credit union representatives at one of these meetings.



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ASI Congratulates Rita Haynes



Rita Haynes, CEO of ASI primary insured Faith Community United Credit Union (Cleveland, Ohio), was honored as the recipient of the 2008 Herb Wegner Memorial Award for Individual Achievement. Haynes received her award in February during a presentation at the National Credit Union Foundation awards dinner at the Credit Union National Association's (CUNA) Governmental Affairs Conference in Washington, DC. The prestigious award is one of the highest honors in the US credit union movement. She was honored for her more than 50 years of service to the underserved residents of Cuyahoga County. She has been the President and CEO of Faith Community United Credit Union since 1989. ASI applauds Rita Haynes for this significant accomplishment!

Thomas Reappointed to Ohio's Council



Recently it was announced that Robin Thomas, ASI Advisory Council member and CEO of ASI primary insured Taleris Credit Union (Cleveland, Ohio), has been reappointed by Ohio Governor Ted Strickland to the state's Credit Union Council Board. Thomas will serve a three-year term that expires September 2011. The seven-member council is part of the Ohio Division of Financial Institutions and provides advice and recommendations on credit union issues to that regulatory agency and the governor. The council meets quarterly and is chaired by Deputy Superintendent for Credit Unions, Rose Bartolomucci.