STATE OF LOUISIANA

OFFICE OF FINANCIAL INSTITUTIONS

BATON ROUGE, LOUISIANA

TO: THE CHIEF EXECUTIVE OR MANAGING OFFICER OF ALL LOUISIANA STATE-CHARTERED CREDIT UNIONS

FROM: SID SEYMOUR, CHIEF EXAMINER

DATE: DECEMBER 21, 2010

RE: LOUISIANA OFFICE OF FINANCIAL INSTITUTIONS (OFI) UPDATE

FINANCIAL PERFORMANCE

Overall Financial Condition – As of 9-30-10, there were 45 state-chartered credit unions, or approximately 20 percent of the 223 credit unions domiciled in the State of Louisiana. For state-chartered credit unions, the net worth ratio decreased to 12.69% as of 9-30-10, from 13.53% as of 9-30-09, but remains significantly above the 9.97% reported on a nationwide basis. As of 9-30-10, net income was significantly below the same period in 2009, with the ROAA reported at (0.03%) at 9-30-10, and 1.01%, at 9-30-09. The decline was primarily the result of a significant decrease in noninterest income and an increase in noninterest expense (including write-downs of membership capital in corporate credit unions). An increase in loan loss provisions was offset by a decline in interest expense. Net income, excluding the NCUA stabilization expense, also declined significantly on a year-over-year basis. As a result of the decline in net income and an increase in average assets, the ROAA (excluding the stabilization expense) was 0.12% as of 9-30-10, compared to 0.98% as of 9-30-09. The net interest margin has declined on a year-over-year basis as the yield on average investment securities has sharply declined with a smaller decline in the yield on loans and the cost of funds.

State-chartered credit unions reported an increase in the delinquent loans ratio to 1.33% as of 9-30-10, up from 1.21% reported as of 9-30-09. Although loans delinquent less than six months continue to comprise the majority of total delinquent loans, the volume of more serious delinquent loans increased significantly on a year-over-year basis. As of 9-30-10, the dollar volume of net charge-offs also increased significantly on a year-over-year basis. Accordingly, the ratio of net charge-offs to average loans increased to 0.88%, up from 0.68% reported as of 9-30-09. However, the delinquency and net charge-offs ratios are below those reported on a nationwide basis of 1.75% and 1.13, respectively. Total loans and total shares both increased on a year-over-year basis; however, because share growth exceeded loan growth, the ratio of total loans to total shares decreased to 73.35% as of 9-30-10, from 74.59% as of 9-30-09.

As noted previously, shares increased on a year-over-year basis with growth in excess of $65mil or approximately 6.77%. Some of this growth replaced borrowed money, which decreased in excess of $16mil over this period, or by approximately 91.22%. While loans increased over this same period, investments (including deposits in commercial banks, savings and loan associations, savings banks) and cash and equivalents also increased, with growth of nearly $20mil or approximately 5.96%. In general, state-chartered credit unions have more than sufficient liquidity to fund membership loan demand at this time.

The accompanying **chart** illustrates the level of delinquent loans to total loans for state-chartered credit unions in Louisiana, all Louisiana-domiciled credit unions, and all credit unions nationwide from 12-31-04, through 9-30-10. Although the ratio for Louisiana-domiciled credit unions was above the national average from 12-31-04 through 12-31-07, the gap between the two ratios generally trended downward. However, since 12-31-08, the ratio for Louisiana-domiciled credit unions has remained below the national average.

	Delinquent Loan Ratio			
Date	State-Chartered	All LA-Domiciled	Nationwide	Diff (LA vs. NW)
9/30/2010	1.33%	1.32%	1.75%	-0.43%
6/30/2010	1.36%	1.32%	1.73%	-0.41%
3/31/2010	1.40%	1.35%	1.76%	-0.41%
12/31/2009	1.56%	1.50%	1.83%	-0.33%
9/30/2009	1.21%	1.36%	1.69%	-0.33%
6/30/2009	1.19%	1.22%	1.60%	-0.38%
3/31/2009	1.06%	1.13%	1.46%	-0.33%
12/31/2008	1.21%	1.24%	1.38%	-0.14%
12/31/2007	1.05%	1.09%	0.93%	0.16%
12/31/2006	0.96%	1.14%	0.68%	0.46%
12/31/2005	1.45%	1.49%	0.73%	0.76%
12/31/2004	1.28%	1.42%	0.72%	0.70%

THE SECURE AND FAIR ENFORCEMENT FOR MORTGAGE LICENSING (SAFE) ACT

While the final rules issued by the various federal agencies for the SAFE Act became effective October 1, 2010, the system that will be used for registration is not yet available to depository institutions. At this time, the federal agencies anticipate that the registration system for employees of insured depository institutions may become available as soon as January 28, 2011.
The agencies will notify its institutions of the date when the registration system becomes available. Please be advised that your institution and its employees are not required to do anything at this time. We will be sure to update you on any progress in this regard on our website and in future correspondence. For more information, you may refer to the SAFE Act link at http://www.ffiec.gov/safeact.htm.

Additional information specific to the registration of employees can also be found at the following: http://mortgage.nationwidelicensingsystem.org/fedreg/Pages/default.aspx. My previous CEO letter stated that a new standard mortgage loan application (FNMA Form 1003) should be utilized which requires a unique identifier for both the loan originator and the loan origination company. However, institutions that originate loans for sale to a Government-Sponsored Entity (GSE), such as FNMA or FHLMC, or to obtain a guaranty from a GSE should use this form. Most institutions that originate mortgage loans choose to use the standard form, rather than develop their own form, even though they may not sell these loans to a GSE. Until the registration requirements of the SAFE Act are in effect for depository institutions, these unique identifiers are not required. Please contact Review Examiner Tim Robichaux at 225/922-0878 or trobichaux@ofi.la.gov with any questions.

More information on the new application form and the SAFE Act may be accessed at https://www.efanniemae.com/sf/guides/ssg/relatedsellinginfo/pdf/mortgageloandelreqsfaqs.pdf.

CREDIT UNION LEGISLATION

The OFI is currently considering the need to sponsor depository-specific legislation during the upcoming 2011 Regular Legislative Session. In the meantime, you can find a complete list of industry-related legislation that was passed during the 2010 Legislative Fiscal Session on our website at www.ofi.la.gov. The short summaries are meant to inform you of the general contents of the legislation but should not be relied upon in lieu of a complete reading of each Act. In order to read the Act in its entirety, simply go to our website and click the link "Index of Acts from the 2010 Legislative Fiscal Session" which is located under "What's New at OFI." This link is permanently located under the "Statutes" section of our website. Click on "Statutes" on the left menu bar and then click on the link "Index of Acts from the 2010 Legislative Fiscal Session." The enrolled bills can also be found at the Legislature's website at: www.legis.la.gov. Please contact General Counsel Sue Rouprich at 225/922-1028 or srouprich@ofi.la.gov with any questions in this regard.

INTERAGENCY APPRAISAL AND EVALUATION GUIDELINES

On December 2, 2010, the Federal Banking Agencies and the NCUA issued their Final Appraisal and Evaluation Guidelines, which supersede previous guidelines which were issued in 1994. These guidelines address some of the following issues: transactions that require appraisal and those that require evaluations, minimum content for evaluations, factors to assess whether an existing appraisal or evaluation remains valid and may support a subsequent transaction, and guidelines for reviewing appraisals and evaluations. The new guidelines can be found at the following website: http://www.fdic.gov/news/news/press/2010/pr10261a.pdf.

MULTI-FEATURED OPEN END LENDING (MFOEL) PROGRAMS

In September 2010, the NCUA issued a letter to federal credit unions, No. 10-FCU-02, discussing Federal Reserve Board (FRB) changes to Regulation Z and the effects of those changes on credit union MFOEL programs. While the FRB has the authority to implement Regulation Z under the Truth in Lending Act, NCUA has enforcement authority for federal credit unions. For state-chartered credit unions, Regulation Z under the Truth in Lending Act is enforced by the Federal Trade Commission (FTC). However, the issues discussed for federal credit unions in NCUA's letter would be similar for state-chartered credit unions.

MFOELs, like CUNA Mutual's LOANLINER program, are single accounts with separate sub-accounts for different loan products such as share overdrafts, unsecured lines of credit, share-secured lines of credit, vehicles, and home equity lines of credit. In February 2010, the FRB published changes to Regulation Z that affect the management of open-end lending.

The changes to Regulation Z clarify that *underwriting* must take place only at the opening of a MFOEL plan**.** Creditors using MFOEL plans are permitted to *verify* a person's creditworthiness to ensure it has not deteriorated (and revise credit limits and terms accordingly), but they must not perform *underwriting* because a person has requested an advance. As a result, credit union must ensure that their open-end lending policies and procedures distinguish between underwriting at the inception of the open-end lending relationship and verification that may take place during the duration of the relationship: including when the member applies for an additional draw on the pre-approved line of credit. In addition, credit unions must ensure that the proper (open-end lending) disclosures are given in conjunction with MFOELs. NCUA's guidance to FCUs also contains a list of best practices.

LCU No. 10-FCU-02 Link: (http://www.ncua.gov/letters/2010/FCU/10-FCU-02.pdf)

NCUA CORPORATE STABILIZATION EFFORTS

On 9-24-10, the NCUA Board approved a final rule which requires higher capital standards, lower concentration risks, sound asset/liability management strategies, and transparent governance for all corporate credit unions.

As part of NCUA's three-part process of stabilization, resolution, and reform for the corporate credit union system. NCUA has also implemented a "Good Bank/Bad Bank" model to facilitate the corporate resolution process. Bridge corporate credit unions ("good banks") are chartered by the NCUA Board to purchase and assume "good" assets and member share deposits from the conserved corporate credit unions ("bad banks"). Bridge corporate credit unions will be highly liquid and operated to ensure stability and minimize disruption of service to member credit unions. "Frequently Asked Questions" regarding bridge corporate operations and governance can be accessed using the following link: http://www.ncua.gov/Resources/CorporateCU/CSR/CSR-17.pdf

As of 11-12-10, four of the five previously conserved corporate credit unions were formed into the newly created "bridge" institutions. They are now known as U.S. Central Bridge Corporate Federal Credit Union; Western Bridge Corporate Federal Credit Union; Members United Bridge Corporate Federal Credit Union; and Southwest Bridge Corporate Federal Credit Union. On 11-30-10, Constitution Corporate Federal Credit Union was liquidated and NCUA transferred its operations to Members United Bridge Corporate Federal Credit Union (Members United). NCUA made this decision after determining it was in the best interest of Constitution's members and the NCUSIF. Additional resources regarding the corporate credit unions are part of a new "toolbox" of information on the NCUA website. Valuable information can be accessed using the following link: http://www.ncua.gov/Resources/CorporateCU/CSRMain.aspx.

In early September 2010, NCUA mailed an informational DVD to each federally insured credit union. The DVD includes separate tracks which outline the corporate structure, the economic crisis that led to the corporates' problems, as well as NCUA's stabilization, resolution, and reform efforts. If you have not already viewed these video presentations, please take the time to watch them as a group and discuss them with your management team. These video presentations are also available on NCUA's website using the following link:
http://www.ncua.gov/Resources/CorporateCU/CSR/Presentations.aspx.

Management is also urged to periodically review NCUA's Letters to Credit Unions for updates or notices regarding upcoming Temporary Corporate Credit Union Stabilization Fund Assessments. The purpose of the Corporate Stabilization Fund is to repay the Treasury over multiple years for borrowings necessary to stabilize the corporate credit union system, which is essential to maintain liquidity and investment services for thousands of natural-person credit unions, and to provide payment systems which settle billions of electronic transactions for millions of credit union members. NCUA must repay the Treasury borrowings through assessments to credit unions during the seven-year life of the Corporate Stabilization Fund, which currently has six years remaining.

UNRELATED BUSINESS INCOME TAX (UBIT) UPDATE

Recent UBIT cases could help CUs challenges: State-chartered credit unions that are subject to unrelated business income tax (UBIT) may now have a good defense against civil tax penalties that the U.S. Internal Revenue Service (IRS) could try to impose on credit unions that do not declare UBIT due on income from the sale of credit life and disability insurance, Guaranteed Asset Protection coverage, and other financial products. The recent decisions in federal court cases involving Bellco CU and Community First CU may give other credit unions "substantial authority" sufficient to not pay UBIT on sales of these products without being subject to tax penalties for maintaining a frivolous tax law position. Services such as mutual funds, stocks, and annuities, as well as income qualifying as "royalties," and a third-party vendor's sale of accidental death and dismemberment (AD&D) insurance policies to members are also addressed by these recent decisions.

On 4-2-10, Judge Christine M. Arguello ruled in the U.S District Court for the District of Colorado that Bellco CU's income derived from credit life and disability insurance, sold directly or indirectly, as well as royalty income from AD&D insurance should not be subject to UBIT. Arguello's ruling supplements a 2009 summary judgment ruling which found that Bellco CU's commissions from a vendor's sales of financial products and services such as stocks and annuities to its members were "substantially related" to its tax-exempt purpose and so therefore not subject to UBIT. A press release on 10-20-10, indicated that the U.S. Department of Justice decided not to move forward with an appeal to challenge the credit union favorable ruling in the unrelated business income tax (UBIT) case brought by Bellco CU.

Technical Advice Memoranda (TAMs): As of 12-15-10, no additional Technical Advice Memoranda (TAMs) have been released and made public by the Internal Revenue Service (IRS) on UBIT in 2010. The IRS has issued more than 26 TAMs since 2006 on UBIT from the audits of unidentified state-chartered credit unions in states other than Louisiana. A list of the products/services addressed in the TAMs that could be subject to federal taxation have been detailed in previous CEO letters and can be made available upon request via e-mail. While the TAMs do not set a precedent for all state-chartered credit unions, they could indicate how an IRS auditor may treat a state-chartered credit union in this regard. You are reminded that appropriate expense allocation will reduce the amount of income that is subject to taxation. If a credit union does not track specific cost centers for such items, it may be allowed to determine the amounts on a pro-rata basis, using the percentage that the unrelated business income represents of the credit union's gross income and net "pro-rata" expenses against the said income. Credit unions should consult with their CPAs/Auditors about Form 990T and seek advice regarding how to calculate income and expenses relating to UBIT.

It should also be noted that each of the TAMs were issued prior to the recent decisions in federal court cases involving Bellco CU and Community First CU; therefore, credit unions may have "substantial authority" sufficient to not pay UBIT on sales of the products addressed in the two cases without being subject to tax penalties. If your credit union is subject to UBIT, you are encouraged to review both federal court cases with your CPAs/Auditors and legal counsel.

5300 CALL REPORT AND REPORT OF OFFICIALS SUBMISSIONS

Managers and report preparers are asked to pay close attention to the NCUA's deadlines for the submission of these reports. Submission deadlines have periodically changed since the transfer to NCUA's online system. The online system login page is located at https://cuonline.ncua.gov/CreditUnionOnline/Login.aspx.

INFORMATION ON THE NASCUS WEBSITE

You are encouraged to periodically check the NASCUS website at http://www.nascus.org for information and updates on the most current matters affecting state-chartered credit unions. The Regulatory Resources Section (http://www.nascus.org/regulatory-resources.htm) contains details on proposed rules and requests for comments that may affect state-chartered credit unions. The Legislative Affairs Section (http://www.nascus.org/legislative-affairs.htm) provides information and NASCUS' commentary on proposed federal legislation that may affect state-chartered credit unions. Generally, NASCUS comments only on federal legislation that may affect the dual chartering system, state-chartered credit unions, share insurance requirements, or infringe upon state regulatory authority.

Closing Comments – We are saying goodbye to Mrs. Dale Jacobs, our Staff CPA for the last twenty years. Dale retired on December 10, 2010, and will be greatly missed by everyone at OFI. However, Mrs. Christine Kirkland has been hired as Dale's replacement. Christine has a Masters in Accounting from LSU and is a CPA and Certified Internal Auditor. Most recently, she has worked as an auditor for the Legislative Auditor's Office for the past 10 years. We are excited and pleased to welcome Christine to OFI! Christine is available to assist you with any accounting questions and can be reached at 225/922-0632 or ckirkland@ofi.la.gov. Again, we are always looking for recommendations to improve the manner in which we conduct examinations. Please contact me at 225/925-4675, or by email at sseymour@ofi.la.gov or Deputy Chief Examiner John Fields at 225/922-0633 or by email at jfields@ofi.la.gov if you have any questions regarding the contents of this Update.

Happy holidays and best wishes for the New Year from everyone at OFI!