Callahan's
CREDIT UNION REPORT
At the Leading Edge of Credit Unions

AUGUST 2012

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BANK OF AMERICA: FOLLOW YOUR CUSTOMERS. CONVERT TO A CREDIT UNION.

A CREDIT UNION CHARTER COULD SAVE BANK OF AMERICA CUSTOMERS BILLIONS OF DOLLARS ANNUALLY. THAT'S A NON-GOVERNMENT STIMULUS WAITING TO HAPPEN.

BANK OF AMERICA'S 2011 RESULTS REVEALED DECLINING TRENDS ACROSS A NUMBER OF KEY BUSINESS COMPONENTS. Consumer deposit balances are down nearly $10 billion. Credit card balances fell by more than $10 billion. The mortgage servicing portfolio shrank by $154 billion in *the last three months of the year* — almost double the $83 billion of first mortgages credit unions originated throughout 2011 — partially due to consumers taking advantage of refinancing options at other institutions.

Bank of America's customers are talking with their feet, and the financial results point to an exodus of relationships — some of which moved to credit unions. The bank's results are in sharp contrast with credit unions, which reported a $41 billion rise in deposits, $1.5 billion increase in card balances, and $12 billion growth in their mortgage servicing portfolio during 2011.

Credit union membership growth is accelerating as more Americans review their financial services options and find value in the cooperative approach. Bank of America's new strategic direction in mortgage banking involves shifting from a market share focus to a relationship focus. The 2011 results seem to indicate consumers are looking for that approach in more than just the mortgage business. To get back on a growth trajectory, Bank of America needs to shift to a model that aligns with customer needs across all of its consumer businesses.

So we have a challenge to Bank of America: Convert your retail banking business into a credit union.

A conversion would require overcoming some hurdles, of course. About half of Bank of America's business is in investment banking and commercial banking, and it would need to decide how to handle those. Bank of America could not include its investment banking business in its credit union charter, so it would have to spin that off. Without a waiver, it could not include its commercial banking segment, either, as that would exceed the member business lending cap.

"CU" QUICK FACTS

Bank Of America Corporation
HQ: Charlotte, NC
Assets: $2.13T*
"Members": 57 Million Households
Employees: 240,000+
Branches: 5,800+
12-Month loan growth: -1.5%
12-Month deposit growth: 2.2%
12-Month customer growth: Not Reported
ROA (post-tax): 0.96%
Common Equity/Capital Ratio (Basel 1): 9.86%
Loans To Deposits: 89.65%

* data as of December 31, 2011

KEY TRENDS AT BANK OF AMERICA (IN MILLIONS)

	4Q10	4Q11	Notes
DEPOSITS	$413,150	$417,110	$9.6B decline in 2H11
CONSUMER RE LOANS OUTSTANDING	$124,933	$116,993	$7.9B decline in 2011
MORTGAGE SERVICING PORTFOLIO ($ BN)	$2,057	$1,763	$294B decline in 2011; $154B in 4Q11
CREDIT CARD OUTSTANDINGS	$112,673	$102,241	$10.4B decline in 2011
OTHER CONSUMER LOANS	$93,138	$92,401	$737M decline in 2011

According to Bank of America, it serves approximately 57 million consumer households. If it were to become a credit union, its customers-cum-members would benefit from lower fees, lower borrowing rates, and higher savings rates. This would put money in the pockets of 57 million Americans and their families and could be the stimulus needed to recharge the consumer segment of the economy. The positive effects would reverberate through millions of households and throughout the nation.

HISTORY REPEATED?

This proposal is not as far-fetched as it appears on the surface, especially considering Bank of America's history. Founder Amadeo Giannini, a formidable and forward-looking man, entered the banking industry after selling his produce business at age 31 to its employees. He soon realized banks operated to serve the wealthy and well-connected yet saw the opportunity in other demographics. In 1904 he founded the Bank of Italy to serve San Francisco's Italian immigrant community, a community other banks would not serve. When fires leveled parts of the city after the 1907 San Francisco earthquake, Giannini hid his bank's reserves in a garbage wagon and spirited them to a suburb, then loaned money on a handshake while conventional banks couldn't even open their vaults for fear of igniting the paper money. In 1928, Giannini merged Bank of Italy with Los Angeles' Bank of America, continuing to stress that the newer, larger bank cater to middle class Americans rather than to the wealthy.

Given this community-focused orientation, we suspect Giannini would have chosen a credit union charter had it been available during those years, so converting its retail business to a credit union in 2012 would not be such a severe move for Bank of America. It would be a return to its roots.

If Bank of America *did* apply for a credit union charter, however, it could not call itself Credit Union of America, one exists in Wichita, KS, or America's Credit Union, one exists in Lewis McChord, WA. But it could adopt a name like Giannini Credit Union or Credit Co-Op of America.

THE BENEFITS OF A CREDIT UNION CHARTER

For the many millions of people and families who filter through Bank of America's doors, call centers, and website each day, there are numerous advantages of a credit union charter not only for members but also for the nation.

Resiliency: Bank of America's present institutional existence has the single goal of maximizing shareholder value. Its charter practically requires it to concentrate on share price as the measure of shareholder value. Accordingly, it puts a great deal of brainpower and other resources into meeting quarterly stockholder expectations.

With a credit union charter, it could strategize for a longer horizon. With a credit union charter, there are no Wall Street analysts and stock watchers examining your every move, ready to punish you if you don't meet projected quarterly earnings. With a credit union charter, members and regulators expect you to operate in the black, but the main point is to deliver high-quality, low-cost financial services. You work hard as a credit union, but you are not beholden to investors looking for quarterly dividend checks. You are beholden to your member-owners and their best interests. The credit union charter measures success by impact and achievement over decades, not months.

Without its singular focus on the bottom line, Bank of America can avoid what it went through in 2008-09. With a bank charter, it is natural to pull in your horns during a credit cri-

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sis. But during this period credit unions increased credit, making it available to members at exactly the time they needed it most. Consider this: In the first quarter of 2012, credit unions leveraged their $1 trillion asset base to originate $26.4 billion in first mortgages. Bank of America, with double the asset base, originated only slightly more than $16 billion in first mortgages.

By being countercyclical, as credit unions are, Bank of America would be able to grow market share and make a larger impact in America's recovery. Under a credit union charter, more money deposited with Bank of America would stay local. According to a study by the nonprofit research firm Institute for Local Self-Reliance and Austin-based consultant Civic Economics, $45 of every $100 spent at a locally owned institution remains local. For larger chains, that drops to $13.

Stakeholder Alignment: Financial institutions have three primary stakeholders: the institution, its customers, and its employees. Bank of America's current charter tilts toward perpetuating the institution. The institution is the vehicle that creates profits, and it does so through serving customers and using employees. This is an imbalance that does not bode well for the future. During the Occupy Wall Street movement and Dump Your Bank Day, participants rose in protest that banks were paying too much attention to the institution and too little attention to the customers. And as for employees, the bank charter leads institutions to consider employees a cost center that should be minimized.

Under a credit union charter, Bank of America could restore balance and more evenly distribute its consideration of the three stakeholders. Credit unions exist for the members, so Bank of America's primary focus would be on them. Sure, it would still work hard to maintain the institution – it would even strive to build retained earnings (aka capital) for future investments – but it would do so in the service of people who join. Under a credit union charter, employees are still a cost center, but they are more than a line on a spreadsheet. Under a credit union charter, self-correcting mechanisms hold balance among institution, members, and employees.

Democracy: Bank of America's current charter tilts interest toward the largest investors. When voting for directors, who hire management, investors are given votes in proportion to their investment. So it is only natural the company is run for the benefit of the largest investors. And the largest investors are likely institutional investors whose officers are cozy with Bank of America's board. What enriches one enriches the other, which reinforces the imbalance of institution over customers and employees. The smaller investors, the customers, and the employees get short shrift.

There are no investors that receive preferential treatment in a credit union charter. Every member-owner is an equal investor. When it comes time to vote for board members, every member gets one, and only one, vote. This ensures the institution is run for the equal benefit of all members, rich and the poor alike.

In this setup, it's not only the members but also their community that benefit from institutional success. Bank of America began as a way to improve the Italian community of San Francisco. Under a credit union charter, Bank of America's obligation would be weighed evenly among the institution, its members, and its employees. Along with working to build institutional longevity, Bank of America would be tasked with helping its members and employees achieve a higher level of living. In doing so, it would also help their larger communities.

SAVINGS "STIMULUS" IN 2011

CREDIT UNION AVERAGE SHARE RATE	0.96%
BANK OF AMERICA AVERAGE DEPOSIT RATE	0.27%
DIFFERENCE	0.69%
AVERAGE 2011 BANK OF AMERICA DEPOSITS (MM'S)	$415,130
SAVINGS STIMULUS FOR BANK OF AMERICA "MEMBERS"	$2.9 Billion

FROM BANK OF AMERICA TO HELP FOR AMERICA

The credit union charter is a member-facing charter. It allows the institution to operate in a philosophically different way. The outcome benefits the people the institution serves.

An important outcome, of course, is that the whole nation is better off. People receive quality products and services at a lower price. As the original Federal Credit Union Act made clear, credit unions are meant to improve the credit component of the American economy and to help persons of modest means.

Based on a comparison of average deposit rates, Bank of America customers would have earned an additional $2.9 billion in interest income in 2011 under a credit union charter. That amount of additional interest on the bank's $417 billion deposit portfolio could almost certainly be matched in interest savings on their $609 billion consumer loan portfolio. That would result in a $5.8 billion stimulus, or approximately $100 for each of Bank of America's 57 million "members," that they would be able to save or spend. That is not an insignificant stimulus.

Bank of America, do yourself and every citizen of this nation a favor. Live up to your name. Live up to your heritage. Convert your retail business to a credit union charter. Put people first. Your customers will like it, your business will grow and the nation will benefit. The future lies in the credit union business model. We'd be happy to have you join us. •

By: Gary Easterling, CEO, United Federal Credit Union | Interview By: Brooke C. Stoddard

UNITED FCU DEMONSTRATES THE BENEFITS OF BEING A CREDIT UNION

THE CREDIT UNION CHARTER SAVED AN AILING INDIANA BANK, RETAINED LOCAL OWNERSHIP, AND ASSUAGED COMMUNITY CONCERNS REGARDING EMPLOYMENT AND SUSTAINABILITY.

UNITED FEDERAL CREDIT UNION BEGAN AS THE CREDIT UNION FOR WHIRLPOOL CORPORATION IN ST. JOSEPH, MI, IN 1949. Since then it has expanded to serve multiple SEGs and members in Arkansas, Indiana, North Carolina, Nevada, and Ohio. Through mergers the credit union has embraced underserved area charters and community charters, and it has an affinity charter with the America Consumer Council. United maintains its headquarters in St. Joseph, not far from the northwest Indiana state line. It has $1.5 billion in assets and 117,000 members.

In 2011, Griffith Savings Bank – a mutual savings bank located in Griffith, IN – approached United with the notion of selling its assets to United and becoming a United branch. Griffith is a town of 17,000 people and is located about 70 road miles from St. Joseph. The proposal was a fit for both institutions, and the acquisition was consummated in January, the first instance of a federal credit union taking over the assets of a bank. In July, *The Callahan Report* talked with United FCU CEO Gary Easterling about the acquisition and the relative merits of the credit union and banking charters as well the effects on the town of Griffith.

WHAT IS THE HISTORY OF THIS ACQUISITION?

GARY EASTERLING: The Griffith Savings Bank began in 1930 as a traditional state charter savings and loan. In 2011, it had about $80 million in assets and even before the recession was not doing particularly well. The CEO wanted to retire and the institution was running out of steam. Griffith's board was somewhat enamored of credit unions and began looking into converting to one; it began discussions with Indiana's examiner. But then the recession hit, the economy soured, and the bank suffered. It wanted an exit strategy, so it hired a consultant, and the consultant came to us. We already had some United members in Indiana. We thought the Griffith community would be a good one for us, and so we pursued the idea. We had an agreement in principle last spring. On January 2 of this year, the Griffith branch (there was just one) opened as a United branch.

HAS THERE BEEN AN IMPACT ALREADY ON THE COMMUNITY?

GE: Yes. The customers of Griffith did not have electronic delivery or credit cards. Immediately we were able to give them as members of United a host of electronic services, credit cards, and more. We could bring our economies of scale to former Griffith customers.

HOW DID THE GRIFFITH CUSTOMERS BECOME MEMBERS OF THE CREDIT UNION?

GE: As you can imagine there were some regulatory questions to address, but we worked it out. Griffith held an open meeting for all depositor/borrower members. The board had proxies for the depositor/borrower members, although these members could show up at the meeting and cast their own votes as they pleased. Voting was not like at a credit union where it is one-member one-vote. At a mutual you vote in proportion to the size of your account. The vote approved the acquisition.

DO YOU KNOW IF THE VOTE WAS CLOSE?

GE: I was at the meeting to answer any questions. But I was not present when the votes were counted, and I was only told the acquisition was approved.

Next the Griffith members voted to join the American Consumer Council, with which we have an affinity charter. That made Griffith's old members new members of United. In addition, persons in the town of Griffith who wish to become United members can join the American Consumer Council and become members of United.

WAS THE GRIFFITH COMMUNITY CONCERNED ABOUT THE CONVERSION?

GE: No. They have been quite welcoming. I think the Griffith depositors and community members were most concerned that they had a continuing and sustainable financial institution and the employees retained their jobs. I am not so sure they understand or debate the pros and cons of a mutual savings bank versus a credit union charter. Their concerns were more practical.

HOW HAVE YOU HELPED THE GRIFFITH COMMUNITY?

GE: We have fulfilled that wish for

a sustainable financial institution. Griffith will not need to fear it will lose the advantages of a healthy institution or that persons will lose their jobs. The community is also getting better financial services.

HOW WILL THE CREDIT UNION CHARTER HELP THE GRIFFITH COMMUNITY IN THE FUTURE?

GE: The credit union charter allows the board and management to look out on a longer-term horizon. It allows for a certain way of operating and making decisions. It is not so driven by quarterly data, and it is not pressured by remote stockholders. We can look to a longer ROI and make decisions that are right in the long run for the community and the credit union. Here is an example from our own credit union.

Last year our net earnings were lower than normal on account of upgrading our computer systems. The new systems were a costly investment, but in addition, to minimize any transitional impact on our members we increased our staffing levels. In other words, we intentionally increased our operating expenses. That meant our quarterly numbers were not as strong as they traditionally were. We entered into these decisions confident that in the long run our service to members would be better and that during the transition our service would be up to their standards. These were costly decisions, but we did not have to worry – so long as we maintained service and the price points – because these investments were in the best long-term interests of the credit union and its members.

We don't have the pressure of stockholders demanding quarterly numbers that uphold stock prices. I think that gives us a competitive advantage. We can make decisions that cause short-term drops in earnings but are all right so long as the board understands and supports the strategic intent of the investment.

There's another advantage to the credit union charter that is sometimes overlooked: Members of the board and management are not tempted with conflicts of interest. Board members are unpaid volunteers and management has no stock options. Every one of them shares the welfare of the common entity, the credit union. There are no incentives to cause anyone to make a decision that could put the credit union at risk for their own gain.

With a bank charter you cannot be sure. The credit crisis of 2008 has revealed that financial institution officers can put their own companies at risk in order to make personal gain. This is an important difference between our charters. In a credit union charter, the ownership structure assures that the board and management are all focused on the welfare of the credit union and its members.

That relates to another way United is helping and will be helping in Griffith: It has the best interest of the Griffith community in mind. It is not there to take out profit. It is there to help the Griffith citizens who join. United will listen to the members and the community and deliver what they want.

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>
> – Gary Easterling, CEO, United Federal Credit Union

DID UNITED NEED A VOTE FROM ITS MEMBERS TO MAKE THIS ACQUISITION?

GE: No, none was required. Obviously, there was quite a bit of discussion with our board, and we kept the membership informed of what we wanted to do and why. We discussed the acquisition at our annual meeting. We brought up why we thought the acquisition was a good idea: more diversification, the value of diversification of markets, economies of scale, and so on.

HOW HAS THE ACQUISITION WORKED OUT SO FAR?

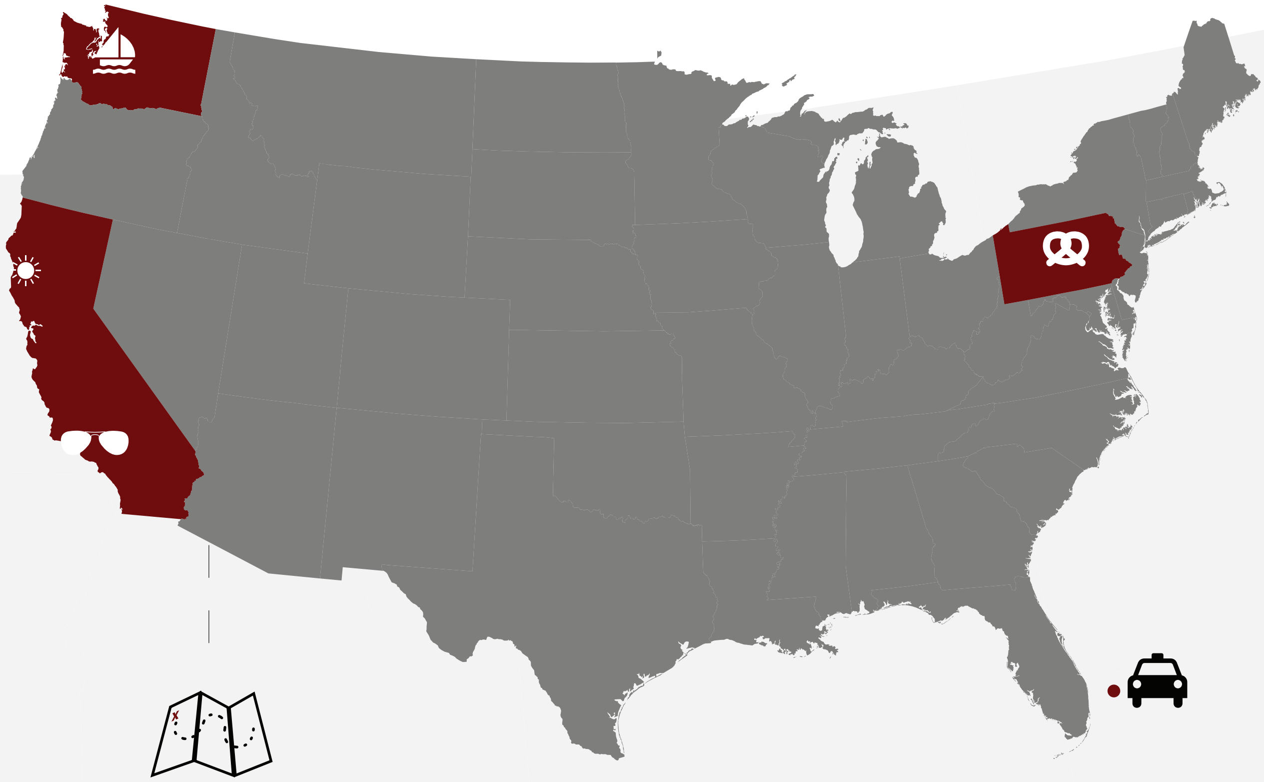
GE: Very well so far. We had a grand opening with the local chamber of commerce. We have not seen significant withdrawals. We recently completed converting the old Griffith computer systems to make them compatible with United's. We expect on account of this, old Griffith customers will be even happier with United.

WHAT HAPPENED TO THE GRIFFITH BOARD AND MANAGEMENT?

GE: The CEO retired before the acquisition was complete. The holding company that owned Griffith sold the assets to United. Then it unwound itself and the old board dissolved.

DESCRIBE THE REGULATORY HURDLES.

GE: Naturally, NCUA needed to approve the acquisition. Its major concern had to do with the field of membership, but when we worked this out, we didn't have trouble. The Indiana Department of Financial Institutions had to approve, and so did the FDIC. Both approved. •



NOTES FROM THE ROAD

WHAT WE'VE LEARNED FROM WHERE WE'VE BEEN.

TRUST FOR CREDIT UNIONS SEMINARS

SAN FRANCISCO
(HOST: PATELCO CREDIT UNION);

LOS ANGELES
(HOST: SCHOOLS FIRST FEDERAL CREDIT UNION)

To refine our understanding of the needs and challenges credit unions have in their investment operations and strategies, Callahan spent a week on the West Coast talking with credit unions of varying sizes. Callahan's CEO, Sean Hession, outlines the salient points addressed during two of the daylong seminars:

1. The requisite investment analysis and work has greatly expanded in the past five years.
2. Getting return while managing the risk of rising rates is tough, especially as current spreads do not cover the expense of generating and managing them.
3. Investment success now requires daily management regardless of credit union size or type of investment.
4. NCUA examiners are pressing credit unions to operationalize plans that presume a rapidly increasing interest rate environment in the next few years. This is a challenge for executives that want to devote analysis and planning resources to cover multiple scenarios because the consensus is, when interest rates rise, they will do so more incrementally.
5. Many small credit unions have at least a material portion of their investable funds in CDs.
6. Credit unions that have success with their regulators are devoting a significant amount of time and effort to education as a prerequisite to opening a discussion on investment strategies and risk management.
7. Board perceptions of and tolerance for investment risk have changed.

Although all credit unions are experiencing yield compression, small credit unions are hungry for more return yet terrified of pursuing it. This is not hyperbole. Fear of both their current status and pursuing better results is palpable. We came away with an invitation to address and interact with a group of small California credit unions who collaborate on investment issues and alternatives. This may be an important lab for refining our understanding of needs and challenge. We can make a real difference for smaller ($50M to $500M) credit unions that are both fearful and needful in regard to their investment portfolios. By combining our knowledge and expertise with a cooperative of smaller and needful credit unions, we can strengthen the cooperative model itself.

CUFSLP PARTNERS MEETING

SEATTLE
(HOST: BECU)

Jon Jeffreys, vice president of Callahan Financial Services and a Callahan & Associates board member, talked investments, risk, and solutions, with Northwest credit unions during the quarterly CUFSLP Partners meeting.

Credit union investments have topped nearly $400 billion, and more credit unions are getting into the investment business. These credit unions talked about the challenges of being a portfolio manager in today's low-rate environment. They must deal with prepayment risk and extension risk. And making sure the credit union is always invested is nearly a full-time job. The market has shown interest in using the TCU mutual funds as a solution to some of these challenges. As one person in Seattle said: "The TCU ultra-short fund has the potential to be the overnight account of the future."

NATIONAL CREDIT UNION MANAGEMENT ASSOCIATION 2012 SUMMER CONFERENCE

PARADISE ISLAND, BAHAMAS

While attending an NCUMA conference in July, Callahan's Vice President of Analytics & New Business, Scott Patterson, got some credit union insight from an unexpected source.

My taxi driver from the airport, a former member of American Airlines Credit Union, was very excited about Bahamas' credit unions. He said credit unions are "directly responsible for the strength of the middle class" because they provide the credit that allows many people to start and maintain the small businesses that banks don't want to finance. He wanted to learn more about starting a credit union because he sees a need for the 1,500 taxi drivers on the island. They have unique needs and seasonal revenue the banks don't understand nor want to understand. Taxi license loans, similar to our medallions, aren't available, and he rents his from someone wealthy enough to have the funds to buy it initially. He has a vision and is going to pursue options to either court an existing credit union to take on taxi membership or explore options for starting a credit union. For any credit union execs in the U.S. looking for pro-bono credit union consulting in the Caribbean ... here is an opportunity!

ANATOMY ROAD TRIP

MECHANICSBURG, PA

Rebecca Wessler, Callahan's director of media, breaks out best practices from a two-day visit with Members 1st Federal Credit Union.

Members 1st has a strong indirect lending channel that includes not only autos but also merchant lending. The credit union launched its merchant program less than a year ago and is booking a considerable amount. All underwriting and quality control is conducted in-house, which is why the credit union is comfortable with its indirect lending exposure. Its pull-through rate in the indirect channel is around 40%, and the credit union is ok with that. It sees indirect loans as money it didn't have before, not members it lost through the indirect channel.

We talked about lending initiatives in the terms of "home runs" and "solid singles." Some of its home runs include 1) an unsecured line of credit up to $75,000, for those members that really need a HELOC but just don't have the equity; 2) a no-cost refi for members that wanted to take advantage of low rates but didn't want to deal with the transaction friction; and 3) new credit card programs that offer either a low-rate or rewards.

And for a solid single? Congratulations CU Student Choice. The credit union had dabbled in student lending in the past but it wasn't jazzed about the results. Now, as a participant in CU Student Choice, student lending is a steady producer. In June, Members 1st approved 32 student loans worth $135,000. In all, it has nearly $30 million in outstanding student loans. •

IN PERSON & ONLINE WHERE YOU'LL FIND CALLAHAN IN AUGUST

AUGUST 6

THE NEW CREDITUNIONS.COM GOES LIVE!

This August, we're re-launching CreditUnions.com, the online hub of Callahan data and analysis that helps credit unions improve performance and provide better value for members. The new site features a sophisticated performance data search module, enhanced multimedia features, and upgraded industry networking tools.

AUGUST 8

CALLAHAN & ASSOCIATES' CFO ROUNDTABLE, WASHINGTON, DC

Callahan Executive Vice President Jay Johnson will moderate a CFO roundtable on the evolving credit union business model. Attendees will explore topics including: what the economy's direction means for loan and share growth dynamics, how the regulatory focus on risk management is affecting balance sheet strategies, what investment strategies credit unions are employing at a time of record liquidity, what is the interest rate outlook and what does it mean for pricing strategies, and more.

Call Victoria Neeb at (800) 446-7453 to register.

AUGUST 15 @ 2 PM EASTERN

REVVING UP RELATIONSHIPS, ONLINE

Join Callahan for a quick-hitting webinar. In this event, Arlington Community Credit Union discusses how it put Gen Y in the driver's seat with early auto buying education.

AUGUST 17-18

PLANNING SESSIONS, NASHVILLE, TN; LAGUNA BEACH, CA

Planning season is underway! Chip Filson and Jay Johnson are taking on two planning projects during the dog days of August as the rest of the country heads to the beach.

Call Victoria Neeb at (800) 446-7453 to register.

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