

NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

NCUA LETTER NO. 60

DATE: October 8, 1981

TO THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION ADDRESSED:

On September 24, 1961, the National Credit Union Administration Board (NCUA Board) took major steps in the deregulation of share, share draft, and share unions to (1) pay up to 12 percent dividends on regular share and share draft accounts effective October 1, 1981 (Credit unions paying dividends on an annual or semiannual basis may only exceed the previous 7 percent limit during the last 3 months of 1981.); (2) establish their own rates and maturities for IRA (Individual Retirement Accounts)/Keogh accounts effective November 1, 1981, and (3) establish a dividend rate on Money Market Certificates up to the higher of 25 basis points above the current 26-week Treasury Bill rate, or 25 basis points above the average 26-week rate for the 4 weeks prior to the date of issuance.

The actions of the NCUA Board are independent of Depository Institutions Deregulation Committee (DIDC) which has been directed by the United States Congress to remove the regulatory restrictions that limit the interest rates which are paid on deposits.

The actions of the NCUA Board and DIDC will have major effects on the financial management of your credit union. You will not be able to rely upon government regulations for decisions pertaining to the pricing of the interest rate to be paid on share, share draft, and share certificate accounts. We would like to caution you about automatically increasing the dividend rate on regular share and share draft accounts to 12 percent without analyzing and forecasting the impact of such a policy upon your credit union's net earnings. We are well aware that some credit unions may not have sufficient net earnings. We are well aware that some credit unions may not have sufficient net earnings to justify paying higher dividends on regular share and share draft accounts. Credit unions that irresponsibly use this authority to dissipate prior years' earnings, (which in some cases may have taken decades to build) may find themselves faced with administrative actions from NCUA if such practices are found to be unsafe with administrative actions from NCUA if such practices are found to be unsafe and unsound. Use this authority carefully to pay what you can afford and to be competitive in the marketplace.

Under the present economic conditions with interest rates not only being at near record highs, but also fluctuating greatly on a weekly basis, it is extremely important that your credit union makes a concentrated effort to build a stable share capital base. All Savers Certificates and IRA/Keogh accounts should not be overlooked as a means to this end. Such accounts may provide your credit union with needed stability to withstand volatile changes in interest rates. All Savers Certificates represent a savings instrument which could be attractive to members currently holding Money Market Certificates. If your credit union is successful in rolling over Money Market Certificates into All Savers Certificates it would both reduce your cost of funds and extend the maturities of the certificates. Failure to offer All Savers Certificates could result in an outflow of funds as occurred in many credit unions when Money Market Certificates were first introduced. In the near future we will be issuing a follow-up letter on All Saver Certificates which will clarify many of the questions asked about them.

Recent legislation will greatly expand the number of your members who can participate in IRAs on January 1, 1982. IRA and Keogh programs represent an attractive tax saving instrument as well as providing members with additional income for retirement. In addition, IRA/Keogh accounts can provide long-term capital for your credit union.

In order to successfully compete in such an environment, it is imperative that you carefully plan funds management strategies to meet the needs of your members. We encourage you to spend as much time in planning how share capital will be invested as was spent in attracting the share capital. Share capital that is rate sensitive should be carefully invested in liquid assets with a profitable return. Having sufficient liquid assets to meet loan demands or share withdrawals is no longer sufficient even for small credit unions. A good policy should take into account the unique characteristics of the credit union, necessary to achieve desired earnings. Forward planning should also take into account anticipated funding needs and the means available to meet these needs. The policy should establish responsibility for funds management decisions and provide a mechanism for the necessary coordination between the different departments within the credit union.

In addition to establishing responsibility for planning and day-to-day funds management decisions, the policy should establish certain guidelines. Examples of some typical guidelines are:

1. Limits on the percentage reliance on a particular liability category. For example, notes payable shall not account for more than ____ percent of total liabilities and equity;
2. Limits on the amount for different categories of assets. For example, the amount of investments over 1 year that are not matched with like-term liabilities shall not exceed more than ____ percent of assets;
3. Limits on the balance between rate sensitive (responsive to money market fluctuation) shares and rate sensitive assets. For example, a credit union may want to balance all the money market share accounts with investments of like maturities or loans with maturities of less than 1 year that have a profitable spread between the cost of funds and the return on the funds.
4. Limits on the average maturity for different categories of assets. For example, the credit union may want the average maturity of its loan portfolio to be no more than ____ months.
5. Identification of sources of funding for various types of loans. For example, a credit union needs to identify the types of share capital that would be used to fund long term loans. Perhaps long-term loans would be funded by IRA/Keogh accounts.

A necessary prerequisite to sound funds management decisions is a workable management information system. Reports containing certain basic information should be prepared and reviewed on a regular basis. Report formats and the content of reports will vary from credit union to credit union depending on the characteristics of each and their funds management practices and methods. However, in general, funds management reports should contain details of the following:

1. Liquidity needs and the sources of funds available to meet those needs. (The maturity distribution of assets and liabilities and expected funding of commitments is vital to the preparation of this report.);
2. Asset yields, liability costs, net margins, and variations from the prior period and from budgeted projections (reports must be detailed enough to permit an analysis of the cause of variations);
3. Any exceptions to policy guidelines; and
4. Economic conditions in the credit union's area, interest rate projections, and any anticipated deviations from the originally planned budget.

Additional types of reports may be necessary depending on the credit union's circumstances. Funds

management decisions must be made on an informed basis and to accomplish this, a good management information system is necessary.

This is not intended to be a comprehensive guide to funds management. Rather, it is intended to emphasize some areas of funds management that may need your attention. To assist in your planning and training we will be publishing, in about 2 to 3 weeks, a complete edition of the NCUA Rules and Regulations governing all share, share draft, and share certificate accounts (Part 701.35).

As NCUA deregulates the rates that can be paid on share and share certificate accounts it is particularly important that you have a funds management program and that your staff has received adequate training since the ultimate success of your credit union may well hinge on your ability to manage the funds of your credit union in a fast changing financial environment.

Sincerely,

LAWRENCE CONNELL
Chairman