11 Ratios Every Credit Union Professional Should Know

Presented by:
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Goals of Asset/Liability Management

• **Capital Adequacy**

Adequate level of net worth to insure the credit union’s solvency. Net worth combines Regular Reserves and Undivided Earnings.
Goals of Asset/Liability Management

• Earnings Stability

Income must be sufficient to cover:
- interest expense
- operating expense
- loan losses
- capital contribution
Goals of Asset/Liability Management

• **Liquidity Management**

  Adequate liquidity to meet normal and seasonal loan/share lows and a contingency plan when liquidity approaches inadequate levels.
Goals of Asset/Liability Management

• **Interest Rate Risk**

Control interest rate risk to avoid a significant decline in earnings and net worth due to changing interest rates.
CAMEL

C – Capital
A – Asset Quality
M – Management
E – Earnings
L – Asset/Liability Management

Liquidity
Interest Rate Risk
Earnings – Asset Yield

• **Definition** – The annualized yield on assets - both earning assets (loans & investments) and non-earning assets (fixed assets, accounts receivable, and cash).
Earnings – Asset Yield

- **Formula** – Annualized Loan & Investment Income ÷ Average Total Assets

- **Industry Standard** – Determined by market conditions. Refer to current Peer Group Statistics and current market rates.

1\textsuperscript{st} Qtr 2014 = 3.5% - 6%
Earnings – Asset Yield

Impact Factors:
• Loan Mix
• Loan Yield
• Loan Portfolio Content
• Investment Mix
• Investment Yield
• Investment Portfolio Content
• Cash Management Procedures
• Fixed Asset Mix
ABC Federal Credit Union
Asset Mixes
Total Assets - $201,268

- Gross Loans: $97,006 (48.20%)
- Core Investments & Surplus Cash: $86,694 (43.07%)
- Minimum Cash & Other Assets: $13,241 (6.58%)
- Fixed Assets & OREO: $4,327 (2.15%)
Earnings – Cost of Funds

- **Definition** – The annualized cost of the liabilities including dividends paid on deposits and interest paid on borrowed funds combined with the zero direct cost of the credit union’s net worth dollars.
Earnings – Cost of Funds

- **Formula** – Annualized Dividend & Interest Expense ÷ Average Total Assets

- **Industry Standard** – Determined by market conditions. Refer to current Peer Group Statistics and current market rates.

1\textsuperscript{st} Qtr 2014 = .15% - 1.75%
Earnings – Cost of Funds

Impact Factors:
• Dividend Rates
• Account Mixes
• Account Rate Structures
• Net Worth Ratio
• Liquidity Position
ABC Federal Credit Union

Liability Mixes

Net Total Funds, Liabilities & Total Capital = $201,268

- Money Market Shares: $37,879, 18.82%
- Share Drafts: $69,202, 34.38%
- Regular & Misc. Shares: $64,558, 32.08%
- Share Certificates: $11,362, 5.65%
- Other Liabilities: $2,236, 1.11%
- Total Capital: $16,031, 7.96%

Net Total Funds, Liabilities & Total Capital = $201,268
Earnings – Gross Spread

- **Definition** – The percentage difference between the income generated on all assets and the cost incurred for all liabilities.
Earnings – Gross Spread

• **Formula** – Annualized Net Interest Income
  \[ \text{÷ Average Total Assets} \]
  OR
  Asset Yield minus Cost of Funds

• **Industry Standard** – 4.5% - 5% or higher
Earnings – Gross Spread

**Impact Factors:**

- Loan Mix
- Loan Yield
- Loan Portfolio Content
- Investment Mix
- Investment Yield
- Investment Portfolio Content
Earnings – Gross Spread

**Impact Factors:**
- Account Rate Structures
- Account Mixes
- Dividend Rates
- Cash Management Procedures
- Net Worth Ratio
- Liquidity Position
- Fixed Asset Mix
Earnings – Net Operating Expense Ratio (NOER)

- **Definition** – Annualized operating expenses (excluding provision for loan loss, dividends, and interest on borrowed money) less fee and other operating income. This ratio adjusts expense ratio by the amount of income collected to offset the cost of offering services.
Earnings – Net Operating Expense Ratio (NOER)

• **Formula** – \((\text{Annualized Operating Expense minus Annualized Non-Interest Income}) \div \text{Average Total Assets}\)

• **Industry Standard** – 2.5% - 3% or lower
Earnings – Net Operating Expense Ratio (NOER)

Impact Factors:
• Expense Amounts
• Fee Income Structure
• Asset Size
Earnings – Operating Return on Assets (Operating ROA)

- **Definition** – The percentage of net operating income after dividends, but before reserve transfers including provision for loan loss; actual net charge offs; non-operating gains or losses; or interest refunds. (Profit after daily operations)
Earnings – Operating Return on Assets (Operating ROA)

• **Formula** – Annualized Net Operating Income ÷ Average Total Assets
  
  OR

  Gross Spread minus NOER

• **Industry Standard** – 1.30% or higher
Earnings – Operating Return on Assets (Operating ROA)

Impact Factors:
• Loan Mix
• Loan Yield
• Loan Portfolio Content
• Investment Mix
• Investment Yield
• Investment Portfolio Content
• Account Mixes
• Account Rate Structure
Earnings – Operating Return on Assets (Operating ROA)

Impact Factors:
• Dividend Rates
• Asset Size
• Expense Amounts
• Fee Income Structure
• Cash Management Procedures
• Net Worth Ratio
• Liquidity Position
• Fixed Asset Mix
Earnings – Net Charge Offs (NCOs)

- **Definition** – The percentage of assets being lost because of annualized net charge offs.
Earnings – Net Charge Offs (NCOs)

• **Formula** – (Annualized Charge Offs minus Annualized Recoveries) ÷ Average Total Assets

• **Industry Standard** - .30% or less
Earnings – Net Charge Offs (NCOs)

**Impact Factors:**

- Loan Rates
- Loan Policies
- Loan Portfolio Content
- Collection Policies
- Economic Conditions
- Asset Increases & Decreases
Earnings – Net Return on Assets (Net ROA)

- **Definition** – The percentage of net operating income after dividends, non-operating amounts, interest refunds, and net charge offs/provision expense. (Amount that increases or decreases Regular Reserves and/or Undivided Earnings.)
Earnings – Net Return on Assets (Net ROA)

• **Formula** – Annualized Net Income ÷ Average Total Assets
  OR
  Operating ROA minus Net Charge Offs/Average Total Assets

• **Industry Standard** – 1% or higher
Earnings – Net Return on Assets (Net ROA)

CAMEL Codes

1% or higher - code 1

.80% to .99% - code 2

.35% to .79% - code 3

Source: NCUA Letter 03-CU-04
Earnings – Net Return on Assets (Net ROA)

Impact Factors:

• Loan Mix
• Loan Yield
• Loan Portfolio Content
• Investment Mix
• Investment Yield
• Investment Portfolio Content
Earnings – Net Return on Assets (Net ROA)

Impact Factors:
• Account Mixes
• Account Rate Structure
• Dividend Rates
• Net Worth Ratio
• Liquidity Position
• Asset Size
Earnings – Net Return on Assets (Net ROA)

Impact Factors:
- Fixed Asset Mix
- Expense Amounts
- Fee Income Structure
- Cash Management Procedures
- Loan Policies
- Collection Policies

Impact Factors:
- Fixed Asset Mix
- Expense Amounts
- Fee Income Structure
- Cash Management Procedures
- Loan Policies
- Collection Policies
Earnings

Asset Yield
- Cost of Funds
= Gross Spread
- Net Op Exp Ratio
= Operating ROA
- NCOs/ATA
= Net ROA
Earnings – Loan Mix

• **Definition** – The percentage of asset dollars in the loan portfolio. Because loan yield is historically greater than investment yield, earnings are directly affected by an increase or decrease in loan mix.
Earnings – Loan Mix

- **Formula** – Gross Loans ÷ Total Assets

- **Industry Standard** – 65% or higher. Refer to current Peer Group Statistics.
Earnings – Loan Mix

Impact Factors:

• Loan Rates
• Loan Types
• Deposit Rates
• Deposit Types
• Marketing Efforts
• Economic Conditions
• Asset Increases and Decreases
Asset Quality – Delinquency

• **Definition** – The percentage of the loan portfolio with payments delinquent two months or longer.
Asset Quality – Delinquency

- **Formula** – Delinquent amounts greater than 2 months ÷ Gross Loans

- **Industry Standard** – 2% or less
Asset Quality – Delinquency

**Impact Factors:**
- Loan Rates
- Loan Policies
- Loan Portfolio Content
- Collection Policies
- Economic Conditions
- Gross Loan Increases & Decreases
Asset Quality – Net Charge Offs (NCOs)

- **Definition** – The percentage of loans being lost because of annualized net charge offs.
Asset Quality – Net Charge Offs (NCOs)

• **Formula** – (Annualized Charge Offs minus Annualized Recoveries) ÷ Average Gross Loans

• **Industry Standard** - .40% or less
Asset Quality – Net Charge Offs (NCOs)

Impact Factors:

- Loan Rates
- Loan Policies
- Loan Portfolio Content
- Collection Policies
- Economic Conditions
- Gross Loan Increases & Decreases
Capital – Net Worth

- **Definition** – Earnings from current and previous periods (as a percent of total assets) set aside to absorb operational losses. Higher levels of Net Worth help the credit union survive difficult periods.
Capital – Net Worth

- **Formula** – Regular Reserves & Undivided Earnings ÷ Total Assets

- **Industry Standard** –
  - 7% or higher (PCA)
  - 9% or higher (Cornerstone CUL)
Capital – Net Worth

Impact Factors:
- Profitability (Operating ROA & Net ROA)
- Provision for Loan Losses
- Asset Growth
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