August 2008

white paper

CREDIT UNIONS

CRITICAL ISSUES FACING CREDIT UNIONS IN 2008

A White Paper presenting the survey results and key challenges indicated by credit union CEOs and CFOs across New Jersey

CURCHIN

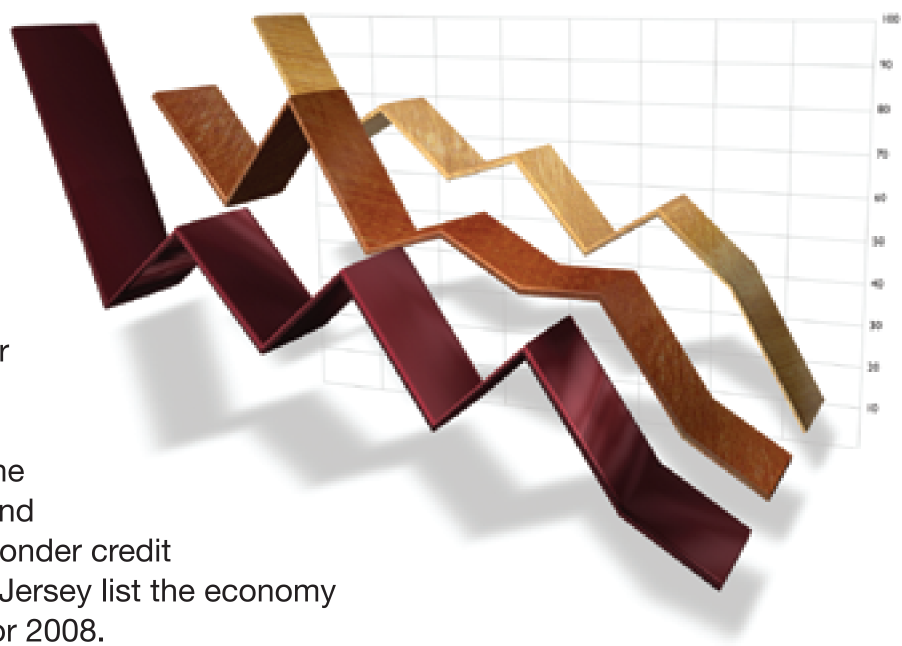
125 Half Mile Road, Suite 108 | Red Bank, NJ 07701 | Tel. (732) 747-0500 | Fax. (732) 747-7700 | email: info@curchin.com | www.curchin.com

Long-term relationships are all about dedication

THE CURCHIN GROUP
CRITICAL ISSUES FACING CREDIT UNIONS IN 2008

As part of a study into concerns facing the credit union industry in 2008, over 100 credit unions from across the state of New Jersey were surveyed. This paper reports the summary and findings of respondents with insight into issues grouped by membership size. Credit Unions were categorized into two groups: those with over 1,000 members (and corresponding higher total assets), and those with 1,000 members or less (and corresponding lower total assets). The survey sought to understand key concerns facing the industry over the next year. Although some variation occurred based on the size of the institution, most concerns were common regardless of the size of the institution. The goal of this paper is to assist the credit union industry in sharing key issues among institutions within the state.

If the economic atmosphere of recent months is any indication, 2008 is going to be a challenging year for financial institutions. The Curchin Group, a Certified Public Accounting firm located in Red Bank, New Jersey recently surveyed the CEOs and CFOs of credit unions across the state of New Jersey. The results indicate a wide range of concerns, beginning with the economy.



The current state of the economy: decreased consumer confidence, new and existing home sales plummeting, unemployment rates spiking, the low interest rate environment and flattening yield curve. It's no wonder credit union CEOs and CFOs in New Jersey list the economy as their number one concern for 2008.

KEY SURVEY RESULTS

As the national economy heads south, credit union management is forced to look for ways to survive and compete in a subprime lending market – avoiding foreclosures and assisting clients in restructuring their debt, while attempting to maintain stability in loan rates for members. In a recent survey of credit union executives from across the state of New Jersey, the economy was only one of a myriad of critical issues facing the industry in 2008. Here are some of the other most commonly cited concerns:

KEY SURVEY RESULTS (cont.)

ECONOMIC STRAINS: The economy has further strained internal resources, creating concern over tightening interest margins, while also focusing credit union efforts in areas of short-term funds management. For many, emphasis is being placed on laddering of investments, managing the internal rate structure and tactics such as limited call features on bonds. For institutions with more than 1,000 members, many cited promotion of non-interest income products, loan participation and lending to underserved markets as key opportunities in 2008. However, these efforts are being approached with caution as member debt/income ratios come under increasing scrutiny and uncertainty over the future direction of interest rates.

DELINQUENCIES: The highly-regulated credit union industry has been somewhat isolated from the challenges faced by other financial institutions in their rate of delinquencies. Still, many CEOs/CFOs noted that anticipated delinquencies are a major concern - believing that it is only a matter of time before the economy will take its toll.

COMPETITION: Market penetration and the inability of the credit unions to compete for membership were also frequently cited by survey respondents. It is no surprise, as one CEO indicated, "In New Jersey, competition for membership in credit unions is fierce." NASCUS (National Association of State Credit Union Supervisors) Chairman George Reynolds commented during the 2007 NASCUS State System Summit that "…credit unions are in a 'service delivery paradigm' due to hyper-competition in the marketplace." This is emphasized as New Jersey boasts over 228 active credit unions across the state.

CEOs/CFOs of credit unions with 1,000 members or less indicated that they struggle with their ability to compete with larger ones, as frequent credit union mergers have allowed some of the larger credit unions to greatly increase their size in a short period of time, dwarfing the smaller credit unions. But within larger credit unions (over 2,000 members), many struggle with intense competition from the banking industry and other financial institutions. Many employ tactics such as financial literacy education for members, increased loan promotional events, hiring in-house marketing resources, and advocating member teams in the workplace to attract and maintain new members.

COMPLIANCE AND REGULATION: Among other critical concerns continues to be the ever-present issue of compliance and regulation. On March 15, 2007 the Credit Union Regulatory Improvements Act (CURIA) was introduced and referred to the House Financial Services Committee in an attempt to help alleviate some of the burdensome regulations faced by credit unions. CURIA initiatives are focused on capital reform, economic growth and regulatory modernization in the industry. This is the first major change to the Federal Credit Union Act since 1998.

KEY SURVEY RESULTS (cont.)

Many respondents believe that CURIA will be a positive step towards relief from the compliance issues faced in the industry. CUNA (Credit Union National Association) continues to lobby Congress to act on CURIA; most recently unsuccessfully attempting to include provisions from the Act in the President's 2008 Economic Stimulus Act.

In a similar concern, NASCUS recently stated that they "disagree with the IRS's interpretation" of the Unrelated Business Income Tax (UBIT) levied on credit unions that provide credit disability insurance to their members.

Both CURIA and UBIT were prominent among many examples cited by respondents as regulatory challenges for 2008.

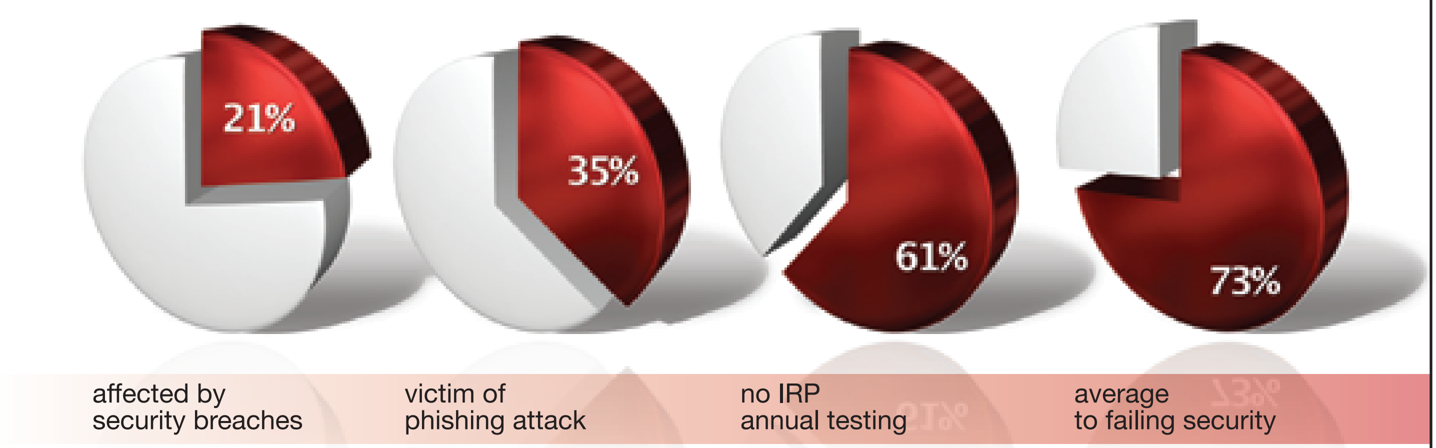
Fraud and Disaster Recovery: Surprisingly, only a few credit unions indicated any concerns with information security threats and disaster preparedness. Most CEOs/CFOs surveyed believe that their customers share their confidence that the institution's security measures are adequately protecting critical information. However, key findings from the "State of Information Security 2008 Survey," reported by Credit Union Information Security, indicates that credit union management has experienced the following:

21% of all credit union respondents have either suffered a security breach during the past two years or don't know

35% have been a victim of a phishing attack during the past year

61% do not test their Incident Response Plan annually

73% assess themselves as "average" to "failing" when it comes to security awareness efforts with customers



These are the statistics that have caused federal regulators to turn up the heat in 2008. Both the FDIC and the NCUA have recently directed banks and credit unions to demonstrate tighter controls, specifically with vendor management, in their examinations. By November 1 of this year, institutions will have to adopt a written Identity Theft prevention program including beefed-up customer awareness efforts. Several respondents indicated the increased costs and time commitment associated with these efforts will further strain their bottom line.

KEY OPPORTUNITIES:

Most respondents believe that continued opportunities for success in 2008 will be enjoyed by those institutions that focus on their commitment to the not-for-profit business model and take advantage of field of membership opportunities. One CEO indicated that, "The NCUA's understanding of our business model will be key to implementation of a successful business strategy." Furthermore, the public's lack of awareness of credit unions and a misunderstanding of exactly what a credit union can offer to its membership were noted as key public awareness opportunities.

If you have any questions regarding information contained in this white paper, please contact us.

Carolyn Giunco Kvalo, CPA, CFE
Audit Partner
ckvalo@curchin.com
732.747.0500

Robert C. Fouratt, CPA
Managing Partner
bfouratt@curchin.com
732.747.0500

CURCHIN'S CREDIT UNION PRACTICE

The Curchin Group is ranked nationally as one of the top fifteen firms providing services to credit unions, and was named as the National Association of Credit Union Supervisory Auditing Committees' (NACUSAC) 2008 Associate Member of the Year, based on our dedication and professionalism in working with credit unions. We are called upon by the National Credit Union Administration to assist in mergers and dissolutions of credit unions as well as bond claims and fraud investigations. We offer our credit union clients a full range of services, including:

- Audits of financial statements
- Supervisory Committee examinations
- Review of internal accounting controls
- Budgeting and financial forecasts
- Internal auditing functions
- Asset/Liability management
- Fraud investigations
- Litigation support
- Bond claim assistance
- Mergers
- BSA audits and ACH compliance
- Financial and managerial consulting:
    - Strategic planning
    - Board of Directors and committee training
    - Manage risks proactively in today's constantly changing market

CURCHIN

125 Half Mile Road, Suite 108 | Red Bank, NJ 07701 | Tel. (732) 747-0500 | Fax. (732) 747-7700 | email: info@curchin.com | www.curchin.com

Long-term relationships are all about dedication