

What's Working

ANOTHER OPPORTUNITY TO IMPROVE PORTFOLIO YIELD FOR CREDIT UNIONS

- The NCUA Board approved a \$160.1 million equity distribution from the Share Insurance Fund that will be paid to eligible credit unions in the second quarter of 2019, providing another one-time income item that federally insured credit unions can use to improve their portfolio yield.
- Any credit union that filed a quarterly Call Report as a federally insured credit union for at least one reporting period in calendar year 2018 will be eligible for a pro rata distribution.
- As a preliminary estimate, eligible credit unions may be able to expect to receive approximately \$18,500 per \$100 million of average insured shares.
- For accounting and call report purposes, we assume the NCUA's recommended treatment of the 2018 equity distribution will be appropriate for the 2019 distribution. The NCUA recommended that the distribution be booked as "Other Operating Income" and reported on line item 14 on the Statement of Income and Expense – Other Operating Income. Some credit unions may choose to record this income item in 1Q 2019 since it has been announced, or they may wait until actual receipt of the distribution in 2Q 2019.

We believe this one-time income provides credit unions with another excellent opportunity to prune lower-yielding bonds from their investment portfolios. Since rates have increased over the past couple of years, these lower-yielding bonds are now carried on the balance sheet with unrealized losses. Using the income from the SIF equity distribution allows credit unions to sell these bonds, offset the realized losses, and reinvest the proceeds into bonds with much higher yields, effectively "reloading" the portfolio with today's higher yields. We included an example of such a trade on the following page:

Disclosures are contained on the last page of this report.

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SELL:

CUSIP	DESCRIPTION	PAR VALUE	BOOK YLD	AVG LIFE	LOSS
Totals			1.975	3.6	(211,102)
3133EGLZ6	FFCB 1.72 4/14/2022	2,500,000	1.729	3.1	(64,230)
3130A7PS8	FHLB 1.9 4/12/2023	2,500,000	2.019	4.1	(55,353)
3130A7RC1	FHLB 1.8 4/20/2022	2,500,000	1.813	3.12	(56,269)
3133EGK7	FFCB 2.35 2/1/2023	2,500,000	2.34	3.91	(35,250)
BUY:					
31418CVE1	FNMA 15-yr 3% MBS	9,762,400	2.973	4.9	
DIFFERENCE			0.998	1.4	

In this example, a credit union sells \$10 million of their lower-yielding agencies, generating a \$211,000 loss. They use the Other Income from the SIF distribution of \$225,000 to offset the loss. By doing so, this credit union is able to sell holdings with a book yield of 1.975% (which is 50 basis points lower than fed funds) and reinvest into a 15-year 3% MBS, picking up almost 100 bps in book yield. The income impact (as shown below) increases income by \$320,000 through the third quarter of 2022, effectively boosting the value of their one-time income item by over 50% over the next 3.5 years. This swap turns a one-time income event into recurring income.

INCOME IMPACT	INITIAL	ANNUAL	CUMULATIVE
LOSS ON SALE OF BONDS	(211,102)		(211,102)
SIF OTHER INCOME	225,000		13,898
DEC 2019		77,938	91,836
DEC 2020		96,831	188,667
DEC 2021		98,948	287,615
SEPT 2022		47,309	334,924

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