Federal Home Loan Bank of New York

PANEL SESSION RECAP: "NOW IS NOT THE TIME FOR BUSINESS AS USUAL"

As part of the FHLBNY's commitment to our credit union member's success, this recap is provided to share some key takeaways from a panel session held for credit unions during the Credit Union Association of New York State's Annual Convention.

Gain insight to top-of-mind challenges credit unions are faced with regularly and learn how your peers are tackling net interest margin compression and interest rate risk, as well as strategies for deposit pricing, secondary market selling, and thoughts on how to remain successful today.

Session Panelists:

» Scott A. Wilson, President & Chief Executive Officer of SeaComm FCU

» Brian D. Snyder, Chief Executive Officer of Olean Area FCU

» Thomas J. Doyle, Vice President and Director of the Mortgage Partnership Finance® (MPF®) Program

Moderator: Thomas R. Settino, Vice President & Calling Officer, FHLBNY

Combat Net Interest Margin Compression

What are some tactics and strategies you are using to combat net interest margin compression in a slower trade environment?

Scott A. Wilson / SeaComm FCU:

» Proactive and diverse investment strategy, putting available cash (even our vaults) to work in investments, such as mortgage backed securities and SBAs

» Moved to a cash management system to optimize the amount of money available

» Have a goal of maintaining net interest margin above 3%

» Developing new products with taxable municipal bonds

» Prudent ALM strategy

> *"Despite the economic downturn and low loan demand, credit unions are doing well. People trust in credit unions and want to bring their money to us."*

Brian D. Snyder / Olean Area FCU:

» Lend and invest every dollar instead of retaining excess — stick with short duration assets

» Continue purchasing mortgage-backed securities that contain 3/1 or 5/1 ARMs (less than a 4 year average life) to reprice in 3 to 5 years

» Create new loan programs with short amortizations

» Maintain an evolving product line – our loan to share ratio is 79%, and we attribute this to our dynamic product offerings

> *"We continuously strive to develop new loan programs. We also try to lend and invest every dollar rather than leaving it in liquid funds earning approximately 25 basis points."*

How the FHLBNY Can Help Combat Net Interest Margin Compression

If you're liability-sensitive, the Fixed-Rate Advance with a LIBOR Cap could help combat net interest margin pressure. This hybrid funding option combines a fixed-rate borrowing with an embedded interest-rate cap tied to the 3-month LIBOR index. The rate remains fixed but may be reduced quarterly if 3-month LIBOR rises above the cap that you choose prior to the transaction. If 3-month LIBOR rises above the predetermined cap, the interest rate would adjust downward depending on how many bps LIBOR is above the cap.

Rapid rises in interest rates could cause the interest expense of the advance to plummet (quarterly reset and a floor of zero), which would help offset declining net interest income. Additionally, the falling coupon rate would increase the present value of the advance in a rising environment, serving to assist with your Economic Value of Equity at Risk.

To learn more, visit fhlbny.com/FixedRateLiborCap.

Mitigate Interest Rate Risk

SeaComm FCU sells a lot of their mortgage production. What's your position on interest rate risk and how are you preparing for an eventual, perhaps sudden, rise in rates?

Scott A. Wilson / SeaComm FCU:

» Try to incent people to move to variable rate products as much as possible

» Keep the average life of securities short

» Diversify the security portfolio to include callables, step-ups, and other features

(Audience) Any success in offering 5/5 ARMs or other products?

Brian D. Snyder / Olean Area FCU:

» We do offer 5/5 ARMs

» We have been successful doing shorter-duration lending to customers readying to retire

» Offering 5/1 ARMs or 10/1 ARMs are another possibility

> *"We had a doctor who came in trying to wind down for retirement — wanted to reduce his payments and so forth to conserve some cash. He knows within the next 10 years he's going to retire, so he took a 30-year amortization with a 10-to-1 ARM. So there are some opportunities, especially with those readying themselves for retirement."*

Scott A. Wilson / SeaComm FCU:

» We do commercial lending as well — these are great opportunities because the majority of them are adjustable, which should give you a chance to put some dollars out with interest rate protection

How the FHLBNY Can Help Mitigate Interest Rate Risk

In addition to the Fixed-Rate Advance with Libor Cap, the Callable Advance is another tool available to members that can help mitigate interest rate risk. The product offers built-in prepayment options that can help you reduce interest rate risk and prepayment risk at minimal added cost.

The Callable Advance is essentially a Fixed-Rate Advance that gives you the option of calling (terminating) the advance on predetermined dates, prior to maturity, without incurring a prepayment fee. They're available with final maturities of 3, 5, 7, and 10 years, and offer 1-, 2-, 3-, or 5-year "lockout" periods before the advance can be called without penalty.

To learn more about funding strategies for the Callable Advance, visit fhlbny.com/CallableStrategy.

Deposit Pricing and Managing Asset Volume

Many financial institutions REALLY lowered their deposit rates. With the business model and mission of credit unions, it's been a little different. What are you doing on the deposit side to address the declining and prolonged rate environment? What have you seen as a result?

Scott A. Wilson / SeaComm FCU:

» We benchmark with an average — price not at the highest, nor at the lowest

» Offer a rewards program and relationship pricing to offset some of those lower rates

» Offer CDs from 30, 36, 48 to 60 months — putting a little bit on the yield curve so that when interest rates rise you won't be as exposed from a rise in your cost of funds

> *"During 2009 especially we saw an influx of deposits from folks that opened up accounts and became members just to enjoy those moderately high rates. So we added a rewards program and relationship pricing, on CDs especially, from 30, 36, 48 to 60 months — putting a little bit on the yield curve so that when interest rates rise we would be protected."*

Brian D. Snyder / Olean Area FCU:

» Price close to the top of the market for continued growth

» Keep expense ratio low in relation to your assets and gross income

» Continued, profitable growth is necessary to balance net interest margin

» Find a place for profits to generate more profit

> *"Without growth and with the declining net interest margin, I think you're going to be in trouble if you don't keep your expense ratio low."*

How the FHLBNY Can Help with Deposit Pricing and Managing Asset Volume

Holding large positions of cash and cash equivalents on the balance sheet for prolonged periods of time may be a common practice, but there could be ramifications. FHLBNY advances in longer durations can be used as a tool to manage deposit outflows and mitigate the interest rate risk associated with putting money to work in longer duration assets.

Check out our *True Costs to Excess Cash* article at fhlbny.com/ExcessCash to learn more about the marginal cost of deposits.

Secondary Market Selling

Do you retain mortgage production on your balance sheet or sell to the agencies or some other secondary outlet? Do you maintain some longer term production?

Scott A. Wilson / SeaComm FCU:

» We have a threshold of how many 30-year fixed mortgages we'll allow on our books based on interest rate risk — so the secondary market is extremely vital to us in terms of being able to put our members in a product that's affordable to them

Brian D. Snyder / Olean Area FCU:

» Sell as many mortgages as you can, keeping everything as short as possible

» Reduced mortgage portfolio in the 15-year bucket by about 25% in the last three or four years

» Create new products — ARMs and 5-, 7-, and 10-year fixed rate mortgages

» Target those who are or will be ready for retirement (get out of debt and plan for retirement)

Have you done any planning or given some serious thought to what the future of the GSEs will be and what the secondary mortgage market will look like in two, three, or five years from now?

Brian D. Snyder / Olean Area FCU:

» The credit unions and banks need an outlet to sell mortgages

» Without those outlets the prices of mortgages offered across the country will go up significantly because of interest rate risk

» Someone is going to have to step up to buy loans, whether it's the FHLBNY or other private sector entities

Scott A. Wilson / SeaComm FCU:

» Many smaller institutions do not want to hold mortgage loans on their balance sheet

» The constant question about this approach is how they will have access to the capital market investors and often the suggested solution is to set up some type of cooperative to meet their needs

» At the Annual FHLB Directors Conference, FHFA Acting Director, Edward J. DeMarco, touched on this topic and in response to forming a cooperative he noted, "we already had one, and that's in the FHLBs"

(Directed to Thomas J. Doyle / FHLBNY) **Can you give your perspective on what our members are doing in regards to maintaining mortgage production, and also share what the FHLBNY is looking at to address this issue?**

» With rates as low as they are, most institutions seem to be selling their 30-year production, as the duration risk would concern anyone

» Even the 15-years, some will hold on their balance sheet, but with rates as low as 2.5-2.75%, the fear is that those loans will last 15 years

» Rates are starting to increase somewhat, but they're still relatively low

» We're an avenue for a lot of institutions that want to sell – institutions not afraid to take on a portion of the credit risk — a natural situation for credit union personnel who want to maintain their valuable customer relationships

» As far as the future is concerned, we are very concerned that without Fannie Mae and Freddie Mac the community lenders like you will not have access to the secondary market in the future — we want to be that access point for you

***(Directed to Thomas J. Doyle / FHLBNY)* Can you elaborate on the competitive advantage of the MPF Program for high-balance loan areas?**

- The agencies will buy fixed 15-, 20-, and 30-year high-balance mortgages, and have pricing sheets for each term and differential pricing based on balances
- With high-balance loan pricing, their pricing falls off 150 bps (plus or minus) from the conforming loan limits to the $625,500 loan
- FHLBNY offers the same price — so if you sell a high-balance loan to us, you might be receiving a benefit of somewhere close to 150 bps
- If you are originating loans in a high-cost area, as determined by the FHFA, you should be selling those loans to the MPF Program — you'd have a great deal going

How the FHLBNY Can Help in Secondary Market Selling

The Mortgage Partnership Finance® (MPF®) Program is an alternate option available to you to fund mortgages and be competitive in offering fixed-rate mortgage loans. The MPF Program can potentially increase your profitability, ensure liquidity, and earn you added income for the loans you originate. A key benefit is the program's unique risk-sharing structure — the FHLBNY pays you a Credit Enhancement fee for retaining a portion of the credit and servicing risks associated with the mortgage loans sold, while the FHLBNY assumes the interest rate risk and option/prepayment risk. With no guarantee fees, adverse market fees, loan level price adjustments, or minimum amount of loan deliveries, it's a win-win situation for participating members. Learn more about the MPF Program at fhlbny.com/mpf.

Closing Takeaways

Credit unions are facing new challenges that are compromising their ability to maintain profitability and grow their balance sheets. Margin compression, the weak economic environment, and heightened regulatory expenses all compromise credit unions' growth and profitability, threatening member access to products and services. Our panelists discussed their heighted focus on "bottom line" profitability and capital growth — being "fully invested" with minimal excess cash has been an important component to their current strategies. Additionally, they advocated proceeding with caution concerning interest sensitivity — their current strategies include pursuing shorter-duration investments and loans, selling long-term mortgages to the secondary market, and match-funding long-term assets with longer-term advances.

Maintaining access to a trustworthy and reliable source of wholesale liquidity is essential for success over the next 10 years. Although not currently acknowledged as an emergency liquidity provider by the NCUA, the FHLBNY lends to our members up to the very last day of their solvency. As a strategic partner to over 75 credit union members, the FHLBNY will lend to a credit union as long as they have the collateral to pledge with us and the capability to also purchase stock. As a system, the Federal Home Loan Banks are working in Washington, and with the NCUA, to be recognized as an emergency wholesale liquidity provider next to the Federal Reserve.

> *"As long as markets remain open, and a member has pledged sufficient qualifying collateral and is willing to purchase the requisite amount of capital stock, the FHLBNY will always continue to lend to our members to help you meet your community's needs."*
>
> – Alfred A. DelliBovi, President and CEO of FHLBNY

To discuss the material covered and how partnering with the FHLBNY can help you better serve your members, contact a Calling Officer at (212) 441-6700. We look forward to serving your credit union's specific needs.

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