

April, 2008

**Total Benefits Pre-Funding:
Helping you manage future benefit cost increases**

FCUL Annual Convention and Expo

June 12, 2008

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ROA – Review

Income/Expense Item	Peer Average Source: (www.ncua.gov)
Net Investment Income	(2.97%)
+ Fee Income	(1.37%)
- Operating Expenses	(3.25%)
- Write-Offs	(0.41%)
Return (%)	(0.68%)

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Benefit Costs & Earnings

ROA versus Health Benefit Costs

- Benefits costs are growing more than credit union earnings
- Margin pressure forcing credit unions to seek incremental benefit across organization
- Total Benefit Pre-Funding can help mitigate pressures


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Employee Benefits ROA Impact: Today's Challenges

- Escalating benefit costs
- Maintaining the level and quality of benefit plans
- Declining operating margins for credit unions



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Total Benefits Pre-Funding (TBPf)

Definition

- Fund future benefit obligations using normally non-permissible investment vehicles.

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TBPf Exclusive Offering to Credit Unions

Regulations & History

- NCUA regulation 701.19 amendment (April, 2003)
- Clarification letters (February, 2004 & December, 2006)
- Allowed for federal and state-chartered credit unions with automatic parity to NCUA rules
- State-chartered credit unions have special handling
- Ongoing dialogue with NCUA

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TBPF: Major Considerations

Regulatory Compliance

Safety & Soundness of Credit Union

Program (Investment) Return

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TBPF: Major Considerations (continued)

Regulatory Compliance

- Compliance with NCUA 701.19
- Accounting treatment
- Adhering to opinions allowing use of non-permissible investments

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TBPF: Major Considerations (continued)

Safety and Soundness

- Ensuring program will not imperil the credit union
- Integration into risk management of credit union
- Ongoing monitoring and testing

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TBPF: Major Considerations (continued)

Program (Investment) Return

Common approaches to TBPF:

- Do it yourself
- Company-Owned Life Insurance -or- Bank-Owned Life Insurance
- Institutional Managed Account Program

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Total Benefits Pre-Funding Program

The diagram illustrates the Total Benefits Pre-Funding Program. At the top, two boxes labeled 'Flexibility' and 'Profitability' point to a central box 'Total Benefits Pre-Fund'. 'Flexibility' is defined as 'You decide where to allocate earnings amongst your benefit programs.' 'Profitability' is defined as 'Earnings from investments can offset costs of underlying benefits.' Below 'Total Benefits Pre-Fund' is a box for 'Earnings Growth', which is supported by 'Qualified Benefits'. 'Qualified Benefits' includes: Stock Asset Purchase, 401(k) Plan, 403(b) Plan, 457 Plan, Executive Incentive Compensation, Defined Benefit Funding, and Retiree Asset Growth.

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Total Benefits Pre-Funding Process

Assess

- Benefit-related liabilities
- Credit union tolerances

Invest

- Deploy funds to offset benefit costs
- Select program based upon credit union preferences

Risk

- Integrate with credit union risk management program
- Ensure safety and soundness is not compromised

Review

- Regular reviews – annually
- Update as credit union characteristics change

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The TBPB Concept in Practice

Assumptions:

- \$500 million in assets
- ROA = 1%
- Capital assets = 11% (\$55 million)
- HR costs = \$5.0 million/year
- Dedicate \$15 million to TBPB
- Investment return on TBPB = 7.5%
- Current portfolio yield = 4.5%



\$\$ Enhance ROA \$\$

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The TBPB Concept in Practice (continued)

Features of TBPB:

- Assets are still on CU balance sheet
- Characteristics are different
 - Influenced by economy
 - Influenced by interest rates
- Integrates risk management, regulatory/compliance and investment performance

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The TBPB Concept in Practice (continued)

\$15 million TBPB

Current situation:

- No change to investments
- Earnings = 4.5%
= \$675,000/year

After Total Benefit Pre-Fund:

- TBPB earnings = 7.5%
= \$1,125,000/year
- \$450,000 potential incremental impact to ROA

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Potential Benefits to Your Credit Union

- ✓ Ability to mitigate costs for ongoing and increasing employee benefit obligations
- ✓ Expanded scope of permissible investments
- ✓ Flexibility to use assets for benefits as needed
- ✓ Potential to help close the "benefits gap"

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Next Steps?

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    graph TD
      A[Perform assessment consulting] --> B[Build Pre-funding proposal based on assessment]
      B --> C[Review proposal modify as needed]
      C --> D[Agreement]
      D --> E[Implementation]
      E --> A
  
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Contact Information

John Moreno
 Executive Benefit Specialist
 CUNA Mutual Group
 John.Moreno@cunamutual.com
 (608) 356-2644 x6921

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