

Local Credit Union Feels Pain Of Failures at Other Institutions

By [Mike Allen](#)

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FINANCE

Mike Allen

Once held up as bastions of conservative lending, credit unions are failing or being forced to merge (such as San Diego's USA Federal CU earlier this month) in far greater numbers this year.

As of Sept. 17, there have been 25 failures of federally insured credit unions, including 15 involuntary liquidations, according to the National Credit Union Association, the main regulatory agency for the industry and the operator of its share deposit insurance fund. It's the equivalent of the Federal Deposit Insurance Corp.'s deposit insurance fund for the banking industry.

There were 28 credit union failures for all of 2009.

These failures are depleting the insurance fund for all credit unions to the point where the NCUA recently passed a special assessment to replenish the fund. The assessment, approved by the agency Sept. 17, requires an additional insurance premium of 12.42 basis points on a credit union's total deposits. Since a basis point is 1/100th of 1 percent, that may not sound like much, but for some of the larger credit unions, it's no small amount.

In the case of USE Credit Union, based in San Diego, the assessment, which will be billed in October and due in November, means the organization will have to cough up about \$800,000, said CEO Jim Harris.

"Obviously we don't like it," Harris said. "This is the second assessment that we've had to pay the NCUA this year."

The first one went to shore up a corporate stabilization fund for the two corporate credit unions that failed last year, Wescorp and U.S. Central Federal. That first assessment was 13.4 basis points and cost USE about \$850,000, Harris said.

Those fees could have gone to help shore up profits at USE, or at least to cut any losses. As of June 30, USE reported a net loss of \$2.3 million, about the same net loss it had in the prior year's first half.

Like many other credit unions (or just about any entity that lent money in the last few years), USE is suffering red ink because more borrowers of its mortgages, auto loans and credit cards aren't making their payments.

At the end of June, USE reported \$7.2 million in delinquent loans. That's 1 percent of its total assets of \$704.7 million.

Again, that ratio may not be so terrible, but because of those delinquencies, USE had to boost its reserve balance by \$6.4 million through the end of June. If its problem loans were much less, it wouldn't have had to increase its reserves by so much.

Harris said the late payments and defaults are a result of more borrowers either losing their jobs or many having to take lower-paying or part-time jobs. The bad loans include credit cards, auto loans and mortgages, but no subprime mortgages which USE never made.

The ongoing losses have also affected USE's net worth, or equity. Net worth is similar to the banking industry's capital, and the key metric that regulators watch closely.

As of June 30, USE's net worth was 6.49 percent, just a bit above its 6.3 percent net worth ratio in June 2009. Credit unions must have at least 6 percent in net worth to be considered adequately capitalized.

Tony Cherin, a director for USE and a finance professor at San Diego State University, said things appear to be improving at USE in recent months. In August, it booked a loss of \$65,000, which was pretty good considering some other months this year when the credit union was losing as much as \$400,000, he said.

To boost USE's net worth, the credit union embarked on a strategy of shrinking in size. By reducing its size, the credit union doesn't have to maintain as much net worth in dollars. Over the year, it declined by about \$100 million. Cherin said the credit union cut interest rates on its time deposits, causing a departure of customers seeking higher rates elsewhere. It also sold an unprofitable branch office in San Jose that resulted in the reduction of \$50 million in deposits, he said. The credit union now has eight branches including six in San Diego County.

Harris said as of the end of August, USE cut its delinquencies to \$4.4 million and that the problem loans appear to be ebbing.

"Some of the changes we put into effect (tighter underwriting standards) are showing results," he said. "By the end of 2011, we should have a net worth that will qualify us as well capitalized (above 7 percent)."

While all this seems to give some hope for USE and its 85,000 members, there is still uncertainty surrounding many other credit unions that are struggling with higher numbers of delinquencies and heavier losses.

And that means more failures by credit unions, and more losses to the industry's insurance fund,

which could lead to more special assessments to support that fund.

Debbie Matz, the chairman of the NCUA, noted in a recent letter to credit unions that the losses to the share insurance fund this year are currently budgeted at \$750 million, or six times the number of losses for all of last year.

“Troubled credit unions are not only growing in number; they are also growing in size,” Matz said.