

NCUA LETTER TO CREDIT UNIONS

**NATIONAL CREDIT UNION ADMINISTRATION
1775 Duke Street, Alexandria, VA 22314**

DATE: March 2004 **LETTER NO.: 04-CU-02**
TO: Federally Insured Credit Unions
**SUBJ: Financial Trends in Federally Insured Credit Unions
January 1 - December 31, 2003**
**ENCL: Financial Trends in Federally Insured Credit Unions
January 1 - December 31, 2003**

DEAR BOARD OF DIRECTORS:

Enclosed is a report highlighting credit union financial trends for 2003. The analysis is based on data compiled from the year-end 2003 call reports submitted by all federally insured credit unions.

Along with the impressive savings and asset growth that we have seen over the past several years, the 2003 performance in lending, delinquency and overall net worth accumulation also provides a positive report.

Credit unions need to remain vigilant in monitoring the impact of changes in interest rates and make appropriate adjustments to maintain an acceptable level of risk.

Thank you for your cooperation in providing this data.

Sincerely,

/S/

Dennis Dollar
Chairman

Enclosure

FINANCIAL TRENDS IN FEDERALLY INSURED CREDIT UNIONS

January 1 - December 31, 2003

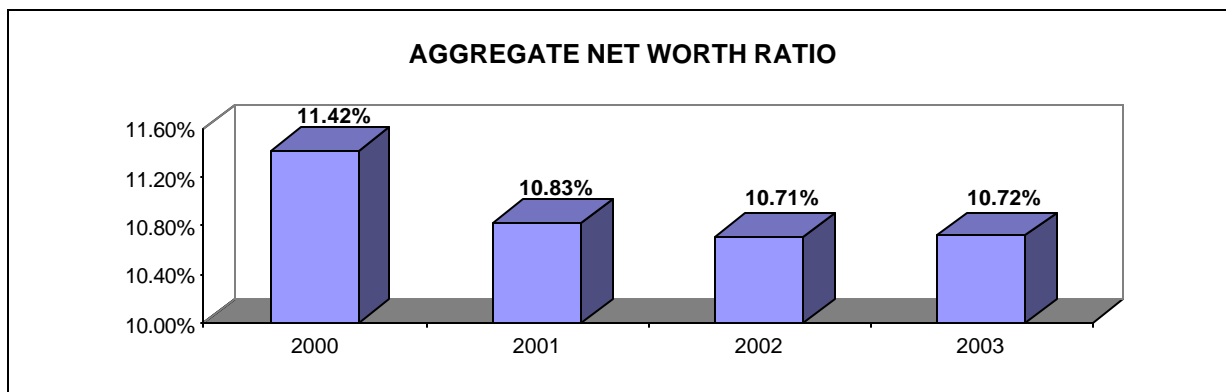
HIGHLIGHTS

This report summarizes the trends of all federally insured credit unions that reported as of December 31, 2003. Change is measured from the prior year-end (December 31, 2002).

- ◆ **Assets** increased \$53.0 billion, or 9.52%.
- ◆ **Net Worth** increased 9.57%, or \$5.7 billion. The Net Worth to assets ratio increased from 10.71% to 10.72%.
- ◆ **Loans** increased \$33.4 billion, or 9.75%. The loan to share ratio increased from 70.78% to 71.19%.
- ◆ **Shares** increased \$44.1 billion, or 9.11%.
- ◆ **Cash on hand, cash on deposit, cash equivalents, plus short-term investments (less than 1 year)** decreased \$6.0 billion, or 5.79%.
- ◆ **Long-term investments (over 1 year)** increased \$23.7 billion, or 28.06%.
- ◆ **Profitability**, as measured by return on average assets, decreased from 1.07% to 0.99%, but remains strong.
- ◆ **Delinquent loans** as a percentage of total loans decreased from 0.79% to 0.77%.

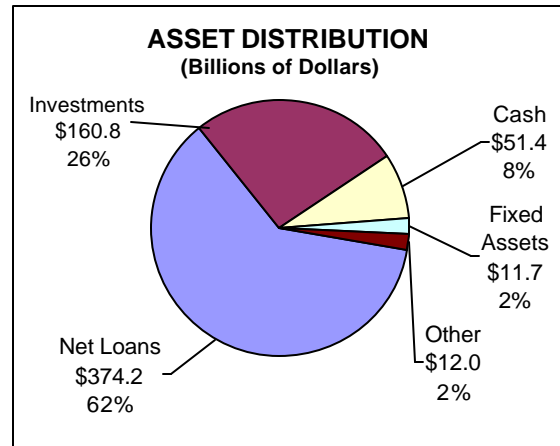
CAPITAL

Total Net Worth increased \$5.7 billion (9.57%) during 2003 due to strong profitability and low loan losses. The aggregate Net Worth to total assets ratio increased slightly to 10.72%. The average (non dollar-weighted) net worth ratio for credit unions is 13.32%.



ASSET QUALITY

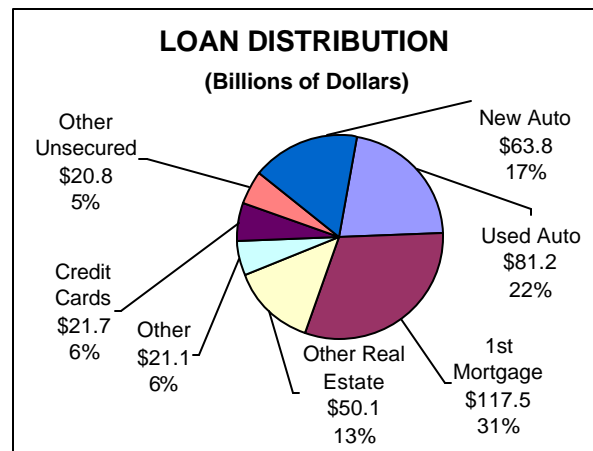
LOAN TRENDS: All loan categories, except for All Other Unsecured Loans and Leases Receivable experienced growth. Loan growth of 9.75% resulted in an increase in total loans of \$33.4 billion. Share growth was slightly slower than loans, causing the loan to share ratio to increase slightly from 70.78% in 2002 to 71.19% in 2003. Growth in the various loan categories is as follows:



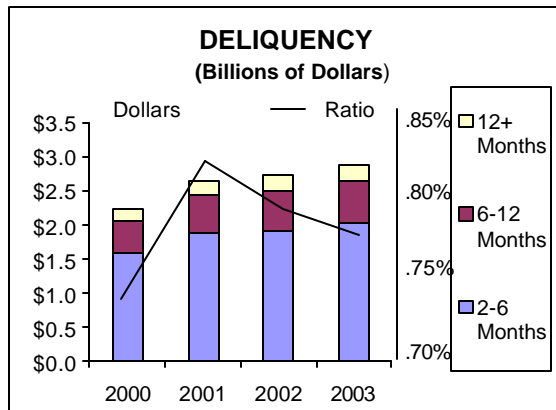
Loan Category	2002 Balance In Billions	2003 Balance In Billions	Growth In Billions	Growth Rate
Unsecured Credit Card	\$21.6	\$21.7	\$0.2	0.81%
All Other Unsecured	\$21.1	\$20.8	-\$0.3	-1.55%
New Vehicle	\$60.5	\$63.8	\$3.3	5.47%
Used Vehicle	\$72.2	\$81.2	\$9.0	12.51%
First Mortgage Real Estate	\$100.8	\$117.5	\$16.8	16.63%
Other Real Estate	\$46.4	\$50.1	\$3.6	7.84%
Leases Receivable	\$1.5	\$1.5	-\$0.0	-2.03%
All Other	\$18.7	\$19.5	\$0.9	4.73%

First mortgage real estate loans account for 31.24% (\$117.5 billion) of all loans, with 72.32% (\$85 billion) being fixed rate. Federally insured credit unions granted \$70.8 billion in fixed rate and \$15.8 billion in adjustable rate first mortgage real estate loans in 2003. Credit unions sold \$37.4 billion first mortgages in 2003 (includes both fixed and adjustable rate loans).

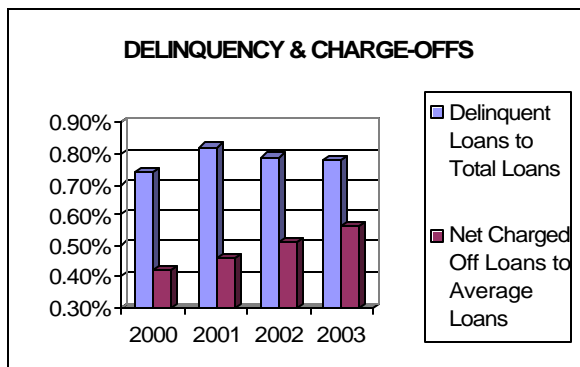
Indirect loans granted grew 38% (\$7.3 billion) from \$19.3 to \$26.7 billion.



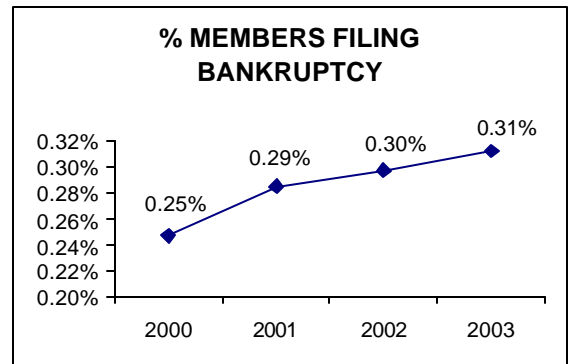
DELINQUENCY TRENDS: Delinquent loans increased 5.78% (\$157.3 million). However, the delinquent loans to total loans ratio decreased slightly from 0.79% in 2002 to 0.77% in 2003. The decline in the delinquency ratio was the result of the increase in total loans exceeding the increase in delinquent loans.



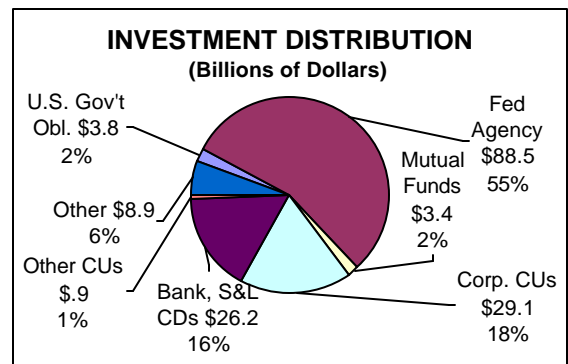
Loan dollars charged off increased 17.64% (\$351.4 million), whereas recoveries on charged off loans increased 13.38% (\$38.1 million). This resulted in net charged off loans increasing by 18.35% (\$313.4 million). The increase in net charged off loans outpaced loan growth, resulting in an increase in the net charged off to average loans ratio from 0.51% in 2002 to 0.56% during 2003.



Federally insured credit unions reported an increase in members filing for bankruptcy. The percentage of members filing bankruptcy increased from 0.29% to 0.31%. Outstanding loans subject to bankruptcy total \$1.9 billion. Bankruptcies accounted for 37.14% (\$870 million) of the loans charged off in 2003.



INVESTMENT TRENDS: Except for *Mutual Funds*, all investment categories increased in 2003. This resulted in a 14.68% (\$20.6 billion) growth in total investments.



Cash on hand, cash on deposit, and cash equivalents decreased 4.16% (\$2.2 billion). These combined categories, along with investments with maturities of less than one year, decreased 5.79% (\$6.0 billion).

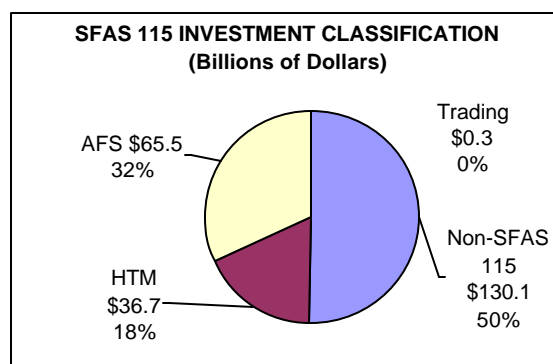
Investments with maturities greater than a year increased 28.06% (\$23.7 billion).

Non-SFAS 115 investments (including cash on deposit and cash equivalents) increased 2.90% (\$2.9 billion) to \$103.1 billion.

Held-to-maturity investments increased 13.87% (\$4.5 billion). *Available-for-sale* investments increased 18.67% (\$10.3 billion). Trading securities increased 2.62% (\$6.6 million).

At the end of 2003, SFAS 115 investments made up 49.83% of the investment portfolio. Non-SFAS 115

investments, cash on deposit, and cash equivalents accounted for 50.17% of the portfolio.



The following table compares the changes in the maturity structure of the investment portfolio over the past year:

Investment Maturity or Repricing Interval	% of Total Investments 2002	% of Total Investments 2003
Less than 1 year	55.09%	47.43%
1 to 3 years	32.01%	34.15%
3 to 10 years	11.76%	16.91%
Greater than 10 yrs	1.15%	1.51%

EARNINGS

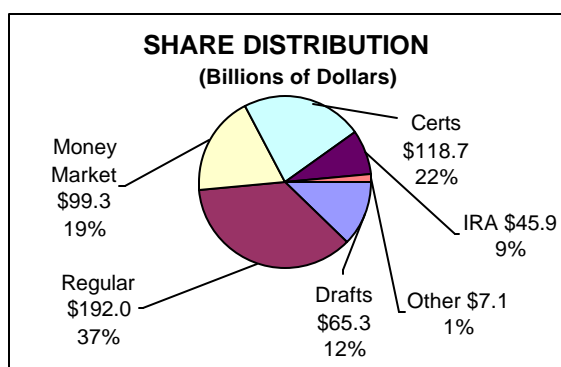
Total net income increased 2.33% (\$131.5 million). The return on average assets decreased from 1.07% to 0.99%. The net interest margin declined to 3.41%, near historical lows. Fee and other income increased substantially, reducing the impact of the lower net interest margin. Total operating expenses increased at a slower pace of 8.83% and operating expenses to average assets declined by four basis points to 3.23%. The Provision for Loan

Loss Expense and non-operating income levels remained stable.

Ratio (% Ave. Assets)	As of 2002	As of 2003	Effect on ROA
Net Interest Margin	3.63%	3.41%	- 22bp
+ Fee & Other Inc.	1.03%	1.12%	+ 9bp
- Operating Expenses	3.27%	3.23%	+ 4bp
- PLL	0.35%	0.35%	0bp
+ Non-Opr. Income	0.03%	0.04%	+ 1bp
= ROA	1.07%	0.99%	- 8bp

ASSET/LIABILITY MANAGEMENT

SHARE TRENDS: Total shares increased 9.11% (\$44.1 billion) in 2003, compared to 10.77% in 2002. Money market and share certificate accounts represent 41% of total shares.



Growth rates for the various share categories are as follows:

Type of Share Account	Change (\$M)	Change Rate
Share Drafts	\$ 7,330	12.64%
Regular Shares	\$19,850	11.53%
Money Market	\$12,939	14.99%
Certificates	\$ 428	0.36%
IRA/Keogh	\$ 3,022	7.05%
Other Shares	\$ 499	9.29%
Non-member Deposits	\$ 63	5.23%
Total	\$44,131	9.11%

Shares with maturities of less than one year and one year to less than three years decreased slightly as a percentage of total shares, while the percentage of shares with three years or greater maturities to total shares increased as the following chart indicates.

Share Maturity or Repricing Interval	% of Total Shares Dec. 2002	% of Total Shares Dec. 2003
Less than 1 year	89.76%	89.44%
1 to 3 years	7.66%	7.33%
3 or more years	2.58%	3.23%

OVERALL LIQUIDITY TRENDS: At the end of 2003, credit unions had approximately 17.07% of total assets in cash and short-term investments, compared to 19.65% at the end of 2002. Long-term assets (defined as assets with maturities or repricing intervals greater than 3 years - 5 years for real estate loans), equaled 25.33% of total assets at the end of 2003, compared to 22.92% at the end of 2002.

For the first time since 2000, the loan growth rate exceeded the share growth rate.

INTEREST RATE RISK: Interest rates have been at historically low levels for enough time to cause credit union assets to reprice downward and resulted in near record low net interest margins. If interest rates rise, credit unions holding significant portions of longer term, fixed-rate assets could see even lower net interest margins, squeezed earnings, and reduced net worth.

CONCLUSION: Financial performance of the industry remains strong despite the challenges presented by the low interest rate environment. Credit unions need to remain vigilant in monitoring the impact of changing interest rates and make adjustments to maintain an acceptable level of risk.