



# NEWS

MAY 1999



AN ELECTRONIC REPORT FROM THE CUNA CHIEF FINANCIAL OFFICER COUNCIL

## GREETINGS TO ALL CFO COUNCIL MEMBERS.

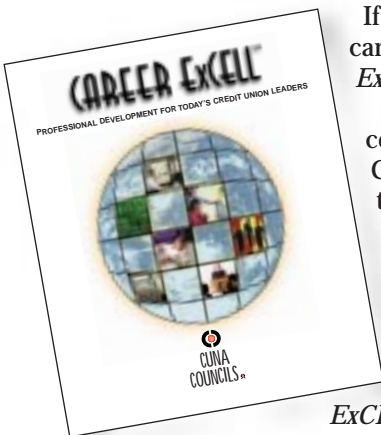
*By Kerry Parker, CFO and Executive Committee Chair, Baton Rouge Teachers FCU*

I would like to thank you for the past two years of successes in the Council. Membership has increased to over 350 members and this year's conference attendance was the highest ever. We have implemented the listserv to provide immediate access to the thoughts, systems, services, and procedures of our membership. We will soon evolve that service into a threaded discussion on our Web site that will offer even greater service. Council members have participated in various CUNA committees providing a resource for the CFO perspective. All of this has been possible because of the hard work by the Executive Committee members and our CUNA staff representatives. A THANK YOU to ALL! No, I am not leaving, but I am turning over the reins-I believe in term limits!

At this year's conference, we will be presenting our new slate of officers. I would like to congratulate Vince Market, Chief Financial Officer Philadelphia Telco, as the new Chair, Larry Hoffman, VP Finance Anheuser-Busch Employees' CU, as the Vice-Chair, and Judith Hillock, CFO, Research Federal Credit Union, as the Secretary/Treasurer. We will also be welcoming our newest Executive Committee member, John Bailey from Baxter FCU.

A special thank you and recognition goes to Ralph Reardon. Ralph is a founding member of the Council and will vacate his Executive Committee seat in May. As many of you know, Ralph has been actively involved in CUNA's Y2K committee including testifying before the House Subcommittee. Throughout his term on the Council, Ralph has always been supportive, innovative, and responsive to the needs of the Council. We will all miss his leadership on the Executive Committee, but we know he is only a phone call away. THANK YOU Ralph! ♦

## TAKE YOUR NEXT CAREER STEP



If you're ready for the next step in your career but aren't sure where to turn, *Career ExCELL*<sup>SM</sup> is the resource you need.

Developed by the CUNA Councils in conjunction with The Cardwell Group, the Cleveland-based consulting firm with a history of cultivating top performers among credit union leaders, *Career ExCELL* provides the knowledge you need to move forward in your career as a credit union chief financial officer. In addition, you can use that knowledge, as well as that of other disciplines found in *Career ExCELL*, to work your way to your credit union's top executive slot.

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*Career ExCELL* is available only through the CUNA Councils and sells for \$199 for

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council members and \$299 for non-council members. Add you own personal copy of *Career Architect* to the order and pay just \$249 (council members) or \$359 (non-council members.)

It's the ultimate professional development resource and critical to those professionals

looking for career advancement. Call CUNA Customer Service at 800/356-8010, ext. 4157, and request item #22420VB1 (*Career ExCELL* only) or #22458VB1 (*Career ExCELL* and *Career Architect* together.)

Or visit CUNA's Web site at [www.cuna.org](http://www.cuna.org), click on "Council" and select *Career ExCELL*. ♦

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## WHEELS TURN ON MEMBERSHIP DRIVE

If you've recruited new members for the CUNA CFO Council, or even if you've just talked about the council during your professional gathering with other credit union CFOs, you've helped spread that word that has made the CFO Council one of the strongest of the six CUNA Councils.

Thanks very much for your support.

With 354 new and renewing members, the CUNA CFO Council has recaptured 95 percent of the membership level it occupied at the end of 1998. And it's set us well on the way toward achieving our goal of 400 members for 1999. The council has reason to be proud. But a lot of work still lies ahead of us.

With our annual conference just completed, there's no better time to sell the council to

your professional friends and colleagues.

And, as the referring member, you'll receive a fashionable CUNA CFO Council logoed golf shirt. The forest green shirt is produced by Seattle-based Cutter & Buck, makers of some of the country's finest sports apparel. You'll look sharp on the links, on the boat or just tooling around this summer. At the same time, you'll boast your membership in the only organization run of, by and for credit union CFOs.

Sell a membership, get a shirt. It's that easy. And more new members mean more resources to better serve existing members. You can't lose with this deal. What's more, everyone wins. ♦



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## PAYMENT CONFERENCE 1999

By Judith Hillock, CFO, Research FCU

Celebrating 25 years of direct deposit and electronic payments, the National Automated Clearing House Association (NACHA) held a conference in Atlanta Georgia, April 11-13th. Approximately 1400 professionals from financial institutions, insurance companies, and merchants were in attendance. It appeared that less than 10% were from credit unions.

Today, there are over 20,000 financial institutions, two million businesses and 100 million consumers using some type of electronic payment. The automated clearinghouse processed payments totaling more than 5.3 billion transactions in 1998.

The hot topic of the conference was "Educating Americans on Conversion of Checks at the Point of Purchase (POP)". Our credit union members will soon be able to present a check to a merchant and the merchant will encode the check, mark it as void and immediately return it to the member. The

check will be presented to the credit union electronically. Technically referred to as "Point of Purchase", this program is currently in the testing phase; the interim phase will begin September 1999 with the final rulings September 2000.

Only consumer checks under \$5,000 are considered eligible items. Merchants' benefits seem significant. Included are elimination of paper handling; reduction in deposit and return check fees; accelerated collection of funds; data entry savings on encoding & return items; earlier notification of returns and timing of representments. Benefits to credit unions include fee income and reduced operating expenses.

Preliminary results found consumers to have a neutral to strong acceptance of electronic check processing. Thirty percent of consumers stated said they read the POP signage and understood it, while 50% read the authorization/receipt and understood it. Consumers preferred the immediate return of



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their check rather than later.

NACHA will undertake a broad, national educational campaign and will enforce operating rules on unwarranted returns. A potential problem may exist for credit unions. If a member's check is converted to an electronic

payment and is processed through ACH, can your computer system identify a stop payment on either means of presentment? (A paper check, as well as an ACH transaction.)

Please contact Judith at 810/826-8003 if you have any questions on The Payment Conference. ♦

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*The following two articles are reprinted with permission from Corporate Network Brokerage Services (CNBS).*

## CREATING AN AGENCY YIELD CURVE

*By: Beth De Lay, CFA, Senior Vice President, Investment Advisory Services*

Last December, the Federal National Mortgage Association (FNMA) announced that it would consolidate its intermediate bullet issues into large offerings issued on a frequent basis. The first issue, a five-year note, came to market in January and was an immediate success. In addition to being more cost effective for the agency, both FNMA and the dealer community plan to use these issues as the basis for a "benchmark" agency curve. In March 1998, the Federal Home Loan Mortgage Corporation (FHLMC) followed suit and began issuing "reference" notes under the same guise. The details of these issues and the potential impact they may have on the market are discussed below.

### Program Details

The FNMA benchmark notes and FHLMC reference notes have minimum new issue sizes of \$2 billion and \$4 billion respectively. For comparison, an average agency issue ranges from \$25-200 million. FNMA has committed to 8-10 benchmark offerings per year (including re-openings) with monthly announcements of its intended funding, if any, for that month. FHLMC, on the other hand, is targeting quarterly issuance. Both agencies plan to issue 2- to 10-year maturities with a focus on creating a yield curve over time.

Securities issued under both programs will be strippable. A "stripped" security is created when the coupon stream is "stripped" or sold separately from the principal repayment amount after issuance. Both the cash flow stream and principal repayment are then discounted at prevailing rates to determine their price at any given point in time. Strip principal notes have longer durations than their coupon bearing counterparts and have no reinvest-

ment risk. Therefore, strip principal notes are attractive to investors expecting rates to fall over the life of the security.

Benchmark and reference issues are also actively traded in the repo market. Dealers stand ready to buy or sell bonds at tight bid/ask spreads. Dealers are also willing to have short positions in these issues as their size makes them very liquid. Repo spreads for both types of issues typically mirror the off-the-run treasuries.

The yield spreads on both the reference and benchmark issues are tighter than on other agency bullets. Currently, the difference between the three-year benchmark and other bullet issues offered by FNMA is 4 basis points. The rationale for this difference is primarily the additional liquidity they offer. Some traders have commented that they view these issues as Treasury substitutes given the liquidity, AAA rating and implied government guarantee. It is important to recognize that while these issues are significantly larger than other agency issues, they are dwarfed by the \$15 billion size of recent 2- and 5-year Treasury note auctions.

### Market Implications

These issues will have several market implications once a full curve is built. First, both smaller agency bullet and callable issues may be priced over the reference or benchmark agency in the future. This would allow for the removal of any credit quality spread over the Treasury, facilitating more meaningful analysis in terms of volatility. Second, as volatility changes, credit unions may be able to trade the spread on these agencies versus treasuries more effectively. For example, spreads on bullet agencies were as narrow as 5-7 bp just a few years ago. If an investor bought a benchmark agency today and held during a period of spread contraction, gains could be taken as the spreads narrowed. Finally, as the treasury reduces the types of maturities it offers, such as the recent elimination of the three-year note, benchmark agency notes may fill in the "gaps" in the yield curve.

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## Conclusion

While investors must concede a few basis points to purchase benchmark or reference securities versus other bullets, the liquidity gained may be worth the price. Strategies such as rolling down the curve could be employed using these bonds without fear of bid/ask spreads widening due to issue size or

bonds being “put away.” It should be recognized that some of the advantages offered by these new notes can only be realized if they are classified as available-for-sale. For more information about either benchmark or reference notes, please contact your CNBS representative at (800) 222-0978. ♦

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## BENCHMARK CALLABLES

*By: Beth DeLay, CFA, Senior Vice President,  
Investment Advisory Services*

In the September, 1998, issue of MarketCast, we highlighted the issuance of benchmark agency securities in an article titled, “Creating an Agency Yield Curve.” If you recall from that article, agency benchmark securities offer enhanced liquidity through larger, regularly scheduled issuance. The benchmark program was a resounding success for the agencies. The Federal National Mortgage Association (Fannie Mae) has issued over \$55 billion in benchmark notes since the initial offering in January 1998. Their timing in introducing this debt was impeccable. The “flight-to-quality” resulting from the meltdown of the Russian debt market last fall provided an excellent test of investors’ perception regarding the liquidity and quality of the agency debt market. While agency spreads still widened to historically high levels, the agencies were able to maintain funding access in a crisis situation. The added liquidity offered by the benchmark program certainly enhanced their position and offered investors an attractive alternative.

On April 7, officers of Fannie Mae announced that they would be expanding the program to include callable bonds as well. The initial offering is expected to come to market in late April. The minimum issue size for these securities will be \$500 million. While this issuance size is small relative to the bullet benchmarks (\$2 billion on average); it dwarfs the typical callable offering.

The issuance plan announced for the callable benchmark program includes two structures commonly purchased by credit unions: a 5-year final maturity callable after 2-

years and a 5-year final maturity callable after 3-years. The two other structures available have 10-year final maturities callable after 3- and 5-years respectively. Fannie Mae has committed to either issuing or re-opening at least one callable benchmark note each month. In a press release, Fannie Mae’s CEO Franklin Raines commented, “With a regular schedule of issuance and a minimum new issue size of \$500 million, Callable Benchmark Notes will offer global investors in Fannie Mae’s callable debt a high credit quality, very liquid debt product driven by investor demand.”

The majority of the callable bonds that Fannie Mae has issued in the past are callable on a continuous basis. We anticipate the same will hold true with the new benchmark issues. However, Fannie Mae occasionally offers bonds with a one-time call feature. If they opt to issue a benchmark with a one-time call, credit unions could place the bond in their available-for-sale portfolio and perhaps benefit from the spread tightening if a one-time callable bond passes its call date. For example, assume the credit union purchases a 5-year benchmark issue callable after 3-years. If the call feature is a one-time call, the bond will effectively be a bullet issue after the 3-year call date passes. Since callables typically trade at wider spreads than bullets, some spread “compression” would occur, as the callable would no longer have any call dates and thus should be priced like a bullet.

The strategy outlined above only applies if the credit union classifies the bond as available-for-sale and is willing to sell the bond to take advantage of spread changes. For those investors who intend to hold the bond to maturity, non-benchmark issues offer wider spreads and would likely be a better alternative. ♦



CFO News is fax broadcast bimonthly by the CUNA Council. Send news and CFO Council information to Vince Market, CFO, Philadelphia Telco CU, Treviso, PA, phone 215/953-5369; fax 215/953-5388 or Harry Jacobson, Asset/Liability Manager, Navy FCU, Merrifield, VA, phone 703/206-3606; fax 703/255-7755. For council membership and administration information, call Cheryl Sorenson, manager of CUNA council administration, at 1-800-356-9655, extension 4393 or e-mail her at csorenson@cuna.com.

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