

From The President –4th Quarter 2006

By Emily Moré Hollis, CFA

First of all, I hope everyone's year is off to a positive start! ALM First had another record year and we thank you for your continued support. Services in demand seem to be our static pool analysis, mortgage servicing rights, asset-liability validation services, and ALM First On-Demand. Credit union valuations are also frequent requests as mergers continue in the industry at the rate of one per day!

I just came back from speaking at the January Risk Mitigation Seminar in Washington, D.C. organized by Vice Chairman Rodney Hood (who by the way, will be speaking at our July Financial Forum) and what an event it was. The list of speakers was phenomenal and the NCUA seems to be making great strides in giving credit unions tools to manage risk instead of stressing avoidance.

We work hard here at ALM First, but that doesn't prevent us from having a little fun. So, to start the year off, we've decided to offer a little contest to our clients. To enter, simply forecast where the two-year Treasury, the ten-year Treasury, and overnight Fed Funds will be at year-end 2007. Applications will be accepted until March 16, and the winner will be announced at the end of the year. The person with the forecasts closest to the reality will receive \$500. To enter, just e-mail your forecasts to your advisor.

By the time this newsletter goes to press, the February Financial Institute will most likely be completed. We had a great turnout this year of over 45 credit union attendees. The Institute has become an annual event and is held each year at the Gaylord Texan in Grapevine just outside of Dallas. Also, please mark your calendars for July 25-27, 2007, when we'll host our Annual Financial Forum at the Ritz-Carlton Bachelor Gulch in Beaver Creek, Colorado. We hope you'll make plans to joins us in the mountains!

If you're on our accounting service, please download your 2006 FAS 115-1 and FAS 124-1 year-end disclosure reports from our website. More information on this report is discussed in this newsletter. Remember that this accounting information is required for fiscal year-end. If your fiscal year-end varies from the calendar year-end, please let us know.

We're looking forward to the year ahead and the opportunity to continue to assist you, our clients, with the evolving needs of your credit union.

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ALM First Liquidity Model

Liquidity planning is an important tool for any financial institution and can have far-reaching effects on the entire balance sheet. Frequently, the impetus for development of a new service or product at ALM First is directly related to a request from our clients. That was the case with the development of our new liquidity model.

This model, which is available now through your advisor, uses the results from a credit union's ALM modeling as a starting point and incorporates the client's input on growth projections for the next 12-24 months. Once the financial advisor has the growth projections, we can input it into the model, process the report, and provide the results in a matter of days.

One of the distinguishing characteristics of the liquidity model is the sophistication involved in projecting cash flows. Traditional liquidity models tend to be static and may not adequately account for changes in key variables. We integrate projected cash flows that are already incorporated in the ALM income simulation which include vectored prepayment speeds as well as budgeted new volumes that will be coming on in the new year.

The results show the credit union's projected liquidity position on a monthly basis for the chosen period of 12 or 24 months. This gives the credit union additional insight, so effective strategies can be developed as needed to deal with excess liquidity or liquidity shortfalls. The credit union and financial advisor can work together to develop and build these strategies.

We are in the process of developing a web-based platform that will allow clients to visit our website and enter their growth projections. The model will be customized so clients will see their balances from their most recent ALM report as a starting point.

Once the projections are added, the data will come back to ALM First, where the model is processed and a report will be produced for the client. We'll provide additional details to you in the coming months. To learn more or run a liquidity analysis for your credit union, please contact your financial advisor.

Andy Popenoe from Cooperative Center FCU Named Contest Winner!

ALM First Financial Advisors would like to congratulate Andy Popenoe from Cooperative Center FCU. He attended Emily Hollis' session at the National Directors Conference in Las Vegas last August and was the closest in guessing where the two-year Treasury, the ten-year Treasury, and overnight Fed Funds would be in six months. Great job, Andy!

Year-End Disclosures about Impaired Investments:

(FSP FAS 115-1 and FAS 124-1 Addresses Investment Impairment)

With the release of the Financial Accounting Standards Board (FASB) Staff Position FAS 115-1 and FAS 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," (the FSP) in November 2005, FASB in the finalized FSP reverted to Paragraph 16 of FASB Statement No. 115, Paragraph 16, and SEC Staff Accounting Bulletin Topic 5 M for the evaluation of whether an impairment is other than temporary. Paragraph 16 of FAS Statement 115 states: "For individual securities classified as available-for-sale or held-to-maturity, an enterprise shall determine whether a decline in fair value below the amortized cost basis is other than temporary. For example, if it is probable that the investor will be unable to collect all amounts due according to the contractual terms of a debt security not impaired at acquisition, an other-than-temporary impairment shall be considered to have occurred."

This FSP does, however, require disclosures in summary tabular format, by sector and segregated between unrealized losses of less than 12 months or 12 months or more:

- Aggregate amount of unrealized losses (the amount by which cost or amortized cost exceeds fair value)
- Aggregate related fair value of investments with unrealized losses

Along with the table, a narrative disclosure is required to allow financial statement users to understand both the aggregated, tabular information, and the positive and negative information the reporting entity considered in concluding that the impairments are not other-than-temporary. This disclosure may include the types of investments, cause, severity, and/or duration of the impairments.

ALM First's Reporting to Clients

ALM First provides reporting for all clients that have been using the financial advisory and accounting service for the full calendar year of 2006. The tabular data reflects the last 13 months of financial reports, 12/31/05 – 12/31/06. Along with this tabular report, ALM First has prepared a written statement addressing the investments, cause of any impairments, and severity and duration of the impairments.

Welcome to ALM First!

We're pleased to welcome the following clients from the 4th quarter:

I-C FCU
Fitchburg, Massachusetts
Norman Boudreau,
President & CEO
\$310 million in assets

Truliant FCU
Winston-Salem, North
Carolina
Marc Schaefer, President
& CEO
\$1.03 billion in assets

Sample Report - Credit Union

Description of Securities	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Treasury obligations and direct obligations of US Government agencies	\$XX	\$XX	\$XX	\$XX	\$XX	\$XX
Federal agency mortgage backed securities	\$XX	\$XX	\$XX	\$XX	\$XX	\$XX
Non-agency ABS and CMO securities	\$XX	\$XX	\$XX	\$XX	\$XX	\$XX
Corporate bonds	\$XX	\$XX	\$XX	\$XX	\$XX	\$XX
Municipal bonds	\$XX	\$XX	\$XX	\$XX	\$XX	\$XX
Total temporarily impaired securities	\$XXX	\$XXX	\$XXX	\$XXX	\$XXX	\$XXX

You can access your report by going to the ALM First website (www.ALMFirst.com) and logging in to the Client Extranet.

Ask Emily

We believe that interest rates are falling; therefore, I am proposing that we increase the amount of fixed-rate mortgages that we have on our books to protect us from loss of income in a falling rate environment. Do you have a standard amount (as a percent of assets) that we should add?

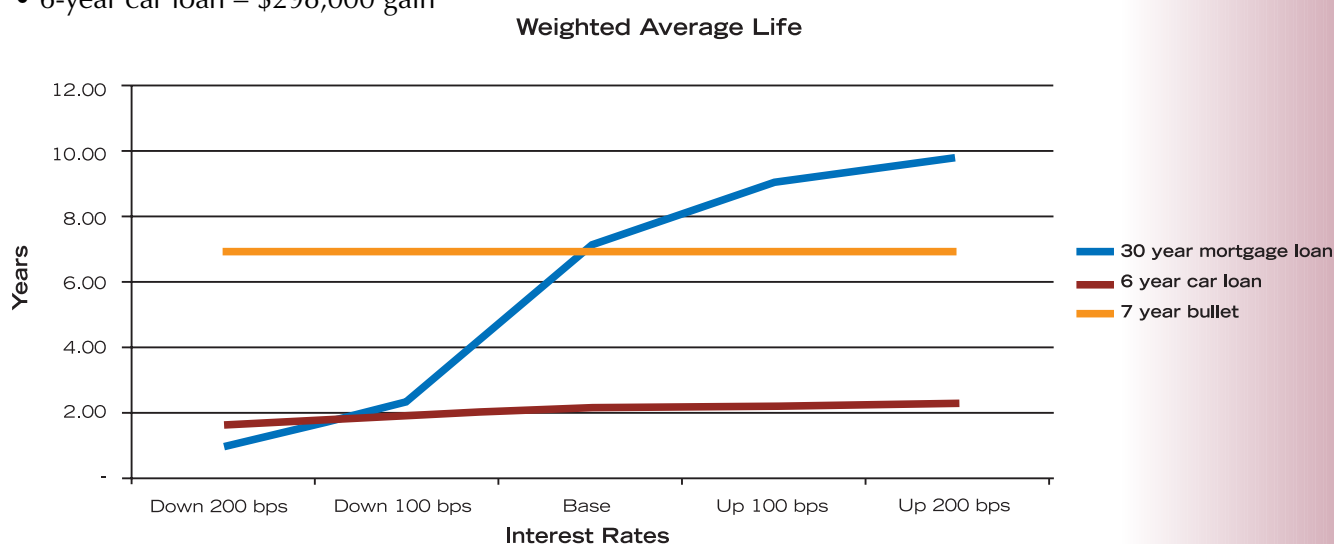


There is no easy answer to this question. The amount that you should add is dependent upon the composition of your remaining balance sheet. With our credit union clients, mortgage loan guideline allocations range from as high as 60 percent to as low as 10 percent of assets – depending upon the credit union’s capital, the rate sensitivity of its liabilities, its risk tolerance level, its hedging capabilities, and other factors. The beauty of asset liability management is the formulation of these target allocations.

In answering the second part of your question, fixed-rate mortgages do not necessarily perform well should rates fall by more than 100 basis points (b.p.), because they are prone to high prepayments. Therefore, don’t depend on them to enhance income. The best performers in falling rate environments are bullets or some form of a derivative such as a floor.

As an example, should rates fall by 200 b.p., current 30-year mortgage loans yielding 6.42 percent are projected to prepay at 74 percent CPR . This means that 74 percent of the principal balance of your 30-year mortgage loan pool will mature and you will be forced to reinvest the funds at lower rates. If you plan to sell in that environment, compare the following asset gains (assuming \$10 million allocation):

- 7-year bullet investment – \$1.215 million gain
- 30-year mortgage – \$191,000 gain.
- 6-year car loan – \$298,000 gain



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¹ A bullet is an investment that has no embedded option (calls amortizing features, puts etc.) such as a Treasury note, an agency debenture, or a corporate share certificate.

¹ A floor is an option that will pay you income at current interest rates minus a predetermined "strike" rate.

¹ One year prepayment estimate from Citigroup for FNMA 2004 vintage.

The graph above compares the three asset options. As you can see, the six-year car loan has a comparable weighted average life to the 30-year mortgage loan should rates fall. If your credit union is prone to spread compression in falling interest rate environments, you probably have a good amount of room for asset duration extension. However, if rates really fall, these mortgage loan additions will not protect your income. Meanwhile, the seven-year bullet investment provides by far the largest gain in this environment since none of the principal is returned prematurely, even though it will generally be the lowest-yielding option.

Having said that, don't let me discourage you from servicing your members with issuing longer-term loans. As always, asset allocation diversity is the key. If you can afford the increase in interest rate risk should rates rise, hedge your bet with a few bullet purchases in case rates do indeed fall!

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Employee spotlight



Maria Giagtzis, Report Analyst

As my third anniversary with ALM First approaches, I consider it a privilege to be a part of this dynamic team of seasoned professionals, sharing values such as excellence in service and client focus.

My title is Report Analyst, and in that role I am responsible for completing various rate sensitivity tests for our clients' investment portfolios in Yield Book, as well as preparing the analytics reports that are included in the quarterly report packages. In addition, I am responsible for modeling loan portfolios, conducting what-if analyses, and preparing ad hoc reports. I also have the opportunity to assist different areas of our operations department with various accounting reports.

In my free time, I enjoy reading a good book, listening to music, and, of course, spending time with my husband and our friends and family. My beloved dog, Jack, is in charge of my wellbeing as he insists on taking me for hour-long walks at least twice a day!

ALM First Financial Advisors Client Forecasting Competition

Where will the two-year Treasury, the ten-year Treasury and overnight Effective Fed Funds be at the end of 2007?

E-mail your advisor with your predictions by March 16, 2007.

The entry closest to the actual numbers will receive \$500!

On the Calendar

NCUA Vice Chairman Rodney Hood's Risk Mitigation Summit

United States Chamber of Commerce
Washington, D.C.
January 11, 2007

Emily Hollis presented "Vendor's Approach to Adding Best in Class Products to Financial Services Industry"

ALM First Financial Institute

Gaylord Texan, Grapevine, Texas
February 5-7, 2007

Courses offered included ALM Fundamentals and Current Topics in Balance Sheet Management

WesCorp Financial Strategies Conference

Honolulu, Hawaii
March 7-9, 2007

Angela Calvert will present "Yield Curve Dynamics"

CUNA CFO Council

Phoenix, Arizona
May 22, 2007

Emily Hollis will present "Loan Analysis: What Are You Really Yielding on Your Loans?"

Financial Managers Society The Finance & Accounting Forum

Gaylord Texan, Grapevine, Texas
June 23-27, 2007

Emily Hollis will present "Emerging Investment Structures"

ALM First Financial Forum

Ritz-Carlton Bachelor Gulch, Beaver Creek, Colorado
July 25-27, 2007

29th Annual National Directors' Convention

Las Vegas, Nevada
August 8-10, 2007

Emily Hollis will present "Volatile Rate Environment: Strike the Right Balance of Loans and Investments"