

RANK of Financial Ratios Defined by CAMEL

Each credit union has a one-line analysis of financial ratios and a one-number summary rank. IDC's unique CAMEL analysis utilizes financial ratios that have a significant impact on the quality of the credit union:

Summary Rank: Superior 200-300, Excellent 165-199, Average 125-164, Below Average 75-124, Lowest Ratios 2-74, Rank of One

Capital risk is determined by net worth as a percent of assets compared to the risk-based net worth requirement.

Adequacy of net worth and reserves measures the levels of delinquent loans, nonaccrual loans, restructured and foreclosed assets relative to loan loss reserves and net worth.

Margins are the best measurement of management's financial controls. Margins represent the spreads between 1) operating profit and net operating revenues or the operating profit margin, 2) return on earning assets and cost of funding, and 3) most important, the return on equity compared to estimated cost of equity capital. Stability of profitability measures the variation of the operating profit margin.

Earning returns measure the success of the credit union's operating strategy. Ratios of revenue yields from investments, loans, and noninterest income compared to operating costs before interest expense are the major components of the net operating return on earning assets (ROEA). ROEA is a measure of **operating strategy** as if the institution was wholly funded by equity capital. Earnings from financial leverage (ROFL) measures the level of leverage and cost of funding compared to the return on earning assets (ROEA). Leverage returns measure the efficiency of the credit union's **financial strategy**.

Liquidity measures (1) balance sheet cash flow as a percent of net worth and (2) loans compared to stable deposits and borrowings plus estimated unused lines of credit.

Financial ratios, which illustrate IDC's CAMEL, represent the vast majority of the components of the RANK, but not all of the financial ratios used in the RANK process.

Limitations to Use of Financial Ratios and Ranks

Ranks are designed to provide IDC Financial Publishing, Inc.'s opinion as to the relative value of financial ratios, and are subject to limitations in their use. The ranks have no value in forecasting the direction of future trends of financial ratios. While in our opinion the selected ratios provide an ample financial picture for evaluating a thrift, the quality of individual savings institutions can also be influenced by factors not taken into account in this analysis.

The quality of a financial institution is not fixed over time, but tends to undergo change. For this reason, changes in ranks occur, reflecting changes in the individual financial ratios.

The data for calculations and ranks and other information found in this publication was obtained from sources believed to be reliable and accurate; however, neither the publisher nor its employees assume responsibility for the correctness or accuracy of data, calculations of ranks, or liability for their use.

© 2016 by IDC Financial Publishing, Inc. All rights reserved. No part of this document may be reprinted, reproduced, or utilized in any form or by any electronic, mechanical, or other means, now known or hereafter invented, including photocopying and recording, or in any information storage and retrieval system, without the express written permission of IDC Financial Publishing, Inc.

Glossary for Credit Union CAMEL Report

C - CAPITAL RATIOS

Net Worth % Assets

The Net Worth Ratio is net worth divided by total assets, as a percentage. Net worth includes the sum of regular reserves, appropriation for non-conforming investments (State Credit Unions only), subordinated debt included in net worth, other reserves, plus undivided earnings. Assets include reported assets at quarter end or averages for assets in current quarter as selected.

Risk-Based Net Worth Requirement

A risk based net worth (RBNW) minimum requirement for credit unions with assets greater than \$1 million is 6%. This risk-based ratio multiplies the risk weighting times the asset concentration percentage for each type of asset, providing for some credit unions an RBNW requirement calculation greater than 6%. For credit unions with less than \$1 million in assets, the RBNW requirement is a minimum 7%.

A - Adequacy of Net Worth and Loan Loss Reserve to Cover Loan Delinquency

Loan Loss Reserve % Net Worth

The allowance for loan losses as a percent of net worth.

Loans 2-6 Months Delinquent % Net Worth

Loans delinquent 2 - 6 months as a percentage of net worth.

Loans 6 Months or more Delinquent % Net Worth

Loans delinquent 6 months or greater plus other real estate owned and expected delinquency from modified loans as a percentage of net worth.

Loan delinquencies and repossessed assets in excess of loan loss reserves provide potential risk to net worth.

M - Margins Measure Management

Net Operating Profit % Equity ROE (1yr)

The core net operating profit return on equity (ROE) is the sum of core return on earning assets before funding costs (ROEA) and return on financial leverage (ROFL) for the previous 12 months. Core net operating profit equals net income before gains or losses on the sale of securities or other assets, and before other operating income (expense), and then is adjusted by adding back the increase in the loan loss reserve. **A return equal to or above the cost of equity is necessary to provide a sufficient return to the credit union's capital employed and provide for the future strength of the credit union.**

Cost of Equity COE (1yr)

The best measure of a credit union's cost of equity is the risk-adjusted return on equity (ROE) of a similar credit union. IDC estimates COE equal to the yield on 30-year U.S. T-Bonds plus a real net worth return of 2.5%. For the quarter ending [December 31, 2015](#), the T-Bond yield was 3.0% and the net worth premium was 2.5% for a normal COE of 5.5%.

The specific COE for an individual credit union varies around the average COE as a function of asset size, risk of delinquency to capital income, and coverage of net loan charge-offs. In order to quantify individual credit union risk, a risk multiplier incorporates specific risk for size, coverage of charge-offs, and delinquency risk to capital. The risk multiplier is set in a range from 0.8 to 1.2 based on the income coverage of charge-offs. The risk multiplier is then multiplied by 0.9 for credit unions over \$200 million in assets, 1.0 for credit unions \$100 to \$200 million in assets, 1.1 for assets between \$50 and \$100 million, 1.2 for assets between \$20 and \$50 million, and 1.3 for assets under \$20 million to adjust for size.

Credit unions with loans 2-6 months delinquent and 6 months or more delinquent plus other REO greater than the loan loss reserve, all stated as a percent of net worth, are evaluated to measure any risk to net worth. If this risk-adjusted net worth ratio is below 5%, the credit union is assigned a risk ratio of 2.0. All other CUs with adequate risk-adjusted net worth above 5% use a risk ratio of 1.0.

Net Interest % Earning Assets (1yr)

Interest income from loans and investments less interest expense is divided by average earning assets, as a percentage

Noninterest Income % Earning Assets (1yr)

Non-interest income, which includes fee income (fees charged to members for services or membership), and other operating income is divided by average earning assets, as a percentage.

Operating Expense % Earning Assets (1yr)

Operating expense measures a credit union's operating efficiency. Non-interest expense including salaries and employee benefits, expenses of premises and fixed assets, as well as other non-interest expenses (excluding provision for loan losses), are divided by average earning assets, as a percentage.

Operating Profit Margin OPM (1yr)

Total operating expenses less provision for loan losses is subtracted from operating revenue and divided by operating revenue less cost of funding, as a percentage for the previous 12 months. The operating profit margin equals 100 less the efficiency ratio.

OPM Risk Standard Deviation

The standard deviation of the operating profit margin over five years (but not less than five quarters) measures the risk or volatility in profit margins. This risk level is also a measure of a credit union's complexity.

E - Earnings Return

Return of Net Operating Profit from Operations % Earning Assets (ROEA)

ROEA represents operating return as if the credit union's only liabilities were net worth and reserves. The components of ROEA include interest income from cash equivalents, investments and loans, non-interest income less the current operating expenses, and excludes gains or losses on the sale of securities or other assets and other operating income (expense). The increase in the loan loss reserve is added to reflect the operating profit excess of the loan loss provision relative to net loan charge-offs. ROEA is simply the core rate (before interest charges or dividends on shares and deposits) the credit union returns on earning assets. **ROEA evaluates the fairness of the rate charged to members on loans as compared to the cost of delivery of these services, or the success of the operating strategy.**

Return on Financial Leverage (ROFL) = Spread X Leverage

ROFL calculates both the degree to which a credit union uses shares, deposits, and borrowings to finance its operating strategy and the weighted average cost of these funds. **ROFL evaluates the competitiveness of the rates paid on shares and deposits to members and the success of the financial strategy.**

ROEA less Cost of Funds = Leverage Spread

The leverage spread is the return on earning assets (ROEA) less the cost of adjusted debt for the previous 12 months. The leverage spread times the leverage multiplier equals ROFL.

Leverage Multiplier

The leverage multiplier is the ratio of adjusted debt to adjusted net worth for the previous 12 months. Adjusted debt is equal to average earning assets less average net worth including the investment and loan loss reserve.

L - Liquidity Determines the Ability to Grow

Balance Sheet Cash Flow % Net Worth

Balance sheet cash flow measures the profit return on physical assets in computing operating cash flow. Balance sheet cash flow separates cash and equivalents (cash and balances due from depository institutions and federal funds) from investments and loans when computing financial cash flow. The end result is balance sheet cash flow, which equals operating cash flow less financial cash flow.

Operating cash flow for a credit union measures the liquidity demand from growth. Operating cash flow equals quarterly changes in net worth minus the quarterly changes in growth producing assets (property, equipment, and other long term assets). The purpose of operating cash flow is to determine the ability to finance internally the change in growth producing assets.

Financial cash flow isolates the sources and uses of funds, other than the changes in net worth, growth producing assets and cash and equivalents. Financial cash flow equals the change in shares, borrowings or capital (excluding net worth) less the change in loans and investments and other non-cash and equivalent current assets. Balance sheet cash flow subtracts the financial cash flow from operating cash flow. If a credit union finances its growth with increases in net worth equal to increases in growth producing assets, but the financial cash flow was positive, then the balance sheet cash flow would be negative, reflecting the change in liabilities or shares in excess of the change in loans and investments. A credit union with poor loan quality or risky investments experiences asset write-offs or write-downs, and at the same time, shares are increased or new borrowings incurred to finance the asset base. Balance sheet cash flow recognizes the shortfall and the risk to net capital of the institution.

Percent Annual Growth in Net Worth

The annual growth of net worth for the last 12 months as a percentage. The internal growth rate of net worth can indicate sustainable future growth.

Nonperforming Assets % Total Loans

Loan delinquencies 2 - 6 months and 6 months or longer, plus other real estate owned and expected delinquency from modified loans, divided by total loans, as a percentage.

Net Loans as a % of Member Shares & Excess Liquidity

Another liquidity ratio measures net loans as a percent of member shares plus excess liquidity. Net loans are defined as total loans less the reserve for loan losses, excluding loans held for sale. Excess liquidity equals estimated unused lines of credit.

Interest-Bearing Liabilities % Earning Assets

Total shares, deposits, and borrowings are divided by earning assets in order to compare interest-bearing liabilities to assets earning interest — a low value maximizes interest rate spreads. Earning assets include cash, investments, and loans. Investments are adjusted to exclude reverse repurchase transactions placed in investments for purposes of positive arbitrage.