DFI

DEPARTMENT of FINANCIAL INSTITUTIONS

Public Protection Cabinet

TEAM KENTUCKY

Ratios & Acronyms

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KDFI CREDIT UNION DIRECTOR TRAINING

KENTUCKY DEPARTMENT OF FINANCIAL INSTITUTIONS, 2021

Net Worth Ratio

=(undivided earnings + regular reserves + net income or loss + other reserves) / total assets

- Net worth ratio provides a snapshot of the current financial condition
- Cushions earnings fluctuations, supports growth, and provides protection against insolvency
- Considered well capitalized when the ratio is greater than 7 percent. However, the adequacy of net worth is dependent on the risk profile of the credit union. More risk requires more capital to support.

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Net Worth

- The retained earnings balance of the credit union at quarter-end as determined under generally accepted accounting principles
- Retained Earnings - consists of undivided earnings, regular reserves, and any other appropriations designated by management or regulatory authorities
- R&R 702.2 and R&R 702 Subpart A
- Call Report page 12

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Delinquency Ratio

= delinquent loans / total loans

- Only includes loans greater than 60 days overdue
- This ratio is an indicator of the effectiveness of delinquency control and the quality of loans in the portfolio

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Net Charge-off Ratio

- (Year to date charge offs – year to date recoveries) / average loans
- Average loans = (prior year end loan total + current loan total) / 2
- The ratio must be annualized
  - 1st quarter - multiply by 4
  - 2nd quarter - multiply by 2
  - 3rd quarter - multiply by 4/3
  - 4th quarter - no need to annualize
- Measures the effectiveness of a credit union's lending and collection practices

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Allowance for Loan and Lease Losses (ALLL)

- Reflects estimated credit losses within the loan portfolio. These losses are the current amount of loans that are probable that the credit union will be unable to collect.
- An appropriate ALLL covers estimated credit losses on individually evaluated loans that are determined to be impaired as well as estimated credit losses inherent to the remainder of the loan portfolio
- The greater the risk of uncollectable loans in a portfolio, the larger the ALLL will be.
- ALLL methodology must be in compliance with GAAP

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Provision for Loan and Lease Loss (PLLL)

- An income statement expense set aside to allow for uncollected loans
- Represents the adjustments to the ALLL each period
- The provision account ensures that the credit union is presenting an accurate assessment of the overall financial health

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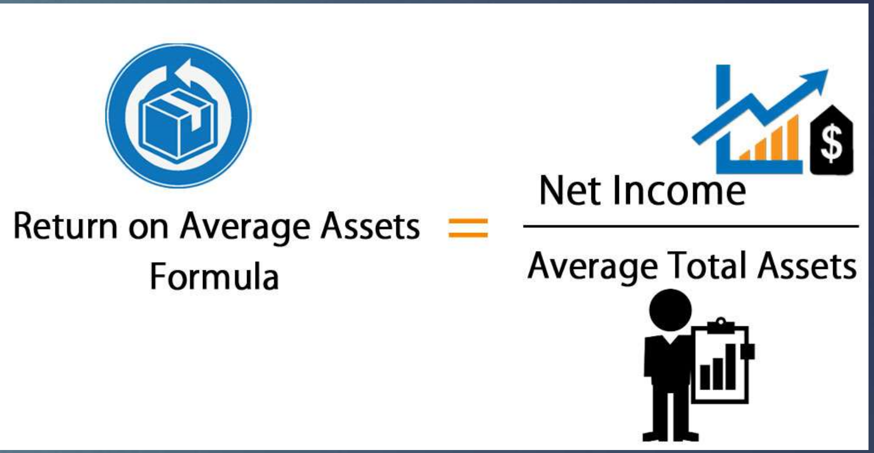
Return on Average Assets

= Net Income / Average assets

- Annualized income
  - 1st quarter - multiply by 4
  - 2nd quarter - multiply by 2
  - 3rd quarter - multiply by 4/3
  - 4th quarter - no need to annualize
- Average assets = (prior year-end assets + current assets) / 2



- Net Income = Interest income – interest expense – PLLL + non-interest income – non-interest expense

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Return on Average Assets

- A positive ratio shows that earnings were sufficient to cover operating expenses and cost of funds
- Shows how a credit union utilizes assets to generate profits
- Review the income statement to see what has the greatest impact on net income
- Significant asset growth from the prior year-end may have a material impact on ROAA

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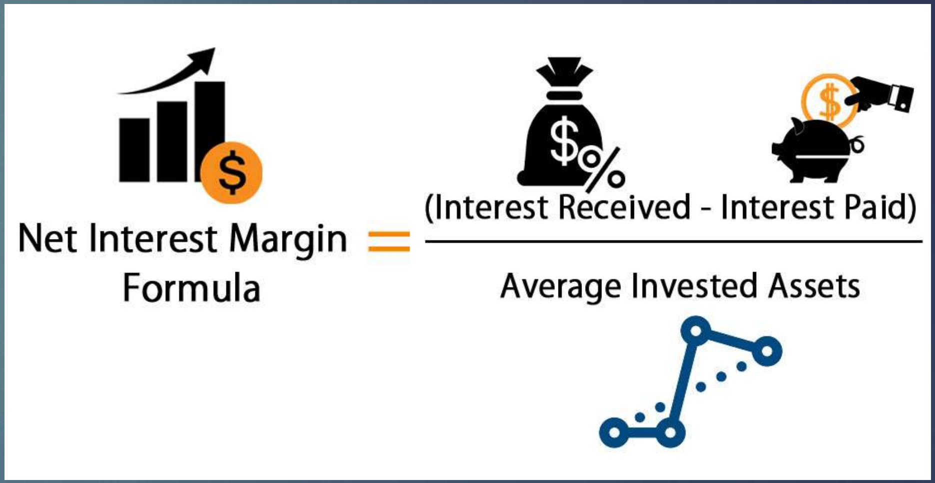
Net Interest Margin (NIM)

= (Interest income – interest expense) / average assets

- Interest income = interest on loans – loan interest refund + income from investments
- Interest expense = interest on borrowed money + dividends on shares + interest on deposits



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Net Interest Margin

- This ratio measures whether income from loans and investments sufficiently covers the cost of funds.
- Can be impacted by changes in interest rates
  - Ex: the low rates as a result of the pandemic decreasing investment income
- Whatever the members currently demand will impact this ratio
  - If members are saving more, interest expense will be higher.
  - If member loan demand is strong, interest income will be higher

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Cash and Short-Term Investments to Total Assets

- Cash on hand
- Cash on Deposit
- Cash Equivalents
- Investments with maturities less than 1 year

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Cash and Short-Term Investments to Total Assets

- This ratio represents the level of cash and liquid assets a credit union has available to meet share withdrawals or other demands
- This ratio is used to determine liquidity risk
- In a potential liquidity event, these assets can be quickly used

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Net Long-Term Assets to Total Assets

- Non-business or commercial real estate loans that mature in greater than 5 years
- Member business loans & commercial loans
- Participation interests to nonmembers
- Total investments with maturities greater than 3 years
- Land & Building
- Other fixed assets
- NCUSIF

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Net Long-Term Assets

- Measures the credit union's exposure to increased interest rate risk and the ability to react to changing interest rates.
- While a higher ratio represents a greater level of interest rate risk, this risk can be mitigated with strong management over the IRR program

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