



Strategic Direction

Final plan is pending input from members.

As of February 18, 2009

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Strategic Direction (Draft)

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Prior Plans

Members United's value proposition has focused on competitive rates, competitive fees, high service levels, aggregation, and stewardship. Many of these elements stem directly from the corporate's expertise in manufacturing and delivering its investment and payment products.

Members United's strategic plans have emphasized growth in both volume and market share while investing members' capital to develop new solutions to meet member needs. Key strategies included a thick distribution channel, expansion beyond core markets, and significant investment in innovation. Net income and capital measures were secondary to positioning Members United as a leading corporate in the industry. Members United's ability to amass scale effectively countered negative industry trends (e.g. margin compression, consolidation, concentration). Member satisfaction rose to all-time highs, growth goals were exceeded, and profitability goals were met or exceeded.

Environment Changes and Impact

The mortgage meltdown, credit crunch, and global economic decline will cause significant, permanent changes in the financial services, credit union, and corporate credit union markets.

The regulatory environment has intensified. Capital requirements will increase as stakeholders (e.g. NCUA, rating agencies, counterparties and members) no longer view the corporates' regulatory capital requirements as adequate. Collective views on risk and capital adequacy have changed dramatically. As an example, Members United's current \$2 billion of unrealized losses resulting from the financial crisis is ten times greater than the "worst case scenario" previously modeled, which showed a \$200 million portfolio decline if credit spreads widened to historical highs.

Interest income will be lower with expected prohibitions on certain investment types and tighter concentration limits. Growth will be significantly challenged with a decline of member confidence in corporates and increased diversification of credit unions' investments. The sustainability of manufacturing models for several Members United products is questionable without the ability to amass additional scale. Merger opportunities will decline as long as Members United has significant accumulated other comprehensive income (AOCI), a low return on assets (ROA) and comparatively low capital.

Members United's ability to innovate on its own will be significantly restricted with the increase in capital requirements and stakeholder scrutiny of initiatives involving non-core business. Financial performance will be strained with a decline in member balances, compressed net interest margins, reduced growth and losses related to other than temporary impairment (OTTI).

2009 Strategic Plan

These environmental changes and their impact upon Members United caused the corporate to pursue a fundamentally new direction in 2009.

The 2009 Strategic Plan, approved by the Board of Directors in November 2008, retained the vision to “Be the Premier Corporate” and mission of “We Delight Credit Unions.” However, Members United began evolving toward a new value proposition to meet the emerging challenges. Key tenets of the new value proposition include:

- Evolving the cash management, liquidity, and settlement products which continue to have advantages for members over alternatives
- Providing solutions to members’ needs, regardless of whether the solutions are manufactured by Members United or others
- Providing assistance (consulting, best practices, education) to help credit unions define, acquire, implement, and manage solutions
- Leveraging the excellent delivery channel to meet more member needs while improving Members United’s income and capital

The courses of action to achieve the vision and fulfill the mission included:

- Ensure financial stability
- Grow assets under management
- Become a payments leader
- Expand offerings
- Implement cooperative models
- Achieve organizational excellence

The 2009 Strategic Plan Goals reflected the need to shift focus from growth to financial performance and capital accumulation. Instead of volume and market share targets, the goals are net income, retained earnings ratio, and Tier 1 capital.

Members United’s actions since adopting the 2009 Strategic Plan have been meaningful and have yielded material results. Operating expense plans for 2009 are \$10 million less than the trend line as staff levels were reduced by approximately 20% and a hiring freeze for 2009 was implemented. Salary increases and discretionary 401k contributions were not awarded for 2008; discretionary bonus pools and targeted incentive pools will not be funded for 2009. In addition to the reductions in personnel-related costs, corresponding reductions have been implemented to reduce planned travel, external training, marketing, league support, event sponsorships and external professional fees. Members United operating expenses totaled \$53.8 million in 2008. Assuming 3% inflation and no other changes, expenses would have increased to \$55.4 million in 2009. Instead, management is focused on implementing a plan to reduce expenses by \$10 million and operate on a budget of \$45 million for 2009.

Members United has stopped seeking new members outside of its traditional core markets, reducing associated operating expenses and involvement in this traditionally low-margin business that leveraged its capital.

Planned actions to improve both short-term and long-term financial performance, many of which are already in process, include:

- Expense reductions as outlined previously
- Implementation of cooperative models for several key functions (e.g. Members Health Network, Innovation)
- Business model changes for manufacturing-intensive products (e.g. share draft, check collection)
- Further reduction in travel expenses through implementation of video conferencing.
- Streamlining some decentralized operations functions
- Increasing revenues through increased member use of existing products and implementation of planned product enhancements for 2009
- Closure of one payment production facility (Jamesburg)

The shift in emphasis from growth to financial performance will enable Members United to absorb losses due to the market crisis and build a strong corporate to meet the needs of its members.

New Developments

Since Members United adopted its 2009 Strategic Plan last November, significant new developments have occurred including:

Continued deterioration of markets – The markets continue to deteriorate, prompting rating agencies to lower their outlook on the entire financial services industry as well as downgrade ratings for nearly all large banks, U.S. Central, and all rated corporates.

Changes in competitive landscape – Banks gained advantages over credit unions and corporates through access to new capital under the taxpayer-financed TARP program and FDIC guarantee of deposits. Corporates also lost a key advantage when the Federal Reserve Banks announced they would begin paying interest on sterile reserves.

Credit union response to bank advantages – Continued market deterioration, increasing corporate unrealized losses, and banks' competitive advantages have contributed to a significant shift in credit union investable funds from corporates to banks.¹ This increased liquidity and earnings pressures at corporates.

Interest rates at historical lows – In order to stimulate the economy, the Federal Reserve Bank continued to lower interest rates. This action compressed margins, further increasing earnings pressures and slowing capital accretion through retained earnings.

¹ Credit union investable funds increased \$8 billion between 9/30/2007 and 9/30/2008. Aggregate deposits in corporates declined \$15 billion over the same period. Credit unions deposited \$11 billion of the \$23 billion difference in banks.

Liquidity solutions developed by the NCUA – Corporate cooperation and coordination of system liquidity proved adequate throughout most of 2008, but liquidity risk mounted as members continued to move funds to banks. Though possessing materially fewer authorities than their peer regulators, the NCUA was able to develop critically needed liquidity solutions to help corporates weather the current liquidity crisis. These solutions included a significant increase in the Central Liquidity Facility (CLF) borrowing cap, a temporary guarantee for unsecured borrowings by corporates, the Credit Union System Investment Program (CU SIP), and the Credit Union Homeowner Affordability Relief Program (CU HARP).

Plans to address corporate challenges – The Corporate Network, and other parties, developed creative plans to address the challenges of liquidity, capital, and efficiency in both the immediate and long term. While many of the ideas have merit, reaching consensus among vested-interest parties has proven difficult in the member-owned cooperative environment. Thus far, the industry has not produced a comprehensive plan that effectively addresses the liquidity, capital, and efficiency challenges facing corporates.

U. S. Central impairment – On January 28, 2009, U.S. Central announced that its 2008 financials would include OTTI of approximately \$1.2 billion. The resulting \$1.1 billion loss for 2008 wipes out all retained earnings and nearly all paid-in capital. A few days later, rating agencies downgraded U.S. Central further.

NCUA Corporate Stabilization Program – The same day, the NCUA announced a series of actions designed to support the corporate system including:

- Temporary guarantee of all non-capital share deposits through the end of February 2009
- An optional program to extend the guarantee through the end of 2010
- A \$1 billion permanent capital investment note in U.S. Central
- An Advance Notice of Proposed Rulemaking (ANPR) on restructuring and improving the corporate system
- An impairment of 51% of the credit unions' NCUSIF deposit and notice of a potential premium to restore the National Credit Union Share Insurance Fund (NCUSIF) equity ratio to 1.30 percent

Member response – Credit unions are justifiably concerned about the cost they will incur (potentially as much as 62 bps in 2009), the condition of the corporates and U.S. Central, and the process employed to develop this solution. While many members continue to be supportive of their corporate, some have said that they will not patronize corporates in the future. Understandably, members want to know what actions U.S. Central, Members United and others are going to take to remedy the problems in the short and long term.

New Plan

These new developments have prompted management to revisit the strategic plan and propose adjustments that will accelerate changes at Members United.

Members United's vision is to be each of its members' primary financial institution: the place they turn to for convenient and reliable cash management, balance sheet management, payment solutions, and knowledge services. Members United will continue its commitment to high service levels and deep member relationships. To achieve the vision and fulfill the mission, the recently-adopted strategic plan must be changed in order to:

- Place even greater emphasis on financial performance and capital accumulation
- Separate non-core corporate businesses from the core corporate
- Ensure all business lines are self-sustaining
- Accelerate implementation of business models that will reduce operating expenses, increase revenues, increase capital and improve product offerings
- Leverage the corporate's excellent distribution channel to meet more member needs and increase profitability
- Reduce risks exposed by the current market crisis

We also fully understand that credit unions' support of the corporate network is placing significant financial burden on our membership. Through these actions, we want to preserve as much capital as possible to minimize the ultimate cost to our membership.

Revised strategies for 2009-2011 include:

- Meet liquidity challenges
- Right-size the balance sheet while building capital
- Reduce existing expenses and tightly control new expenses
- Implement cooperative models for key functions
- Redefined our role in non-core markets
- Lead fundamental reform of the Corporate Network
- Reposition balance sheet products as necessary
- Expand off-balance sheet investment and lending offerings
- Evolve payment business models
- Leverage our existing distribution channel
- Expand knowledge service offerings
- Reengineer staff for revised strategies

Each of these strategies is discussed further below.

Meet liquidity challenges – Members United will continue to meet short-term liquidity challenges while holding illiquid securities until market conditions improve enough to selectively sell securities at fair prices. Key actions include:

- Minimize investment in securities to keep funds liquid
- Leverage NCUA deposit guarantee programs to increase member deposits
- Maintain available credit lines

Right-size the balance sheet while building capital – As illiquid securities pay down, Members United will shrink its balance sheet to be in line with its available capital. This will require:

- Leveraging NCUA deposit guarantee programs to increase member deposits and associated income, to offset any investment write-downs and preserve existing capital
- Developing a capital restoration plan in accordance with current regulation, as it is likely that the retained earnings ratio will fall below the required regulatory 2% threshold
- Deleveraging the balance sheet by paying down costly borrowing
- Scaling back the core corporate infrastructure and related costs to accommodate the smaller balance sheet
- Improving profitability of product offerings, making each self-sufficient
- Acquiring Tier 1 member-contributed capital

Reduce expenses and tightly control new expenses – Members United will identify additional expense savings beyond the recent reduction in force and other expense reductions. Areas for savings will include no merit increases for all staff in 2009, implementation of a hiring freeze, and elimination of all bonuses and targeted incentive plans. Controls for new expenses will be tightened and return on investment will become a more heavily weighted criterion for initiatives and large capital purchases.

Implement cooperative models for key functions – Members United will continue efforts to expand its offerings to meet credit union needs, but will do so in a manner that does not require the same level of capital investment and expenses. Specifically:

- Innovation – Members United will implement a cooperative innovation model that will attract credit union capital and greater credit union involvement in the innovation process. Members United will take and manage minority stakes in new CUSOs (as opposed to wholly-owned entities) to minimize capital consumption, while ensuring strategic alignment of entities
- Members Health Network – Members United will not contribute new capital to Members Health Network but will seek credit union ownership to gain greater involvement of members and attract new capital as needed
- Balance Sheet Solutions – Members United will examine the structure (ownership, capital, distribution) to optimize value and market positioning of Balance Sheet Solutions. Potential benefits include increased focus on meeting credit union needs, reduced expense for the corporate, perceived objectivity and independence, access to new (non-credit union) markets for scale, and potential partnerships with other retail or wholesale credit union entities
- Payment products – Members United will pursue consolidation of payments across the entire Corporate Network. With prospects for national cooperation on such an effort uncertain, Members United will conduct a parallel effort to examine the benefits and feasibility of spinning off its payment products into a separate entity. Potential benefits of a spin-off include increased focus on meeting credit union needs, reduced expense for the corporate, access to new (non-credit union) markets for scale, and potential partnerships with other wholesale credit union entities

Redefined role in non-core markets – Corporate competition for credit union deposits has provided good returns for members, but it has also decreased corporate margins and slowed capital accumulation. Since adoption of the 2009 Strategic Plan, Members United has dramatically scaled back its sales and marketing efforts outside its core markets, reducing expenses accordingly. Members United will no longer seek growth for growth’s sake in non-core markets, but will reposition itself by:

- Maintaining existing member relationships in non-core markets (primarily as a source of lower-cost liquidity) and not proactively seeking new members in non-core markets
- Presenting the corporate balance sheet as a diversification option only
- Not seeking to expand product utilization of existing non-core market members beyond investment diversification and Balance Sheet Solutions’ products, without the member contributing capital

Lead fundamental reform of the Corporate Network – Members United has continuously sought to improve efficiency of the Corporate Network through consolidation of corporates, distribution partnerships with fellow corporates, and efforts to consolidate redundant functions regionally or nationally. It has successfully completed several mergers and pursued others without a predisposition to be the surviving corporate. Members United has established three distribution partnerships with fellow corporates and consistently pursued others (e.g. “Partnership CDs”). It has continuously championed consolidation of payment services on regional and national levels. During each engagement, Members United has placed the interests of its members and the credit union movement before the interests of the corporate, its board, and staff. Members United will continue to champion fundamental reform of the Corporate Network, working with members, regulators, and other industry leaders to the benefit of credit unions.

Reposition balance sheet products – Corporates’ ability to compete for term deposits will be significantly impaired for the next two years, due to liquidity demands and the willingness of banks to pay up for deposits. Long-term, the competitive environment, declining margins, and anticipated regulatory restrictions on investment authorities will likely make corporate certificate products unattractive for term deposits. Similarly, term lending will be constrained by liquidity demands and competitive pressures. Members United will position itself as the cash management, short-term liquidity, and settlement provider for its members. Ultimately, this may lead to Members United not offering term products from its balance sheet, but distributing others term products via the corporate or Balance Sheet Solutions (see below). Key actions associated with this strategy include:

- Leverage the NCUA deposit guarantee to attract short-term and intermediate-term share certificate deposits as a lower-cost source of liquidity over the next two years
- Voluntarily suspend several expanded investment and lending authorities under Part 704
- Scale back investment, lending, and risk management functions related to term products

Expand off-balance sheet investment and lending offerings – Members United will offset its withdrawal from term balance sheet products by expanding its off-balance sheet offerings. Key actions include:

- Continue promoting SimpliCD and marketable securities
- Promote credit union issuance of certificates through SimpliCD, as an alternative source of liquidity for the credit union
- Seek strategic partnerships to bring others' term investment products to members
- Seek strategic partnerships to join with others to offer term lending products to members

Evolve payment business models – Most of Members United's payment products operate under a model where the corporate distributes a partner's products while adding value. This value is added through volume aggregation, distribution, implementation services, training/education, product support, and/or expertise. However, a few key products (e.g. share draft, check collection, corporate share draft) employ manufacturing models that are highly duplicative across the Corporate Network. Members United will seek to cement its role as the primary provider of payment solutions to its members by:

- Continuing to aggressively realize efficiencies in the check processing line through migration to all-electronic processing, closing the Jamesburg data center, and consolidating two redundant data centers
- Championing the consolidation of the Corporate Network's entire payment operations into one robust, efficient, and effective provider
- Conducting a parallel effort to examine the benefits and feasibility of spinning off its payment products into a separate entity. Potential benefits of a spin-off include increased focus on meeting credit union needs, reduced expenses for Members United, access to new (non-credit union) markets for scale, and potential partnerships with other wholesale credit union entities. This move would be done in a manner to preserve the option of future consolidation with other credit union-owned payment organizations

Leverage its existing distribution channel – Members United continues to have strong member relationships and a robust distribution channel. Its field staff, with the support of its call center and electronic delivery platform, is one of its core competencies and a source of competitive advantage. Members United will seek to meet additional member needs and enhance profitability through distribution arrangements with solution providers who have quality products and similar core values. Members United will add value through volume aggregation, distribution, implementation services, training/education, product support, and/or expertise. Like all other products, its delivery channel must be self-sustaining and contribute to the corporate's capital building efforts.

Expand knowledge services offerings – Members United will expand its existing knowledge service offerings (e.g. analytics, benchmarking, policy review, training/education, audits) in order to help credit unions meet their needs as well as enhance Members United's profitability. Like all other products, this line must be self-sustaining and contribute to the corporate's capital building efforts.

Reengineer staff for revised strategies – Members United will rally staff to meet the changes and challenges of the new strategic direction. The organization, staff makeup, and staff capabilities will evolve to align with the new value proposition, business models, and product mix.

Financial Impact

The strategies outlined above will help Members United reduce costs, improve earnings, and accelerate capital accumulation. Changes implemented or in process will reduce 2009 operating expenses by \$10 million from trend. Additional changes are expected to reduce annual operating expenses by another \$2 million, for a 2009 expense plan target of \$43 million.

Outlook

Throughout this recent crisis and its impact upon the corporates and credit unions, Members United has been consistently mindful that the corporate belongs to its members which, as owners, are entitled to thorough and timely information. To that end, Members United has consistently demonstrated transparency regarding its condition, events impacting the corporate, and actions it has taken. Members United will continue to do so.

Members United remains focused on understanding and meeting its members' needs. The environmental changes and anticipated impact require that Members United alter its value proposition and business models but not its commitment to member-owners. By proactively implementing fundamental change, Members United will reposition itself more rapidly than others in the industry, and emerge a leader in the new marketplace.