

**Is that Security Creditworthy? Look Before You Leap.**

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On June 11, 2013, the NCUA issued Supervisory Letter 13-03 – *Investing in Securities without Reliance on Nationally Recognized Statistical Rating Organizations (NRSRO) Ratings* (to review the letter, visit [www.ncua.gov/Resources/Documents/LCU2013-05\\_SupervisoryLetter.pdf](http://www.ncua.gov/Resources/Documents/LCU2013-05_SupervisoryLetter.pdf)). In essence, due to an over reliance on NRSRO credit ratings and a failure to perform independent credit analysis, many investors suffered significant credit losses during the credit crisis. Supervisory Letter 13-03 mandates that natural person federal credit unions (FCUs) can no longer rely “solely” on the rating agencies (i.e. Moody’s or S&P) in determining the creditworthiness of an investment. Instead, they must demonstrate their own credit due diligence.

The NCUA expects FCUs to consider a number of factors (i.e. the security’s credit quality, the size of the investment, the complexity of the structure) when making a creditworthiness determination. Again, NSRO credit ratings may supplement, but cannot be the sole determinant of investment suitability. Among factors to consider are those listed in the following chart.

**Due Diligence Considerations**  
By Security Type

Security Type	Key Factors to Consider in Analysis
<b>Private Issue Residential Mortgage-Backed Security</b>	<input type="checkbox"/> Class tranche <input type="checkbox"/> Relative position in cash flow waterfall <input type="checkbox"/> Underwriting and collateral quality <input type="checkbox"/> Adequacy of subordination levels <input type="checkbox"/> Impact of collateral deterioration on tranche performance
<b>Private Issue Commercial Mortgage-Backed Security</b>	<input type="checkbox"/> Class tranche <input type="checkbox"/> Relative position in cash flow waterfall <input type="checkbox"/> Underwriting and collateral quality <input type="checkbox"/> Adequacy of subordination levels <input type="checkbox"/> Impact of collateral deterioration on tranche performance
<b>Municipal Securities (Rated)</b>	<input type="checkbox"/> Spread to U.S. Treasuries consistent with bonds of similar quality <input type="checkbox"/> Capacity to pay <input type="checkbox"/> Debt profile <input type="checkbox"/> Soundness of budget process <input type="checkbox"/> Stability of revenue sources and taxing authority
<b>Municipal Securities (Unrated)</b>	<input type="checkbox"/> Source and strength of revenue structure <input type="checkbox"/> Reserve levels <input type="checkbox"/> Debt service and coverage ratios <input type="checkbox"/> Legal covenants and nature of project

## Due Diligence Considerations By Security Type

Security Type	Key Factors to Consider in Analysis
<b>Bank Notes (Uninsured)</b>	<input type="checkbox"/> Spread to U.S. Treasuries consistent with bonds of similar quality <input type="checkbox"/> Capacity to pay <input type="checkbox"/> Financial performance levels and trends <input type="checkbox"/> Third-party analytics, as appropriate
<b>Mutual Funds</b>	<input type="checkbox"/> Investments and transactions in fund are restricted to those permissible for federal credit unions

### Investing in Corporate Debt

In the investment-grade corporate debt sector, FCUs are only able to invest in non-insured rate “bank notes” with maturities of five years or less. Bank notes may be fixed or floating, and senior or subordinated in status. Bank holding company debt is not permitted.

It is important to note that the regulator’s Supervisory Letter 13-03 does not address state-chartered credit unions. In the case of credit unions with state charters, the existing investment rules and regulations in some states may be less stringent, but they are not consistent from state to state. For example, although FCUs can purchase bank notes, purchases of corporate debt are limited depending on the state. In Georgia, for instance, the banking regulator must give permission to the specific credit union. Elsewhere in the U.S., purchases can be explicitly allowed or strictly impermissible.

Below is a partial list of states in which a credit union can invest in corporate debt, and states where credit unions are prohibited from doing so.

### Participating States Eligibility to Purchase Corporate Debt Security (partial list)

Eligible (or with conditions)	Ineligible (or by approval)
<ul style="list-style-type: none"> <li>✓ <b>Florida</b></li> <li>✓ <b>Illinois</b> (obligations of financial institutions only)</li> <li>✓ <b>Indiana</b></li> <li>✓ <b>Iowa</b> (AA-rated or higher)</li> <li>✓ <b>Michigan</b> (investment-grade)</li> <li>✓ <b>Minnesota</b></li> <li>✓ <b>Rhode Island</b></li> <li>✓ <b>Vermont</b></li> <li>✓ <b>Virginia</b> (federally-insured banks; others with specific approval from regulator)</li> <li>✓ <b>Wisconsin</b> (debt of bank operating companies or specific approval by regulator)</li> </ul>	<ul style="list-style-type: none"> <li><b>California</b></li> <li><b>Colorado</b> (need specific approval by state regulator)</li> <li><b>Connecticut</b></li> <li><b>Georgia</b> (need specific approval by state regulator)</li> <li><b>Missouri</b> (need specific approval by state regulator)</li> <li><b>Massachusetts</b></li> <li><b>New Jersey</b></li> <li><b>New York</b></li> <li><b>Ohio</b></li> <li><b>Pennsylvania</b></li> <li><b>North Carolina</b></li> <li><b>South Dakota</b></li> <li><b>Tennessee</b></li> </ul>

Furthermore, more stringent guidelines (consistent with the FCU Supervisory Letter 13-03) may be forthcoming. If so, then state-chartered credit unions would be required to perform their own credit due

diligence. Anecdotally, we have heard that many state-chartered credit unions that invest in corporate debt have experienced additional regulatory scrutiny of their credit due diligence and surveillance.

Federal- and state-chartered credit unions that invest in bank notes or corporate debt – or would like to – will need to allocate more time and resources (hiring a credit analyst, for example) when investing in corporate debt securities.

In some cases, the additional expense and time may be cost prohibitive. As a result, some credit unions may opt to reduce or eliminate their corporate debt exposure. **If so, this could have the undesirable impact of significantly lowering yields and income from the investment portfolio.**

To preserve the potential income offered by corporate debt securities while managing risk, more and more credit unions are turning to professional bond research and analysis services. Because features offered by these services vary widely, it pays to comparison shop.

**TOP 5 BENEFITS**  
**Third-Party Credit Analysis**

- 1) Supports newly required due diligence
- 2) Validates investment decisions
- 3) Enhances portfolio risk management
- 4) Helps diversify investment portfolio
- 5) Uncovers yield/income opportunities

**Evaluate the Evaluators – Checklist**

Compare Features offered by Corporate Bond Research and Analysis Services

Feature	Service 1	Service 2	Service 3
Daily research reports –real-time information	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Industry reports	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Independent credit analysis	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Credit scores (upgrades, downgrades): companies, sectors, indices	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Capital structure	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Valuation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Market prices	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Intraday comments – implications of events, market activity	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ongoing credit surveillance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Direct, personal access to senior analysts	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
In-person	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Conference call	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Email	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Are analysts’ bios available to prospective clients?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other –	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other –	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other –	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

For information on value-priced, high quality, third-party credit analysis services offered by Balance Sheet Solutions, please read on.

Available through Balance Sheet Solutions  
**Third-Party Credit Analysis Services – Gimme Credit**

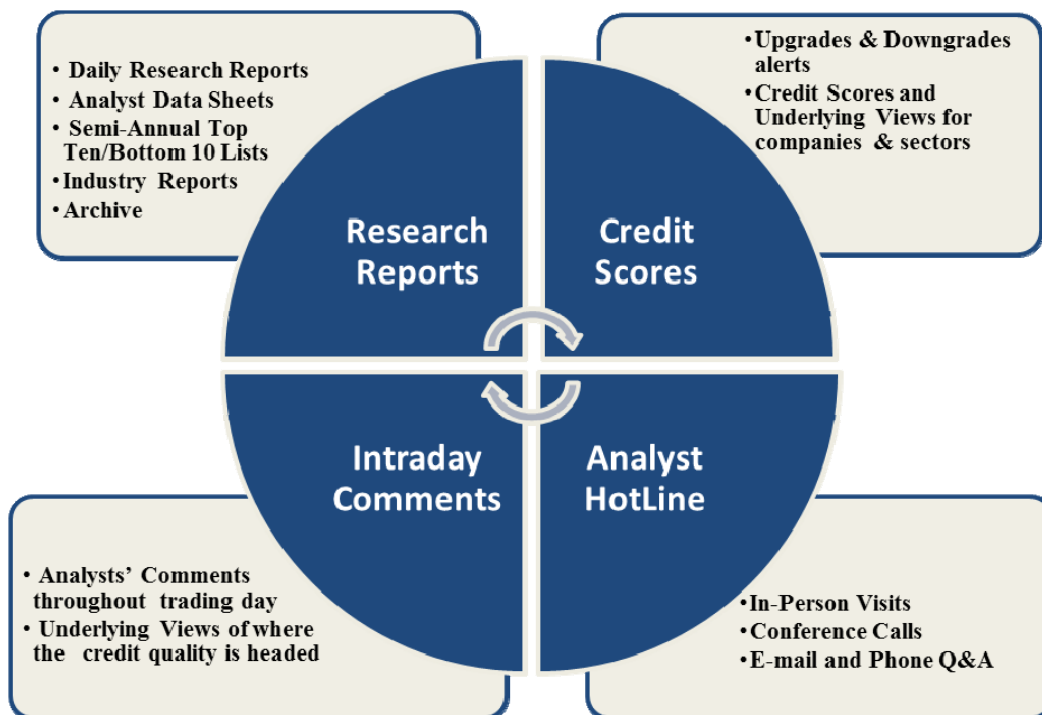
NCUA’s Supervisory Letter 13-03 – *Investing in Securities without Reliance on Nationally Recognized Statistical Rating Organizations (NRSRO) Ratings* – provides new due diligence guidance for credit unions (see [www.ncua.gov/Resources/Documents/LCU2013-05\\_SupervisoryLetter.pdf](http://www.ncua.gov/Resources/Documents/LCU2013-05_SupervisoryLetter.pdf)).

To assist credit unions in meeting increased regulatory requirements, Balance Sheet Solutions has partnered with *Gimme Credit LLC* – one of the most experienced independent credit firms in the industry. *Gimme Credit* provides corporate bond research services for credit market investors and traders worldwide. The company offers research reports that provide recommendations based on the research of credit quality, capital structure, valuation and market prices. They also provide intraday comments, an analysis of the implications of events and market activities, and credit scores which are forward looking quantitative indicators for companies.

**Gimme Credit Overview**

*Gimme Credit* is supported by more than 15 years of analytical experience, an understanding of what is important, and the *independence* to make bold investment recommendations. The firm provides concise, solid analyses and recommendations aimed at maximizing relative value, preserving capital and anticipating changes in credit quality. *Gimme Credit* tells **the hard truth** about **credit risk**.

**Gimme Credit**  
 Summary of Services



**Gimme Credit**  
 Summary of Services (*continued*)

➤ **Research Reports**

- Daily research reports – *Signature One Page Report* (see below)
- Supporting analyst data sheets
- Semiannual *Top Ten* lists of improving credits
- Semiannual *Bottom Ten* lists of deteriorating credits
- Industry reports
- Unlimited archive access



- **Intraday Comments.** *Gimme Credit's Intraday Comments* provide immediate analysis of the implications of events and market activity. Comments are published throughout the trading day and are accompanied by the Senior Analyst's Credit Score and Underlying View of the company.
  - Analysts' comments assess the importance of events and market action on individual corporate issuers throughout the trading day.
  - Underlying views give snapshots of where the issuer's credit quality is headed and why.
  - Credit scores quantify the direction of credit quality for companies, sectors and overall market indices.
- **Credit Scores.** *Gimme Credit* does not rely on the rating agencies when assessing the quality of a bond. Agency ratings tend to be backward looking and the market typically responds much more quickly than the agencies to new information. *Gimme Credit's* analysts determine their own ratings based on all the components of the research process, and they may differ from agency ratings.

*Gimme Credit's* Senior Analysts assign **Credit Scores** to each of the companies in their universe. This score indicates their judgment of the direction of a company's credit quality over the upcoming six months. The Credit Score is, thus, a forward-looking, quantitative indicator. A company is assigned a Credit Score of "-1" to indicate "Deteriorating" credit quality, "0" for "Stable" credit quality, and "+1" for "Improving" credit quality.

- Upgrade and downgrade alerts, as they are published
- Credit scores and underlying views for individual companies
- Aggregate credit scores by market, sector and rating group
- Data downloads



## CREDIT SCORES - UPGRADES & DOWNGRADES

The screenshot shows a notification for Zions Bancorporation's credit score upgrade from 'Deteriorating' to 'Stable'. The callouts highlight the following features:

- 1. Real Time:** The alert is dated 07/23/2012 at 10:51 PM EDT.
- 2. Why it's important:** The alert states 'Upgrade to Stable from Deteriorating'.
- 3. Impact on Credit:** The text explains that Zions repaid \$700 million of TARP preferred shares and expects to repay the remainder by the fourth quarter of 2012, leading to a credit quality improvement.
- 4. Underlying view and credit score:** A 'New Underlying View' is provided, describing Zions as a regional bank with a concentrated portfolio of commercial real estate and bank TruPS CDOs, noting that credit quality is gradually improving.
- 5. Contact the Analyst:** The analyst's name, Kathleen Shanley, CFA, is listed at the bottom.
- 6. More on this company:** A link is provided for 'Recent Reports and Comments on this company'.

- **Independent Credit Analysis.** Analysts at *Gimme Credit* are more than “number crunchers.” They are sector experts with the ability to judge industry and business trends beyond reported numbers. Analysis includes detailed sector knowledge, a clear understanding of economic drivers, an accountant's understanding of balance sheets and direct contact with management teams. Any credit research effort is ultimately measured as the ability to add value in several ways, including sector and security selection, avoidance of “black holes” and defaults, and value-generating, relative-value calls. When deciding on an investment, investors rely on the careful risk and quality assessments made by *Gimme Credit*.
- **Direct Access to Senior Analysts.** Through Balance Sheet Solutions, credit unions now have **Direct Access** to the industry-leading team of senior analysts at *Gimme Credit*. Interact via:
  - In-person visits
  - Conference calls
  - Phone Q&A
  - Email

**Industry Leading Team of Senior Analysts**  
Informed, Experienced, Educated

Name	Type	Specialization	Years	Background	Education
<b>Phil Adams, CFA</b>	Investment Grade	Utilities, Energy	31	Banc One, ABN-AMRO, BankAmerica, Continental	M.B.A., Indiana University
<b>Carol Levenson, CFA</b>	Investment Grade	Basic Industries, Retail, Leisure, Healthcare	28	Harris Investment Management	M.B.A., University of Chicago
<b>Evan Mann, CFA</b>	High Yield, Distressed	Apparel, Aerospace, Lodging, Food and Drug, Retail, Homebuilders, Health	26	Delaware Investments, BankAmerica, Dillon Read, Lord Abbott	M.B.A., Hofstra University
<b>Kim Noland, Esq.</b>	High Yield, Distressed	Airlines, Utilities, Gaming, Consumer Products, Telecom	26	Salomon (Head of Distressed Research), CIBC/Oppenheimer (MD of High Yield), Merrill Lynch	M.B.A., Harvard University
<b>Dave Novosel, CFA</b>	Investment Grade, High Yield	Banc One	23	Banc One (Director of Research)	M.B.A., Northwestern University
<b>Kathy Shanley, CFA</b>	Investment Grade	Banks, Brokers, Finance, Insurance, Real Estate	26	BankAmerica	M.B.A., Wharton School

**Third-Party Credit Analysis Services – Now Available to Balance Sheet Solutions Clients**

Leverage the power of Balance Sheet Solutions. Effective immediately, Balance Sheet Solutions is able to provide direct access to *Gimme Credit's* credit research for credit union clients. In other words, credit unions now have one of the most experienced teams of credit analysts at their disposal. We believe this credit research capability will greatly enhance the overall risk management of investment portfolios and expand the universe of investment opportunities – while greatly reducing the regulatory burdens.

**Benefits of *Gimme Credit***

- ***Independent and unbiased*** credit analysis
- Required ***due diligence*** to support the investment decision
- ***Ongoing credit surveillance*** and monitoring
- ***Proactive, real time response*** to credit changes (upgrades/downgrades)
- Enhanced ***portfolio risk management*** process
- Better ***diversified*** investment portfolio
- ***Increase yields and income***

**Learn More**

For more information about third-party credit analysis services available through Balance Sheet Solutions, please call your Fixed Income Representative, [contact](#) the author, or [send a message](#) to us via our website.