

Excess Share Insurance Corporation



Gain the Advantage

State of the Fund Report 2007





Leading the Market

This State of the Fund Report provides an overview of the operating and financial performance of Excess Share Insurance Corporation (ESI), and a snapshot of the summary statistics and ratios for its excess-insured credit unions, for the year ended December 31, 2007. To the extent possible, we also take a look ahead to what may be anticipated in the coming year. With the stock market trending downward, and recessionary pressures looming, consumers are searching for a safe haven for their hard-earned savings. ESI's excess share insurance product can provide the competitive edge credit unions need to not only gain the confidence of their members but to place them apart from the competition.

In 2007, credit unions across the nation continued to take advantage of the unique benefits afforded by excess share insurance, which resulted in ESI's insurance-in-force and the number of policyholder credit unions increasing to record levels. At year-end 2007, a total of 288 credit unions in 31 states actively insure with ESI. Collectively these credit unions account for \$76 billion, or about 12%, of all assets in the over 8,200 credit unions in the U.S. movement.

Total insurance-in-force within ESI's policyholding credit unions of \$3.9 billion represents shares that would have otherwise gone elsewhere. It is evident that the program works as more credit unions join ESI with each passing year.

ESI's growth in aggregate coverage occurred despite the slower share growth rates experienced in the industry during the year. Industry share growth rates, as well as those for ESI insureds, reported through the first five months of 2008, indicate that growth rates are on the rise and could easily result in a double-digit annual growth rate by the end of the year, as a "flight to quality" toward insured credit union share accounts evolves for consumer investments.

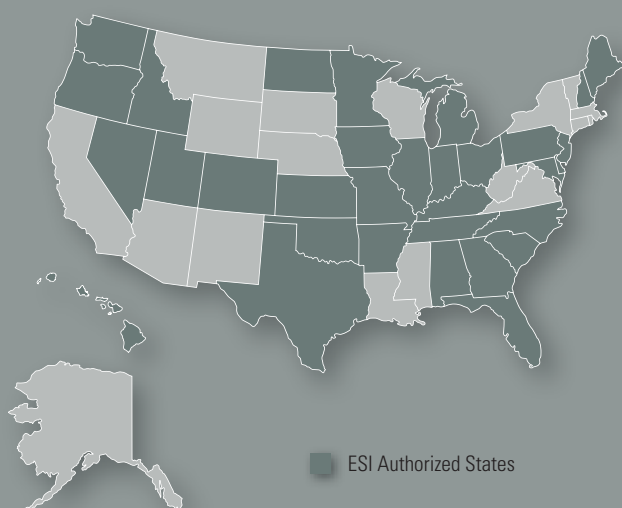
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STATES OF OPERATION AND INSURANCE-IN-FORCE

American Share Insurance (ASI), ESI's parent company, first began offering excess insurance in 1983. The ESI program was first introduced to the credit union industry in 1993 when ESI was incorporated and licensed as a property and casualty insurer in its home state of Ohio. Since that time, ESI has aggressively pursued and obtained licenses in 33 states in order to facilitate the expansion of this unique product (Chart 1).

Chart 1: Geographic Dispersion



Despite the continued consolidation in the credit union industry and the strict underwriting criteria for the excess insurance program, the number of credit unions participating in the program has continued to grow over the years. Total insurance-in-force increased by nearly 7% during 2007 from \$3.65 billion to \$3.89 billion (Chart 2), reflecting the credit union industry share growth rate of 5% and the addition of new policyholder credit unions. Looking ahead, it appears that shares are on the rise in 2008; for the five months ended May 31, 2008, growth in ESI's insurance-in-force has accelerated to an annualized rate of 17%. Except for the period of 2006-2007, when an industry-wide decline in share growth occurred, the growth rate of ESI's insurance-in-force has exceeded 17% every year since 1995, when ESI wrote its first policies. ESI's historically high growth rate and the recent return to this higher level provide clear evidence of the popularity of the program.

Chart 2: Insurance-in-Force

	# of Credit Unions	\$ Millions	% Growth in Coverage
2007	288	\$ 3,889	6.58 %
2006	278	\$ 3,649	5.10 %
2005	266	\$ 3,472	20.43 %
2004	236	\$ 2,883	17.86 %
2003	230	\$ 2,446	29.21 %

FINANCIAL CONDITION OF ESI

ESI reported record levels of net income and total assets for the year ended December 31, 2007. Net income of \$2.4 million increased 15% from 2006 and total assets eclipsed the \$60 million mark for the first time in the company's 15 year history. Additionally, no actual claims losses were incurred in 2007 and all prior years of ESI's operations.

ESI has always been and continues to be in good standing with insurance departments and regulators in all states of operations. The corporation has operated safely and soundly, and has been financially stable since its incorporation in 1993. Annually, ESI's financial statements are audited by a nationally recognized "Big 4" CPA firm and its loss reserves are certified by internationally recognized actuaries. The corporation maintains \$20 million in committed lines of credit, including a significant portion of the aggregate lines with a major US bank. Further strengthening ESI's financial position is reinsurance from an A++ rated third-party US reinsurance company authorized in all of ESI's states of operations; and despite the current troubled times in the credit and insurance markets, in February 2008 our reinsurer agreed to an early three-year renewal of our reinsurance contract.

Finally, while many financial institutions' balance sheets are being scrutinized and criticized for investing in Mortgage-Backed Securities (MBSs), Collateralized Mortgage Obligations (CMOs) and Collateralized Debt Obligations (CDOs), ESI reports *none* of its \$59 million investment portfolio as being invested in these types of securities. Furthermore, over 98% of our portfolio is invested in cash and cash equivalents (30%), and government-issued or government-backed debt instruments (68%) with a weighted-average maturity of approximately 26 months.

SPONSOR AND GEOGRAPHICAL DISTRIBUTION

At year-end 2007, ESI offered excess insurance to credit unions in 33 states, including the District of Columbia. We continue to work to increase the number of credit unions that offer excess share insurance across a diverse group of core sponsors. Our diversity, both by state (Chart 3) and sponsor group (Chart 4), helps mitigate the risk of loss to the program from economic contraction in a specific region or industry.

Chart 3: Distribution of Insured Shares by State

State	2007	2006
Texas	13 %	11 %
Ohio	10	11
Indiana	8	8
Illinois	7	8
Washington	6	6
Nevada	6	6
Florida	6	6
Michigan	5	4
Maryland	4	6
Pennsylvania	4	4
Alabama	4	4
Missouri	3	3
Minnesota	3	3
Oklahoma	3	3
New Jersey	2	2
Tennessee	2	2
Others (15 states)	14	13
Total	100 %	100 %

Chart 4: Sponsor Base Distribution (Percent of Total Excess-insured Shares)

Primary Sponsor Classification	2007	2006
Associations/Community	35 %	32 %
Government	20	21
Education	18	18
Manufacturing/Labor	15	15
Utilities	5	5
Retail/Wholesale	4	4
Medical	2	3
Others	1	2
Total	100 %	100 %

News reports abound about the current weakness in the US economy and most of us have likely felt the results of the recession in both our professional and personal lives. The good news is that credit unions in general, and ESI's excess-insured credit unions specifically, have little or no direct exposure to many of the problems plaguing the financial markets, such as the sub-prime mortgage mess. Even so, credit unions must be vigilant against the expected fallout from the current economic conditions and its impact on their members and their operations caused by higher unemployment and escalating loan delinquency rates. This can best be accomplished by maintaining stronger than normal operations and safe and sound lending and collections programs.

Credit unions insured by ESI have strong capital cushions that will help them survive a downturn in the economy over the next few years. More specifically, with regard to mortgage lending issues, ESI-insured credit unions, have on average about 51% of their loans and 34% of their total assets invested in mortgage-secured loans, which is slightly less than the average distribution reported by all credit unions nationally. Further, our numerous on-site examinations confirm that our insured credit unions generally have very limited exposure to sub-prime mortgage risk.

However, credit unions involved in second mortgage lending or in construction lending – in those markets where severe housing price depreciation is occurring (e.g., California and Florida) – are likely to feel more immediate pressure and could be forced to merge with healthier credit unions or even close. California has been hit the hardest by the weaknesses in residential lending and declining real estate collateral values; fortunately ESI does not provide excess insurance to any credit unions in that state. ESI's business is distributed across its 33 licensed states so that no single state represents a risk concentration; only two states comprise 10% or more of its insurance-in-force (Texas – 13% and Ohio – 10%), and Florida only represents 6% of ESI's business. Further, in ESI's states of operations, its insured credit unions have little or no direct exposure to the types of lending risks that have plagued financial institutions in California and generally show no signs of being unable to weather the current economic crisis.

MONITORING AND EXAMINATIONS

Excess-insured credit unions are subject to periodic monitoring and on-site examinations by ESI's parent company's Risk Management and Audit Departments. In 2007, our examiners visited ESI-insured credit unions representing nearly 20% of the \$3.9 billion in ESI's total insured shares and we anticipate performing a similar or greater number of on-site examinations in 2008. ESI will continue to emphasize extra due diligence when monitoring and examining the mortgage lending area in 2008 as we did in 2007.

ESI's examination coverage supplements the periodic statutory exams completed by the credit union's state regulators and primary insurer, and the audits conducted by independent CPA firms. Well over 90% of ESI's insured credit unions, representing over 95% of ESI's insurance-in-force, have an independent third-party audit performed annually. These various sources of attestation provide a sound basis for our conclusions as to the safety and soundness of ESI's insured credit unions.

COVERAGE INFORMATION

The program enables federally and state-chartered credit unions alike to offer their members up to an additional \$250,000 of coverage on qualifying accounts at a nominal cost. Those credit unions that have been approved for ESI coverage are required to meet the stringent underwriting standards established by the company and are subject to periodic monitoring and examinations by the company to ensure that they maintain financial stability for continued insurability.

Given that excess insurance coverage only protects account relationships that exceed a credit union's primary insurance limits, most excess share insurance is placed with larger credit unions (Chart 5); i.e., larger credit unions tend to have a greater number of members with larger account balances. The total assets of an average participating credit union continued to increase from \$252 million at year end 2006 to \$262 million in 2007 (Chart 6), a 4.0% increase, despite a negative personal savings rate in the U.S. and the general slow down in share growth. The average excess policy outstanding also increased by over 3.0%, from \$13.1 million at year end 2006 to \$13.5 million in 2007.

Chart 5: Coverage Distribution (By Credit Union Asset Size)

Total Assets	2007	2006	2005
Over \$250 Million	62.23 %	58.61 %	53.72 %
\$100 - \$250 Million	29.53 %	32.60 %	36.45 %
\$50 - \$100 Million	5.94 %	6.28 %	6.97 %
Under \$50 Million	2.30 %	2.51 %	2.86 %
Total	100 %	100 %	100 %

Chart 6: Insured Credit Union Financial Profile

	2007	2006	2005
Average Asset Size	\$ 262 M	\$ 252 M	\$ 236 M
Gross Capital Ratio	11.81 %	11.72 %	11.28 %
Loans/Shares Ratio	84.79 %	85.23 %	84.76 %
Delinquency Ratio	0.83 %	0.62 %	0.67 %
Solvency/Share	\$ 1.139	\$ 1.127	\$ 1.132
Gross Income*	7.66 %	7.25 %	7.02%
Operating Expenses*	4.26 %	4.01 %	3.86 %
Cost of Funds*	2.76 %	2.33 %	1.85 %
R.O.A.*	0.70 %	0.88 %	0.89 %

*As a percentage of average total assets

Credit unions participating in the program not only grew in size during the year, they also improved their financial condition. This improvement is evident in the higher capital ratio and solvency of the participants, at 11.81% and \$1.139, respectively (Chart 6).

As a result of the weakening US economy, delinquencies at year-end 2007 were 0.83% of loans, up nearly one-third from 0.62% in 2006 (Chart 6) but still below the national average of 0.93% for all credit unions. Delinquencies declined to 0.76% of loans at March 31, 2008, which is significantly below the national average of 0.91% and are subject to periodic monitoring and examinations by the company. The national average in 2008 is being adversely impacted by deteriorating credit and real estate valuation issues in California. Higher delinquencies have necessitated the need for credit unions to increase their loan loss provision expense, resulting in a decline in the return on assets for ESI-insured credit unions from 0.88% for 2006 to 0.70% in 2007 (Chart 6), which is still slightly ahead of the national average ROA of 0.65%. In the first quarter of 2008, the annualized ROA for ESI-insured credit unions remained steady at 0.69%, while the national average has declined to 0.60% as a result of the softening California credit market and real estate values.



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