STATEMENT

OF

THE HONORABLE DEBORAH MATZ
CHAIRMAN
NATIONAL CREDIT UNION ADMINISTRATION

“THE STATE OF THE CREDIT UNION INDUSTRY”

BEFORE THE

SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

THURSDAY, DECEMBER 9, 2010

I. Introduction

The National Credit Union Administration (NCUA) appreciates the opportunity to provide views on "The State of the Credit Union Industry." NCUA's primary mission is to ensure the safety and soundness of federally-insured credit unions. It performs this important public function by examining all federal credit unions, participating in the supervision of federally-insured state-chartered credit unions in coordination with state regulators, and insuring federally-insured credit union members' accounts. In its statutory role as the administrator for the National Credit Union Share Insurance Fund (NCUSIF),[1] NCUA provides oversight and supervision to 7,402 federally-insured credit unions, representing 98 percent of all credit unions and 90.8 million members.[2]

The severe economic crisis that began in earnest in 2007 has impacted all facets of the financial sector. Though credit unions by and large maintained traditional standards and risk profiles, they have not been immune to the broad effects of historically high unemployment and severely declining home values. More specifically, these national trends systemically affected credit unions in two particular ways. First, several of the largest corporate credit unions'[3] investment portfolios were subjected to material losses.

---

[1] The NCUSIF was created by Public Law 91-468 (Title II of the Federal Credit Union Act), which was amended in 1984 by Public Law 98-369. The Fund was established as a revolving fund in the United States Treasury under the NCUA Board for the purpose of insuring member share deposits in all federal credit unions and in qualifying state credit unions that request insurance.

[2] Approximately 152 state-chartered credit unions are privately insured and are not subject to NCUA oversight. The term "credit union" is used throughout this statement to refer to federally insured credit unions.

[3] Corporate credit unions provide necessary liquidity, investment, and payment services to consumer credit unions.

Second, many consumer credit unions,[4] have experienced increased delinquency and loan losses. This is most pronounced in states hardest hit by the economic downturn, such as Arizona, California, Florida, and Nevada. The combined impact of these two occurrences has presented significant financial and operational challenges for both NCUA and credit unions and is discussed in detail in sections II and III below.

Throughout the crisis, NCUA, with the assistance of Congress and the Administration, has taken extraordinary steps to successfully maintain the stability of the credit union system for the 90 million Americans who depend on it.

II. Corporate Credit Union System

The primary purpose of a corporate credit union is to provide consumer credit unions with correspondent banking, liquidity and investment services. Correspondent banking services help financial institutions, including credit unions, to process and clear checks, process and settle electronic transactions, and move funds through the financial system.

In the mid-2000s, several of the largest corporate credit unions invested heavily in mortgage-backed securities (MBS), which resulted in concentrated exposure to the real estate market. Virtually all of the investments were AAA or AA rated when purchased. However, their value plummeted when the housing bubble burst.

[4] The term "consumer" credit union is used throughout this document to refer to retail "natural person" credit unions which interact with consumers on a daily basis. "Corporate" credit unions provide services to consumer credit unions and process consumer payments, but do not interact with consumers directly.

In April 2007, several months before the distress in the mortgage market surfaced, NCUA issued *Corporate Credit Union Guidance Letter No. 2007-02*. This letter addressed credit, liquidity, market, and concentration risks associated with MBS. By and large, corporates ceased the purchase of non-agency mortgage-related securities by mid-2007. At that time, all investments held by corporate credit unions, including MBS, were rated investment grade, and 98 percent were rated AA or higher.

What began as a market disruption thought to stem from concerns with subprime products, spread throughout the overall financial and real estate markets sector with unprecedented severity. By the time it became apparent that this was not an isolated market dislocation, there was no longer an active market for these types of securities. Like other financial institutions, the corporates could not have found buyers for the volume of these types of investments they held. The declining values of these mortgage-backed securities created severe liquidity and capital problems for these institutions.

Five corporate credit unions, which served more than half of the entire credit union system, were financially imperiled by the losses in their investment portfolios, with a far-reaching effect on the entire credit union industry. The industry has been adversely impacted by consumer credit union losses from impaired capital investments held in corporate credit unions.

Consumer credit unions will continue to face necessary NCUA assessments to resolve the non-financially viable corporates. Had the agency not acted to inject liquidity and guarantee deposits in the corporate credit unions in the face of this crisis, the costs to the industry would have been far greater – threatening the entire credit union system.

Without NCUA intervention, the losses, in their entirety, from immediate failure of large corporates would have cascaded to consumer credit unions via their uninsured shares in the corporates.[5] This would have resulted in the failure of approximately 1,000 consumer credit unions. Consistent with the manner in which deposit insurance functions, the costs of resolving these failures would have been borne by all remaining federally-insured credit unions, generating additional losses and failures. Ultimately, inaction would have resulted in massive disruption to consumer services and total costs to any remaining insured credit unions would have been far greater than the resolution strategy NCUA employed.

To address the systemic financial and operational impact of these five troubled corporate credit unions, NCUA designed a three-phase strategy to *stabilize*, *resolve*, and *reform* the corporate system based on the following guiding principles:

- ✓ Prevent interruption of payments services to consumer credit unions and their 90 million members;
- ✓ Preserve confidence in the credit union system;
- ✓ Manage to the least long-term cost consistent with sound public policy; and

[5] Credit unions refer to deposit and savings accounts as share accounts, or “shares” for short.

- ✓ Facilitate an orderly transition to a new regulatory framework for the corporate credit union system based on consumer credit union choice.

Specific details of the actions implemented during these three phases are discussed below.

Stabilization Phase

Given the deterioration of the corporates' financial conditions and quality of their investment portfolios, their access to external sources of funds was compromised. This resulted in consumer credit unions losing confidence in the corporate credit unions and starting to withdraw their deposits. These withdrawals, and the prospect of a wave of additional withdrawals, placed severe liquidity pressures on the corporates, peaking in 2008. The losses and operational impact on the credit union system from a non-orderly resolution of this crisis would have been untenable, severely impacting consumer credit unions and their 90 million members.

Accordingly, in the fall of 2008, it became critical for NCUA to initiate dramatic action to bolster confidence in the corporates and ensure the flow of liquidity in the credit union system. In the last half of 2008, NCUA began implementing actions to stabilize and strengthen the credit union system. The first step in the stabilization program was to increase liquidity throughout the entire credit union system, especially within the corporates.

NCUA's primary tool to address liquidity concerns in the credit union industry is the Central Liquidity Facility (CLF).[6] At the time, the CLF was operating under a Congressionally-imposed borrowing cap of $1.5 billion. At the NCUA Board's request, in September 2008, Congress raised the CLF's borrowing cap to its full statutory limit of approximately $41 billion. Ultimately, lifting the cap proved to be one of the primary reasons NCUA could successfully develop and implement a series of critical liquidity interventions that served as the foundation for its corporate stabilization efforts.

With the full borrowing authority of the CLF now available, NCUA began working with staff at both the Board of Governors of the Federal Reserve System (FRB) and the U.S. Department of the Treasury (U.S. Treasury) to develop tools, such as the Credit Union System Investment Program and the Credit Union Homeowners Affordability and Relief Program, to address the liquidity pressures in corporates. These two programs enabled consumer credit unions to essentially invest funds borrowed from the CLF into corporate credit union offerings, which raised approximately $8.5 billion in liquidity.

The NCUA Board approved the "Temporary Corporate Credit Union Liquidity Guarantee Program" (TCCULGP) on October 16, 2008. Under the TCCULGP, the NCUSIF provided a 100 percent guarantee on new unsecured debt obligations issued by eligible corporates on or before June 30, 2009, and maturing on or before June 30, 2012.[7] The

[6] The Central Liquidity Facility was created by Congress in 1978 to improve the general financial stability of the credit union industry by meeting the liquidity needs of individual credit unions.
[7] On May 21, 2009, the TCCULGP was revised to cover unsecured debt obligations issued on or before June 30, 2010, and maturing on or before June 2017.

TCCULGP and the other CLF-based programs were successful in restoring credit lines and funding in the corporate system.

To address the lack of confidence in the corporates and the resulting deposit outflow, the NCUA Board approved the “Temporary Corporate Credit Union Share Guarantee Program” (TCCUSGP), which presently guarantees uninsured shares, excluding capital accounts, at participating corporates through December 31, 2012. This program was vital in maintaining the confidence of consumer credit unions and stabilizing the precarious liquidity situation at the corporates. The TCCUSGP has proven very successful in stabilizing liquidity and continues to serve an important role in the transition process under the resolution phase discussed later.

The NCUA Board also issued a $1 billion NCUSIF capital note to U.S. Central Federal Credit Union (U.S. Central) to address realized losses on MBS and other asset-backed securities. This action was necessary to maintain external sources of funding and to preserve confidence in U.S. Central, given its pivotal liquidity and payment systems roles as a wholesale service provider to the corporate credit union system.

Creation of the Temporary Corporate Credit Union Stabilization Fund

The stabilization programs discussed so far came at a significant, but unavoidable, cost to the industry. Given the structure of the NCUSIF and existing law in early 2009, NCUA would have been required to assess this cost to consumer credit unions in one lump sum. To give the NCUA Board flexibility to manage the impact of the costs to

consumer credit unions, NCUA requested that Congress establish the Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund). On May 20, 2009, the Helping Families Save Their Homes Act of 2009[8] was signed into law and created the Stabilization Fund, allowing costs to be assessed over a seven-year period instead of in a lump sum.[9] This is, perhaps, the most critical tool available to NCUA to help ease the credit unions' burden of resolving the corporate crisis. The NCUA Board is appreciative that Congress acted so quickly to pass this legislation.

In addition to the Stabilization Fund provision, the Helping Families Save Their Homes Act of 2009 also contains another important provision that assisted NCUA's ability to mitigate the corporate problems. This law increases the NCUSIF's authority to borrow from the U.S. Treasury from $100 million to $6 billion, an aggregate total available to both the Stabilization Fund and the NCUSIF. The Stabilization Fund relies on the $6 billion borrowing authority in providing the NCUA Board flexibility to manage the impact of the assessments on credit unions. The enhanced authorities provided by Congress will permit NCUA to fairly and effectively distribute the insurance costs associated with the current economic downturn, including not just the costs of the corporate losses but also other costs that may arise. The Stabilization Fund must repay the U.S. Treasury, with interest, all amounts borrowed. As such, the total costs of the corporate stabilization, resolution, and reform will be fully borne by credit unions with the flexibility to absorb those costs over a longer time period.

---

[8] Public Law 111-22, which was amended in July 2010 by Public Law 111-203.
[9] The closing date of the Stabilization Fund can be extended with the concurrence of the U.S. Treasury. Subsequently, as part of its plan to reduce the annual burden of assessments on credit unions, in September 2010, NCUA requested the concurrence of the U.S. Treasury to extend the life of the Stabilization Fund to June 2021; the U.S. Treasury concurred with this request.

NCUA's stabilization efforts were successful in preserving the vital electronic payments and liquidity services that credit unions provide to over 90 million Americans.

Resolution Phase

The stabilization phase provided NCUA with the time and resources to design and implement a strategy to resolve the troubled corporate credit unions and the distressed securities they held. Collaborating with the FRB and the U.S. Treasury, NCUA carefully evaluated a wide range of options to arrive at the least cost, long-term solution consistent with sound public policy. On September 24, 2010, the NCUA Board approved a comprehensive strategy to fully resolve the ongoing solvency, liquidity, and reputation risks associated with the non-financially viable corporate credit unions.

NCUA conducted a comprehensive evaluation of the entire corporate system. Of the 27 corporates, this evaluation identified five corporates that were not financially viable. These five corporates represented approximately 70 percent of the entire corporate system's assets and 98.6 percent of the investment losses within the system. NCUA took direct control of these five institutions through federal conservatorship.[10] In doing so, NCUA was able to achieve the goals of (1) protecting the vital services to the thousands of consumer credit unions that rely on the corporate network and (2) implementing the process to resolve the distressed assets.

---

[10] On September 24, 2010, NCUA conserved Constitution Corporate Federal Credit Union, Members United Corporate Federal Credit Union, and Southwest Corporate Federal Credit Union. Western Corporate Federal Credit Union and U.S. Central were conserved on March 20, 2009.

NCUA employed a traditional resolution model used in the financial sector often referred to as the "good bank/bad bank" model. The "good bank/bad bank" model was necessary given that the conserved corporates were correspondent service providers to thousands of credit unions and no viable acquisition partners were available. This strategy involved the creation of new charters, called "bridge" corporates, and transfer of the good assets, deposits, and operations from the conserved corporates to these new entities.

The four bridge corporates are led by chief executive officers selected by NCUA, and who report directly to NCUA. Additionally, NCUA maintains control over their operations. NCUA has established policies to ensure that the bridge corporates operate soundly, and minimize the long-term costs to the insurance fund. The bridge corporates are temporary entities, created to maintain necessary services during the transition period. NCUA intends to maintain the bridge corporate operations long enough to allow consumer credit unions adequate time to determine their long-term service options, perform appropriate due diligence, and implement the necessary operational changes.

Remaining assets in the failed corporate charters were then placed into an inactive status and managed via asset management estates established to house the "legacy assets."[11] With the legacy assets isolated in the asset management estates, NCUA is pursuing a least-cost solution for an orderly disposition of these assets. After extensive analysis, NCUA determined that the least-cost disposition strategy involved holding the

---

[11] The term *"legacy assets"* is used to describe the impaired private-label residential mortgage backed securities and other asset-backed securities held by the failed corporates.

distressed assets by obtaining long-term funding. This strategy prevents much larger market losses and, in conjunction with the extension of the Stabilization Fund, provides credit unions more time to absorb the lower credit losses.

The long-term funding is being obtained through securitizing the legacy assets. In summary, the legacy assets are being combined into new structured securities that are being issued in the financial markets as NCUA Guaranteed Notes (ticker symbol NGN). The new securities have a guarantee on the timely payment of principal and interest from NCUA, which is backed by the full faith and credit of the United States. To date, NCUA has finalized four issuances of the structured notes; all met with strong investor demand.

The underlying defaults on distressed legacy assets and other resolution costs are expected to be between $13.9 billion to $16.1 billion.[12] This cost will be borne solely by the credit union system. Credit unions that contributed capital to the corporates holding these legacy assets bear the first loss, totaling $5.6 billion. The losses above $5.6 billion will be borne by all federally-insured credit unions through Stabilization Fund assessments over time. Currently the expected range of total assessments is between $8.3 billion and $10.5 billion. Credit unions have already paid $1.3 billion in

[12] Given the complexity of projecting credit losses, the NCUA has relied on multiple expert sources to validate NCUA's internal results. These external sources include the analysis done by the corporates' external vendors; a detailed, bond-by-bond analysis conducted by the Pacific Investment Management Company (PIMCO) expressly for NCUA; and a detailed bond-by-bond analysis performed by Barclays Capital, New York, New York, as part of the securitization. These analyses incorporate assumptions about future economic events. Hence NCUA relies on a range of estimates to project future costs to credit unions.

assessments. Thus, the projected range of remaining assessments is $7.0 billion to $9.2 billion to be paid in annual installments through 2021.

Reform Phase

On September 24, 2010, NCUA issued a final rule reshaping the regulatory framework of corporate credit unions, addressed in Part 704 of NCUA's rules. NCUA's primary purpose in reforming Part 704 was to prevent catastrophic losses from ever recurring. The new corporate regulation is designed to both address the cause of the current crisis and to provide stronger protections against future potential risks.

The major elements of this new corporate rule can be divided into 1) investment and asset liability management (ALM) restrictions, 2) capital standards, and 3) corporate governance.

Investment and ALM Restrictions

Through a series of provisions related to investment suitability and asset liability management, NCUA's new corporate rule will force corporate credit unions to properly diversify their investments and take other steps to minimize potential credit, market, and liquidity risk. In short, key provisions:

- Institute a variety of more stringent standards that each security must pass before a corporate can purchase the investment.

- Prohibit certain highly complex and leveraged securities. Going forward, a corporate cannot buy a particular security if it is a collateralized debt obligation, a net interest margin security, a private-label residential mortgage-backed security, or a security subordinated to any other securities in the issuance.

- Reduce the single obligor limit. The new rule tightens the existing limit on securities from a single obligor from 50 percent of capital down to 25 percent of capital.

- Establish sector concentration limits. The new rule establishes sector concentration limits to diversify the composition of the investment portfolio.

- Limit portfolio Weighted Average Life (WAL) to two years or less. The WAL limit reduces not only market and liquidity risk, but also credit risk, since credit fears negatively affect the price of longer-lived assets more severely than shorter-lived assets.

The new rule contains other ALM measures to reduce risk. For example, to discourage investment arbitrage, the rule tightens a corporate's borrowing limits. To reduce the potential for overdependence by a corporate on one member credit union, the rule also limits funding from a single member, whether it comes from deposits or loans.

Capital Standards and Prompt Corrective Action

The new corporate rule strengthens capital requirements including new minimum capital ratios, new risk-based capital calculations, and new definitions of capital modeled after the Basel I capital requirements.[13] Corporate credit unions will now need to satisfy three different minimum capital requirements: a 4 percent leverage ratio, a 4 percent tier one risk-based capital ratio, and an 8 percent total risk-based capital ratio.[14] The rule also mandates that a certain portion of a corporate's capital consist of retained earnings.

The rule also contains new Prompt Corrective Action (PCA) standards for enforcement of the capital requirements. The consequences of failing to retain adequate capitalization can include restrictions on activities, restrictions on investments and asset growth, restrictions on the payment of dividends, restrictions on executive compensation, requirements to elect new directors or dismiss management, and the possibility of conservatorship, liquidation, or a supervisory merger. These new capital and PCA requirements will ensure that corporates hold adequate capital commensurate with the risks of both their balance sheet assets and off-balance sheet activities.

[13] Basel 1 is a risk-based capital framework developed by the Basel Committee, a group of eleven industrialized nations, including the U.S., formed to harmonize banking standards and regulations among member nations.

[14] Both the old and new corporate rules also require that a corporate maintain a minimum net economic value ratio of 2 percent.

Corporate Governance Provisions

As a result of the recent corporate crisis, NCUA identified certain weaknesses in corporate governance. The new corporate rule improves upon the existing governance provisions in several ways. All board members will be required to hold either a CEO, CFO, or COO position at their member credit union or other member entity. A majority of a corporate's board of directors will have to be representatives of consumer credit unions. No person will be permitted to sit on the boards of two or more corporates at the same time, nor will a single organizational member be permitted to have more than one individual representative on the board of any given corporate.

Other governance changes relate to transparency. The new rule requires that each corporate disclose to its members the compensation of its most highly compensated employees.[15] In the case of merger involving a federally-chartered corporate, the corporate must disclose to both its members and NCUA any material merger-related increase in compensation for any senior executive or director as a result of the merger.

The new rule also prohibits "golden parachutes," defined as payments made to an institution-affiliated party that are contingent on the termination of that person's employment and received when the corporate making the payment is either troubled, undercapitalized, or insolvent.

[15] The disclosure includes the three, four, or five most highly compensated employees at each corporate, with the exact number of employees depending on the size of the corporate. The compensation of the corporate credit union's CEO must also be disclosed, even if the CEO is not among the most highly compensated at the corporate.

Additional Proposed Amendments to NCUA's Corporate Rule

During the rulemaking process leading to NCUA's recent final amendments to its corporate rule, NCUA received many suggestions for further amending the rule that deserved consideration. Some of these suggestions were beyond the scope of the proposed rule, and so legally could not be included in the final rule. Other suggestions were within the scope of the first proposal, but deserving of additional public comment before adoption.

Accordingly, on November 18, 2010, NCUA issued seven additional proposed amendments to the corporate rule for public comment. Briefly, these proposed amendments, if adopted by NCUA, would:

- Increase the transparency of corporate credit union decision-making by requiring corporates conduct all board of director votes as recorded votes and include the votes of individual directors in the meeting minutes;

- Require that corporate credit unions follow certain audit, reporting, and audit committee practices required of commercial banks by the Federal Deposit Insurance Act, Part 363 of the Federal Deposit Insurance Corporation Regulations, and the Sarbanes-Oxley Act of 2002;

- Provide for the equitable sharing of Stabilization Fund expenses among all members of corporate credit unions, including both credit union and non-credit union members, by establishing procedures for requesting members not insured by the NCUSIF to make premium payments to the Stabilization Fund;

- Protect against unnecessary competition between corporates by limiting consumer credit unions to membership in one corporate of the consumer credit union's choice at any one time;

- Improve risk management at corporates by requiring corporates to establish enterprise-wide risk management committees staffed with at least one independent risk management expert;

- Provide corporates with more options to grow retained earnings by allowing corporates to charge their members reasonable one-time or periodic membership fees; and

- Require the disclosure of compensation received from a corporate credit union service organization (CUSO) by highly compensated corporate credit union executives who are also employees of the CUSO.

The public comment period on these proposals ends January 28, 2011.

Current State of Corporate Credit Unions

The corporate credit union system is in a state of transition, which is going according to plan. To date, that transition process has been extremely successful. The four bridge corporates continue to deliver the critical payment and settlement services on which their members depend. The 22 corporates operating independent of NCUA control are in the process of implementing critical operational changes to conform with the new regulatory framework.

NCUA's number one priority in launching the corporate resolution efforts was to ensure that the critical payment, settlement, and liquidity services corporates provide their member credit unions would continue uninterrupted. That goal has been met. At no time over the past two years was there a lapse in services to the 90 million consumers served by credit unions.

The future of the corporate credit union system will ultimately be decided by the consumer credit unions they serve. If consumer credit unions are committed to a corporate system for their financial service needs, the system must conform to the new more rigorous regulatory framework NCUA has established. If credit unions choose not to obtain services from corporates going forward, NCUA will ensure an orderly transition for credit unions to new service providers. Under either circumstance, NCUA's primary goal is to ensure uninterrupted financial services to the 90 million credit union consumers.

NCUA is working closely with consumer credit unions to provide as much guidance as possible in making the critical decisions related to their future service needs. NCUA has assured credit unions that they do not need to make an immediate decision. However, NCUA has also been clear in communicating that the decision process is complex and that credit unions need to begin evaluating their options now.

III. Status of Consumer Credit Unions

Despite the stresses on credit union earnings, the industry remains very well capitalized. As of September 30, 2010, aggregate net worth totaled $90.6 billion, representing the highest dollar level in credit union history. This equates to a net worth ratio of 9.97 percent of total assets. Ninety-eight percent of all credit unions were at least "adequately capitalized" or better, with 94.8 percent of all credit unions "well capitalized."[16]

During the past several years, credit unions have experienced strong membership and deposit growth, indicating they continue to provide valuable services to members. They currently serve 90.8 million members, an increase of 5 million since 2006. Over the same period, shares have grown by $178 billion, or 30 percent, to $780 billion.

---

[16] See 12 C.F.R. Part 702.

Credit Unions Continue to Meet Member Lending Needs

Even during the height of the recent recession, credit unions continued to lend to their members as demonstrated by 15 percent growth in loans originated since 2008. Loans account for 62 percent of all credit union assets, with more than half secured by real estate.

Focusing more closely on credit union mortgage lending, 68 percent of credit unions offer mortgage loans to their members, originating $55 billion in first mortgage loans through the third quarter of 2010. In the first nine months of 2010, total mortgage loans held on credit union balance sheets increased $667 million, to a new high of 54.6 percent of total loans.

All other consumer loans, such as auto loans and credit cards, make up 40 percent of credit unions' loan portfolios. Used vehicle loans are the fastest-growing segment of consumer lending.

Regarding member business loans (MBLs), currently, 2,210 or approximately 30 percent of all credit unions offer these types of loans. MBLs comprise 6.5 percent of all outstanding loans, or $36.7 billion. The majority of these MBLs are secured by real estate. The average size of an MBL is $249,000, indicating credit unions are largely serving the needs of small businesses.

Loan Portfolio Quality

Despite overall adherence to sound underwriting practices, the credit union industry was not immune to the macroeconomic impact of high unemployment and home value declines. Since the end of 2006, the aggregate delinquent loan ratio and net charge-off ratios more than doubled to highs of 1.84 percent and 1.21 percent respectively as of year-end 2009. However, aggregate delinquency and net charge-offs have stabilized in 2010. While historically high for credit unions, these figures still compare favorably to other types of lenders.

Real Estate Loan Delinquency

At more than half of total loans, real estate is the predominant factor in overall portfolio performance. Rising delinquency rates and losses present a challenge for credit unions. Real estate loan delinquency has been steadily increasing as the economic crisis has unfolded, from 0.34 percent in 2006 to 2.06 percent as of September 2010. For this same time period, net charge-offs for real estate loans demonstrate a similar trend, increasing to 0.63 percent as of the third quarter 2010.

Loan Modifications and Foreclosures

NCUA continues to support loan modifications to resolve credit union member issues. For borrowers experiencing financial difficulties, in lieu of foreclosures, it may be in the best interest of credit unions and their members to develop prudent workout arrangements or loan modifications. Credit unions have shown a willingness to work with their members experiencing financial difficulty as noted by the rapid growth in loan

modifications. They have increased from $1.5 billion in 2008 to $8.4 billion, which is approximately 2 percent of total real estate loans.

Foreclosed assets represent only a small fraction (0.49 percent) of total real estate loans outstanding in credit unions, but have been rising since 2007. In light of the recent concerns over market-wide real estate foreclosure practices and documentation, NCUA is examining a sample of the largest credit unions selling mortgages to ensure adequate controls are in place.

Member Business Loan Delinquency

While MBLs represent only 4 percent of total credit union industry assets and approximately 1 percent of total commercial loans in the financial markets,[17] the levels of delinquent member business loans have increased from 0.53 percent to 4.29 percent from 2006 to September 2010 (compared to total loan delinquency of 1.74 percent). A similar trend during this period was noted in net MBL charge-offs, which increased to 0.71 percent. Presently, at 270 of the 633 credit unions which have a 3, 4, or 5 CAMEL rating[18] and make member business loans, MBLs are the primary or secondary contributing factor for the supervisory concern.

---

[17] Mortgage Bankers Association Commercial and Multifamily Mortgage Debt Outstanding Report as of 6/30/2010. <http://www.mortgagebankers.org/NewsandMedia/PressCenter/74019.htm>

[18] Credit unions with a CAMEL rating of 3 have supervisory concerns; credit unions with a CAMEL rating of 4 or 5 are considered "troubled."

Investment Portfolio Quality

Credit union investments account for a third of total assets. These are generally short-term in nature, with nearly half maturing in less than one year, and the majority are conservatively invested in federal government obligations.

Earnings Have Been Stressed

Earnings have been depressed over the last several years and will likely continue to be stressed in the near future. As of September 2010, credit unions reported a return on average assets of 0.45 percent compared to 0.82 percent in 2006. This has reduced credit unions' ability to build net worth. Credit union earnings are under stress due to compressed net interest margins in the current interest rate environment, NCUSIF premiums and Stabilization Fund assessments, and higher provision for loan loss expenses. Also, any future rise in interest rates will likely further reduce margins. NCUA's ability to better manage the timing of Stabilization Fund assessments improves the credit union system's capacity to absorb these costs, continue to provide needed member services, and remain well capitalized.

The Number of Troubled Credit Unions Is Increasing

The level of troubled credit unions[19] is highly correlated to the state of the economy. As of October 31, 2010, there were 363 troubled credit unions holding $44.4 billion in assets and $39.1 billion in shares. These credit unions represent 5.0 percent of all

[19] NCUA defines a troubled credit union as rated either a CAMEL Code 4 or 5.

credit unions and total shares. The number of troubled credit unions has increased in the current year, from 328 at year-end 2009.

Similarly, CAMEL code 3 credit unions, which exhibit some degree of supervisory concern due to less than satisfactory risk management practices, increased from 1,648 to 1,779 over the same period. The following charts illustrate the changes in the number of troubled and CAMEL code 3 credit unions and the dollars in total shares held by these credit unions since year-end 2007.

Chart 1

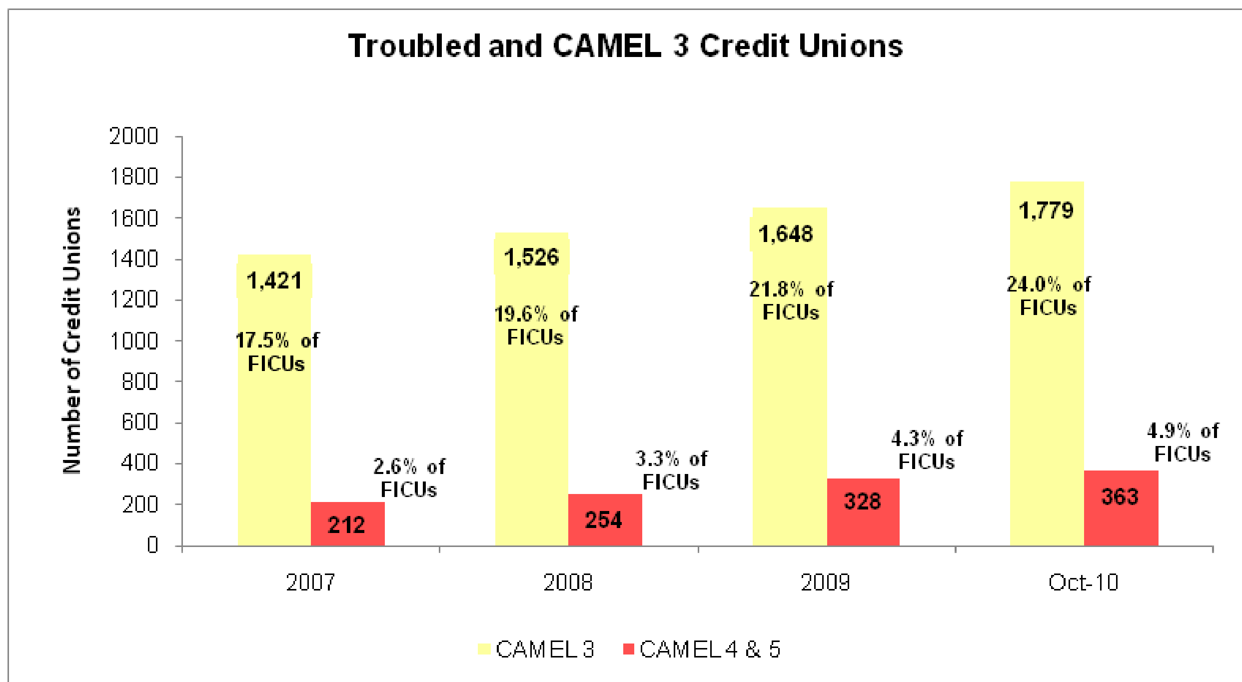
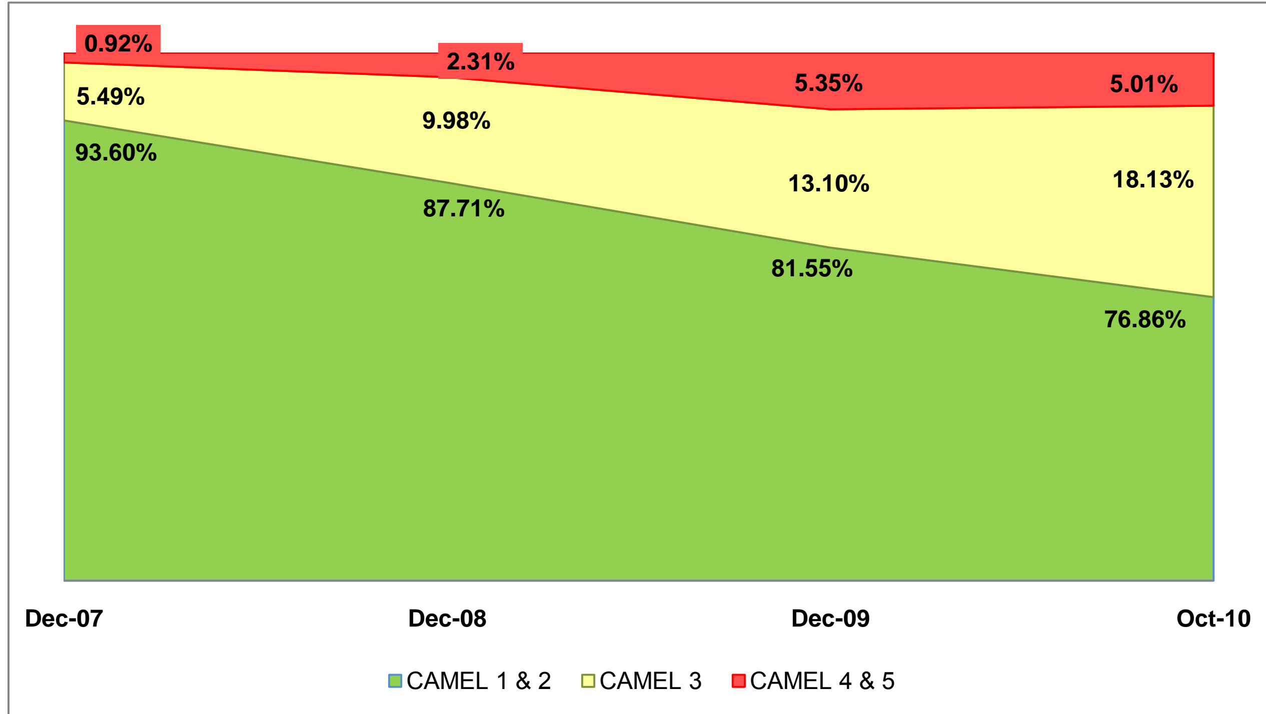


Chart 2
Distribution of Shares in CAMEL Codes



As Chart 2 illustrates, the majority of shares are held in CAMEL 1 and 2 credit unions. While NCUA is working diligently with affected credit unions to resolve problems in weaker institutions, the level of troubled credit unions will also depend heavily on the pace of the economic recovery.

Impact on the NCUSIF

One of the primary factors impacting the NCUSIF equity level is losses due to credit union failures. As a result of the above stresses on the credit union system and the corresponding increase in troubled credit unions, the NCUSIF has experienced increased losses during the past two years.

For proper financial statement reporting, the shifting of credit union assets to more adverse CAMEL codes results in an increase in the amount of NCUSIF reserves for credit union failures. The increase in reserves lowered the equity ratio[20] of the NCUSIF below 1.2 percent during the summer of 2010. Thus, in September the NCUA Board approved a restoration plan consisting of a premium of 0.124 percent of insured shares to return the equity ratio to near 1.3 percent. The September 2010 premium was slightly more than the 2009 premium of 0.10 percent of insured shares. As of October 31, 2010, the NCUSIF's equity ratio was restored to 1.29 percent and is projected to remain above 1.2 percent through at least June 2011.

NCUA regularly conducts stress tests to measure the resilience of the NCUSIF. The most recent tests included analyzing the impact of further declines in real estate values and other economic conditions. The results of this year's stress tests indicate the risk profile of the NCUSIF has not changed. The amount of losses at modeled stress levels remain within the ability of the NCUSIF to absorb. NCUA will continue to assess the risk profile of the NCUSIF and take appropriate actions based on the results.

Potential Future Risks

While credit unions are financially strong and well positioned to weather the continuing impact of the economic recession, NCUA has identified the following potential future risks.

---

[20] *Equity ratio* means the ratio of the amount of NCUSIF's capitalization, meaning insured credit unions' 1 percent capitalization deposits plus the retained earnings balance of the NCUSIF (less contingent liabilities for which no provision for losses has been made) to the aggregate amount of the insured shares in all insured credit unions.

Interest Rate Risk

As of September 2010, fixed-rate mortgages represent 63 percent of total mortgage loans, indicating a clear preference by credit union members for this product in the current economic environment. While NCUA recognizes the benefit to consumers of refinancing higher-rate real estate loans into lower fixed-rate loans, NCUA is concerned with the interest rate and liquidity risk associated with a high level of fixed-rate, long-term assets should rates rise rapidly.

Credit unions are taking some positive steps to mitigate interest rate risk. Credit unions sold $27.6 billion in first mortgage real estate loans to date in 2010. These sales represent nearly 50 percent of first mortgages granted. However, significant exposure to rapidly rising rates remains.

Credit Union Service Organizations

A Credit Union Service Organization (CUSO) is a corporation, limited partnership, or limited liability company that provides services primarily to credit unions or members of affiliated credit unions. These entities can be wholly owned by a single credit union or owned by a group of credit unions with or without other investors. A credit union's invested interest in a CUSO is subject to NCUA regulations.[21]

Credit unions are increasingly using CUSOs to perform various functions and achieve economies of scale by partnering with other financial institutions. This partnering is

[21] See 12 C.F.R. Part 712.

especially critical to the 2,833 credit unions with less than $10 million in assets. Credit unions currently have $1.3 billion invested in CUSOs and approximately 33 percent of all credit unions reported using CUSO services. While this arrangement can be beneficial from an efficiency standpoint, especially for smaller credit unions, it places the systemic risk inherent in the delivery of these services outside of NCUA's direct regulatory and supervisory domain. NCUA is the only federal financial institution regulator that does not have oversight authority of third-party vendors.

Privately-Insured Credit Unions

While NCUA has no regulatory authority over privately-insured institutions, they do pose a unique reputation risk to federally-insured credit unions. All financial institutions have been negatively affected by high unemployment, declines in real estate values, and loan losses all arising from the recent, protracted recession. Consumers do not always differentiate between private share insurance and federal share insurance. As a result, any pervasive problems that may develop with privately-insured credit unions could have an impact on federally-insured credit unions.

American Mutual Share Insurance Corporation (ASI) is a private share insurer incorporated in Ohio. ASI, along with its wholly-owned subsidiary Excess Share Insurance Corporation (ESI), provides primary share insurance to 152 credit unions in nine states and excess share insurance to several hundred credit unions, including

federally-insured credit unions, in 32 states.[22] ASI has geographic concentration in two states particularly hard hit by the recent recession: California and Nevada.

IV. NCUA Supervisory Improvements

The last several years have provided clear evidence of the importance of a strong regulatory and supervisory approach. The depth and severity of the recent economic crisis has provided new insight to all regulatory agencies. NCUA is committed to proactively identifying areas of concern and implementing corrective action in a timely manner.

To better accomplish this, NCUA modified its risk-based examination program to require annual examinations of every federal credit union and increased on-site reviews of state-chartered credit unions. Annual examinations provide more frequent onsite contacts at credit unions, enabling NCUA to more effectively stay ahead of developing problems than the previous 18-month examination schedule allowed. Full implementation of the annual exam cycle is anticipated in 2011 as NCUA hires and trains additional staff.

In addition to more frequent contacts at credit unions, NCUA is also taking stronger resolution action earlier in the process when problems are identified. In 2010 NCUA

[22] ASI provides primary insurance directly in nine states (Alabama, California, Idaho, Illinois, Indiana, Maryland, Nevada, Ohio and Texas), excess insurance directly in Arizona and California, and excess insurance indirectly through ESI in 30 other states. ASI and ESI both operate websites that list their respective states of operation.

issued a supervisory letter and increased training for field staff directing more rapid escalation of administrative remedies to resolve problems that had been left uncorrected by credit union management.

NCUA has increased the resources provided for credit union supervision to ensure problem areas are brought to a timely and appropriate resolution. A particular focus going forward will be strong regulation and supervision relative to interest rate risk management. NCUA has also been acquiring additional specialized expertise and incorporating an enhanced training program for examination staff.

NCUA has made necessary adjustments over the past two years to address the increased challenges associated with the financial crisis and implement additional proactive risk mitigation programs.

While NCUA remains a highly effective regulator and insurer, NCUA is also operating more efficiently. For every $1,000 in federally-insured credit union assets, NCUA is currently spending just 22 cents – compared with 31 cents in the year 2000.

V. Legislative Remedies

Current Legislative Requests

Due to the financial environment and the evolving nature of financial reporting rules, NCUA is requesting statutory changes to its enabling statute, the Federal Credit Union

Act (Act), to enhance its ability to serve as an effective safety and soundness regulator of over 7,400 credit unions and deposit insurer for 90 million members. While these amendments are technical and non-controversial, they are nonetheless critical to NCUA's role as regulator and insurer.[23]

NCUA requests the following statutory changes to the Act.

- Change the "Net Worth" definition to allow certain loans and accounts established by the NCUA Board to count as net worth. NCUA's ability to resolve problem credit unions at the least cost to the NCUSIF has been limited by the Financial Accounting Standard Board's changes in accounting standards, in combination with the existing statutory definition of net worth. Since NCUA does not have the ability to adjust the definition of net worth similar to the Federal Deposit Insurance Corporation's authority, this results in the dilution of a credit union's net worth when it acquires another credit union, regardless of whether or not NCUSIF assistance is provided to facilitate the acquisition. This increases costs to resolve failed institutions and necessitates more outright liquidations instead of mergers. Liquidations immediately cut members off from credit union services.

- Amend the Act to clarify that the equity ratio of the NCUSIF is based on NCUSIF-only, unconsolidated financial statements. Evolving accounting standards could result in the consolidation of the financial statements of the NCUSIF with

[23] See Appendix 1 for applicable proposed legislative text.

regulated entities when NCUA exercises its role as the government regulator and insurer by conserving failed institutions. The requested amendment would be consistent with Congress' original intent in defining the NCUSIF equity ratio, and prevent insured credit unions from being assessed artificially-inflated insurance premiums resulting from the consolidation of financial statements with failed institutions.

- Streamline the operation of the Stabilization Fund. As currently written, the Stabilization Fund must borrow from the U.S. Treasury to obtain funds to make expenditures related to losses in the corporate credit union system. The Stabilization Fund then assesses federally insured credit unions to repay the U.S. Treasury borrowing over time. Relevant amendments to Section 217(d) of the Act would give NCUA the option of making premium assessments on federally-insured credit unions in advance of anticipated expenditures, thereby avoiding borrowing directly from the U.S. Treasury. In addition, while the existing statutory language includes the implicit authority for ongoing advances, a clarification of this in the statute is recommended.

Anticipated Requests for Next Congress

The following are important legislative initiatives for further improving the regulation of the credit union industry.

- Statute of Limitations. NCUA proposes that Congress amend the Act to extend the statute of limitations[24] provision applicable to actions filed by NCUA as conservator/liquidating agent of a credit union. This would provide parity with similar authority already provided to FDIC, clarify other ambiguities in the statute, and allow the NCUSIF to better mitigate losses.

- Third-Party Vendor Authority. NCUA is the only regulator subject to the Financial Institutions Reform, Recovery and Enforcement Act of 1989 that does not have authority to perform examinations of vendors which provide services to insured institutions. Credit unions are increasingly relying on third-party vendors to support technology-related functions such as internet banking, transaction processing, and funds transfers. Vendors are also providing important loan underwriting and management services for credit unions. The third-party arrangements present risks such as threats to credit risk, security of systems, availability and integrity of systems, and confidentiality of information. Without vendor examination authority, NCUA has limited authority to minimize risks presented by vendors.

- Supplemental Capital. Some financially healthy, well-capitalized credit unions that offer desirable products and services are discouraged from marketing them too vigorously out of concern that attracting share deposits from new and existing members will inflate the credit union's asset base, thus diluting its net worth for purposes of PCA. In effect, the reward for their success in attracting new shares

[24] 12 U.S.C. §1787(b)(14).

is the risk of a demotion to a lower net worth category if accepting those shares drives down the credit union's net worth ratio. NCUA believes two legislative remedies would help reverse the disincentive to accept new share deposits—one that addresses the "total assets" denominator of the net worth ratio, and another that addresses the "retained earnings" numerator. For more information on the specific remedy proposed, refer to NCUA's letter to the Honorable Barney Frank (appended to this testimony document as Appendix 2).

- Member Business Lending Statutory Limit. The Act limits the amount of member business loans the vast majority of credit unions can grant to the lesser of 1.75 percent of net worth or 12.25 percent of assets. NCUA recognizes the importance of small businesses in our nation's economy. As such, NCUA supports efforts to allow credit unions to provide businesses additional avenues of credit when appropriate under a comprehensive regulatory framework, by increasing or eliminating the current statutory MBL limitation. Given such a change, NCUA would promptly revise MBL regulations to appropriately mitigate any additional risk. For more information on the specific remedy proposed, refer to NCUA's letter to the Honorable Timothy Geithner (appended to this testimony document as Appendix 3).

VI. Conclusion

Over the last 24 months, the credit union industry has faced profound and unprecedented threats to its stability. A steep plunge in global financial markets triggered the most severe economic downturn in recent memory. The resulting cascade of job losses, home foreclosures, and bankruptcies exerted significant pressure on the entire American financial services sector, including credit unions.

NCUA's experience during these years of crisis demonstrated the value of rigorous regulation, diligent oversight, and a robust insurance fund. NCUA's increased supervision contributed significantly to the credit union system's ability to withstand the extraordinary economic shocks over the past two years.

Going forward, NCUA has also implemented proactive measures to address the ongoing strains and emerging risks to consumer credit unions. Coming out of this extraordinary economic downturn, the credit union industry remains financially stable and well positioned to emerge from the current economic downturn as a leader in the delivery of financial products and services to more than 90 million consumers.

Appendix 1

National Credit Union Administration's Request for Congressional Actions in this Session – Legislative Language

The National Credit Union Administration (NCUA) needs statutory changes to its enabling statute, the Federal Credit Union Act (Act), to enhance NCUA's ability to serve as an effective safety and soundness regulator. The proposed amendments to the Act include 1) revising the Prompt Corrective Action definition of "net worth" to include loans to, or the establishment of accounts in, an insured credit union by the NCUA Board; 2) clarifying that the equity ratio of the NCUSIF is based solely on the unconsolidated financial statements of the NCUSIF; and 3) clarifying that NCUA may make assessments directly against credit unions to pay Temporary Corporate Credit Union Stabilization Fund expenses. The following statutory amendments would accomplish these goals.

SECTION 1. DEFINITION OF NET WORTH.

Section 216(o)(2) of the Federal Credit Union Act, 12 U.S.C. 1790d(o)(2), is amended by striking existing subsection (2) and inserting the following:

(2) **Net worth**.—The term 'net worth'—

(A) with respect to any insured credit union, means the retained earnings balance of the credit union, as determined under generally accepted accounting principles, together with any amounts that were previously retained earnings of any other credit union with which the credit union has combined;

(B) with respect to any insured credit union may, at the Board's option and subject to rules and regulations established by the Board, include loans to, or the establishment of accounts in, and insured credit union provided pursuant to section 208; and

(C) with respect to a low-income credit union, includes secondary capital accounts that are—

(i) uninsured; and

(ii) subordinate to all other claims against the credit union, including the claims of creditors, shareholders, and the Fund.

SECTION 2. EQUITY RATIO OF SHARE INSURANCE FUND.

Section 202(h)(2) of the Federal Credit Union Act (12 U.S.C. 1782(h)(2)) is amended by striking ''when applied to the Fund,'' and inserting ''which shall be calculated using the financial statements of the Fund alone, without any consolidation or combination with the financial statements of any other fund or entity,''.

SECTION 3. STABILIZATION FUND.

(a) ADDITIONAL ADVANCES.—Section 217(c)(3) of the Federal Credit Union Act (12 U.S.C. 1790e(c)(3)) is amended by inserting before the period at the end the following: ‘‘and any additional advances’’.

(b) ASSESSMENTS.—Section 217 of the Federal Credit Union Act (12 U.S.C. 1790e) is amended by striking subsection (d) and inserting the following:

‘‘(d) ASSESSMENT AUTHORITY.—
‘‘(1) ASSESSMENTS RELATING TO EXPENDITURES UNDER SUBSECTION (B).
—In order to make expenditures, as described in subsection (b), the Board may assess a special premium with respect to each insured credit union in an aggregate amount that is reasonably calculated to make any pending or future expenditure described in subsection (b), which premium shall be due and payable not later than 60 days after the date of the assessment.

‘‘(2) SPECIAL PREMIUMS RELATING TO REPAYMENTS UNDER SUBSECTION (C)(3).—
Not later than 90 days before the scheduled date of each repayment described in subsection (c)(3), the Board shall set the amount of the upcoming repayment and shall determine whether the Stabilization Fund will have sufficient funds to make the repayment. If the Stabilization Fund is not likely to have sufficient funds to make the repayment, the Board shall assess with respect to each insured credit union a special premium, which shall be due and payable not later than 60 days after the date of the assessment, in an aggregate amount calculated to ensure that the Stabilization Fund is able to make the required repayment.

‘‘(3) COMPUTATION.—Any assessment or premium charge for an insured credit union under this subsection shall be stated as a percentage of its insured shares, as represented on the previous call report of that insured credit union. The percentage shall be identical for each insured credit union. Any insured credit union that fails to make timely payment of the assessment or special premium is subject to the procedures and penalties described under subsections (d), (e), and (f) of section 202.’’.

Appendix 2

National Credit Union Administration

Office of the Chairman

December 7, 2009

The Honorable Barney Frank, Chairman
Committee on Financial Services
U. S. House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Frank:

As Chairman of the NCUA Board, I am writing to call your attention to a trend reported by some credit unions that adversely affects consumers—including those of modest means, who benefit from access to the reasonably-priced financial services that credit unions offer. Some financially healthy, well-capitalized credit unions that offer desirable products and services are discouraged from marketing them too vigorously out of concern that attracting share deposits from new and existing members will inflate the credit union's asset base, thus diluting its net worth for purposes of prompt corrective action ("PCA").

Under PCA, a credit union's classification among five statutory net worth categories is determined by its "net worth ratio"—the ratio of retained earnings (numerator) as a percentage of total assets (denominator). 12 U.S.C. 1790d(o)(3). As a credit union accepts new share deposits, its total assets (denominator) rises. Unless a credit union's retained earnings (numerator) grows commensurately, the rising denominator will dilute the credit union's net worth ratio. As a credit union's net worth ratio declines, so does its classification among the five statutory net worth categories, exposing it to an expanding range of mandatory restrictions imposed by law, as well as discretionary restrictions imposed by regulation—all designed to restore net worth. *Id.* §1790d(c); 12 C.F.R. Part 702, Subpart B.

For example, a credit union's decline from "well capitalized" (net worth ratio of 7 percent or greater) to "adequately capitalized" (net worth ratio between 6 and 6.99 percent) triggers a mandatory "earnings retention requirement" that compels the credit union to annually transfer 40 basis points of net income to build net worth. 12 U.S.C. 1790d(e). A credit union's decline from "adequately capitalized" to "undercapitalized" (net worth ratio between 4 and 5.99 percent) triggers not only the "earnings retention requirement," but also three further mandatory restrictions: a freeze on its asset balance, a freeze on its Member Business Loan balance, and the requirement to obtain NCUA approval of a Net Worth Restoration Plan ("NWRP"). *Id.* §1790d(f) and (g). A further decline below

"undercapitalized" subjects a credit union to all four mandatory restrictions plus a series of further discretionary restrictions. *Id.* §1790d(b)(A); 12 C.F.R. 702.203, 702.204.

The risk of reputational damage from being branded less than "well capitalized" and in need of "restoring" net worth, and from being subjected to the mandatory and discretionary restrictions that accompany a falling net worth ratio, is reportedly having a significant chilling effect on the willingness of some "well capitalized" credit unions to accept new share deposits. In effect, the reward for their success in attracting new shares is the risk of a demotion to a lower net worth category if accepting those shares drives down the credit union's net worth ratio. In turn, the net effect on existing and new credit union members is that they cannot fully rely on the financial institutions that are supposed to be the most accessible to persons of modest means who have the least consumer choice.

It is clear that controlling accelerated, unmanageable growth of credit union assets was a principal purpose of PCA, and NCUA's implementing regulations respect that goal. It is for that reason that in the course of implementing PCA over the last 9 years, NCUA did not propose statutory remedies in response to occasional periods of reluctance by credit unions to grow assets. That reluctance in the present period of national economic distress has become acute, however, warranting a statutory remedy. Surely it was never the objective of PCA to discourage manageable asset growth by financially healthy credit unions in times of economic distress. To the extent PCA does so now, it does not contribute to the objective of "resolv[ing] the problems of insured credit unions," 12 U.S.C.1790d(a)(1); it unintentionally creates a problem for them, which redounds to the detriment of consumers.

I believe two legislative remedies would help reverse the disincentive to accept new share deposits—one that addresses the "total assets" denominator of the net worth ratio, and another that addresses the "retained earnings" numerator. With respect to the denominator, I encourage Congress to consider allowing qualifying credit unions to exclude from the "total assets" denominator those assets that have a zero risk-weighting, exposing the credit union to virtually no risk of loss. An example of such "no-risk" assets is short-term Treasury securities.

To qualify for exclusion of no-risk assets from its denominator, I propose that a credit union should be required to meet at least two criteria: (1) Maintain a minimum net worth classification, as determined by the NCUA Board, calculated *before excluding no-risk assets;* and (2) show that share growth is the cause of its declining net worth ratio, *i.e.,* that the decline is not due to poor management or material unsafe or unsound practices. Permitting the "total assets" denominator to exclude "no risk" assets would moderate the growth of assets due to the inflow of new shares, while still imposing PCA that is appropriate to the circumstances.

With respect to the numerator of the net worth ratio, I encourage Congress to consider authorizing qualifying credit unions, as determined by the NCUA Board, to issue alternative forms of capital to supplement their retained earnings. To ensure the proper authority, alternative forms of capital would be subject to necessary regulations addressing safety and soundness criteria, investor protections, and any impact on the cooperative credit union governance model.

Congress already permits low-income designated credit unions to offer uninsured secondary capital accounts to non-members. 12 U.S.C. 1757(6); *see also* 12 C.F.R. 701.34. Modifying the Federal Credit Union Act ("Act") to permit qualifying credit unions to offer uninsured alternative capital instruments subject to regulatory restrictions, and expanding the Act's definition of "net worth" to include those instruments, would allow well-managed credit unions to better manage net worth levels under varying economic conditions.

The legislative remedies suggested above would, I believe, go a long way toward removing an obstacle to accepting new shares, thereby enhancing consumers' access to the benefits of credit union service. Please do not hesitate to contact me should you have questions or wish further information about this proposal.

Sincerely,

Debbie Matz
Chairman

National Credit Union Administration

Office of the Chairman

February 24, 2010

The Honorable Timothy F. Geithner, Secretary
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Geithner:

I am writing as a follow-up to the recent discussions our agencies have had about credit union member business loan limitations.

The Federal Credit Union Act limits the amount of member business loans (MBLs) the great majority of credit unions can grant to the lesser of 1.75 percent of net worth or 12.25 percent of assets. Congress presently contemplates legislation that would raise or eliminate that statutory limitation by enabling credit unions to grant more MBLs. Should the legislative process result in an increase to or elimination of the current MBL limitations, I assure you NCUA would remain vigilant in carrying out our supervisory responsibilities.

NCUA has long exercised caution in monitoring MBLs from the standpoint of safety and soundness. We routinely issue guidance to ensure the credit union community and agency staff understand the risks associated with MBLs. For example, last month, the agency released NCUA Letter to Credit Unions 10-CU-02 ("Current Risks in Business Lending and Sound Risk Management Practices"). This guidance reminds credit union officials of the importance of ensuring that risk management practices must continue to evolve as the size and complexity of MBL portfolios increase. NCUA also plans to provide extensive MBL training to our field staff in the coming months.

NCUA recognizes that successful MBL programs depend upon credit unions limiting products to only those consistent with the capabilities of their respective lending staffs and the principles of sound risk management. In consideration of these precepts, NCUA already has efforts underway to strengthen the regulatory qualifications that credit union officials must have to serve as business lenders.

Let me assure you: **If legislative changes increase or eliminate the current aggregate MBL cap, NCUA would promptly revise our regulation to ensure that additional capacity in the credit union system would not result in unintended safety and soundness concerns.**

As one of the most important changes, NCUA would only permit credit unions to increase their MBL capacities on a gradual basis by adopting a tiered approval process. In addition to other regulatory changes, the agency would develop procedures to fully monitor MBL growth.

Earlier this month, NCUA joined the other Federal Financial Institution Examination Council members in advocating prudent lending to creditworthy small businesses. We recognize the importance of small businesses in leading our nation's recovery efforts. As such, we support efforts to allow credit unions to provide businesses additional avenues of credit when appropriate under a comprehensive regulatory framework.

Sincerely,

Debbie Matz
Chairman

CC: Michael Barr
Assistant Secretary for Financial Institutions