CREDIT UNION NATIONAL ASSOCIATION
2005 GOVERNMENTAL AFFAIRS CONFERENCE

Remarks by

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NCUA Chairman

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Thank you, CUNA, for the opportunity to address your members.

For the past three years, I have emphasized the importance of good communication. Your invitation to address your membership gives me that opportunity to communicate with the leaders of the credit union community from across the nation.

I am pleased to join you today and welcome you to this beautiful city, Washington, D.C.

Throughout your meetings, you are going to be hearing words of wisdom from many speakers. But just as important, you'll be sharing your wisdom and insight with those who represent you on The Hill. Your participation is democracy in action, and it's gratifying to experience.

Indeed, it's an exciting time to be involved in the Credit Union Movement. It's certainly an energizing time for me, as a regulator, to be able to work on an agenda which is forward looking and innovative.

To that end, NCUA's recent proposal, calling for Prompt Corrective Action Reform, is the culmination of over a year's worth of work reviewing and analyzing various alternatives to the current mandated statutorily PCA structure.

After initiating the concept of a capital standard that incorporated both a leveraged and risk-based component, our real work began. Staff diligently analyzed, then analyzed some more. I would recognize NCUA Executive Director Len Skiles, General Counsel Bob Fenner, and two valuable members of NCUA's Examination and Insurance team, Director Dave Marquis and Director of Risk Management, Larry Fazio for their leadership as we pursued this concept. In addition, input was sought from the credit union industry. We called for a Summit on Credit Union Capital last fall, where credit union leaders from across the nation participated in the forum.

We have consulted with the Department of the Treasury, and worked with members of Congress. I would especially like to acknowledge Congressmen Royce and Kanjorski and their staffs for their support for including a risk-weighted capital proposal in their CURIA bill and for the opportunity to serve as a resource in those discussions.

The guiding principle behind PCA is to resolve problems in federally insured credit unions at the least long-term cost to the National Credit Union Share Insurance Fund, which is consistent with our fiduciary responsibility.

Meaningful capital standards are important in protecting the federal insurance funds, taxpayers, and the stability of America's financial system.

However, because of the higher leverage requirements in the current system placed on credit unions, inequities are created for credit unions with low-risk balance sheets, and it limits NCUA's ability to incorporate behavioral incentives related to higher risk activities.

A risk-weighted system would address these inequities. A well designed system would alleviate regulatory concerns by not penalizing low risk activities and by providing credit union management with the ability to manage their compliance through adjustments to their assets and activities.

A risk-based PCA system would better achieve the objectives of PCA and is consistent with sound risk management principles. Credit unions manage risk every day. A risk-based capital standard as proposed by NCUA will provide the opportunity for you to more effectively manage that risk.

If adopted, the result will be a balanced and credible approach to making credit unions PCA system aptly robust, yet not unduly burdensome or constraining. It's time for comparability with the capital standards for FDIC-insured institutions. Our proposal tailors the risk-asset categories and weights of BASEL 2, as well as related aspects of the FDIC PCA system, to the operation of credit unions. It's time for modernization. I encourage you to discuss this with your legislator on The Hill!

As Chairman, one of my goals remains to have the best examining force in the field. After all, that's our job. Qualified lenders deserve qualified examiners.

We're working to enhance our examination process. We recently issued an examiner guidance white paper titled "Supervising Community Development Credit Unions – Balancing Their Mission and NCUA's Regulatory Responsibilities."

The primary purpose is to better understand the unique challenges that community development credit unions face, but the contents of the paper are applicable to all credit unions in their continuing efforts to serve members of modest means.

The paper explains what the examiner will keep in mind when looking at credit unions serving those of modest means. Included is information and direction for non-traditional underwriting and effective collection programs. I encourage each of you to access the paper on our website. The examination process should add value to your credit union, and this is one way to achieve it.

Some of you have expressed concern over the use of the matrix in determining individual elements of the CAMEL rating. To clarify, by policy, an examiner can deviate from the matrix. The purpose of the matrix in the risk-focused examination is to provide guidance to the examiner – not dictate the rating.

Therefore, the examiner should be making the determination of the CAMEL elements based on the data and entire circumstances presented by the examination. However, as has been noted to me, occasionally that may not be the case.

For example:

Considering the natural progression of NCUA's risk-focused examination program, the matrix may not be relevant to your Credit Union's unique goals. This is best illustrated when a credit union that has high capital purposefully decides to decrease capital over a two year period of time and return it to the members. The credit union may, for instance, plan for reduced earnings over the next two years. The decrease in earnings is driven by better rates on loans and members shares along with some investment in technology.

If the examiner relied solely on the matrix, this credit union would be downgraded, even though the credit union could demonstrate it had a solid business plan which benefited the members in a safe and sound manner.

Although this is not the purpose of the matrix under the risk focused examination, it is possible this could happen if policy is not followed.

The matrix is not risk-focused; it relies on ranges of numbers without taking into account the complexity of the institution. The matrix is not dynamic or forward looking.

To address this issue, I have asked staff to review the relevance of the matrix to the risk-focused examination and report back to me as to whether it should be modified, or even perhaps eliminated as an examination guidance tool. Our responsibility is to consider the entirety of the safety and soundness issues, policies and procedures before assigning a CAMEL rating. The individual components of the CAMEL should not be dictated by the combined experiential data gathered from other credit unions.

A quick review demonstrates that the nation's credit unions posted solid gains in 2004:

- Assets increased over 6%
- Loans increased over 10%
- Shares increased over 5.25%
- Net Worth increased by over 8.5%
- And membership grew to 83.6 million credit union members

But you can't rest on your laurels. Continue the great work you are doing. As President Bush has said, "The true measure of compassion is more than good intentions, it is good results."

Through operating a safe and sound credit union, diversifying your membership and reaching out to serve Americans from all walks of life, you are indeed making a positive difference in the lives of over 83 million Americans.

Last year, 139 federal credit unions adopted 240 underserved areas, providing over 27 million residents eligibility for credit union membership and access to affordable financial services. NCUA's Access Across America initiative has enabled credit unions to take unprecedented steps in providing economic empowerment opportunities in well over a thousand communities. I commend your dedication and commitment to responding to your members and community's needs.

America's credit unions have a clear role today in the President's 'ownership society' agenda and have responded with great magnitude. Through helping credit union members become small business owners, save for retirement, and by being an integral element of the progress to raise homeownership to the highest level in history, credit unions are indeed making 'ownership' a reality in the lives of millions of Americans.

Just as we realize that all Americans should have access to affordable health care, credit unions are positioned to provide Health Savings Accounts for their members. I commend the credit unions that are providing these accounts and encourage all credit unions to consider the opportunity to help those who especially need it most, including low-income children and families and employees of small businesses and the self-employed.

I share President Bush's optimism for the economy and job creation, and I am confident that the nation's credit unions in 2005 will have a tremendous opportunity to continue to facilitate the American Dream for millions of credit union members.

As I mentioned earlier, it's an exciting time in the credit union movement, and it's an opportune time to be a regulator. Working to make sure that regulations are effective, rather than excessive, we will achieve our goal of having each regulation we issue actually add value to the industry.

Thank you and I wish you a most successful conference.