Chairman JoAnn Johnson Addresses the Credit Union National Association Governmental Affairs Conference

February 26, 2007

Charles Kettering said, "If you have always done it that way, it is probably wrong."

When I ran across that quote, the name Charles Kettering, at first didn't ring a bell, so I did a little checking: "screwdriver and pliers" inventor who, even today, continues to impact our lives on a daily basis. More than 140 patents, Inventions included:
Spark plug, Freon for refrigerators and air conditioners—in fact, his residence was the first air conditioned home in America, leaded gasoline, safety glass, the automatic transmission, and for perhaps the reason his name may seem most familiar, in 1945 he and Alfred Sloan established the Sloan-Kettering Institute for Cancer Research in NYC.

"If you have always done it that way, it is probably wrong."

Does this mean that I'm advocating you disregard established practices, precedents and traditions that have made the credit union industry the overwhelming success it is today? Of course not.

But I am suggesting that you, and we as an agency, undertake a common-sense evaluation of the things that we do on a routine basis and at least subject them to some critical thinking. If "because we've always done it this way" is the first answer to the question "why are we doing this?" we may want to step back and re-think things a bit.

Over the past several months, I've been particularly interested in taking a good hard look at some of the things we as an agency have been doing the same way for a long time. Not necessarily because they are being done wrongly, but perhaps they can be done better and more effectively.

In that regard, I would like to touch on three areas which, in my opinion, deserve a hard look and potential change: Prompt Corrective Action, The use of the Matrix, which is the range of numbers used as guidance for establishing your CAMEL rating, and lastly the Enforcement, or lack thereof, of the Bylaws.

The first, of course, has actually become recognized as a desired improvement over our current system of Prompt Corrective Action and will require a legislative change.
We have the necessary experience with the current system, in place since 1998, and have made a solid recommendation to Treasury and Congress advocating for a risk-based system which preserves the leverage system and provides comparability with the standards for FDIC-Insured Institutions.
This will allow credit unions to better manage safe and sound growth and provides improved identification and measurement of risk in each institution.

The current system penalizes low risk institutions, resulting in inefficient use of capital. Our Division of Examination and Insurance, and Deputy Director Larry Fazio, in particular, have put together a solid proposal for driving a needed change in legislation. During your visits to The Hill, please encourage your legislators to give due consideration to this proposal.

The second item on my list is actually an idea I first advanced in my presentation here at the GAC two years ago, that of addressing the Matrix used for compiling your CAMEL ratings.

Concern had been expressed over the use of the Matrix in determining individual elements of the CAMEL rating. The purpose of the Matrix in the risk-focused exam is to provide guidance to the examiner, not to dictate the rating.

Staff has been reviewing the relevance of the Matrix, which itself is not risk-focused. The Matrix relies on **ranges of numbers** without taking into account the complexity of the institution. It's not dynamic or forward looking.

Last August we took a big first step, regarding the Matrix, by issuing guidance to our field staff and your credit unions concerning the evaluation of earnings. The guidance was well received.

There is no simple metric for determining what a credit union's earnings level should be. The arbitrary 1% Return on Assets is a widely recognized benchmark for financial performance but can not be applied as a single benchmark for all credit unions. Each credit union's earnings level must be evaluated relative to net worth needs, financial and operational risk exposures, the current economic climate, and your strategic plans.

We encourage examiners and credit unions to continue to engage in an open dialog about ROA goals and make sure it is consistent with the business plan and provides for maintenance of adequate capital.

Now, the time has come to address the Matrix itself. NCUA was the only agency to adopt a Matrix in 1987 when all the FFIEC agencies adopted the CAMEL rating system to assess risk to the institution and on a system wide basis.

It's been a tool in use at NCUA for the last twenty years, but longevity doesn't necessarily make it the best process. We are in the final phase of evaluating CAMEL updates necessary to eliminate the CAMEL Matrix.

This change addresses concerns from the industry about the Matrix as well as compliments our Risk Focused Examinations. Updates will focus on a credit union's individual risk profile rather than looking at isolated benchmark measures.

I would expect questions on how this update will impact your credit union's CAMEL rating. We will communicate to the industry prior to implementing any change and

ensure everyone has a consistent understanding of CAMEL's purpose and the update. The revisions will be consistent with the recent Letter on Earnings which stresses the need to assess each credit union's performance individually.

Examiners will receive training to ensure consistency. We do not anticipate the update negatively impacting a credit union's ratings; however, if a component or overall code changes up or down, examiners will be required to support and explain the change.

The third area where we are rethinking how we've done things for a long time, and in this case for the past 25 years, is whether and to what extent NCUA should enforce the FCU bylaws.

Let me share a little background and historical context. The Federal Credit Union Act establishes that federal credit unions must adopt NCUA-approved bylaws and the agency's position is that it has the authority under the Act to enforce the bylaws. The only specific remedies in the Act for violation of a bylaw, however, are the antiquated and extreme remedies of charter suspension and liquidation.

For decades the bylaws were incorporated into NCUA regulations and a bylaw violation could therefore be handled as a regulatory violation. In the early 1980's, NCUA deregulated the bylaws and began a policy that has continued until now, namely, that NCUA would not intervene in bylaw disputes unless a matter presents a violation of the Act, NCUA regulations, or a safety and soundness concern.

Please note that we have never said NCUA lacks authority to enforce bylaws based on the FCU Act, but rather opted to leave much bylaw enforcement to members and FCUs.

What we have seen this past year, in particular, is that this position has resulted in little to no enforcement of some of the members' most critical rights the bylaws seek to protect. State courts are understandably reluctant to become involved in bylaw disputes. The time and expense required for legal action also makes it an unrealistic option in many cases.

So we had to ask ourselves the question, how should NCUA address the enforcement of federal credit union bylaws?

The hallmark of responsive government is its ability to recognize changing circumstances and understand what that means, in this case, to the industry that we regulate. The simple fact is that the judicial remedies that both the industry and the Agency assumed were underpinning the bylaws have been proven by events to be absent.

That represents a change with a very real implication for the Nation's credit union members, and it is something that anyone with any interest in protecting consumers cannot let stand without considering remedies.

Over the past several weeks, at my direction, the staff has weighed the advantages and disadvantages of various approaches to enforcing the bylaws. The most obvious option is to return to incorporating the bylaws in the regulations by reference, as NCUA did before 1982.

By reincorporating the bylaws into the regulations, the agency can enforce the bylaws using any of the enforcement authorities it has for regulatory violations. And also, reincorporating the bylaws would give us confidence that any enforcement actions we take based on bylaw violations would stand.

We have seriously considered a number of other options, including enforcing the bylaws under the existing provisions of the Act.

After weighing the pros and cons, it appears to me that incorporating the bylaws into the regulations is the most direct and straightforward way to clarify our authority to enforce bylaw violations in appropriate cases.

Let me assure you, the last thing NCUA wants to do, or frankly is able to do, is to get involved in every technical violation of the bylaws.

Furthermore, even a cursory look at the history of the federal credit union industry from 1934 until 1982 reveals that, during the time when the bylaws were a part of NCUA's regulations, NCUA did not routinely intervene in ordinary, operational activities that make up the day-to-day life of a credit union.

But incorporating the bylaws into NCUA regulations unambiguously gives NCUA the authority to intervene when we believe a violation **warrants** intervention. And it does so without imposing any new regulatory burden on Federal credit unions.

I believe it likely that NCUA will issue a proposal in the near future, for public comment, to incorporate the FCU bylaws into NCUA's regulations. Of course this will require NCUA Board deliberation and a Board vote, so it is possible that we will decide on a different approach.

In any event, let me assure you we will listen carefully to your feedback and suggestions for how to protect member rights without imposing needless burdens on Federal credit unions. To that end, it is also likely that we will propose standards or guidelines for the types of situations where NCUA might become involved in bylaw disputes.

Now I suspect that those of you with perhaps a bit more credit union history might be saying, "Wait a minute! Isn't reincorporating the bylaws really just a return to the way NCUA has done things most of the time?"

In fact, I believe that NCUA's stance on enforcing the bylaws shows appropriate flexibility given our position as a regulator of member-owned, democratic, not-for-profit institutions.

In the earliest years of the credit union movement, having bylaws incorporated in the regulations allowed NCUA flexibility to intervene in bylaws disputes as both credit union members and boards adopted to this novel form of financial institution.

Admittedly, by 1982 the bylaws probably didn't need to be in the regulations, as the credit union system flourished and all parties had adapted to the once-revolutionary concept of member ownership and control.

I would argue that the present era of the credit union movement has many similarities to its beginning, as continued success and growth has resulted in many members who are unfamiliar with the important differences between being a credit union member versus a customer of another type of financial institution. Thus, I believe now is the right time for NCUA to step forward and once again make itself available to protect the rights of both members and the credit unions that they own.

Our decision now is not simply a return to the past, but demonstrates that we can learn from history and change course when that is warranted. I look forward to working with you as we address this important issue, and we will be open to your suggestions and comments.

We have a number of forward looking projects in various stages of development, including "The Four Seasons" project, which is our long-term strategy to implement an integrated, **online system** to capture, display, and deliver credit union information.

I'm sure you're eager for the convenience of being able to update your profile including identifying information such as addresses, phone numbers, hours of operation, emergency contacts, your 5300 report and your Report of Officials by this "one-stop" shop. Plus, you won't have to re-enter information that hasn't changed.

Change can be intimidating, frightening, challenging, exciting, or all of the above. I choose to look at it as an opportunity to continue to produce effective legislation and regulation which make for a stronger industry with a bright future.
Pause

I'm reminded of the new bride who wanted to impress her husband with her first home-cooked dinner, so she prepared the best roast she could buy. It turned out wonderful, but at the end of the meal he asked why she had cut off both ends of the roast before cooking it.
"Because that's the way my mother did it," she replied.

So the next time she saw her mother, she asked, "Why did you always cut off the ends of the roast before cooking it?"

“Because that’s the way my mother did it.”

When she asked Grandma, “Why did you cut off both ends of the roast before cooking?” Grandma replied, “Because my oven was too small.”

To carry out our responsibilities as if the oven is too small is to potentially cut off more responsive and more effective regulation that will strengthen the credit union industry.

“If you have always done it that way, it is probably wrong.”

Thank you for the opportunity to address you this morning.

JoAnn Johnson, Chairman NCUA
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