The NCUA REPORT

NATIONAL CREDIT UNION ADMINISTRATION

FEBRUARY 2011 NUMBER 2 WWW.NCUA.GOV

HIGHLIGHTS

Chairman Debbie Matz cuts the ribbon opening the new Office of Minority and Women Inclusion with OMWI Director Tawana James on January 21, 2011.

GENERAL COUNSEL REPORT —

Regulations Scheduled for Change

NCUA reviews all regulations every three years to update, clarify and simplify existing regulations and eliminate any redundant or unnecessary provisions in compliance with *Interpretive Ruling and Policy Statement (IRPS) 87-2, Developing and Reviewing Government Regulations.*

To carry out IRPS 87-2, the Office of General Counsel (OGC) reviews one-third of the regulations each year and identifies the regulations considered for change. NCUA recently reviewed the second third of the regulations, Parts 711 through 747, which were being considered for amendment in 2011. Based on OGC review, the following seven regulations are involved in current rulemakings, part of interagency rulemakings, or recommended for possible amendments in 2011:

- Part 712, Credit Union Service Organizations
- Part 722, Appraisals
- Part 723, Member Business Loans
- Part 740, Accuracy of Advertising and Notice of Insured Status
- Part 741, Requirements for Insurance (§741.8)
- Part 745, Share Insurance
- Part 747, Administrative Actions

Examination & Insurance Report

MORTGAGE FORECLOSURE CONCERNS

In a recent newsletter, NCUA's Chief Economist provided a primer on the economic impact of foreclosure related problems on credit unions and the overall economy. Mounting news accounts of incorrect and improper foreclosures have sparked nationwide concern. The problems outlined include:

- Legal challenges to the Mortgage Electronic Registration System – an electronic system used to transfer and track serviced mortgages;
- Missing or defective loan documents;
- Documentation deficiencies related to "Robo-signing;" and
- Contractual repurchase (known as "Put Backs") risk with sold/serviced mortgages.

In response, NCUA conducted a sample study of potential foreclosure problems within the credit union industry during December. Initial results indicate limited exposure among the sample of credit unions reviewed. However, we identified potential risk in several areas.

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CHAIRMAN'S CORNER

NCUA "Toolbox" Will Reduce Costs to Credit Unions

Debbie Matz
Chairman

NCUA continues to look for ways to cut costs to credit unions. Some of these initiatives are more visible than others. Well, good news!

Last month President Obama signed into law S. 4036, a bill proposed by NCUA which will save credit unions hundreds of millions of dollars.

S. 4036 passed unanimously in both the Senate and House shortly after I testified before the Senate Banking Committee on the need to enact three technical amendments to the Federal Credit Union Act. Within NCUA, we called this package of amendments the "NCUA toolbox" – because it will give the agency tools to reduce the costs of managing the National Credit Union Share Insurance Fund and the Corporate Stabilization Fund.

Lawmakers introduced our three toolbox amendments and also added a fourth provision. The fourth provision will initiate a study by the Government Accountability Office (GAO) to look back at NCUA's resolution of the corporate credit union crisis.

While much of the news coverage about S. 4036 focused only on the fourth provision, the three amendments will have a huge positive impact on credit unions going forward.

Provides Capital Assistance

The first amendment strengthens NCUA's ability to help credit unions complete emergency mergers.

Before this amendment became law, a recent change in merger accounting diluted the net worth of recipient credit unions—thus discouraging mergers. As a result, some troubled credit unions had to be liquidated because potential merger partners could not afford to absorb the capital hit.

Under the new law, NCUA assistance to failing credit unions will be counted as capital by surviving credit unions.

Minimizing liquidations will reduce costs to the Share Insurance Fund and provide members of troubled credit unions with continued services from healthy credit unions.

Prevents Artificial Insurance Premiums

The second amendment prevents credit unions from being assessed artificially inflated insurance premiums.

The new law clarifies that the equity ratio of the National Credit Union Share Insurance Fund is based solely on its own unconsolidated financial statements. This eliminates any confusion about whether the Share Insurance Fund is required to consolidate statements with credit unions under conservatorship.

Preventing conserved credit unions' losses from being charged against the Share Insurance Fund's equity ratio ensures that credit unions will not have to pay hundreds of millions of dollars in additional insurance premiums as a result of conservatorships.

Eliminates Interest on Assessments

The third amendment allows NCUA to repay expenditures from the Corporate Stabilization Fund without having to first borrow from the U.S. Department of Treasury.

For the past two years, the statute had required NCUA to borrow from Treasury before assessing costs to credit unions.

Eliminating this unnecessary borrowing will save credit unions about $60 million in interest payments over the next 10 years.

With NCUA's toolbox, America's credit unions will be better equipped to raise return on assets, strengthen capital, and serve more members for years to come.

Debbie Matz

PERSPECTIVES (FROM PAGE 4)

volunteers who have stepped forward to take part in educational programs and webinars. The acknowledgement by so many of the importance of financial literacy for directors is a clear sign that credit unions are again a step ahead of other finical institutions in meeting the many challenges faced by directors.

Education can be good for all of us and I appreciate the feedback from so many of you that value this type of requirement. We face many challenges in this turbulent economic environment and the more we know, the better we can handle the challenges. I look forward to learning and working with you to do the best job we can.

BOARD ACTIONS January 13, 2011

NCUSIF ends 2010 with strong equity; TCCUSF repays Treasury

The National Credit Union Share Insurance Fund (NCUSIF) equity ratio was 1.28 percent at December 31, 2010, based on projected collections related to an increase in estimated insured shares. The year ended with a $1.26 billion NCUSIF reserve balance—$749.1 million was added to insurance loss expense reserves over the year and $317.2 million in losses were charged against the reserve account. NCUSIF 2010 net income totaled $283.6 million.

At year-end, 368 federally insured credit unions, with assets of $43.8 billion and shares of $38.9 billion, were designated CAMEL code 4 or 5. In addition, 1,827 CAMEL 3 credit unions had assets of $156.7 billion and shares of $138.4 billion. Overall, 22.2 percent of all credit union assets were held in CAMEL code 3, 4 or 5 credit unions.

Through December, 28 federally insured credit unions failed in 2010—18 liquidations and 10 assisted mergers. The NCUSIF cost of failures was $220.7 million during 2010.

The Temporary Corporate Credit Union Stabilization Fund (TCCUSF) total liabilities and net position was $373.5 million at year-end 2010. A $4 billion loan to stabilize the corporate credit union system was repaid to TCCUSF and subsequently repaid to Treasury on December 21. TCCUSF ended the year with no outstanding Treasury borrowings.

Financial data reported for both the Share Insurance Fund and the Temporary Corporate Credit Union Stabilization Fund are preliminary and unaudited.

Truth in Savings rule updates overdraft disclosures

The NCUA Board approved final rule Part 707 clarifying provisions affecting electronic disclosure of overdraft fees, overdraft fee disclosure terminology, and retail sweep accounts.

The Truth in Savings Act requires NCUA to promulgate substantially similar regulations within 90 days of the effective date of Federal Reserve rules. The attached rule is substantively identical to the Federal Reserve's 2010 final rule, but contains changes in nomenclature and minor editorial and reference changes. The rule is unchanged from the interim final rule issued at the July 2010 NCUA Board meeting.

NCUA sets strategic goals for 2011

The NCUA Board approved the NCUA Annual Performance Budget (APB) 2011, which serves as the agency's annual plan. The plan outlines NCUA objectives, strategies and initiatives for the year. It also provides guidance and serves as a tool that illustrates how staff contributes to meeting agency goals and objectives.

High-priority goals include monitoring risks in federally insured credit unions and continuing to stabilize the corporate credit union system.

A cross-agency working group developed the initial draft NCUA Annual Performance Budget 2011 using input from all offices and regions. Regional and central office leadership provided concurrence.

Some significant enhancements to NCUA's APB include: a description of agency programs and offices that contribute to goals; a clearer connection between annual objectives and strategic goals, and the addition of annual measures for each objective in addition to strategic measures. Overall, the plan is an improved management tool and offers the public and staff increased transparency.

NCUA Strategic Plan 2011-2016 is available online at **http://www.ncua.gov/Resources/Reports/plans-and-reports/index.aspx.**

Supervisory Review Committee can hear grant appeals

The NCUA Board issued an interim final Interpretive Ruling and Policy Statement (IRPS) that combines IRPS 95-1 and IRPS 02-1 and adds denials of technical assistance grant reimbursements to the list of items credit unions can appeal to NCUA's Supervisory Review Committee.

Effective when published in the Federal Register, the IRPS was issued with a 30-day comment period.

Board votes are unanimous unless otherwise indicated. All Board Action Memorandums are available online at www.ncua.gov under *Agency Leadership/NCUA Board and Actions/Draft Board Actions*, and NCUA rule changes are posted online at www.ncua.gov under *Resources/Regulations, Legal Opinions and Laws.*

The NCUA Report is published by the National Credit Union Administration, the federal agency that supervises and insures most credit unions.

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The TDR Tango

FROM GIGI HYLAND

I'll admit two things – accounting has never been my strong suit and I love *Dancing with the Stars*. While I'm always ready to moderate an NCUA webcast, I was more than a bit nervous about hosting a two-hour webcast in early January entitled *Troubled Debt Restructurings (TDRs): What Are They and How Does the Accounting Work?*

I was fortunate to be joined by two subject-matter experts and partners in the accounting firm of Crowe Horwath, Sydney Garmong and Dave Lawrence. Listening to these accounting gurus masterfully present a very complex subject somehow reminded me of the back and forth rhythms of the tango; *ergo*, the TDR Tango.

At the end of the webcast, I came away with five key points on TDRs:

First, there are two criteria for loan modifications to meet the TDR definition and each has related conditions. Credit unions need to determine whether the borrower is experiencing financial difficulty (default on any debt, bankruptcy, going concern, unable to service debt currently or in the future, and credit availability). Then, credit unions need to decide whether a concession has been granted. The conditions for this criteria include comparing the loan modification to prior debt (forgiveness of principal/interest would be included) and looking at the effective borrowing rate of restructure.

Second, there exists a rebuttable presumption in the current environment that loan modifications are TDRs.

Third, "amend and pretend" strategies are not appropriate. During the webcast, Dave Lawrence used the great expression, "A rolling loan gathers no moss." In other words, a TDR does not make a collateral dependent loan "good" again. Credit unions need to document current financial information, collateral valuation, business conditions, outlook for the future and why and when the loan will get better again.

Fourth, TDR modifications have impairment (i.e., loss) implications. Provisions in your allowance account need to be established in the context of the original contract effective rate.

Finally, TDR modifications have income implications. It's not appropriate to accrue interest on TDR loans until a sustained period of repayment performance and collection has occurred under the revised terms. This is generally interpreted by the financial institution regulatory community as six consecutive payments under the revised contract terms.

If you didn't get a chance to see the webcast or want to learn more about accounting for TDRs, visit **www.ncua.gov** under *Agency Leadership/Board Member Gigi Hyland/Presentations* to view the archived TDR webcast, slides and resource documents.

Knowledge Is the Key to Success

FROM MICHAEL E. FRYZEL

There is a reason why, in almost every state, doctors, lawyers, teachers, real estate agents and other professionals are required to attend classes and take courses on a regular basis. This is done so they are aware of changes in procedures or the law, thereby enhancing the service they provide their clientele.

Recently, NCUA passed a regulation requiring credit union directors have a working familiarity with basic finance and accounting practices, including the ability to understand the credit union's balance sheet and income statement. This will allow them, when appropriate, to ask substantive questions of management and internal and external auditors. Clearly, the minimal requirements put forth are something that directors should want to participate with in order to fulfill their fiduciary responsibility to the members of the credit unions they serve.

Board of Directors should have knowledge of the subject, understand the components of the issue, and know how to apply the principals they are working with. When one has this knowledge and increased awareness, they are able to make informed decisions with substance and reason while reinforcing what may have been their initial instinct. This kind of decision making helps the safety and soundness of the credit union industry. Making uninformed or uneducated decisions benefits no one.

I greatly admire people who never stop wanting to learn. Those who take classes, attend seminars, listen to lectures or read books are the ones who maintain the competitive edge we all need.

A credit union's Board of Directors is made up of volunteers who give their time, energy and effort to keep the credit union safe, sound, competitive and member driven. Continuing training is another tool to help the Board direct the activities of their respective credit unions.

It is encouraging to see the number of state leagues, CEO's and credit union

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Asset Liability Management Report

CREDIT UNIONS ARE MINOR PLAYERS IN DERIVATIVES GAME

Derivatives grabbed headlines this year as Congress debated legislation to increase their transparency. Such headlines naturally raise the question: To what extent do credit unions use these instruments?

Federal natural-person credit unions must obtain NCUA permission to enter derivatives contracts, though some states allow state-chartered institutions more leeway. As a consequence, only 9 of 4,631 federal credit unions (0.2 percent) had outstanding contracts at year-end. All nine were large, holding on average $1.88 billion in assets as of September 30th. Total notional value—the base used to calculate cash flows on derivatives—was $842 million, roughly 5 percent of the assets of participant institutions and just 0.2 percent of the assets of all federal credit unions. All 58 contracts were interest-rate derivatives, breaking down into 43 swaps and 15 caps. Swaps accounted for about 57 percent of total notional value.

What are swaps and caps, and why use them? Depository institutions rely on both instruments to hedge interest-rate risk—the risk a change in rates will materially impair earnings. In a "vanilla" swap – the type credit unions use—one party makes a fixed payment (equal to an unchanging rate times notional value) and receives a floating payment (equal to a varying short-term rate times notional value). Suppose, for example, the floating rate is one-month LIBOR—currently 30 basis points (or bps, three-tenths of a percentage point)—and the fixed rate is 20 bps. Further, suppose notional value is $10,000,000; payments are annual; and settlement is due.

A credit union committed to receive floating/pay fixed will collect the net amount—$10,000 (the difference in rates, 0.001, x $10,000,000)—from the counterparty. In an interest-rate cap, the buyer pays an upfront premium to receive compensation when a floating short-term rate exceeds a fixed rate (say, a payment if one-month LIBOR exceeds 20 basis points on a certain date, equal to notional value times the spread). Note in both cases receipts rise with LIBOR.

An institution funding a fixed-rate mortgage portfolio with short-term deposits will typically see earnings squeezed in a rising-rate environment because interest expense rises with market rates but interest income does not. So a receive floating/pay fixed swap or interest-rate cap can help stabilize earnings.

Banks are much bigger players in the derivatives game. Total notional value in the banking sector is $204.3 trillion—nearly 20 times total assets. Although 1,065 banks reported derivatives activity in the third quarter of 2009 (roughly 16 percent of U.S. commercial banks), four large banks—J.P. Morgan Chase, Bank of America, Goldman Sachs, and Citibank—accounted for 95 percent of notional value.

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EXAMINATION AND INSURANCE REPORT (FROM PAGE 1)

As a result, NCUA recently issued Letter to Credit Unions 11-CU-01 outlining the major foreclosure concerns that may affect credit unions, including guidance for credit unions to evaluate and properly structure their foreclosure management polices and processes.

To more fully understand the risks to individual members and the credit union industry, NCUA will also perform a review of the foreclosure process, including the pre-decisional evaluation of modification alternatives during 2011 examinations.

Key indicators examiners will be looking for include:

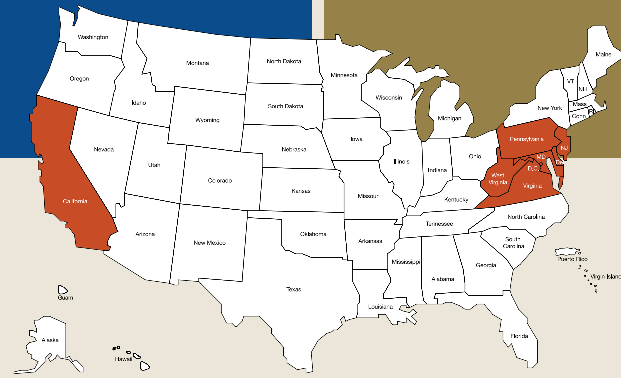
- Appropriate policies and procedures for all aspects of the foreclosure process, and tailored to comply with the state laws where the credit union does business;
- Experienced and knowledgeable staff qualified to handle foreclosures;
- Effective internal controls surrounding the foreclosure process;
- Adequate oversight, due diligence and control of third-party servicers performing foreclosures on behalf of the credit union;
- Legally compliant documentation to support foreclosure actions; and
- Appropriate reporting to the board of directors of the number and volume of foreclosure actions and the financial impact on the credit union.

Credit unions should be prepared by evaluating foreclosure policies, procedures and third party relationships. In addition, credit unions should strive to:

- Avoid or eliminate dual tracking – proceeding with a foreclosure simultaneously with a modification agreement. This causes confusion and costly errors.
- Evaluate the borrower for potential modification before proceeding with a foreclosure when possible and when the cost benefit of a modification makes sense.
- Closely monitor third parties to ensure they obey applicable laws when conducting a foreclosure proceeding.

NCUA believes that employing best practices can avoid costly mistakes and maximize value for credit unions.

RESOURCES FOR CONSUMERS



REGION II

A primary purpose of credit unions is to promote thrift among its members. The opportunity to educate members about their personal finances goes hand-in-hand with this goal. NCUA shares this responsibility with credit unions. In fact, there is an amazing amount of educational material on NCUA's web site **www.NCUA.gov** to help consumers, and help credit unions educate their members.

Our "Resources and Publications" tab includes "Resources for Consumers." Here you will find various topics such as Identity Theft, Consumer Complaints, Privacy, Share Insurance, Financial Education, and Fraud. Under Financial Education you will find a FREE Financial Education Library with printable PDF Brochures on ID Theft, Credit Reporting, and Credit Cards, and links to other useful sites, calculators and strategies for saving.

NCUA Chairman Debbie Matz is a member of the Financial Literacy and Education Commission. The website **www.mymoney.gov** assembles financial education help from over 20 different Federal web sites in one place.

NCUA also partners with *America Saves*, a national campaign involving more than 1,000 non-profit, government and corporate groups that encourage individuals and families to save and build personal wealth. A special part of the *America Saves* campaign is the *Military Saves* program to support and encourage military family goals to save money regularly.

America Saves Week 2011 and *Military Saves Week 2011* are scheduled for February 20-27, 2011, so this is an especially good time to consider how you can promote thrift among credit union members.

NCUA is doing our part to educate consumers and promote thrift through our new Office of Consumer Protection. Credit unions and members can contact staff on our Consumer Assistance Hotline at 1-800-755-1030 or e-mail **consumerassistance@ncua.gov**. We will help consumers get the information they need to improve their financial well-being, and encourage them to take advantage of opportunities to save and obtain financial education through their credit union. And of course, we are happy to explain NCUA's share insurance coverage.

ASSET LIABILITY MANAGEMENT

(FROM PAGE 5)

The dominance of large banks makes those with fewer than $40 billion in assets (the size of Navy Federal) a better peer group. As of September 30th, peer institutions held contracts with notional value totaling $286.1 billion, about 9 percent of their collective assets. The bulk of these were interest-rate derivatives (90.5 percent of total notional value), with swaps the most common (54.9 percent of the notional value of interest-rate contracts).

In short, derivatives activity in credit unions is small in scale and limited to simple hedges of interest-rate risk. That said, credit unions involved with derivatives should take care to understand the attendant risks—even if the scale and complexity of that involvement is dwarfed by their banking peers.

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