The NCUA Report

July/August 2010
Number 7
National Credit Union Administration

NCUA cuts budget; enhances PR program

Savings will reduce 2011 FCU fees; outreach will educate consumers

After a mid-year review found NCUA operations running 8 percent below the original budget during the first half of 2010, NCUA Chairman Debbie Matz announced that the agency's budget for this year has been reduced by $2 million.

The reduced 2010 NCUA budget will allow operating fees, which are charged to federal credit unions, to be reduced by $2 million in 2011.

"We are well aware that credit unions are under enormous pressure to generate positive earnings this year," said Matz as she announced the budget cuts at the July 29 NCUA Board meeting. "This is particularly difficult at a time when credit unions are paying assessments, which are required to cover other credit unions' losses. So we have done our due diligence to ensure that any new item in the budget will be a prudent use of agency resources nd credit union funds."

Matz assured all stakeholders, "Wherever an addition to the budget was found to be necessary, we worked to offset the addition with a comparable reduction. We also reviewed budgeted expenses versus actual expenses over the first half of this year. In areas where we projected a significant surplus by year-end, we were able to make further reductions in the mid-year budget."

NCUA's actual spending for the first six months of 2010 was $91,631,201—8.0 percent under budget. The agency is now budgeted to spend a total of $198,923,512 for all of 2010—a reduction of $2 million from the previous budget.

The mid-year budget review allowed NCUA to make various budget adjustments, where funding was trimmed from some programs and redirected toward other programs. The planned reductions of about $9.2 million will offset about $3.9 million in reallocations and $3.3 million worth of new initiatives, resulting in the budget savings of about $2 million.

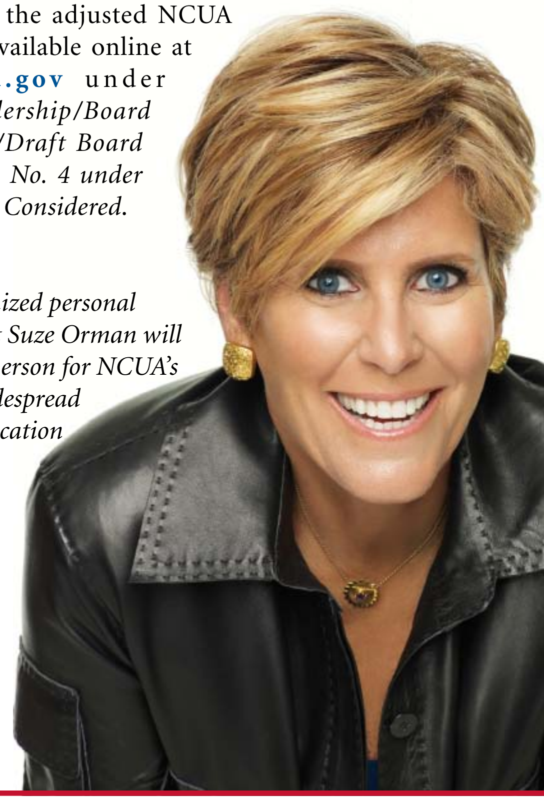
The most significant new initiative will be a major consumer education campaign that will broaden public awareness of the federal share insurance program. The campaign, aiming for a fall launch, will include television, radio, print and companion advertisements. Designed to strengthen consumer confidence in the nation's federally insured credit unions, the campaign will reassure consumers that their money—up to $250,000 per account—is safely insured through the National Credit Union Share Insurance Fund.

The campaign will feature CNBC's personal finance expert Suze Orman as its spokesperson. Both a 30-second and a 60-second television ad are planned.

"All of you who have seen 'The Suze Orman Show' on CNBC know that Suze really lights up the screen," said Matz. "She comes on the air with amazing energy and tremendous passion. When she speaks directly to consumers, she serves as their trusted financial advisor. She makes complex financial issues sound perfectly clear."

The campaign is projected to cost $1.7 million. This includes production of the ads and nationwide media placement.

Details of the adjusted NCUA budget are available online at **www.ncua.gov** under *Agency Leadership/Board and Actions/Draft Board Actions, item No. 4 under Matters to Be Considered.*



Widely recognized personal finance expert Suze Orman will be the spokesperson for NCUA's upcoming widespread consumer education campaign designed to heighten awareness of federal share insurance protection.

HIGHLIGHTS

Chairman's Corner

Assessments are primarily determined by credit unions, not NCUA

Almost every day, credit union representatives ask me to "keep NCUA's assessments low."

The fact is: The amount required for each assessment is *not* determined by NCUA. It is determined by *credit unions*. If credit union *losses* are lower, credit union *assessments* will be lower.

NCUA's calculation of assessments is based on the anticipated amount we need to reserve against losses. This is *carefully* derived from information gathered from call reports and exams.

By law, NCUA must levy assessments based on which types of credit unions cause losses:

- Losses in *corporate* credit unions must be paid through assessments from the Corporate Stabilization Fund. This year's assessment from the Corporate Stabilization Fund will amount to 13.4 basis points.
- Losses in *consumer* credit unions must be paid through assessments from the National Credit Union Share Insurance Fund. This year's assessment from the Share Insurance Fund will hinge on two huge factors that are controlled by *credit unions*, not by NCUA:

Actual losses in failed credit unions

- This includes losses covered by the Share Insurance Fund when credit unions must close due to assisted mergers, purchase & assumptions, or liquidations.

Anticipated losses

- We consider *capital depletion*. Many credit unions, while still well-capitalized, will be draining capital this year due to negative earnings.
- We examine trends in *delinquencies* and *loan losses*. In many parts of the nation, these losses continue to increase.
- We also weigh trends in *financial* and *managerial strength*, as measured by CAMEL ratings.

Unfortunately, anticipated 2010 losses are increasing. Currently budgeted at $750 million, this is more than six times actual losses in all of 2009.

And there is reason for concern as we look ahead. Nearly 2,100 credit unions are now CAMEL codes 3, 4 and 5. This threat is up more than 30 percent since the beginning of the recession in December 2007, when there were about 1,600 troubled credit unions.

Troubled credit unions are not only growing in number; they are also growing in size. With more than $150 billion now deposited in troubled credit unions, their risk to the Share Insurance Fund is more than three times greater than it was three years ago.

This is why NCUA is working so diligently to strengthen supervision in areas that are causing credit union losses. We have implemented a "red flag" tracking system to detect the highest risks. Our examiners are aiming to partner with credit unions to mitigate those risks. When examiners and credit unions work together, they can fix problems earlier and prevent costly failures.

But regulators can only do so much. *The assessment amounts ultimately depend on credit unions' own performance*. This is a direct result of decisions made by credit union executives and board members.

It is worth repeating: If credit union *losses* are lower, credit union *assessments* will be lower.

So instead of asking NCUA to keep assessments low, *ask your colleagues at other credit unions to operate safely*—by *managing risks* effectively and by *restraining costs* reasonably. Just as you are counting on your colleagues, *they* are counting on *you*. By leveraging the collective strength of the cooperative system, *you* can prevent further losses and minimize future assessments.

Debbie Matz

Debbie Matz

NCUA INSIGHTS

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

Debbie Matz, Chairman
Christiane Gigi Hyland, Board Member
Michael E. Fryzel, Board Member

Information about NCUA and its services may be secured by contacting 703-518-6330.

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BOARD *ACTIONS* July 29, 2010

NCUA BUDGET REDUCTION WILL CUT OPERATING FEES $2 MILLION

At midsession, NCUA's budget was reduced by $2 million, which is projected to reduce cash needs by $2 million for 2011 federal credit union operating fees.

With total NCUA operating costs for the 12-month period ending December 31, 2010, reduced by $2 million, this year's annual budget is $198,923,512. Staffing vacancies provide the bulk of unused 2010 funding.

Various budget reductions more than offset $3 million worth of new initiatives, which are slated to support and expand core programs and agency goals.

Details are provided on page 1.

INTERIM TRUTH IN SAVINGS RULE ISSUED

The NCUA Board approved an interim final rule that clarifies provisions within Part 707 that address electronic disclosures of overdraft fees, overdraft fee disclosure terminology, and retail sweep accounts. The Truth in Savings Act requires NCUA to promulgate regulations substantially similar to those promulgated by the Federal Reserve Board within 90 days of the Federal Reserve Board's rule. This interim final rule is substantively identical to the Federal Reserve Board's June 2010 final rule, but contains changes in nomenclature and minor editorial and reference changes.

While this is an interim final rule, a 60-day comment period welcomes stakeholder input. The rule becomes effective 30 days after publication in the Federal Register, but compliance with the changes to §707.11(a)(1)(i) will not be mandatory until October 1, 2010.

PROPOSAL WOULD CURTAIL GOLDEN PARACHUTES AND INDEMNIFICATION PAYMENTS

The NCUA Board issued a proposal to rule Part 750 to prohibit, with some exceptions, a federally insured credit union (FICU) from making unwarranted golden parachute and indemnification payments to an institution-affiliated party (IAP). The proposal is intended to help safeguard the National Credit Union Share Insurance Fund (NCUSIF) by preventing disposition of FICU assets and lucrative rewards to IAPs who may have contributed to an FICU's troubled condition.

Applicable to all FICUs, the proposal was issued with a 30-day comment period.

INTERIM FINAL RULE CLARIFIES LOW-INCOME MEMBER DEFINITION

The NCUA Board approved interim final rule §701.34, amending the definition of "low-income members" to clarify that when comparing credit union data on member income with Census Bureau data to determine if a credit union qualifies as low-income, the comparison must be between like data categories. The amendment clarifies regulatory text so it is consistent with the geo-coding software NCUA uses in making its determination.

The interim final rule will be effective on publication in the Federal Register but will have a 60-day comment period; NCUA will consider any public comments it receives before issuing a final rule, which is likely later this year.

NATIONAL CREDIT UNION SHARE INSURANCE FUND REPORT

NCUA's Chief Financial Officer reported a National Credit Union Share Insurance Fund reserve balance of $1.1 billion at June 30, 2010, with $16.6 million charged to insurance loss expense in June, and $326.1 million charged to total insurance loss expense through June 2010.

NCUSIF equity was reported at 1.21 percent for June 2010, when including the 1 percent capitalization deposit adjustment associated with the June 30, 2010, increase in reported insured shares.

Eighteen federally insured credit unions have failed thus far in 2010 at a cost to the Fund of $16.4 million. Ten credit unions were liquidated through June, resulting in five purchase and assumptions, and eight assisted mergers occurred.

There were 366 CAMEL code 4&5 credit unions at June 30, representing 5.69 percent of mid-year 2010 total insured shares. There are 15 more CAMEL code 4&5 credit unions than reported last month.

The current distribution of federally insured credit union assets by CAMEL code follows:

- 78.4 percent of assets are held in CAMEL code 1&2 credit unions;
- 16.3 percent of assets are in CAMEL code 3 credit unions; and
- 5.3 percent of assets are held in CAMEL code 4&5 credit unions.

Board votes are unanimous unless otherwise indicated. NCUA rule changes are posted online at www.ncua.gov under *Resources/Regulations, Legal Opinions and Laws.*

WATCH NCUA BOARD MEETINGS VIA STREAMING VIDEO

NCUA now posts an online video of each open NCUA Board meeting beginning with the July 29, 2010, meeting. Future Board meetings will be available to view within a few weeks after it is recorded, and the video will remain online for several months.

"Posting the unedited video of each open NCUA Board meeting will enhance the agency's transparency," said NCUA Chairman Debbie Matz. "Our intent is to provide the credit union community and other interested stakeholders with opportunities to watch the NCUA Board in action. We believe it will be informative for stakeholders who cannot attend our meetings in person to see and hear the deliberations that result in NCUA Board actions."

The videos will be captioned for the hearing-impaired. The captions also will serve as official minutes of the meetings.

The July 29 Board meeting video is online at **www.ncua.gov** under *Agency Leadership/NCUA Board and Actions/NCUA Board Meeting Webcasts.* Link directly to the initial Board meeting video at **http://event.on24.com/r.htm?e=229730&s=1&k=F43DD0C28B76EC74D8C50B813BDC6B55**.

Appearance calendar

Date: August 20, 2010
Who: Board Member Fryzel
Event: Uzbekistan Credit Union Professionals Seminar
Location: Naperville, IL

Date: August 24, 2010
Who: Board Member Fryzel
Event: Defense Credit Union Council 47th Annual Conference
Location: Minneapolis, MN

Date: September 14, 2010
Who: Board Member Gigi Hyland
Event: Miami University CEO Roundtable
Location: Oxford, OH

Date: September 15, 2010
Who: Chairman Debbie Matz
Event: Massachusetts CUL Hike-the-Hill Program
Location: Washington, DC

Date: September 20-22, 2010
Who: Board Member Fryzel
Event: NAFCU Congressional Caucus
Location: Washington, D.C.

Date: September 21, 2010
Who: Chairman Debbie Matz
Event: NAFCU 2010 Congressional Caucus
Location: Washington, DC

Date: September 30, 2010
Who: Chairman Debbie Matz
Event: NASCUS 2010 Summit
Location: San Antonio, TX

PLEASE CONTACT THE FOLLOWING PEOPLE WITH QUESTIONS RELATED TO APPEARANCES:

Chairman Matz
Angela Sanders at **asanders@ncua.gov** or 703-518-6309

Board Member Hyland
Jessica Vogel at **jvogel@ncua.gov** or 703-518-6318

Board Member Fryzel
Katie Supples at **ksupples@ncua.gov** or 703-518-6307

Visit the NCUA website www.ncua.gov to access the latest information directly from NCUA.

OFFICE OF GENERAL COUNSEL

Gaining low-income designation

In the wake of the new Community Development Capital Initiative, there have been questions about how a credit union qualifies for low-income credit union (LICU) designation. LICU rule 701.34 provides some flexibility in the metrics regional directors use to determine which federal credit unions qualify for the designation, while logic and statistical reasoning are significant factors in the rule's application.

A regional director may approve the LICU designation for a federal credit union when membership consists of a majority (51 percent) of low-income members. State regulators approve the LICU designation for state-chartered credit unions with NCUA's concurrence. Low-income members are members whose median family income is 80 percent or less than median family income (MFI) for the metropolitan area where they live or the national metropolitan area, whichever is greater. Students are also considered low-income members.

NCUA initially determines whether members are low-income using information obtained during the examination process. Using geo-coding software, members' street addresses are linked to publicly available data from the U.S. Census Bureau to estimate family and individual earnings and compare those earnings to either MFI or median earnings for individuals where the members live. If a member's estimated earnings are based on MFI for the geographic area, then estimated earnings are compared to MFI for the member's metropolitan area. If estimated earnings are based on median earnings for individuals, they are compared to the median earnings for individuals in the metropolitan area. This ensures the designation is based on a statistically sound, mathematical comparison.

A federal credit union may also provide actual member income data to the regional director according to current regulations. As an alternative to NCUA geo-coding, the credit union might get the information from loan applications or conduct a member survey. If a federal credit union relies on loan applications to secure member income, it must be able to demonstrate that 51 percent of total membership, not just borrowers, consists of low-income members. A true income survey—in other words, a questionnaire—may also show that 51percent of credit union members are low-income.

continued on page 9

A world of regulators

FROM GIGI HYLAND

I have the honor to serve as the NCUA Board representative to the World Council of Credit Unions (WOCCU). In July, I attended the annual meeting of WOCCU's International Credit Union Regulators' Roundtable. Attendees included representatives from entities/agencies around the world that supervise credit unions. This year, we had 32 participants from 12 countries—from Kenya to Poland, Australia to Canada, India to Belize.

So, what do international credit union regulators talk about? Well—you, the credit unions we supervise and often insure. What is interesting is that regardless of the newness or maturity of the credit union system, we as regulators face remarkably similar issues. Topics of discussion included things like corporate governance, assessment of systemic risk, and sustainability of credit unions.

As regulators, we have all wrestled with the effect of the economy on our institutions. We continue to look for ways to timely identify emerging risks and to take appropriate supervisory actions to address such risks. Like any conference, the benefit of this meeting is to have the chance to talk one-on-one and learn from fellow regulators how they regulate their institutions. Technically, we all pretty much do the same thing; but how we do it varies. Sharing those differences and experiences helps all of us to be better regulators.

July 13, 2010, Las Vegas, Nev.*—The General Session panel on* Recent Regulatory Developments *at the World Council of Credit Unions (WOCCU)* credit union conference. *From the left are Daniel Burns, WOCCU director-Canada; Andy Poprawa, CEO, Deposit Insurance Corporation of Ontario/ Société ontarienne d'assurance-dépôts; and Gigi Hyland, board member, National Credit Union Administration.*

All aboard the member business loan express

FROM MICHAEL E. FRYZEL

After years of trying to get an increase in the limits placed on credit union participation in member business loans, it appears as if everyone may be on board the train to get it done.

The Administration, Congress, NCUA and the credit union industry all appear to have agreed that there should be an increase in the lending limit, and finalizing the legislative language is all that remains to be done.

It is small business owners who have made this country great. Their hard work, initiative, drive to succeed and resilience are a large part of what has put strength in our economy. Their ideas and ability to get through tough times is a badge of honor they proudly wear.

The banking industry has severely curtailed its lending to small businesses. Someone needs to step up and close the gap that banks have created. Credit unions have repeatedly said they are ready to do so, and they have.

Small business owners, and those looking to start a new business, need financial assistance as the economy struggles. They are the foundation for the business community, and in these difficult times they need a financial-service provider that listens and can give advice as needed. Credit unions fit the bill.

I am mindful that member business lending does carry a burden of risk and requires a thorough knowledge of the "how to's" in making such a loan. Expertise is needed in the credit union to determine if the borrower is a default risk, has a definitive business plan in place, and meets the required standards for securing a member business loan. If legislation is passed, NCUA stands ready to revise our current regulations to ensure the necessary safety and soundness concerns are addressed and the rules promulgated for a safe, successful member business loan program.

Sound reasoning exists for raising the current member business loan cap. By giving credit unions greater lending authority, Congress can solve a problem for small business entrepreneurs. Part of the credit union philosophy is people helping people, and what better way to carry out that philosophy than providing assistance to small business owners.

The train is at the station and ready to pull out. Let's make sure we do not derail its intended mission by piling on more than it can carry.

All aboard!

From the Hill

Reforms will bring sweeping change

President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act into law July 21, 2010. The legislation is widely viewed as the most sweeping reform of financial regulation since the Great Depression.

"President Obama and Chairmen Dodd and Frank all deserve particular credit for this achievement," Chairman Matz stated attending the signing ceremony. "Given the complexity and scope of the task and the volatile financial issues at stake, this new law is an accomplishment in which all Americans can take pride. For consumers and for the credit union industry, the reform affords important protections and enhancements that will lead to a stronger and safer financial landscape. I am grateful to the President for his vision and leadership in making real reform possible."

The intent of the legislation is to:

- Promote financial stability by improving accountability in the financial system;
- Grow the economy and create jobs;
- Enhance consumer protections, including mortgage reform and prohibiting unfair lending practices;
- End "too big to fail" bailouts;
- Rein in Wall Street; and
- Prevent another financial crisis like the most recent one.

To protect consumers, the legislation also creates the Consumer Financial Protection Bureau (Bureau) within the Board of Governors of the Federal Reserve System. The Bureau will regulate consumer financial products or services under federal consumer financial laws, and it has greater jurisdictional authority over financial institutions with assets in excess of $10 billion.

For a complete legislative summary, visit the United States Senate Committee on Banking, Housing, and Urban Affairs website: **http://banking.senate.gov/public/_files/070110_Dodd_Frank_Wall_Street_Reform_comprehensive_summary_Final.pdf**.

The following points highlight some aspects of the legislation that may be of particular interest to credit unions and their members.

The legislation:

- Creates the Financial Stability Oversight Council, a body consisting of the heads of the eight primary federal financial regulatory agencies, the Director of the Bureau, and an independent Presidential appointee. The Chairman of the NCUA Board is a voting member of the Council, which is charged with monitoring potential systemic risks and maintaining the country's financial stability. The Council is authorized to recommend, or in some instances to mandate, that financial regulatory agencies implement certain rules and policies. As a member of the Financial Stability Oversight Council, the NCUA Board will be able to petition the full Council to stay or set aside Bureau regulations it believes could compromise the safety and soundness of the credit union system.
- Makes $250,000 the permanent standard maximum share insurance amount.
- Temporarily authorizes NCUA to fully insure the net amount maintained in non-interest-bearing transaction accounts through December 31, 2012. Share insurance coverage is provided by the NCUA National Credit Union Share Insurance Fund.
- Requires NCUA and other federal financial regulators to provide guidelines to their institutions regarding low-cost remittance transfers and no-cost or low-cost basic consumer accounts, as well as agency services to remittance transfer providers.
- Requires NCUA and other federal financial regulators, within nine months of enactment of the legislation, to jointly prescribe regulations or guidelines requiring regulated entities with $1 billion or more in assets to disclose the structure of all offered incentive-based compensation arrangements. It does so to enable regulators to determine if those arrangements provide excessive compensation or could lead to material financial loss. Also within nine months, regulators must jointly prescribe regulations or guidelines that prohibit or feature incentive-based arrangements or those that encourage inappropriate risks by regulated entities with assets of $1 billion or more by providing excessive compensation or that could lead to material financial loss.
- Provides financial institutions with an appeals process requiring the Bureau and agency to issue a joint statement of coordinated supervisory action in an effort to avoid supervision conflicts between the Bureau and a federal financial regulator when both have a supervisory interest. Where appropriate, NCUA will have a representative on the governing panel hearing such appeals. The legislation also requires the Bureau and NCUA (and other federal financial regulators) to issue regulations prohibiting retaliation against any financial institution that initiates an appeal.
- Requires NCUA and other agencies, not later than six months after the date of enactment, to establish an Office of Minority and Women Inclusion that will be responsible for all matters relating to diversity in management, employment and business activities.

Additionally, the legislation provides for the following mortgage reforms.

Mortgage reforms:

- **Ensure borrowers' ability to repay.** Establishing a simple federal standard for all home loans, institutions must ensure that borrowers can repay the loans they are sold.
- **Prohibit unfair lending practices.** Reforms prohibit financial incentives that steer subprime borrowers into

continued on page 7

Matz to NAFCU: Managing Risks, Preventing Losses Will Reduce Insurance Fees

Chairman Debbie Matz urged National Association of Federal Credit Unions 43rd Annual Convention participants July 22 to wisely manage risks, noting that credit union losses are the key factor in determining the fees required for their federal deposit insurance fund. If credit union losses are lower, credit union assessments will be lower.

While NCUSIF has absorbed more than $1.1 billion in losses in 2010, Chairman Matz assured industry leaders their insurance fund is "strong and resilient." Throughout this period of economic volatility, NCUA has carefully managed the NCUSIF to keep its equity ratio within the normal operating range of 1.2 percent to 1.3 percent. The ratio of retained earnings divided by insured shares was recently calculated at 1.21 percent.

NCUA continues to exercise its responsibility to supervise all federally insured credit unions closely. "Through stepped-up examinations and regulations, we want to catch problems early, so potential failures can be avoided, and so resources will not be drained from the Share Insurance Fund. It is far wiser to manage the Share Insurance Fund cautiously—maintaining a reasonable margin of safety today, rather than risk a loss of confidence tomorrow. Rigorous standards will help credit unions survive these tough economic times," Matz concluded.

Full text of Matz's speech is posted at **http://www.ncua.gov/GenInfo/Members/Matz/Speeches.aspx**.

July 22, 2010, Chicago, Ill.—After speaking to more than 1,200 participants in a general session, NCUA Chairman Debbie Matz answers questions from credit union officials in the exhibit hall at the National Association of Federal Credit Unions' 43rd Annual Conference & Exhibition in Chicago, Ill. Many questions focused on the National Credit Union Share Insurance Fund's equity ratio and assessments resulting from credit union losses. Chairman Matz plans to continue her open dialog with credit union officials.

Access new consumer privacy notices online

CONSUMER PRIVACY

NCUA and other agencies adopted model privacy forms that financial institutions may rely on as a safe harbor to provide disclosures under consumer privacy provisions of the Gramm-Leach-Bliley Act. Several versions of optional new *Model Privacy Notice* forms are now available online at **www.ncua.gov** under *Resources and Publications/Resources for Consumers/Consumer Privacy/Interagency PDF Versions of Model Consumer* Privacy Notices.

Visit the NCUA website www.ncua.gov to access the latest information directly from NCUA.

FROM THE HILL from page 6

loans where lenders pay brokers to inflate the costs and prohibit pre-payment penalties that trap borrowers in unaffordable loans.

- **Expand consumer protections for high-cost mortgages.** Reforms lower the interest rate and the points-and-fee triggers that define "high-cost" loans where consumers are protected by law.
- **Establish penalties for irresponsible lending.** Consumers can avoid foreclosure and recover as much as three years of interest payments and damages if lenders violate standards.
- **Require additional disclosures on adjustable-rate mortgages.** Lenders must disclose the maximum amount a consumer could pay on an adjustable-rate mortgage.

Consumer education:

- Creates an Office of Financial Literacy, as part of the Bureau, to ensure that consumers get the clear, accurate information they need when shopping for mortgages, credit cards, and other financial products. The office will protect consumers from hidden fees, abusive terms and deceptive practices.

Consumer complaint resolution:

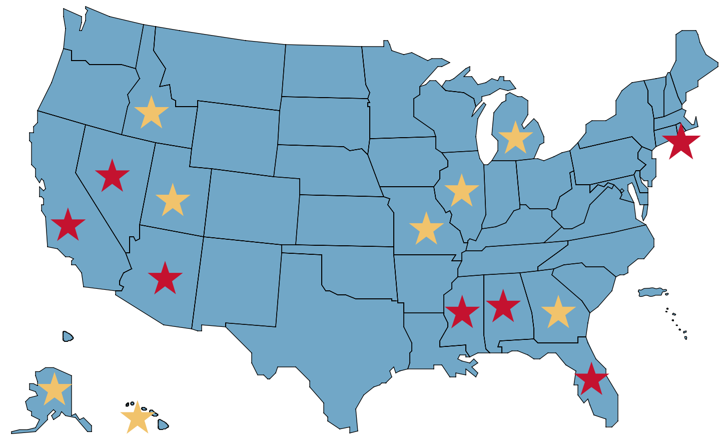
- Creates a National Consumer Hotline. Consumers will have a single toll-free number to report problems with financial products and services.

NCUA will provide additional information and details in the future about the legislation as we begin the rulemaking process required by the legislation and, where appropriate, will coordinate our efforts with other federal financial regulators.

Concentrations: Are some states riskier?

With a recovery beginning in most of the country, numerous pockets of weakness still remain that present potential risks to credit unions and their members.

To identify risk concentrations, the Office of Examination and Insurance undertook a state-by-state analysis of economic developments. Risk was assessed and ranked based on each state's local performance in 10 selected economic indicators, including labor and housing market statistics, commercial real estate trends, bankruptcy and per capita income performance.



The analysis identified seven states with the most significant risk concentration (★): *Nevada, Florida, Arizona, California, Alabama, Mississippi*, and *Rhode Island*. Additional states with significant risk concentrations include (★): *Georgia, Idaho, Illinois, Michigan, Utah, Hawaii, Alaska* and *Missouri*. Credit unions located in these states, as well as others, will benefit from continuously monitoring their economic environment, evaluating its impact on their balance sheet and members, and adapting with sound strategic planning.

NCUA-issued guidance and resources are available to help identify and address different forms of risk:
Investment/Asset Liability Management: **http://www.ncua.gov/Resources/ALManagementInvest/index.aspx**
Letters to Credit Unions:
Natural Person: **http://www.ncua.gov/Resources/LettersCreditUnion2010.aspx#top**
Corporate: **http://www.ncua.gov/Resources/CorporateCU/CorpLetters.aspx**
Risk Alerts: **http://www.ncua.gov/Resources/RiskAlert/index.aspx**
Credit Union and Bank Rate Data: **http://www.ncua.gov/DataServices/BankRateData/index.aspx**

Numerous other resources beneficial to identify and mitigate risk include:
ALM Facts and Tips: **http://www.almfirst.com/include/parser.cgi?t=archive.html&nav=4&h=ae)**
Bankruptcy Statistics: **http://www.abiworld.org/am/template.cfm?section=Bankruptcy_Statistics1**
Commercial Real Estate Trends: **http://www.realtor.org/research/research/reportscommercial**
Credit Score and Credit Usage Trends: **http://www.nationalscoreindex.com/**
Delinquency Rates: **http://data.newyorkfed.org/creditconditionsmap/**
Economy Tracker: **http://www.cnn.com/SPECIALS/map.economy/index.html**
Fed Watch: **http://www.financialsensearchive.com/resources/fed/fedwatch.html**
Foreclosure Statistics: **http://www.realtytrac.com/states/index.html**
Housing Trends:
Housing Equity Reports: **http://www.realtor.org/research/subscription_data/09metroareahousingequityreports**
Housing Valuation Monitor: **http://www.ihsglobalinsight.com/Highlight/HighlightDetail2350.htm**
Housing Opportunity Index: **http://www.nahb.org/fileUpload_details.aspx?contentID=535**
House Price Reduction Monitor: **http://www.trulia.com/**
Prices, Sales, etc: **http://www.realtor.org/research/research/ehspage**
Real Estate Market Reports: **http://www.zillow.com/local-info/**
Strategic Default Monitor: **http://www.financialtrustindex.org/**
Key Market Rates: **http://www.bloomberg.com/markets/rates-bonds/key-rates/**
Labor Market Statistics: **http://www.bls.gov/eag/home.htm**
State Profiles: **http://www.fdic.gov/bank/analytical/stateprofile/index.html**
Supervisory Insights: **http://www.fdic.gov/regulations/examinations/supervisory/insights/index.html**

NCUA staff is always available to answer questions and provide additional information, as NCUA and credit unions work as partners to ensure the continued safety and soundness of the credit union system and its members.

CAPITAL MARKETS

Private-label mortgage-backed securities: conditional default rate

The April NCUA Report included an article about the need to evaluate risk in private-label mortgage-backed securities by addressing characteristics of the collateral and structure of these securities. As a following-up, this article focuses on one of the key measures of risk in structured instruments, the "*conditional default rate*." With the term more frequently employed following recent events in financial markets, we clarify this concept, what it represents and why it is important.

Credit risk in investments traditionally focuses on the default risk of a counterparty. Credit risk is present in private-label mortgage-backed securities because it is not absorbed by an issuing agency such as Ginnie Mae, Fannie Mae or Freddie Mac. For private-label mortgage-backed securities, the source of credit risk lies with the original mortgage borrower. The security investor is removed from the borrower. Payments made by mortgage borrowers are received by those administering the mortgage-backed security and reallocated from a pool of payments to the investors. This reallocation mechanism is described in the prospectus of the security, and it can be quite complex.

Overextending credit to mortgage borrowers and declining property values during the recent economic downturn led to delinquencies and foreclosures. Defaults resulting from foreclosures are passed on to mortgage-backed securities investors. The *conditional default rate* (CDR) measures the level of defaults by taking the monthly rate of defaults and expressing it as an annualized default rate. The monthly default rate formula is the sum of liquidated loans divided by the sum of the pool of loans bundled together in a mortgage-backed security. It is "conditional" because it assumes that loans no longer in the pool for reasons other than defaults—such as loans paid off through voluntary prepayments—are excluded from the denominator.

The CDR in a mortgage-backed security is one of the most significant indicators of credit losses. Prior to the recent crisis, mortgage-backed securities were somewhat protected from loss. The main reason for reallocating payments received from borrowers, as payments make the way to investors, is to provide extra protection to senior classes of investors, and to allow investors who wish to take more risk to invest in subordinate classes of the bond. Increased defaults in mortgage-backed securities cause the protection provided to senior investors to shrink.

CDRs are based on historical data, while an investor focuses on future return and possible losses. Just as it is important for credit unions to understand the implications of the characteristics of a mortgage-backed security, it is critical to be able to interpret the relevant statistics and calculations that measure return and loss, including the loss from default, and to refrain from taking investment risks that are not fully understood. The CDR of a mortgage-backed security is an important risk measure on any mortgage security exposing an investor to credit risk.

July 29, 2010, Alexandria, Va.— *Board Member Fryzel listens to a staff presentation at the July Board Meeting.*

OFFICE OF GENERAL COUNSEL from page 4

Sampling loan applications or contacting a portion of the membership is not sufficient to demonstrate that a federal credit union qualifies for LICU designation. Additionally, if a credit union provides actual members' income information, the median earnings for individuals must be used to determine if members are low-income.

Looking ahead, the NCUA Office of General Counsel plans to propose a new regulation this fall that would allow stakeholders to comment on alternative ways to demonstrate that a credit union qualifies for low-income designation.

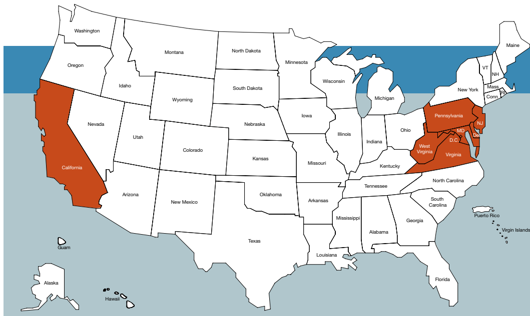
REGIONAL REPORT from page 10

non-federally insured credit union will contain a clear statement that the credit union is not federally insured.

The final rule is effective 60 days after publication in the Federal Register. Compliance is required 180 days after public notice that the NMLS and Registry is accepting federal registrations. The NCUA Board approved its final rule on Parts 741 and 761, by notation vote.

Please link to **www.ncua.gov** under *Resources and Publications/Resources for Credit Unions/S.A.F.E. Act.* NCUA is in the process of preparing a *Letter to Credit Unions*, with frequently asked questions, which will be issued soon.

Also, please be aware that the federal registry is still in development, and *no* registrations can be taken at this time. NCUA anticipates the registry will begin taking registrations in early 2011. Credit unions will be notified when the registry will be available.



Region II

SAFE Act mortgage loan specifics adopted

NCUA's SAFE Act regulation, 12 CFR Part 761, introduces a brand-new requirement—every credit union employee who originates more than five consumer residential mortgage loans per year will have to register on a new federal database and submit fingerprints, criminal background information and financial employment history, and they will be assigned a unique identifier that is theirs for their career. New Wall Street reform and consumer protection legislation stipulates the SAFE Act will be enforced by the new Consumer Financial Services Protection Agency. Meanwhile, regulatory agencies are setting up the registry.

At the May 2010 NCUA board meeting, staff provided a briefing on the interagency final rule on mortgage loan originator registration requirements for depository institutions and their employees based on provisions of the Secure and Fair Enforcement for the Mortgage Licensing Act of 2008 (SAFE Act). The SAFE Act, enacted July 30, 2008, is part of the Housing and Economic Recovery Act of 2008. The SAFE Act will aggregate and improve the flow of information to and between regulators; provide increased accountability and tracking of mortgage loan originators; enhance member protections; reduce fraud in the residential mortgage loan origination process; and provide members with easily accessible information at no charge regarding the employment history of, and publicly adjudicated disciplinary and enforcement actions against mortgage loan originators.

The SAFE Act mandates a nationwide licensing and registration system for mortgage loan originators, the Nationwide Mortgage Licensing System (NMLS) and Registry. The SAFE Act specifically prohibits an individual from engaging in residential mortgage loan origination without first obtaining and maintaining:

- Registration as a mortgage loan originator and a unique identifier if employed by a federally regulated institution, or
- License and registration as a state-licensed mortgage loan originator and a unique identifier.

The Federal banking agencies, through the FFIEC and the Farm Credit Administration, are working with the Conference of State Bank Supervisors (CSBS), who developed and maintain a web-based NMLS, to modify the system so that it can accept registrations from mortgage loan originators employed by agency-regulated institutions.

The NCUA final rule will require credit union employees, including volunteers who have originated more than five residential mortgage loans during the past 12-months, to register with NMLS and Registry and to obtain a unique identifier and maintain the registration. The Act requires an annual registration renewal. All credit unions originating residential mortgage loans also have to adopt, and employees have to follow, written policies and procedures designed to assure compliance with the rule.

NCUA's regulation contains additional requirements for non-federally insured credit unions participating in the federal registry. Section 761.101(c)(3) addresses how appropriate state supervisory authorities will enter into memoranda of understanding with NCUA. The registry listing for employees of a

continued on page 9

The NCUA Report
National Credit Union Administration

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