National Credit Union Administration
Chairman Debbie Matz

Remarks to the
Massachusetts Credit Union League

National Harbor, Maryland
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Thank you very much for that kind introduction. It is a great pleasure to join you today and to welcome you to the Washington area for your annual conference.

Let me just start by saying to all you Celtics fans out there: As a huge Washington Capitals hockey fan, "I feel your pain." Many of us Caps fans are still trying to figure out what hit us in our Game Seven with the Montreal Canadiens – so we know what you're going through after your Game Seven with the Lakers. But now that the basketball and hockey seasons are over, it has freed me up to focus on my real favorite team – the current and next World Champions: the New York Yankees!

But I'm very open-minded, so it is great to have you here – even though you're Red Sox fans! And it is always a pleasure to salute Massachusetts executives and board members for your continuing leadership in the nation's credit union industry.

In credit union history, Massachusetts is synonymous with creativity. It was Boston's own Edward Filene – the millionaire merchant who was a champion of "the little guy" and of progressive workplace reform – who recognized the power of cooperative credit to help small savers, and who envisioned the potential of a nationwide credit union movement. It was a Massachusetts banking commissioner, Pierre Jay, who wrote the country's first statewide credit union law. And it was Roy Bergengren, a Massachusetts attorney recruited by Filene, who guided the Credit Union National Extension Bureau as it grew to become a nationwide success. Thanks to the vision of those three Bay Staters, the financial innovation that started in New England developed into a thriving national industry.

As the oldest continuously operating trade association in the nation, the Massachusetts Credit Union League certainly has a distinguished history – and a promising future, as you continue to serve your members with the products they need and with the member-friendly services they appreciate.

Perhaps because of that, overall, Massachusetts credit unions are very strong.

Comparing state-by-state performance data, good management and sound lending standards seem to be the rule rather than the exception in Massachusetts. Among your 218 credit unions, 166 – about 80 percent of the state's total, holding more than 90 percent of your total assets – have a strong CAMEL rating of 1 or 2. That's a sign that, even during the economic downturn, the Bay State's credit unions are soundly managed.

Nationwide, NCUA is always concerned about the trend in the number of vulnerable CAMEL 3 credit unions – but it's good to see that, in Massachusetts, you're doing much better than the national average. While 44 Massachusetts credit unions – about one-fifth of the total – are CAMEL 3, with just 6.3 percent of your total assets, you are well below the national average of almost 14 percent. An additional 11 Bay State credit unions – with 3.5 percent of your total assets, compared to 5.3 percent nationally – are in the troubled category of CAMEL 4. And none are CAMEL 5. And that is very good news.

A closer look at the details illustrates the strength of your state's performance. As of March 31, both your delinquency rate and your charge-off rate were much better than the national rates. Your efforts to reduce operating expenses are certainly paying off, and I congratulate you for this: Over the past year, expenses have fallen

dramatically from 4.3 percent to 2.7 percent – and are now below the national average of 3.1 percent. Your profitability of 0.41 percent is slightly below the national rate of 0.48 percent – but your net-worth ratio of 10.2 percent is slightly higher than the national 9.9 percent.

Judging by those numbers, your credit unions are well-positioned to emerge from the economic downturn in a very sound position.

If there is a silver lining amid our country's economic crisis, it is this: At a time when every other part of America's financial-service sector has seen its reputation tarnished, credit unions are still shining – with overall strong net worth, growing membership, and even continued growth in lending.

Yet no part of America's financial sector has been immune from economic pressure. Nationwide, the credit union industry now confronts an array of challenges that will surely test your resilience. As the federal agency that ensures the safety and soundness of the credit union system, NCUA is committed to helping you through these volatile times.

Many credit unions – while still well-capitalized – will be draining capital this year, due to negative earnings. At the same time, delinquencies and loan losses continue to increase in many parts of the nation. Undoubtedly, these adverse trends will lead to an increase in credit union failures this year.

That is why NCUA is becoming even more vigilant, to ensure that negative capital trends and loan losses do not hit more credit unions. Because the types of loans

that tend to be growing fastest – fixed-rate first mortgages, indirect loans, and member business loans – are also among the riskiest types of loans, NCUA is stepping up to the plate, in Massachusetts, throughout New England and in every other region. Our examiners are carefully monitoring the call reports of all federally insured credit unions, looking for red flags. These include increases in delinquencies in member business lending, indirect lending, and loan participations. Yesterday, some of you may have heard Tim Segerson of our Office of Examination and Insurance, who discussed these red flags. If you are taking on these risks without doing your due diligence, you will soon be hearing about it from an examiner who may show up at your credit union – even if an exam is not on the regular schedule, and even if your credit union is state-chartered.

We are also looking very closely at any credit unions that are holding too many fixed-rate, long-term mortgages on the books. In Massachusetts, credit unions are tied closely to the health of the state's real-estate market, with about two-thirds of credit unions' loans in real estate. That kind of concentration risk concerns us. We have been warning, for months now, that higher interest rates are a question not of "if" – but of "when." We urge you to take action now to make sure your portfolio is strong enough to withstand the interest-rate risks that will soon hit your balance sheets.

NCUA is determined to take a realistic approach to the difficult economic trends, by taking precautions to prevent dangerous situations from arising before it is too late. We are taking the disciplined steps required to protect the credit union system as a whole. We must uphold rigorous standards, because we aim to protect the 90 million members who depend on the safety and soundness of the credit union system.

Now I would like to switch gears, and talk with you about a subject that is on everyone's mind – the corporate credit union crisis.

As I know you are all aware, NCUA has taken decisive action to deal with the corporate crisis. And, yes, that term is fully justified: It was indeed a crisis. If we had not confronted the situation head-on, the nation's credit unions would have faced a grave systemic risk.

I know that there has been a great deal of confusion about how the corporate crisis unfolded, and a great deal of uncertainty about what will come next. To help your credit union directors and executives explore the complexities of these problems, NCUA is producing a series of presentations on DVDs to explain the situation in great detail. The first one is posted on our website, and we will be mailing the series to every credit union. I hope that board members will watch the DVDs together, discuss them, and use them as a resource in making the difficult business decisions that lie ahead.

I'd like to take a few minutes to discuss the highlights of the issues involving the corporates.

First I want to assure you that I fully recognize the legitimate anger that many of you feel. That anger came through loud and clear during the comment period for the proposed new corporate rule.

I have heard directly from many of you about the pain you have felt. I know that many of you blame NCUA: After all, two examiners were on-site at US Central

and WesCorp. NCUA definitely shares some of the blame – but there is plenty of blame to go around, especially among the corporate officers and directors who exercised such poor judgment.

Much of the blame falls outside the credit union industry. Mortgage brokers made dubious loans that led to waves of foreclosures. Rating agencies handed out Triple-A ratings for mortgage-backed securities that are now merely “toxic assets.”

When the mortgage bubble burst in 2007 and 2008, the fallout caused an extraordinary decline in the global economy – and exposed the four giant corporates to extreme shock, because of their vast investments in residential-mortgage-backed securities. When the market for those bonds came to a halt, the corporates’ losses pushed them toward insolvency.

If the corporates had abruptly stopped operating, that would have threatened to end the services that they have long provided to natural-person credit unions. That is because three-quarters of natural-person credit unions have used the corporates as their primary agents for clearance and settlements.

In addition, about 90 percent of natural-person credit unions had investments in corporates. If the corporate system had collapsed, natural-person credit unions would have suffered huge and insurmountable losses – shattering confidence in all of America’s credit unions. Natural-person credit unions would have lost about $30 billion in net worth – about one-third of their net worth at the time. At least 800 natural-person credit unions would have collapsed.

On top of all that, your federal Share Insurance Fund would have had to levy huge assessments on the surviving credit unions, to cover the remainder of the losses. Many of those remaining credit unions might not have withstood the strain.

To preserve capital and confidence, NCUA had to put the two largest corporates – US Central and WesCorp – into conservatorship. And we have also had to carefully monitor the operations of the other large corporates.

To stabilize the system, NCUA placed guarantees on shares at all corporates. As a result, credit union investments in the corporates are backed by the full faith and credit of the United States government.

It is important to understand that our aim was not to "bail out" the corporates. We aimed to stop them from bleeding, as their assets were hemorrhaging value. NCUA did what we had to do, to save the system by preserving public confidence.

Our proposed new corporate rule is focused on providing a framework for safety and soundness that protects the system.

The proposed rule has four main themes, aiming to change four critical areas in the current rule.

First: On capital standards: The new rule will strengthen capital requirements; subjecting corporates to a leverage capital requirement to help reduce risk; and imposing Prompt Corrective Action standards on corporates that match those that apply to all other federally insured financial institutions.

Second: On asset-liability management: It proposes specific ALM requirements to ensure that the gap between the average life of assets and liabilities does not present excessive risk.

Third: On risk concentration: It will limit risk by forbidding corporates from excessive concentration in a single type of asset. Promoting a diverse portfolio of investments will help avoid the kind of risk concentration that was permitted under the flawed corporate rule that was approved in 2002. Back then, I voted against that rule, for this very reason.

Fourth and finally: On governance standards: It will raise eligibility standards for corporates' board members, aiming to elevate their level of experience and expertise.

Strengthening these four areas will go a long way toward preventing another corporate crisis from ever occurring.

In light of all the comments we have received, undoubtedly we will be making further improvements to the rule.

We're also aiming to respond to what your comments have told us is the highest priority: the need for NCUA to dispose of the toxic assets that caused the crisis. Isolating the so-called "legacy assets" is a necessary step in our effort to avoid further damage.

I understand why some of you do not want to recapitalize corporates as long as toxic assets remain on their books. And I understand why you are frustrated that

NCUA has not yet announced a plan to remove these legacy assets. So, now I am going to share with you our plans to date.

Let me be clear: This is very much a work in progress. It is an enormous undertaking. There is no easy way to un-bundle more than $50 billion worth of assets, repackage them into marketable bonds, and move them from corporates' balance sheets without realizing losses.

This effort is so huge – and so important – that we are dedicating many of our top staff to work on it. In recent months, our team has been brainstorming countless ideas for safely resolving the corporate crisis at the lowest possible cost to credit unions. With every possible solution, more questions – and more legal and accounting issues – are raised, so it is a very time-consuming effort.

Our team is formulating a plan that would remove the riskiest legacy assets from ongoing corporates, while carrying forward the most valuable pieces of the corporate system. The plan would empower natural-person credit unions to choose which corporates they will support.

If the plan proceeds as we envision, it could even allow credit unions to recover future earnings from legacy assets that out-perform current loss projections.

Our team is still working to answer a host of questions – about underwriting, funding, and much more. But we are cautiously optimistic that this careful process will generate the best possible solution.

It is my intention to unveil a comprehensive corporate resolution plan as quickly as realistically possible. But I do not want to rush this vital process. So please bear with us until we are sure that we have refined the best possible solution.

In the meantime, let me assure you: Based upon your comment letters, we will design a comprehensive plan that deals with the legacy assets; that creates stronger rules for how corporates will operate in the future; and that gives natural-person credit unions the power to determine the future of the corporate system. We envision a system in which corporates will start with clean balance sheets and can maintain those clean balance sheets.

Speaking of clean balance sheets: NCUA received some good news recently. After working diligently to ensure the accuracy and transparency of our agency's financial statements, last week we received "unqualified," or "clean," audits for the National Credit Union Share Insurance Fund, the NCUA Operating Fund, the Community Development Revolving Loan Fund, and the Central Liquidity Facility.

I want to emphasize: The federal Share Insurance Fund remains strong and robust.

In fact, every month at NCUA's open Board meeting, we report on the financial condition of the Share Insurance Fund and the Corporate Stabilization Fund. At our Board meeting last week, we reported that, although the Share Insurance Fund's equity ratio has declined, it remains within the normal operating range. Likewise, the Corporate Stabilization Fund remains well-positioned to cover the costs of corporate losses over time.

I bring this up to underscore the difference between the two funds, and to help you understand the basis for future assessments. Last year, we announced a single sum, which was actually a combination of payments for the Share Insurance Fund and for the Corporate Stabilization Fund. We are, of course, very mindful of the effect these assessments have on your balance sheets. Let me also assure you: We consider that fact in every decision we make.

We have now separated the Share Insurance Fund assessment from the Corporate Stabilization Fund assessment. This separation will not increase the total amount of assessments – but it will clarify exactly what each assessment is for: The Share Insurance Fund assessment covers losses at natural person credit unions, and the Corporate Stabilization Fund assessment covers losses at corporate credit unions.

Separating these two assessments has improved the transparency of NCUA's assessment process – and at the same time, should help improve the accuracy of credit unions' budget estimates.

That is why, at last week's Board meeting, we voted to levy an assessment of 13.4 basis points on natural-person credit unions to cover Corporate Stabilization Fund costs. This assessment will be invoiced in July, and due in August. I know that this assessment will put added pressure on many credit unions. And we are very mindful of the burden. Some of you may find it hard to believe, but we always strive to keep this assessment as low as realistically possible – and we will continue to work to restrain future assessments that are now a necessary part of the corporate stabilization process.

Looking at the Share Insurance Fund: When we consider the number and size of CAMEL 4 and 5 credit unions, and the anticipated losses to the fund, another assessment later this year seems unavoidable. Again, we will do everything we can to keep the assessments as low as possible. But the amount of such assessments really is a function of the performance of the industry itself – and this is a direct result of the decisions that you make, as executives and board members, in conducting your business. We are hopeful that our red flag reviews will prove helpful to you in making these decisions.

For the credit union community, and for the economy overall, the recovery from our recent problems will take time. But we have taken strong measures to make sure that credit unions, and the system that supports them, will remain sound.

Building on your record of service and success, you are positioned to broaden your appeal to millions of potential new members. The energy and spirit of innovation in the credit union community give me confidence that the industry has a bright future.

After the global crisis tarnished the reputation of every other part of the financial-services sector, Americans' confidence in credit unions continues to grow.

Let us not forget: During the financial crisis, the credit union system was just about the only part of America's financial sector that did not buckle under stress.

With American families struggling, and with big banks turning their backs on Main Street, it was credit unions that stepped up to the challenge.

It was credit unions that reached out – that made loans – that provided advice and reassurance.

It was credit unions that set out to modify mortgages, so that their members could stay in their homes.

It was credit unions that helped millions of Americans regain a measure of financial stability, and thus regain their confidence.

That is the kind of positive impact you can continue to achieve, as the economy moves from recession toward recovery.

In a spirit of partnership – drawing on the faith that millions of Americans place in their credit unions – I am looking forward to working closely with you in the years ahead . . . to help you make the most of the opportunities that your industry enjoys, and to help you provide the benefits that American consumers deserve.

Thank you very much.