Board Action Bulletin

PREPARED BY THE OFFICE OF PUBLIC AND CONGRESSIONAL AFFAIRS

NCUA BOARD MEETING RESULTS FOR JULY 24, 2012

NCUA Sets 2012 Stabilization Fund Assessment at 9.5 Basis Points

Board Saves Credit Unions $2 Million in Budget Adjustment, Renews 18 Percent Interest Rate Cap, and Proposes Emergency Liquidity Backstop

ALEXANDRIA, Va. (July 24, 2012) – The National Credit Union Administration (NCUA) Board convened its fourth open meeting in 2012 at the agency's headquarters here today and unanimously approved five items:

- Setting the 2012 Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund) assessment at 9.5 basis points of insured shares as of June 30.
- Reprogramming NCUA's 2012 operating budget to produce a $2 million savings to credit unions that will offset the 2013 operating budget.
- Renewing the current 18 percent interest rate cap for most loans, and 28 percent for short-term small loans, at federally chartered credit unions through March 10, 2014.
- Releasing a proposed rule—with a three-tiered approach targeted by asset size—for federally insured credit unions to plan for or maintain access to emergency liquidity.
- Issuing a proposed rule to permit NCUA to declare a federally insured, state-chartered credit union (FISCU) in "troubled condition" based on NCUA's CAMEL code 4 or 5 composite rating.

The Board also received briefings on an upcoming joint agency proposed rulemaking on appraisals, and the financial performance of the National Credit Union Share Insurance Fund (NCUSIF) and the Stabilization Fund. The NCUSIF equity ratio stood at 1.3 percent as of June 30, and the net position of the Stabilization Fund slightly improved in the quarter ending June 30.

Corporate Obligations Drive 2012 Stabilization Fund Assessment

The anticipated fixed, near-term cash needs of the Stabilization Fund drove the Board's decision to set the 2012 Stabilization Fund at 9.5 basis points of insured shares as of June 30, an amount substantially lower than the 25 basis point assessment charged in 2011.

The funds generated by the assessment, along with funds borrowed from the U.S. Treasury, will pay $2.66 billion in net obligations due in 2012, primarily principal and interest on maturing Medium Term Notes issued by corporate credit unions and guaranteed by the Stabilization Fund.

For budgeting purposes, NCUA previously provided an estimate of between 8 and 11 basis points of insured shares for the 2012 assessment. With the assessment now declared for 2012, credit unions should consult their accounting practitioner and show the expense in August and report it on the September 5300 Call Report. The Chief Financial Officer will prepare and distribute invoices to all federally insured credit unions, with the assessment due by Oct. 9.

The 2012 assessment will raise an estimated $790.5 million. With the 2012 assessment, federally insured credit unions will have paid a total of $4.1 billion in expenses for the Corporate System Resolution Program, including $337.4 million in 2009, nearly $1 billion in 2010, and almost $2 billion in 2011. After 2012, federally insured credit unions can expect to pay between $1.9 billion and $5.2 billion in total remaining assessments from 2013 through 2021, based on current loss estimate projections from the liquidation estates of the five failed corporate credit unions.

The Board also authorized up to $2.5 billion in Stabilization Fund borrowing from the U.S. Treasury. The timing and amount of borrowing is consistent with original cash needs and uses envisioned under the Corporate System Resolution Program, including an appropriate contingency amount.

Budget Review Yields $2 Million in Savings for Credit Unions

After completing a mid-year review, the Board approved a revised and reprogrammed operating budget that will reduce NCUA's overall expenditures for the remainder of 2012 by $2 million.

"The Board takes stewardship of the NCUA budget very seriously, and I hope today's action sends a positive message to credit unions," said NCUA Board Chairman Debbie Matz. "We are well aware that many credit unions, particularly smaller credit unions, are still struggling to generate positive earnings. So we have done our due diligence to ensure that this budget will be a prudent use of agency resources and credit union funds. We directed all NCUA offices to increase efficiencies and reduce line items wherever possible—without sacrificing the agency's mission. It's important to emphasize that effective regulation saves credit unions money, by minimizing losses to the Share Insurance Fund. This Board has a responsibility to continue providing the necessary resources to fulfill NCUA's statutory mandate."

NCUA's revised budget will be $234.9 million in 2012. A $3.7 million reduction in employee pay and benefits produced the greatest savings, while NCUA anticipates spending slightly more for travel, communications, administration, and contracting.

18 Percent Loan Rate Cap Kept for 18 More Months

Mindful of the needs of both credit unions and borrowers, as well as market conditions, the NCUA Board voted to extend the current interest rate cap of 18 percent for most credit union loans for an additional 18 months.

"Allowing the cap on loan rates to revert to 15 percent would have been harmful to federal credit unions," Matz said. "A significant number of federal credit unions make some loans between 15 and 18 percent, and lowering the rate would put greater pressure on earnings. Consistent with the requirements of the Federal Credit Union Act, we determined that market conditions existed to maintain the present interest rate cap for most federal credit union loans. At the same time, we were able to extend the 28 percent cap on short-term small loans, which provide a consumer

friendly alternative to predatory payday loans. This decision also preserves access to loans for many borrowers with lower incomes or lower credit scores."

Approximately 61 percent of federal credit unions made some loans at rates above 15 percent in the first quarter of 2012. Recent trends in short-term Treasury and federal fund rates have moved upward, a key condition for allowing the current 18 percent interest rate cap on loans to remain in effect for an additional 18 months.

The current 18 percent ceiling has been in place since May 1987. The Federal Credit Union Act caps the interest rate on most credit union loans at 15 percent, but the NCUA Board has the discretion to raise that ceiling for an 18-month period.

Proposed Rule Requires Credit Unions to Plan for Emergency Liquidity Needs

U.S. Central Bridge Corporate Credit Union (U.S. Central Bridge) is scheduled to close in late October, and that means more than 6,000 credit unions will lose access to the Central Liquidity Facility (CLF) for emergency liquidity. In response, the NCUA Board has issued a targeted proposed rule (new Section 741.12) to require credit unions to plan for emergency liquidity.

Currently, most credit unions have access to emergency liquidity by belonging to a corporate credit union that is part of the agent group headed by U.S. Central Bridge, which holds CLF stock on behalf of the entire agent group. However, when U.S. Central Bridge closes and redeems that stock upon closure, those credit unions will no longer have the CLF as a source of backup liquidity, unless they choose to join the CLF directly.

"As noted in the Financial Stability Oversight Council's 2012 Annual Report, capital and liquidity buffers form the most fundamental protection for the broader financial system against unexpected risks or failures of risk management at financial institutions," said Matz. "As U.S. Central Bridge works to wind down its services, including its access to the CLF, credit unions should be taking steps to make sure they have access to emergency liquidity. The targeted approach outlined in the proposed rule provides flexibility for credit unions to reset and put in place a reliable and stable source of backup liquidity."

The proposed rule on emergency liquidity incorporates a three-tiered approach, based on the size of the federally insured credit union:

- Credit unions under $10 million in assets would have to maintain a written liquidity policy approved by their board. The policy would provide a basic framework for managing liquidity and having a list of contingent liquidity sources in emergency situations.
- Credit unions with more than $10 million in assets would have to establish a formal contingency funding plan that clearly sets out strategies for addressing liquidity shortfalls in emergency situations.
- Credit unions with more than $100 million in assets would also have to demonstrate access to at least one of the following three options for a backup federal liquidity source:
  - becoming a member of the CLF;
  - becoming a CLF member through a CLF agent; or
  - establishing direct borrowing access to the Federal Reserve's Discount Window.

The proposed rule on emergency liquidity builds upon comments received as part of an advance notice of proposed rulemaking issued in December 2011. The proposed rule has a 60-day comment period once published in the *Federal Register*.

Proposed Rule Modifies "Troubled Condition" Definition

In order to better protect the NCUSIF from losses, the Board voted to issue a proposed rule allowing NCUA to declare a FISCU to be in "troubled condition" based on the CAMEL rating NCUA assigns (Section 701.14). Currently, only a state supervisory authority (SSA) can make this declaration for a FISCU.

The NCUSIF has seen an increase in the number of credit unions with assets between $250 million and $500 million experiencing some degree of financial stress. As a result, NCUA has increased the number of joint FISCU examinations in which it participates with SSAs. In some instances, NCUA and the applicable SSA have issued different CAMEL scores.

While the actual number of examinations where this has happened is relatively small, it is nonetheless significant from a supervisory perspective, particularly given the rise in credit unions experiencing stress. The proposed rule would permit NCUA to declare a FISCU in troubled condition based on NCUA's CAMEL code 4 or 5 composite rating. Credit unions with a troubled condition designation are subject to enhanced supervision.

The Board issued the proposed rule with a 60-day comment period, once published in the *Federal Register*.

Joint Agency Rulemaking on Appraisals Required by Dodd-Frank Act

The Board received a briefing from the Office of General Counsel and the Office of Examination and Insurance on an upcoming interagency proposed rulemaking on appraisals required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA).

Section 1471 of DFA established a new section in the Truth in Lending Act (TILA). This section sets forth appraisal requirements applicable to "higher-risk" mortgages, including the need to obtain written appraisals based on a physical interior inspection of the property, protections against mortgage flipping scams, and access to free appraisal reports. DFA requires NCUA, the Federal Reserve Board of Governors, the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, the Federal Deposit Insurance Corporation, and the Federal Housing Finance Agency to jointly issue final rules to implement this new section of TILA by Jan. 21, 2013.

Each agency is working through its approval process. The agencies anticipate issuing the proposed rule on appraisals in August or shortly thereafter. After the agencies publish the proposed rule in the *Federal Register*, interested parties will have an opportunity to comment.

NCUSIF and Stabilization Fund Remain Stable

The Chief Financial Officer briefed the Board on the financial performance of the NCUSIF and the Stabilization Fund through June 30. Both funds remain stable.

The NCUSIF equity ratio was 1.30 percent as of June 30, which is the normal operating level set by the Board. This ratio is based on estimated insured share base of $839 billion as of June 30, and reflects the additional one percent deposit adjustment that NCUA will bill in September to account for growth in insured shares.

For the second quarter of 2012, the NCUSIF reported gross income of $53.5 million, operating expenses of $34.6 million, and insurance loss expenses of $32.3 million, resulting in a net loss of $13.4 million for the quarter. First-half net income for the NCUSIF was $5.5 million.

There have been 12 consumer credit union failures in 2012. Six were assisted mergers, and six were involuntary liquidations, of which five were assisted purchase and assumptions. The cost of these failures through June 30 was $94.6 million.

The number of CAMEL code 3, 4, or 5 credit unions increased slightly from the previous quarter. CAMEL code 4 and 5 credit unions increased by three, for a total of 399 as of June 2012. Assets and shares were $30.0 billion and $26.8 billion, respectively. As a percentage, CAMEL code 4 and 5 credit unions represent 3.2 percent of total estimated insured shares.

CAMEL code 3 credit unions increased by 17, for a total of 1,679 as of June 2012. Assets and shares were $138.0 billion and $123.0 billion, respectively. CAMEL code 3 credit unions represented 14.7 percent of the total estimated insured shares as of June 2012. Overall, 16.1 percent of all credit union assets were in CAMEL code 3, 4, or 5 institutions, a small improvement from 16.3 percent at the end of the first quarter.

As of June 30, the net position of the Stabilization Fund was negative $5.1 billion, reflecting a slight change from the negative $5.3 billion net position reported at the end of 2011. In the second quarter, the Stabilization Fund repaid $300 million to the U.S. Treasury, reducing the outstanding borrowing to $3.2 billion. The Stabilization Fund had net operating income of $17.5 million for the quarter and $126.8 million through June 30.

The 2012 financial data for the NCUSIF and the Stabilization Fund is preliminary and unaudited.

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