# NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION

NATIONAL CREDIT UNION SHARE INSURANCE FUND LETTER TO CREDIT UNIONS -- #154

APRIL 1994

DEAR BOARD OF DIRECTORS:

The Federal Credit Union Act says credit unions are to, "...make more available to people of small means credit for provident purposes... ."

No other financial sector has such a charge. It is one of many critical differences between credit unions and banks.

Today, we at NCUA are operating under the principle that loans to members are the credit union's core business. The future of credit unions is not as investment houses or commercial lenders. The very best investment a credit union can make is a loan to a member.

Real estate loans are a natural part of helping to serve the credit union member and I would like to dispel a few apparent misunderstandings on this subject. There is no truth to any rumors that NCUA has imposed an arbitrary limit on real estate loans. A credit union may make as many real estate loans as it wishes as long as it has the appropriate staff, management capacity, and a well thought out plan.

Neither is there any requirement that all real estate loans be written to secondary market standards. Writing to secondary market standards is, generally, a good business practice. However, we also believe that a certain proportion of a credit union's portfolio can be nonconforming without calling that credit union's lending into question. However, your board should have appropriate underwriting and asset liability management policies in place for these nonconforming loans.

If a credit union has strong capital, sound charge-off procedures, and a reasonable level of delinquency, we think it should aggressively market consumer loans. In the best credit union tradition, a portion of your portfolio could be directed at the credit union member who may not have the best credit history, assets or employment record. This is not an endorsement of bad loans, but rather a recognition that credit unions are willing to take reasonable steps to help meet their members' credit needs.

For our part, we at NCUA are instructing our examiners not to overemphasize the importance of low delinquency and loan losses, thereby forcing credit unions to tighten lending policies. Rather than fixating on individual ratios, examiners will be asked to look at overall management and evaluate a credit union on effective risk management.

Lending is never risk free. The object is not zero delinquency and zero loan losses. Credit unions should take reasonable risks while seeking to build or maintain strong earnings and capital.

Members want loans delivered to them conveniently, quickly, efficiently, and at competitive rates. Credit unions must ask themselves if they are meeting their members' needs in this area. Some credit unions are doing very well in lending; many are not. NCUA recognizes that there might be credit unions with good and sufficient reason for low loan ratios (such as age or status of membership), and we are asking our examiners to address such questions under the management section of the credit union's CAMEL rating.

Credit unions with strong capital should not be automatically adversely affected during an exam simply because they are trying to increase member lending. Such credit unions that do make the effort to increase loan ratios and meet members' needs will find NCUA flexible on the CAMEL ratios.

But let us be very clear. Increased lending must be accompanied by a demonstrated ability to manage any resulting increase in risks. Safety and soundness of the credit union and of the NCUSIF will not be compromised.

It is important that the management of the credit union have documentation demonstrating their plans to improve loan delivery. Care must be taken to monitor levels of fixed rate or long term investments and loans. Now is the time to think and plan your strategies for funding loan growth.

Credit unions are unique. One of your distinctive characteristics has traditionally been an ability and willingness to serve those often ignored or abandoned by other financial institutions. A renewed commitment to sound lending is wholly consistent with the special and vital role credit unions are intended to play in our nation's economic well-being.

Norman E. D'Amours
Chairman