NCUA Chairman Debbie Matz

Remarks to NAFCU 2011 Congressional Caucus
on
NCUA Regulatory Modernization Initiative
to
Relieve Regulatory Burdens, Strengthen Safety and Soundness

Monday, September 19, 2011

Thank you, Mike.

It's a pleasure to join you here today.

I'm not sure if many of you know this, but in 1933, at the depth of the Great Depression, FDR came here, to this hotel, to write his First Inaugural Address.

That was the famous speech in which he said, "The only thing we have to fear is fear itself." What people remember less is that a large portion of the speech was devoted to the banking industry, and his words were tough.

He said that our nation's problems have occurred primarily – and I'm quoting FDR here, "because the rulers of the exchange of mankind's goods have failed." He called bankers, quote, "unscrupulous money changers."

FDR used those arguments to launch his 100 days agenda – including the Securities Act of 1933.

The goal was to identify what led to so many bank failures… and ultimately the Great Depression… and to prevent it from happening again.

Certainly, nobody in this room equates bank behavior with credit union behavior – then or now.

In fact, I always encourage consumers to learn the distinctions between credit unions and banks. And I heartily second Fred Becker's words when he tells people that credit unions are "prudent and consumer friendly."

In a way, those broad and necessary reforms in the 1930s – and the climate of regulation they created -- led to the formation of NAFCU in the 1960s with the express mission "To directly shape the laws and regulations under which federal credit unions operate."

Those broad reforms also led to important conversations about the role and limits of regulation. These conversations continue in many industries to this day – including credit unions.

In July, I was invited to a meeting at the White House with President Obama to discuss job growth and financial stability. About a dozen of us were there, including the heads of the FDIC, SEC, and several cabinet secretaries and administration officials.

We went around the table in the Roosevelt Room, sharing ideas that would create American jobs and strengthen our financial system. It became clear that these goals go hand-in-hand. More robust job growth will lead to more robust lending – which in turn will ensure more stable financial institutions.

Many innovative proposals to increase job growth will require an act of Congress. So when you visit Capitol Hill this week, I encourage you to engage your senators and representatives in conversations about what they can do to create jobs.

President Obama recognizes that regulators also play a role in creating jobs. As regulators, our role is to create a regulatory environment that empowers businesses to succeed while keeping consumers safe.

So as we reached the end of our conversation at the White House, the President discussed the Executive Order he had issued the previous week. Executive Order 13579 asked independent regulatory agencies to periodically review existing significant regulations for those that may be – and I'm quoting: "outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them" accordingly.

By law, the President of the United States cannot order independent agencies to take action. So in our meeting, President Obama acknowledged the challenges facing regulators and emphatically asked for our support of his Executive Order.

I believe – and the Executive Order requests -- that in cases where regulations are ineffective or overly burdensome; they should be eliminated or streamlined.

I also believe – and the Executive Order requests -- where new risks have arisen and current regulations are outdated or insufficient, those regulations need to be modernized.

Today I will discuss NCUA's Regulatory Modernization strategy. You will notice that this theme will be front and center at NCUA in the coming months.

Let me be clear: In modernizing regulations, my goal is to target risky behaviors in credit unions, not credit unions themselves.

We're living in a time when the pace of change in our financial markets has accelerated considerably. Electronic transfers move billions of dollars in a nanosecond. Changes in the financial marketplace come rapidly, often on a breathtaking scale.

The last several years have seen wave upon wave of financial innovations to syndicate the inherent risks in financial products. Many credit unions have grown more complex and now engage in more sophisticated risk-taking ventures.

Generally speaking, this increased sophistication is a positive trend for the credit union industry. However, it presents a significant challenge to the regulator. A new product, service, tool or relationship may seem innocent enough to an individual credit union – but when adopted by many credit unions, can pose significant risk to the Share Insurance Fund. And as you know, a risk to the Share Insurance Fund is a risk to your bottom line.

For instance, one or two credit unions participating in a relatively small business loan may not be an issue. But when a large number of credit unions participate, and the loan amounts to several million dollars, the stakes change. As we have experienced, credit unions can be brought down by poor underwriting, a lack of due diligence, or a sudden change in the economic climate.

Likewise, a CUSO performing back-office functions for several small credit unions likely poses little risk to the Fund. But when a CUSO originates speculative commercial loans or steers sub-prime indirect auto loans to dozens of credit unions, it becomes another story. A poorly run CUSO poses significant risk to each of the member credit unions.

As the products, services, tools and relationships used by credit unions evolve, NCUA rules must also evolve – to protect the Fund, to protect your members, and ultimately to protect you.

In response to President Obama's issuance of the Executive Order, I have asked NCUA staff to review our rules for those in need of modernization.
In that effort, we'll also be taking into account the letters we've received from Fred Becker, Dan Berger, Carrie Hunt, and others advocating NAFCU positions.
Once the Board reviews all recommendations, we will be offering proposals for comment over the next 12-18 months.

Frankly, I understand why many of you are frustrated by regulatory restrictions that seem outdated, confusing or counterproductive. I was the Executive VP and COO of a large credit union. I've walked in your shoes.

And believe it or not, sometimes regulators get frustrated too. Many of the top regulatory compliance burdens that credit unions ask me about, such as the Bank Secrecy Act and Reg Z, were not issued by NCUA. NCUA is responsible for enforcing these rules – but because these rules are statutory, NCUA cannot eliminate or modify them. Those changes would take an act of Congress.

For rules which NCUA can control, we will ensure that they are in sync with the modern marketplace, clearly written, and targeted to areas of risk.

Again, our intent is to target only those products, services, tools and relationships that pose the greatest threats to the Share Insurance Fund. Our targeted approach will affect only those behaviors most likely to cause losses which would be borne by credit unions.

So where there are risks, there will be regulations. But we need to be honest with ourselves here. There are times when our examiners have told credit union officials, "You should really follow NCUA guidance on this… or best practices on that."

And the credit union's response is: "Show me where it is in the regulations. If it's not a regulation, we do not have to do it."

Some credit union officials would prefer examiners to act like the British police that comedian Robin Williams described. According to Williams, British police

armed only with nightsticks are forced to shout to lawbreakers, “Stop! Or I’ll say stop again!”

But if we learned anything from the events of the last several years, it’s that everyone ends up paying a price for losses caused by a few.

And so, in the months ahead, you’ll see us pursuing modernization in two key areas.

The first is “safety and soundness.” We must continue to protect consumers – and the Share Insurance Fund – by helping credit unions manage risk.

The second initiative is clear, straightforward, “Regulatory Relief” – stripping away regulations that limit flexibility and growth.

Let me start with four proposed changes that are intended to enhance safety and soundness.

In recent years, loan participations have exploded in popularity. In fact, over the last five years, while most other types of loans declined, outstanding loan participations have increased more than 50 percent, from $8 billion to over $12 billion. Because some of these individual loans are very large and involve several credit unions, failure of one or more of these syndicated loans could cause a significant loss to the Share Insurance Fund.

This fall, the NCUA Board plans to consider a Loan Participation Protection rule which is intended to further strengthen safety and soundness.

The proposed rule will cover both originators and buyers of loan participations.

First, originators of these loans would have to retain some of the original loan risk on their balance sheets. They cannot solely reap the rewards while exporting all of the risk to other credit unions. Requiring originators to keep some “skin in the game” will provide a disincentive for the kinds of reckless behavior that puts the Share Insurance Fund at risk.

Second, the proposed rule would require participating credit unions to investigate these loans thoroughly – not just at origination, but with consistent, on-going due diligence, just like your credit union monitors in-house loans.   It’s crucial for

credit unions to be fully aware of the risks before they enter into participation agreements – and to monitor them closely.

Another safety and soundness rule involves Investment Concentration Exposure Limits.

By next year, we aim to limit concentrations in the riskiest investments. When I say "riskiest," I'm talking about investments like private-label mortgage-backed securities and collateralized debt obligations – assets which were directly responsible for the global financial meltdown. Consistent with prudential practices, less risky investments could be held in greater concentrations.

This proposed rule for consumer credit unions would be consistent with new standards for corporate credit unions. And it would ultimately mitigate investment risks throughout the credit union system.

We originally intended to issue this proposed rule last spring. However, we decided to postpone it until 2012 while we hammer out ways to reduce the compliance burden on credit unions.

On every NCUA rule, our goal is not just to get it out, but to get it right – by imposing the least possible burdens, especially on smaller credit unions, consistent with safety and soundness.

That's exactly what we proposed with the Interest Rate Risk Management rule. It would exempt all credit unions up to $10 million in assets – and also exempt credit unions up to $50 million if their interest rate risk is relatively low.

The idea behind this rule is simple: We cannot expect interest rates to remain at their historically low levels forever. With credit unions holding increased concentrations of fixed-rate assets at these historically low rates, any sudden upward rate shock could threaten the earnings of thousands of credit unions.

Other regulators have enforced strict rules on interest rate risk for many years.

Yet despite the fact that NCUA's proposed rule will not affect a majority of credit unions, our proposal appears to be controversial.

Why? Because there are already "guidelines" that govern interest rate risk.

But again, when our examiners try to get credit unions to adhere to the guidelines, credit union officials often push back, arguing that guidelines are just "suggestions."

So we need to turn this suggestion into a rule – in the name of making credit unions more secure.

"Stop – or I'll say stop again" – just won't get the job done.

Another important reform is the CUSO Risk Transparency rule, which is open for comments through the end of this week. This proposed rule is designed to provide transparency so that we will all get a better picture of the financial condition at virtually all CUSOs.

I assure you: NCUA understands the enormous value of CUSOs to many credit unions. CUSOs can provide essential back-office functions and affordable member services that some credit unions cannot offer on their own.

Because of the important role of CUSOs in the credit union industry, it is essential that they are financially healthy. That is certainly in the best interest of all credit unions.

Yet right now, NCUA has no regulatory authority over CUSOs. In fact, you may be surprised to learn that NCUA is the only federal financial regulator without authority to examine vendors.

To do our job, however, NCUA needs to be able to assess the risk, ascertain the exposure to the Share Insurance Fund, and advise credit unions of any CUSO problems.

Therefore, this rule would require credit unions to only deal with CUSOs that file annual reports on their audited financials.

And it sends a simple message: Those with nothing to hide have nothing to fear.

Speaking of transparency – at NCUA we continue to look for new ways to increase transparency. You can now sign up to receive all of our news releases and other important notices through a free e-mail system we call NCUA Express.

One of the new documents that you might find interesting is the NCUA Report. This monthly newsletter provides short, easy-to-understand articles on current issues. Just go to ncua.gov, follow the link to NCUA Express and type in your e-mail address. Once you sign up for NCUA Express, you will receive the NCUA Report and other important information. You will be the first to know about NCUA initiatives that affect your credit union.

And that brings me to five initiatives that will lessen your compliance burden and make leading your credit union into the future much safer and easier.

While on one hand, we're moving forward the Interest Rate Risk Management rule, on the other, we will be proposing a rule on Derivatives as an Interest Rate Hedge.

This rule will effectively provide new tools to manage balance sheet interest rate risk by allowing qualified credit unions to use simple derivatives.

As we sharpen our focus on behaviors, not credit unions, I believe that fast-growing, well-capitalized credit unions should not be punished for their success. That's why I've asked Congress to consider permitting supplemental capital and risk-weighted capital for credit unions.

It's also why, as part of a larger rule next year, we plan to propose counting subordinated debt toward risk-based net worth and assigning zero risk weights to most Treasury securities.

This is a way to provide real net worth relief. For credit unions with high concentrations of risky assets subject to higher net worth requirements, subordinated debt could provide a valuable form of supplemental capital. At the same time, the proposal would reward credit unions holding less risky assets, including Treasuries. Right now, only 7 percent of credit unions hold Treasuries. So I hope this proposal will ultimately encourage credit unions to purchase Treasuries as a liquidity backstop that could also be a source of income, backed by the full faith and credit of the federal government.

Giving you greater flexibility to grow, to thrive, and ultimately to serve more members also means modernizing old rules to remove unnecessary burdens.

For example, we've changed the Field of Membership rule, saving federal credit unions time and money.

In the past, community charter applicants had to hire consultants. No more.

They had to go through a very onerous, expensive, labor-intensive process to define a community for their field of membership. No more.

And after they did all of this, they still had to go through a lengthy approval process. No more.

If GEICO didn't have the rights to the line, I'd say that this process is now "so easy, even a caveman could do it."

We've also taken two steps to empower credit unions that serve low-income households.

The first was to remove the regulatory burden for credit unions serving low-income members in areas surrounded by higher-income residents.

The second was to streamline the Community Development Revolving Loan Program, which will be finalized this fall.

Today, only 56 low-income credit unions take advantage of Congressionally-appropriated loans from NCUA's Office of Small Credit Union Initiatives. Yet over a thousand low-income credit unions are eligible. We want to dramatically increase that participation.

So we've lowered the interest rates on these loans from 3 percent to below-market rates. We slashed the amount of paperwork credit unions need to fill out. And we're doing everything we can to let low-income credit unions know – NCUA has $12 million available to lend.

It's good for credit unions, and it's good for communities. So take advantage of it!

A final chapter of important regulatory history involves the RegFlex rule. What was originally intended to give credit unions more freedom became a growing threat to safety and soundness. So we eliminated four of the RegFlex provisions, although on key provisions we preserved a waiver option on a case-by-case basis.

And to provide more balance, we soon plan to propose extending six of the seven remaining RegFlex provisions to all federal credit unions. That is, there won't be

any hoops to jump through or paperwork to fill out. Any federal credit union will be able to take advantage of those six RegFlex benefits.

As a regulator, NCUA needs to make sure that credit unions comply with important safety and soundness rules. But we also want to make it as easy as possible for them to comply.

Because I know you will be talking to your senators and representatives this week, I'd also like to call your attention to two important legislative initiatives that NCUA is supporting, and for which I've advocated repeatedly.

As I said earlier, I'd like to see policymakers lift restrictions on member business lending. Small business owners need capital. So Congress should make it easier for credit unions to make small business loans.

In addition, I believe we should permit supplemental capital under some circumstances. Healthy credit unions should no longer be punished for taking new deposits. But with interest rates still at historic lows, new deposits lower the net worth ratio, which could become a weakness that by law must be remedied. Without supplemental capital, many credit unions have no choice other than to discourage new deposits.

It makes no sense that at a time when more consumers are discovering credit unions as a safe place to save, in effect, the law requires many credit unions to turn their deposits away!

I wholeheartedly believe healthy credit unions should be able to access supplemental capital to relieve the pressure that new deposits put on their net worth ratio.

These are areas in which we speak with one voice. I hope your voices in the coming days make a decisive difference.

Now let's look at the whole picture. I understand that many of you look at regulation as a potential impediment.

In fact, NAFCU's website makes its skepticism of regulation quite clear. One of NAFCU's primary goals is, and I quote, "lessened regulatory burden on credit unions."

But following directly on NAFCU's list of goals is "the preservation of federal credit unions."

And that's why effective – not excessive – regulation is so important.

That's why we're committed to balance – to ensure the safety and soundness of all credit unions, while allowing the industry to remain dynamic and competitive by providing regulatory relief wherever possible.

So when comment time comes, take the time to evaluate proposed rules. We do want to hear from you! I urge you to consider how the proposal would affect riskier credit unions – and how that would protect your credit union from paying for their losses.

Before I leave you today, I'd like to take a moment to reflect on a goal I set during my first speech as NCUA Chairman. In September 2009, I said to this very gathering, that I hoped by the end of my term, credit unions would be serving 100 million members – because that milestone would be good for you, and good for America.

I still believe that. And that is ultimately what our efforts are about – putting in place the foundation for long-term growth.

We're fortifying the structure of credit unions, while also shaking off the rust of inertia. And we're fixing the structural issues that have threatened the safety of the credit union industry.

But modernization doesn't mean getting rid of everything that came before.

I began with a little history about this hotel, and that's where I'll end.

After World War II, the Mayflower was not in ideal shape. Skylights were covered up, and decorations were in disrepair.

So the owners undertook a series of renovations to restore the classical flourishes. More recently it was renovated again when the management recognized that the rooms needed to have all the modern amenities expected at a luxury hotel. They could not simply be a throwback to an earlier time, preserved and unchanged.

Neither can the credit union industry; nor can NCUA.

We all envision a vibrant, relevant credit union industry that continues to succeed in the future.

NCUA is dedicated to finding modern, effective ways to ensure that all of you achieve success. Only then will we truly have nothing to fear – and everything to gain.

Thank you.