The NCUA Report

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National Credit Union Administration

NCUA explains corporate credit union crisis in plain English

DVDs Being Sent to All Consumer Credit Unions

The significant losses associated with corporate credit union investments have been a major issue for the past two years. During this time, NCUA has issued numerous letters and continuing guidance related to the impact of corporate credit unions' losses on the overall credit union system. However, because of the complexity of this issue, many stakeholders are still struggling to understand what has occurred and what the NCUA proposal is all about.

Because credit union board members will be making the important decision about whether to recapitalize a corporate, it is essential that they be well informed on this complex issue. To make sure that this occurs, NCUA is finalizing a DVD presentation to explain, in plain English, the history of corporate credit unions, the evolution of the crisis and NCUA's proposed resolution. The presentation consists of three sections:

- **Section 1** provides a brief history of corporate credit unions and the services they provide to consumer credit unions.
- **Section 2** explores the factors that led to the economic crisis and explains why the economic downturn had such a strong impact on the financial condition of corporate credit unions.
- **Section 3** summarizes the impact the crisis has had on all federally insured credit unions and the actions NCUA has taken to stabilize the credit union system and bring about a least costly resolution to the crisis.

The presentation is expected to be available for download from the NCUA website by May 31. NCUA will also send a complimentary DVD to all federally insured credit unions. For more information on the availability of the DVDs, please contact our Office of Public and Congressional Affairs via **pacamail@ncua.gov**.

INSURANCE FUND REMAINS STRONG
NCUA Chairman Debbie Matz and NCUA Board Member Michael Fryzel met with Illinois Governor Pat Quinn (center) during the Illinois Credit Union League's 80th Annual Meeting in Chicago. During her keynote address, Chairman Matz updated more than 700 credit union officials on the health of the National Credit Union Share Insurance Fund (see page 3), and anticipated that audits of NCUA's financial statements would be finalized within the next several weeks. Full text of Matz's speech is posted at **http://www.ncua.gov/GenInfo/Members/Matz/Speeches.aspx.**

HIGHLIGHTS

Chairman's Corner

RegFlex revisions will strengthen safety & soundness

My number one goal as Chairman of NCUA is to set the highest standards for safety and soundness. From Day One of my term, I have emphasized that credit unions must be aggressive about managing their risks and performing due diligence.

My concern about safety and soundness has caused us to review many of our regulations to ensure that they are not permitting credit unions to make overly risky business decisions. To this end, in March the NCUA board proposed amending certain provisions of the Regulatory Flexibility (RegFlex) program. I encourage you to read this proposed rule and consider the important lessons we have learned over the years.

I served on the NCUA Board when RegFlex was first approved in 2002. I voted for the original version because I believed RegFlex would reward well-run credit unions by exempting them from certain regulations without jeopardizing safety and soundness.

But after my first term on the NCUA Board ended in 2005, the net worth requirement for federal credit unions to qualify for RegFlex was lowered from 9 percent to 7 percent. At the same time, RegFlex was expanded to add more exemptions from safety and soundness regulations. These changes allowed the vast majority of federal credit unions to take additional risks—risks that further reduced many RegFlex credit unions' capital.

Over the past four years, hundreds of former RegFlex credit unions have experienced operating weaknesses and have been subject to enhanced supervisory oversight by NCUA.

Of course the economic recession was a major factor. But for too many credit unions, regulatory exemptions hastened their decline.

The preamble to NCUA's newly proposed RegFlex rule outlines just a few real-world examples. Unfortunately, there are many cases like this:

In December 2006, one credit union had fixed assets of only 1.5 percent of total assets. Management projected that the credit union could grow by building a new main office in 2007. As a RegFlex credit union, it was exempt from NCUA's fixed asset limit of 5 percent—so the building cost was not an issue. But due to the economic downturn and building cost overruns, results fell far short of projections. Since 2007, the credit union's net income has been negative. By late 2008, fixed assets had risen to 17.5 percent of total assets, largely due to building costs. Now the credit union is seeking a merger partner. But it has not found one. The ongoing cost and devaluation of the main office has proven to be a deterrent to potential partners.

Other credit unions have suffered severe losses—and even collapsed—after neglecting to require personal guarantees on member business loans, failing to stress-test their investments, or delegating discretionary control to third-party investors who lost more than 100 percent of the credit unions' net worth. All of these exemptions were authorized by RegFlex.

This is why the proposed RegFlex revisions are so critical. By restoring these four common-sense safety and soundness standards —limiting fixed assets to 5 percent, requiring personal guarantees on MBLs, stress-testing investments, and delegating no more than 100 percent of net worth to third-party investors—credit unions will have greater protections for their hard-earned capital.

Yet credit unions will still have some flexibility. Two of the limits will be phased in, so that credit unions will not have to immediately sell fixed assets or delegated investments in order to come into compliance. Credit unions will still have the right to appeal for waivers from NCUA regional offices. And RegFlex credit unions will still be exempt from six other rules that don't directly impact safety and soundness.

Especially during these difficult economic times, it's a tremendous challenge to balance the credit union industry's need for strong regulation and individual credit unions' need for regulatory relief. But I believe NCUA's proposed RegFlex changes do exactly that.

Debbie Matz

Debbie Matz

Senator recognizes NCUA's small-loan proposal

Hawaii Senator Daniel K. Akaka drew attention to NCUA's newly proposed small loan program in his April 30 statement on the floor of the U.S. Senate when emphasizing the great need for working families to have access to affordable small loans:

The National Credit Union Administration has provided assistance to develop these small consumer-friendly loans. More working families need access to affordable small loans.This program will encourage mainstream financial service providers to develop affordable small loan products.

The full text of Senator Akaka's statement on financial literacy and the need for financial reform is available online at **http://akaka.senate.gov/press-releases.cfm?method=releases.view&id=af60e153-f985-4d9c-a37d-b19de7392dbe**.

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* April 29, 2010

ALTERNATIVE PAYDAY LOANS PROPOSED

The NCUA Board issued proposed rule §701.21, with a 60-day comment period, to provide federal credit unions with the ability to offer a viable alternative to onerous payday loans by proposing closed-end, short-term, small (STS) loans charging a maximum 28 percent APR.

After extensive research and thoroughly reviewing FDIC's small dollar loan pilot program, NCUA's proposed STS loan program includes:

- STS loans are between $200 and $1000;
- Minimum loan term is 1 month and maximum term is 6 months;
- FCUs make only one STS loan at a time to a borrower and make no more than three STS loans in any rolling 6-month period to one borrower;
- FCUs cannot roll over an STS loan;
- FCUs charge an application fee to all members applying for a new STS loan that reflects actual costs associated with processing the application, provided the application fee does not exceed $20; and
- FCUs implement appropriate underwriting guidelines to minimize risk, and their written lending policies include a cap on the aggregate number and aggregate dollar amount of STS loans made.

While the FCU Act stipulates a 15 percent lending ceiling, the NCUA Board has authority to adjust the loan ceiling. This proposal would amend NCUA's general lending rule by permitting FCUs to charge an APR for STS loans 1,000 basis points above the general interest rate ceiling.

Additional information in the proposal includes STS loan program guidance and best practices that address program features, minimum underwriting standard requirements, and risk avoidance strategies. The proposal also requests specific comment on using an all inclusive 36 percent APR, minimum membership requirements, and a requirement that members participate in direct deposit or payroll deduction as a condition of receiving credit under the rule.

CORPORATE CAPITAL WAIVER EXTENDED

The NCUA Board extended a waiver permitting corporate credit unions to (1) continue using their November 30, 2008, capital level to determine regulatory compliance with capital-based requirements and limitations in the corporate rule, (2) establish a new termination date for the waiver one year after final amendments to Part 704 are published in the *Federal Register*, and (3) delegate authority to the corporate credit union office director to modify or restrict the waiver.

NCUA's corporate rule has several provisions setting regulatory limits and requirements based on corporate credit union capital. 2007 and 2008 losses associated with mortgage-backed security investments severely impacted corporate credit union capital. And many corporates experienced a loss with U.S. Central's write-down of paid-in capital and membership capital investments.

To ensure uninterrupted service to natural person credit unions, in April 2009 the NCUA Board approved a waiver and issued an Order permitting corporate credit unions to use the capital level reported on November 30, 2008, call reports when determining certain capital-based requirements and limitations in the corporate rule. Terms of the 2009 Order terminates the waiver on the effective date of final amendments to Part 704 of *NCUA Rules & Regulations*.

Proposed amendments to Part 704 provide corporate credit unions with one year after publication of the final rule before the new capital requirements become effective. To ensure continued access to services for natural person credit unions during this one year time frame, the Board is permitting corporates to continue to use November 30, 2008, capital levels out to the one year anniversary of Federal Register publication of final Part 704.

Extending the use of past capital levels is strictly an interim measure. As proposed amendments indicate, NCUA intends to strengthen corporate capital standards to align them with international Basel standards. This extension period gives corporate credit unions a fair chance to consider and implement new capital standards and also to address the resolution of legacy assets.

SHARE INSURANCE FUND REPORT

NCUA's Chief Financial Officer reported the Fund's reserve balance totaled $726.7 million March 31, 2010, with $7.1 million charged to insurance loss expense thus far in 2010.

March 2010 ended with an NCUSIF equity ratio of 1.26 percent based on the amount of shares held by the nation's federally insured credit unions at year-end 2009. Credit unions are submitting $267 million in a 1 percent capitalization deposit adjustment, which was due April 15, 2010.

Eight federally insured credit unions have failed thus far in 2010 at a cost to the Fund of $12 million.

There were 349 CAMEL code 4&5 credit unions at March 31, 2010, representing 5.68 percent of total insured shares as of December 31, 2009. This is 12 more CAMEL code 4&5 credit unions than were reported last month.

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

- 81.49 percent of assets are held in CAMEL code 1&2 credit unions;
- 13.16 percent of assets are in CAMEL code 3 credit unions; and
- 5.35 percent of assets are held in CAMEL code 4&5 credit unions.

Through March, NCUSIF's annual revenue and expenses included total income of $65.9 million and total expenses of $43.1 million, resulting in net income of $22.8 million.

During March, reserves for the Temporary Corporate Credit Union Stabilization Fund were increased by just over $1 billion. This increase was based on analysis that showed a significant decline in the level of cash flows for mortgage-backed securities at corporate credit unions. This reduced level of cash flows resulted in a significant increase to the Stabilization Fund's exposure to losses, requiring the increase to reserves.

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

Appearance calendar

Date: June 2, 2010
Who: Board Member Gigi Hyland
Event: Women's Leadership Symposium
Location: Chicago, IL

Date: June 4, 2010
Who: Chairman Debbie Matz
Event: 2010 Women's Leadership Symposium
Location: Chicago, IL

Date: June 4, 2010
Who: Board Member Gigi Hyland
Event: Nebraska Credit Union League Annual Meeting & Convention
Location: Lincoln, NE

Date: June 9, 2010
Who: Board Member Gigi Hyland
Event: NFCDCU 36th Annual Conference on Serving the Underserved/6th Latino Credit Union Conference
Location: Pittsburgh, PA

Date: June 10, 2010
Who: Board Member Gigi Hyland
Event: NACUSAC Annual Convention & Exposition
Location: Baltimore, MD

Date: June 11, 2010
Who: Chairman Debbie Matz
Event: NFCDCU 36th Annual Conference on Serving the Underserved
Location: Pittsburgh, PA

Date: June 11, 2010
Who: Board Member Michael Fryzel
Event: Ukrainian National Credit Union Association Meeting
Location: Yonkers, NY

Date: June 28, 2010
Who: Chairman Debbie Matz
Event: MACUMA Monthly Meeting
Location: Arlington, VA

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

CAPITAL MARKETS

Investment Alternative—Certificate of Deposit Account Registry Service

As credit unions struggle to find viable investment alternatives, more and more are considering the merits of the Certificate of Deposit Account Registry Service (CDARS) and rightly questioning the permissibility of this activity.

The CDARS program was started by the Promontory Interfinancial Network, in July 2002, as a deposit-placement service. It was designed to allow FDIC-insured depository institutions (relationship institutions) to accept deposits over the standard FDIC insurance limit and to obtain full principal and interest coverage for the depositor by spreading the funds among as many separate FDIC-insured institutions (issuing institutions) as necessary so that no institution would hold more than the standard FDIC insurance limit for each depositor. The FDIC issued an opinion stating that deposits placed with banks using the CDARS network are eligible for deposit insurance as custodial accounts on a pass-through basis.

A CDARS Deposit Placement Agreement provides the terms and conditions upon which the relationship institution will place a depositor's funds with other issuing institutions and act as the depositor's custodian with respect to the certificates of deposit (CDs). BNY Mellon acts as a clearinghouse between relationship institutions and issuing institutions and acts as a sub-custodian with respect to the CDs.

Federal credit unions purchasing CDs through a relationship institution must comply with NCUA's rules on broker-dealers (§703.8) and safekeeping of investments (§703.9). Primarily, credit unions may purchase CDs through a financial institution that is part of the CDARS network, provided the institution's broker-dealer activities are regulated by a federal or state regulatory agency. In addition, the relationship institution may act as a safekeeper for the credit union's CDs, pursuant to a written custodial agreement requiring the safekeeper exercise at least ordinary care.

As with any investment transaction, credit unions should fully evaluate the suitability of the CD in relation to its business plan, asset liability management strategies, liquidity, and net worth position.

How green is NCUA?

FROM GIGI HYLAND

Funny, you should ask.

After being named Chairman in 2009, Ms. Matz set forth a goal—and a challenge—for NCUA. The goal stated: "NCUA will be a model corporate citizen recognizing the responsibility to implement environmentally sound practices and procedures whenever and wherever feasible." Transforming this goal into action became a reality with the launch of ***greeNCUA*** at this year's NCUA regional conferences in April.

The ***greeNCUA*** initiative, described on NCUA's employee Intranet, highlights ways that NCUA and its employees can be green in our buildings, offices, homes and on the road. For example, the site provides recycling information for all NCUA offices and lists how each building is working toward increasing energy efficiency and being green. The site also has a green "tip of the day," and *The Green Scene* newsletter highlights what examiners, regional and central office staff do to live and work green.

In addition, ***greeNCUA*** has a wealth of information about government and nongovernment green efforts, including information on the Energy Star program, links to the Environmental Protection Agency, Earth911 Guide to Recycling and the Green Guide by National Geographic.

All this work is thanks to a dedicated and committed group of NCUA employees: MaryAnn Woodson, Sharon Burlas, Dena Contompasis, Pavla Decoteau, Fred Haines, Staci Hawkins, Trish Krobath, Christy LaPointe, Jess Vogel and Jeri Walker. A sincere thanks to this committee for all its efforts to help the agency achieve its corporate-citizenship responsibilities to the environment.

Tough times, tough decisions

FROM MICHAEL E. FRYZEL

Have you noticed that when the economy is good, everything seems so much easier? People's moods are more pleasant, there are more smiles to go around, and attitudes are more positive. When the economy is adverse, everything seems to take a turn for the worse. People's attitudes are less pleasant and moods tend to be more negative. So, as we begin moving toward recovery, according to some economists, what is the mood within the industry?

I have had the opportunity to talk to thousands of credit union advocates over the last 20 months. I have seen the expressions on their faces and heard the tones in their voices. From what I am hearing and seeing, people's moods are changing. Instead of looking to the past seeking fault and blame, they are now looking ahead to real-life solutions. Today, there are those in the industry focusing on answers and seeking the smallest offering of good news. They want things to get better for their credit unions and for their members.

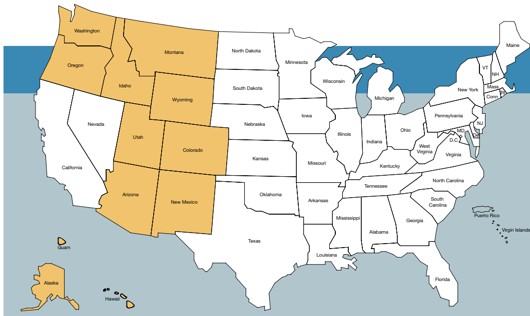
At NCUA, we are striving for resolution within the credit union industry. So how can we move forward? We need to acknowledge what occurred and to recognize that all of us—the regulator and the regulated—could have done a better job. Having done that, we must continue working together to do our best to solve the problems we are faced with, to make needed changes and to put into place the safeguards necessary to prevent future problems.

As the agency moves to implement new rules, tighten our examination procedures, strengthen existing rules, and take necessary administrative actions, tough decisions will continue to be made. While tough decisions may not be embraced with open arms or be the most popular, I would be remiss if I did not share with you that decisions will only be made after all voices that want to be heard are heard, all comment letters are read, every alternative is explored, all ideas inside and outside the box are fully vetted, and the best interests of more than 90 million members are considered with the principles of safety and soundness foremost in our decision making.

The best decisions, especially tough ones, are made when we have all the facts and as much input as possible. Only then can we clearly see the choices, evaluate the consequences and decide upon the best possible path.

It is never easy to make hard decisions that will affect people, especially when times are tough. However, credit unions are much more than tax-exempt financial institutions. They are the story of service and commitment to members. They have a passion to survive and be stronger and a willingness to do so in a way that prepares for future success.

As the NCUA Board looks ahead and continues to make tough decisions, we must work in partnership as we strive toward the days of growing financial strength and health for the entire industry.



Region V

Region V in Transition

Region V, headquartered in Tempe, Arizona, consists of 11 states and one territory. In prior years, we supervised 13 states and Guam; however, the supervision of Nevada and California was transferred to Region I and Region II in 2009 and 2010, respectively. Reassignment of these supervision responsibilities ensures that emerging risks in California and Nevada have the appropriate resources.

NEW LEADERSHIP, EXPANDING FIELD STAFF

Change in workload has come with many personnel changes. A series of new appointments were made in Region V. Elizabeth A. Whitehead was selected by the NCUA Board as the new regional director. Mike Dyer is the newly appointed associate regional director of Operations, and Jon Flagg is the newly appointed associate regional director of Programs. Each Region V division (Supervision, Insurance, Special Actions, and Management Services) has experienced significant personnel changes as well.

Region V hired 19 more field examiners in 2009 and expects to continue hiring throughout 2010. Accelerated hiring ensures our field examiners have the sufficient resources and time to appropriately identify, address and monitor significant risk areas.

ECONOMIC EFFECTS, PROACTIVE RESPONSE

Region V has faced many challenges in recent years. The weak economy and declining real estate market caused many credit unions in Region V to financially deteriorate. In the aggregate, Region V credit unions experienced a decline in net worth, negative earnings, and increased delinquencies and charge-offs throughout 2009. As risk increases, the need grows to mitigate risk. Risk mitigation is accomplished by scheduling more frequent contacts, ensuring corrective actions are implemented by management, and continually monitoring a credit union's financial position.

Through years of dealing with large, complex credit unions with rapidly changing risk, Region V implemented many proactive measures, such as regional models and risk reports. For example, a "Flag Report" is generated on a quarterly basis that identifies multi-layer risks at credit unions. This "Flag Report" looks at 56 credit union ratios and assigns a score for any ratio exceeding the established benchmark. Many of the ratios compare risk exposure to net worth. Other ratios measure growth, liquidity and interest rate risk. In 2009, the "Flag Report" was used to select credit unions for a targeted supervision contact. Contacts focused on credit unions displaying elevated levels of concentration, credit, interest rate and liquidity risks.

With strong organizational leadership and proactive supervision measures in place, Region V will continue helping fulfill NCUA's mission to ensure the safety and soundness of credit unions.

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