The NCUA REPORT

NATIONAL CREDIT UNION ADMINISTRATION

JANUARY 2011 NUMBER 1 WWW.NCUA.GOV

HIGHLIGHTS

FINANCIAL LITERACY PROVISIONS APPLY TO ALL FCU DIRECTORS

NCUA's new rule governing fiduciary duties of federal credit union directors will take effect on January 27, 2011; and compliance with the financial literacy provisions will be required by July 27, 2011.

All FCU directors—including current directors—must have the ability to read and understand their credit union's balance sheet and income statement. Specifically, the new rule states:

"Each FCU director has the duty to... At the time of election or appointment, or within a reasonable time thereafter, not to exceed six months, have at least a working familiarity with basic finance and accounting practices, including the ability to read and understand the FCU's balance sheet and income statement and to ask, as appropriate, substantive questions of management and the internal and external auditors...."

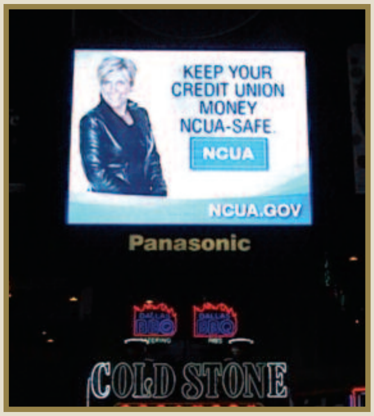
Current and new directors who do not yet have this ability should plan to receive financial literacy training in 2011.

Federal Credit Union Directors	Financial Literacy Compliance Date
Current Directors	July 27
New Directors Elected Before January 27	July 27
New Directors Elected After January 27	6 Months After Election

Training will be available in workshops presented by NCUA's Office of Small Credit Union Initiatives, at **www.ncua.gov**, as well as through private sector providers.

"Volunteers are the heart and soul of the credit union community," said NCUA Chairman Debbie Matz. "I share the concern expressed by many commenters about the difficulty some have in recruiting volunteers. Our goal is not to make that job any more difficult, but to strike a fine balance between recruiting volunteers and ensuring that they understand their fiduciary responsibilities. We have structured our rule to focus on training and retaining qualified directors, and we believe that the changes promote good governance."

The NCUA Board approved the new rule to document the fiduciary duties of directors and better protect credit unions and their members. *(See the Board Actions on page 3.)*



CU Money is NCUA-Safe

NCUA's consumer education campaign has earned over $2.6 million in free advertising across America. Public service announcements featuring Suze Orman promote the safety of credit unions' federal deposit insurance in multi-media: national and local TV, radio, bus shelters, mall posters. and the message board above one of the nation's busiest intersections — New York's Times Square.

CHAIRMAN'S CORNER

Understanding the Role of the Regulator

Debbie Matz
Chairman

Clearly there is a great deal of stress in the credit union industry, and I certainly understand the angst that credit union officials are feeling. They are paying a heavy price for losses — at other credit unions. At the same time, their own credit unions are dealing with tight budgets, narrow margins, and members who are struggling to make payments.

I also understand that NCUA is an easy target at which credit union officials can unload their frustration. During tough times when the financial conditions of many credit unions are declining, some do not understand why NCUA must strengthen regulatory resources to protect safety and soundness.

Effective regulation, however, is counter-cyclical. This means regulators need more resources — not less — during their industry's lean years. NCUA is not unique in this regard. For example, FDIC raised its budget 55% last year before leveling off this year.

At NCUA, we have been working to keep our budget increases as low as possible, budgeting only for necessary items. This includes hiring and training the staff needed to return to an annual examination program so we can catch and correct problems in credit unions earlier.

NCUA's enhanced supervision program is designed to ensure that the credit union industry will get through these tough times stronger and more resilient. Unfortunately, some credit unions — for a variety of reasons — will not make it through. But our goal is to keep the costs of resolving those failing credit unions as low as possible.

> *"NCUA will not sacrifice safety and soundness as we work to help the credit union industry recover in the coming years."*

Minimizing Credit Union Losses

In fact, we completed 2010 with 28 consumer credit union failures — five times fewer failures than the banking industry.

The costs of those credit union failures amounted to less than $300 million. However, the National Credit Union Share Insurance Fund had budgeted for losses of $750 million — because at the beginning of 2010, there were dozens more credit unions in danger of failure.

While the public only sees the failures, regulators also see the successes. For every failure, we have many more cases where we have helped credit unions avoid losses to the Share Insurance Fund.

Fortunately, as we enter 2011, some of the endangered credit unions are stabilizing under strong supervision. If we are able to hold the line on failures this year, we will again save credit unions hundreds of millions of dollars in potential losses.

It is important to note that NCUA does not charge credit unions for the dollars budgeted in the Insurance Fund or the NCUA budget. Credit unions are only charged for the dollars spent.

Already we know that one line item in the 2011 NCUA budget will not be spent. Effective January 1, President Obama signed a pay freeze affecting federal workers whose salary increases were not negotiated under existing union contracts.

NCUA will certainly honor the pay freeze for all affected employees – and we will reduce our budget accordingly. The cost savings will be shown in July when the NCUA Board conducts our annual mid-year budget review.

Sharing Sacrifices

As President Obama said, "Federal workers are not just a line in a budget. They are public servants who, like their private sector counterparts, may be struggling in these difficult economic times."

So please understand that many NCUA employees will be making their own sacrifices along with credit unions.

But I assure you: NCUA will not sacrifice safety and soundness as we work to help the credit union industry recover in the coming years.

Debbie Matz

BOARD ACTIONS December 16, 2010

Final rules adopted to protect members

The NCUA Board approved, by a 2-to-1 vote, final amendments to NCUA rules Parts 701, 708a and 708b to better protect credit union member rights and ownership interests. Effective 30 days after publication in the *Federal Register,* the rule amendments: (1) create new §701.4 to address fiduciary duties of FCU directors; (2) create new Subpart C of Part 708a to address credit union to bank mergers; and (3) revise existing rules on charter and insurance conversions in Parts 708a and 708b.

New fiduciary duty rule §701.4 requires all FCU directors to carry out their duties in good faith, in a manner reasonably believed to be in the best interests of the membership of the credit union, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances, and within six months learn to read and understand the credit union's balance sheet and income statement. Also, §701.33 is amended to prohibit FCUs from indemnifying officials or employees for liability associated with misconduct that is grossly negligent, reckless, or willful in connection with a decision that adversely affects the fundamental rights of members. The credit union may, however, purchase liability insurance and/or advance funds to a director if the director needs the funds to prepare a legal defense and the credit union believes the director will not be found liable.

New Subpart C of Part 708a establishes procedural and substantive requirements for converting a credit union to a bank through merger. New requirements for merger valuation, regional director approval, member disclosure, and member participation are intended to ensure that members' interests are protected during the process of converting to a non-credit union charter. The new requirements apply to direct mergers as well as transactions where the credit union first converts to a mutual savings bank (MSB) and then merges with another bank without operating as a stand-alone MSB.

Finally, the proposed amendments to Parts 708a and 708b revise existing rules to enhance the secrecy and integrity of the voting process in MSB and insurance conversions and require additional disclosures to members about the cost and effect of charter conversions.

More flexible low-income qualification proposed

The NCUA Board issued proposed qualification criteria that would enable federal credit unions to add the option of using sample data from loan files or a member survey to meet low-income designation requirements.

Issued with a 60-day comment period, the Section 701.34 amendment would permit a federal credit union to rely on a sample of membership income data drawn from loan files or a member survey. The FCU must demonstrate the sample is a statistically valid, random sample by submitting, along with data, a narrative describing the sampling technique and evidence supporting validity of the analysis, including actual data used in the analysis.

A low-income designation authorizes FCUs to accept non-member deposits, raise supplemental capital, apply for NCUA grants, and earn an exception to the member business lending cap.

Federal insurance statement proposed for advertising

The NCUA Board issued, by a 2-to-1 vote, a proposal to revise provisions within the advertising rule to require the official NCUA advertising statement appear in all radio and television advertisements, annual reports, and statements of condition required to be published by law. The verbal statement can be as brief as "Federally insured by NCUA." The Part 740 proposal, issued with a 60-day comment period, also defines the term "advertisement" and clarifies size requirements for the official advertising statement in print materials.

Low-income definition amended

The NCUA Board amended the definition of "low-income members" in §701.34 to clarify that, when comparing credit union data on member income with Census Bureau data to determine if a credit union qualifies as low-income, the comparison must be between like data categories. The rule was previously issued as an interim final rule, which became effective on publication August 5, 2010, and is being published now as a final rule without change.

Insurance unlimited on noninterest-bearing transaction accounts

The NCUA Board issued a proposed rule amending Part 745 to clarify the insurance protection provided by the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

The Dodd-Frank Act provides that through December 31, 2012, the NCUA Board, in addition to insuring member accounts up to at least $250,000, shall fully insure the net amount that any member or depositor at an insured credit union maintains in a noninterest-bearing transaction account.

While this insurance protection is self-implementing and already in place, this proposed rule would: (1) clarify the definition of the term "noninterest-bearing transaction account;" (2) provide that this new insurance coverage is separate from, and in addition to, other coverage provided in NCUA's share insurance rules; and (3) impose certain notice and disclosure requirements. The proposal was issued with a 60-day comment period.

CONTINUED ON PAGE 7

Credit Union Vendor Information No Longer Public

FROM GIGI HYLAND

Several months ago, I was made aware of a concern regarding identifying the software solution credit unions use in the "Credit Union Online Profile" section of the NCUA website. The concern included worry that hackers or former employees of the software vendors could use their knowledge of the particular system weaknesses to compromise the credit union's system.

The agency looked at the issue extensively and decided to make an important change to publicly available credit union information. Beginning with the June 30, 2010 Call Report cycle, we removed vendor names from the public view in Credit Union Online and the 5300 Call Report Quarterly Data Files. Similarly, effective in the near future, this vendor information will no longer be available to query from the NCUA website. Freedom of Information Act (FOIA) requests for vendor data will be denied.

The information security threat landscape has changed significantly in recent years. Further, new threats continue to emerge at an alarming rate. Hacking techniques are becoming increasingly sophisticated and their damage more devastating. The financial services industry has been a target in this escalating threat environment. Restricting vendor information will reduce the exposure of credit unions' operational and member information to external security risks.

NCUA will continue to collect vendor names through Credit Union Online, as they provide useful information in case of a disaster, such as Hurricane Katrina; when a vendor failure appears likely; and as a measure of potential systemic risk, present when one or a few vendors dominate the market for credit union data processing systems. Credit unions wishing to perform due diligence over current or prospective vendors may be able to obtain existing customer contact information from the vendors themselves.

We value the service our nation's credit unions provide to consumers, and we will continue to provide guidance to ensure the safety and security of credit union information systems.

Game Change

FROM MICHAEL E. FRYZEL

Every two years, the citizens of our country release some of the players in the congressional league and bring in a number of rookies. Depending on the number of new players, management positions may change as well.

This past November, voters filled out their lineup cards and there are lots of new faces that will be playing and managing the game.

Changes like this take place when citizens become dissatisfied and believe that the legislative game has become stagnant and the players are not producing as they should. Citizens like results. Citizens like action and they like those playing the game to achieve the results that they want and make them believe the players are doing their jobs well.

The schedule for the last two years has been a difficult one. The games have been closely played and won or lost by just a few runs. Neither of the teams have been outstanding or provided the results the citizens want.

Sometimes, in an effort to get the players they want to play the game the way they would like it played and achieve their results, citizens form interest groups. These interest groups help the players get selected and work to keep them in the game if they produce to the satisfaction of the group.

Credit unions are one of the many interest groups that are part of the game. They are actively involved in selecting the players and helping those who perform to their satisfaction. Credit unions compete with other interest groups who support their own players. Usually, the interest groups with the deepest pockets field the players who score the most runs and win the most games. The recent election resulted in a substantial change in the players as well as their management. It's a new ball game.

Will credit unions succeed in rallying their players to score for them? Did they pick the right players in the November draft? Will they pursue a winning agenda?

Without question the competition for success is going to be fierce. Credit unions have much at stake. Everyone will watch with great interest how their leaders work with the new players. Who will determine the winners and losers? This is America's favorite pastime. Play Ball!

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

Office of Public & Congressional Affairs
Cherie Umbel, Editor

National Credit Union Administration
1775 Duke Street, Alexandria, Va. 22314-3428

Examination & Insurance Report

RISK MANAGEMENT FOR MOBILE BANKING

New and emerging electronic banking services

Mobile banking is the fastest growing electronic banking (e-banking) service in credit unions. The rapid adoption rate has many credit unions and their examiners interested in best practices for sound implementation and risk management for these new services. Below are some best practices credit unions should consider for mobile banking as well as other forms of electronic banking.

RISK ASSESSMENT — Proper risk assessment prior to implementation of new e-banking services is essential. In addition to protecting the privacy of consumer information, credit unions need to consider other operational risks associated with the new service, such as strategic, transaction, and reputation risk.

COMPLIANT AUTHENTICATION — Most mobile banking applications should require multifactor authentication. The most prevalent approach seen is the use of "challenge questions" which carry over from Internet banking. Authentication credentials such as the user name and password required to log into the application should not be predictable or easily guessed. This can be controlled by requiring a combination of numbers, letters and keyboard characters to make an acceptable password. The application should time out after short periods of inactivity due to the increased potential for loss of a mobile device.

APPROPRIATE RISK LIMITS — The system should have per transaction limits. Credit unions should consider limits per day and other time periods such as multiple days or a week.

SUBCONTRACTING — Is there a subcontracting relationship that requires additional due diligence? For example, does the mobile banking contract fall under an umbrella contract for Internet banking? The contract should list subcontractors and require credit union approval for significant changes. Credit unions should also consider whether a direct contract is preferable.

E-BANKING MONITORING:

Policies and procedures are necessary to adequately monitor the service. Risk areas to consider in a formalized e-banking monitoring program include:

- Bad login attempts
- Cross-account transfers
- Large or unusual transaction activity
- Changes to critical information (address/phone number/e-mail)
- Administrator activity
- New enrollments
- Password resets

CUSTOMER AWARENESS — Mobile devices can be especially useful for performing "out of band" verification of other home banking channel transactions such as Internet banking. However, members should be aware that both channels are subject to potential compromise.

Credit unions should draw upon established regulatory guidance and apply those standards to new and emerging e-banking services such as mobile banking. The 2005 FFIEC authentication guidance (reference Letter to Credit Unions 05-CU-18) applies not only to Internet banking, but other forms of electronic banking with similar functionality. NCUA is currently developing a new e-banking work program in the form of updated examination questionnaires. Watch for a letter to credit unions in 2011 to announce the issuance of these new questionnaires.

John D. Worth
Chief Economist

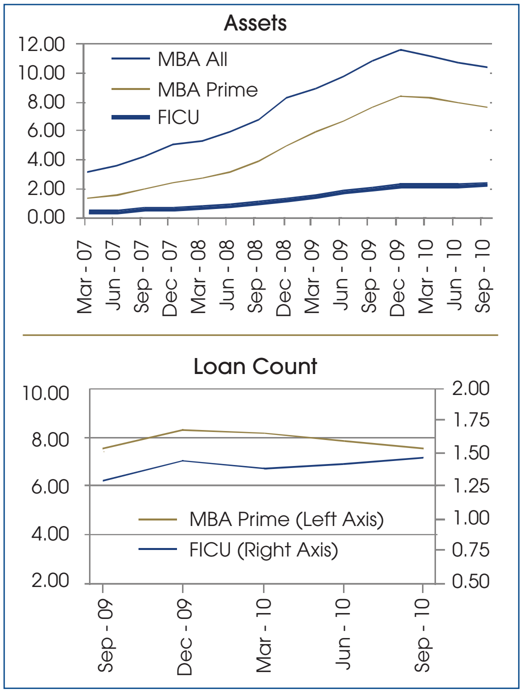
Chief Economist Report

TRENDS IN MORTGAGE DELINQUENCY — HOW DO CREDIT UNIONS COMPARE?

This month's column compares trends in first-lien, mortgage-delinquencies at credit unions with aggregate trends from the Mortgage Bankers Association National Delinquency Survey (MBA-NDS). The comprehensive MBA-NDS covers approximately 85 percent of mortgages, including most government-sponsored enterprise (GSE) backed loans, loans in major bank portfolios and many loans in private-label securities.

Delinquency rates in the MBA-NDS are based on the number of delinquent loans. Until September 2009, the NCUA Call Report only required delinquency information denominated in unpaid principal balance (UPB). Counts of delinquent loans were added and have now been available for five quarters. The new data element allows better comparability between credit union and aggregate loan performance.

Mortgage Delinquency Rates



National delinquency trends

The figures to the right show comparative shares of loans 60 or more days past due (including in foreclosure).[1] The top panel compares the percentage of delinquent UPB for federally insured credit unions (FICUs) with the percentage of all delinquent loans and the percentage of prime-only loans from MBA-NDS. The bottom panel compares the percentage of delinquent FICU loans with prime MBA-NDS. By either measure, FICU mortgages are clearly performing better than mortgages in the aggregate, even when the sample is restricted to prime loans, with the FICU rate almost 650 basis points below the national prime loan delinquency rate. This pattern also holds across loans types; both FICU fixed-rate mortgages and ARMs have lower delinquency rates than MBA-NDS.

Despite their higher level, aggregate delinquencies have started to decline while credit union delinquencies continue to rise. MBA-NDS delinquency rates peaked in the 4th quarter of 2009 and have declined for three consecutive quarters. In contrast, FICU mortgage delinquencies continue to rise, albeit at a slower pace than during 2008 and 2009. Between the 4th quarter of 2009 and 3rd quarter of 2010, the MBA-NDS delinquency rate on all loans fell by 40 basis points to 10.22 percent and the prime delinquency rate edged down 2 basis points to just under 7.5 percent. Over the same time, the FICU delinquency rate rose 33 basis points from 1.93 to 2.26 percent.

Comparing the two measures from NCUA Call Reports, the delinquent percentage of UPB is consistently around 50 percent higher than the delinquent percentage of loans. For example, September 2010 Call Report data indicates 2.26 percent of credit union UPB are delinquent, compared to 1.45 percent of loans.

State delinquency trends

It is also instructive to compare delinquency rates at the state level. FICU delinquency rates are lower than MBA-NDS prime mortgage delinquency rates in every state. In general,

CONTINUED ON PAGE 7

[1] The NCUA call report classifies mortgages as delinquent throughout the foreclosure process, MBA-NDS reports separately on mortgages in foreclosure. For consistency, this analysis compares the sum of FICU Call Report delinquency categories for 2-6 months, 6-12 months, and 12+ months with MBA-NDS categories 60+ days, 90+ days, and In foreclosure on a non-seasonally adjusted basis.

CHIEF ECONOMIST REPORT (FROM PAGE 6)

while FICUs and the broader mortgage market are experiencing similar patterns, there are some striking differences.

The final table shows the 10 states with the highest FICU delinquency rates. Only four of the top-10 FICU states are also in the MBS-NDS top 10. Some states that are performing well in the broader MBA-NDS have relatively high FICU delinquency rates, notably Utah and Montana. In Utah, delinquency rates at many institutions are elevated and one of the largest institutions has an unusually high delinquency rate. By contrast, the high Montana delinquency rate is driven entirely by a single large institution experiencing higher than average delinquency rates, while other Montana institutions have a combined delinquency rate below the national average.

The delinquency experiences of FICUs and the broader mortgage markets do not move in lockstep; however, they are highly correlated, and both FICUs and regulators are well served to track delinquency trends in both sectors.

Comparison of Top 10 States by FICU Delinquency Rates

	FICU 1ST LIEN MORTGAGES		MBA-NDS 1ST LIEN MORTGAGES		
STATE	DELINQUENCY RATE*	CHANGE FROM YEAR AGO	DELINQUENCY RATE**	CHANGE FROM YEAR AGO	RANK
	(Percent)	(Basis Pts)	(Percent)	(Basis Pts)	
Nevada	10.53	155	19.53	-8	2
Arizona	9.40	552	12.45	-187	3
Utah	8.01	132	8.14	25	24
Delaware	7.41	152	8.71	79	20
Florida	5.11	72	21.15	23	1
Montana	4.55	173	4.59	10	47
California	3.33	47	11.62	-178	6
Minnesota	3.00	-40	6.62	-112	39
Washington	2.84	28	7.49	82	29
South Carolina	2.54	88	8.94	16	17
United States	**2.26**	**33**	**10.22**	**-40**	**-**

* Delinquent loans as share of outstanding unpaid balances.
** Delinquent loans as share of number of loans.

BOARD ACTIONS (FROM PAGE 3)

NCUSIF equity holds steady

The National Credit Union Share Insurance Fund (NCUSIF) equity ratio of 1.29 percent at November 30 remained unchanged from the prior month.

The NCUSIF reported year-to-date net income of $329 million as of November 30.

No insurance loss expense was recorded in November, and the provision for credit losses (reserves) for natural person credit unions remained $1.21 billion.

As of November month end, 372 federally insured credit unions, with assets of $43.4 billion and shares of $38.3 billion, were designated as CAMEL code 4 or 5. In addition, there were 1,792 CAMEL 3 credit unions with assets of $158.2 billion and shares of $139.7 billion. Overall, 22.3 percent of all credit union assets are in CAMEL code 3, 4 or 5 credit unions.

Through November, 27 federally insured credit unions have failed in 2010—17 liquidations and 10 assisted mergers.

The Temporary Corporate Credit Union Stabilization Fund (TCCUSF) total liabilities and net position remained unchanged at $4.37 billion.

Financial data reported for both the Share Insurance Fund and the Temporary Corporate Credit Union Stabilization Fund are preliminary and unaudited

Chief economist added to NCUSIF Investment Committee

The NCUA Board approved revisions to the National Credit Union Share Insurance Fund investment policy that add the NCUA chief economist to the NCUSIF Investment Committee and identify the chief economist's role on the committee.

FOM appeal denied

The NCUA Board denied the field of membership expansion appeal of Tri-State Federal Credit Union to add members of the YMCA of East Liverpool, Ohio. NCUA approved adding the YMCA employees, but found that the proposed membership group does not meet the common bond requirements for an associational group contained in the *NCUA Chartering and Field of Membership Manual.*

CLF modifies expense reimbursement allocation

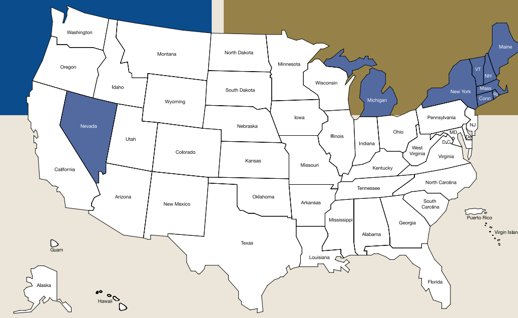
The NCUA Board approved a change to the calculation the Central Liquidity Facility uses to reimburse the NCUA Operating Fund for certain indirect expenses. The change will be retroactive to January 1, 2010.

The FCU Act empowers the NCUA Board to determine the amount of expenses that will be assessed to the CLF. CLF reimburses the Operating Fund quarterly for direct expenses such as salaries and benefits of CLF staff and CLF's portion of space rental. CLF reimburses annually for indirect expenses such as Board and Central Office staff, supplies, postage, printing and telephone. Congress has set a maximum CLF budget of $1.25 million.

Board votes are unanimous unless otherwise indicated. All Board Action Memorandums are available online at www.ncua.gov under *Agency Leadership/NCUA Board and Actions/Draft Board Actions*, and NCUA rule changes are posted online at www.ncua.gov under *Resources/ Regulations, Legal Opinions and Laws.*

Regional Report

CONTINGENCY FUND PLANNING



REGION I

The economic events of 2008 highlighted the significant risk events that can unexpectedly affect all financial institutions. This crisis, in particular, highlighted the significant costs related to a high level of exposure to liquidity risk and the need for appropriate planning to address liquidity shortfalls in emergency situations.

NCUA Letter to Credit Unions 10-CU-14: *Final Interagency Policy Statement on Funding and Liquidity Risk Management* provides sound business practices for managing funding and liquidity risk and for strengthening overall liquidity risk management. The letter also provides specific guidance for developing a contingency funding plan (CFP).

All credit unions, regardless of size and complexity, should have a formal CFP to address contingent liquidity events. These unexpected situations or business conditions may increase liquidity risk. They can be institution-specific or arise from external factors and encompass a number of scenarios, including an inability to fund asset growth or renew or replace funding liabilities, disturbances in payment and settlement systems, and changes in market values or price volatility of various asset types.

A CFP typically focuses on events that, while relatively infrequent, could significantly impact the credit union's operations. The plan should:

- Identify stress events;
- Assess levels of severity and timing;
- Assess funding sources and needs, including liquidity gap analysis and stress tests;
- Identify potential funding sources;
- Establish liquidity event management processes; and
- Establish a monitoring framework for contingent events.

The Letter also highlights other factors that management should consider when developing a CFP. For instance, credit unions should be prepared for specific contingencies that may become applicable under prompt corrective action. This could include restrictions on rates paid for deposits, the need to seek regulatory approval to accept brokered deposits, or the inability to accept brokered deposits.

Credit unions that rely on secured funding sources are also subject to potentially higher margin or collateral requirements that can be triggered by deterioration of a specific portfolio or the credit union's overall financial condition. These same factors, in addition to counterparty concerns, could also affect credit unions that rely on participation lending and/or asset securitization programs.

The Letter also addresses the need to regularly update and test a CFP. For certain components, such as the liquidation of assets, testing may be impractical. In those situations, the credit union should test operational components. However, credit unions should be aware that during real stress events, prior market access testing does not guarantee that these funding sources will remain available with the same timeframes and/or terms.

The NCUA
REPORT

1775 Duke Street | Alexandria, VA 22314-3428