The NCUA REPORT

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FREE DIRECTOR TRAINING

Register for Fiduciary Duties Workshops

As a new regulation takes effect this year to clarify duties of federal credit union directors, NCUA has committed resources to assist directors in fulfilling their roles. NCUA's Office of Small Credit Union Initiatives (OSCUI) is offering 34 free educational sessions with a new main topic: *Duties of Federal Credit Union Board of Directors.*

Training on this mission-critical topic will cover key requirements of the new Regulation Part 701.4 — including reviewing a credit union balance sheet, income statement, and financial performance report. Participants will experience hands-on exercises to reinforce important financial concepts.

Directors who do not yet have these financial skills are required to receive training by July 27, 2011, or within six months after their election (whichever date is later).

The OSCUI workshops also include a variety of topics designed for managers as well as directors: *Due Diligence for Evaluating Payment Systems Service Providers; Examination Issues; Issues Facing Credit Unions; NCUA's Consumer Protection Office; and Partnership with the Department of Education.*

The table on this page lists free OSCUI training opportunities through July 23. Credit union officials can register online at www.ncua.gov under Upcoming Events. Workshop dates and locations from July 28 through November 8 are also online.

Questions?
E-mail OSCUITraining@NCUA.gov or call 703-518-6610.

Directors unable to attend an OSCUI workshop will have access to similar online training. NCUA's Office of Examination and Insurance is planning to release an Internet-based "Financial Literacy" training module before July 27.

UPCOMING WORKSHOPS

Date	Location
March 17, 2011	Philadelphia, PA
March 26, 2011	Los Angeles, CA
April 13, 2011	Meriden, CT
April 14, 2011	Birmingham, AL
April 28, 2011	Newark, NJ
May 4, 2011	Chicago, IL
May 6, 2011	Detroit, MI
May 12, 2011	Minneapolis, MN
May 14, 2011	Seattle, WA
May 21, 2011	New York, NY
May 21, 2011	Houston, TX
May 25, 2011	Rapid City, SD
June 2, 2011	Portland, ME
June 11, 2011	Salt Lake City, UT
June 23, 2011	Atlanta, GA
July 8, 2011	Little Rock, AR
July 9, 2011	New Orleans, LA
July 14, 2011	Louisville, KY
July 22, 2011	Tampa, FL
July 23, 2011	Albany, NY

CHAIRMAN'S CORNER

NCUA's Dodd-Frank Act Initiatives

Debbie Matz
Chairman

This year, U.S. financial regulators have worked overtime to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (DFA). This landmark law aims to empower consumers and investors, mitigate problems identified during the financial crisis, and ensure the future stability of our financial system.

Without question, DFA will alter the way that the U.S. financial sector functions, and it has already begun to change the way that NCUA operates. Like all financial regulators, NCUA must issue new rules, revise some existing regulations, and take on additional duties. The NCUA Board and staff have already rolled up our sleeves and begun the hard work needed to implement DFA within the required deadlines.

In rewriting the rules of the financial marketplace, NCUA recognizes the need to adopt sensible regulations tailored to the unique circumstances of credit unions. Our goal is to impose the least possible burden on credit unions, especially smaller ones.

Recently, NCUA has focused on implementing the following key changes.

Interchange Fee Caps

DFA requires the Federal Reserve to consult with NCUA in crafting new rules governing fee caps on debit card interchange transactions. In order to protect the solvency of smaller credit unions, NCUA recently called for the adoption of a final rule containing meaningful exemptions for issuers with less than $10 billion in assets.

Credit Ratings

The inflated grades of credit rating agencies exacerbated the financial crisis. DFA, therefore, requires all regulators to replace credit rating rule references with new creditworthiness standards that regulated entities must follow. In February, the NCUA Board approved a proposed rule implementing this mandate.

> “NCUA needs the input of credit unions to get this challenging job done right!”

Share Insurance Protection

DFA permanently raised the maximum amount of share insurance protection to $250,000 per account. NCUA satisfied this requirement with a rule revision last September. NCUA will soon finalize rules for unlimited coverage for noninterest-bearing accounts.

Incentive-Based Compensation

Incentive-based compensation packages led many financial executives and professionals to favor short-term self gain over long-term financial stability. DFA requires credit unions and other regulated entities with more than $1 billion in assets to disclose the structures of their incentive-based compensation practices. Credit unions above $10 billion in assets have additional obligations. In February, NCUA proposed a new rule to implement these changes.

Financial Stability Oversight Council (FSOC)

FSOC works to monitor and ensure the stability of the U.S. financial system. As one of 10 voting members, NCUA has new responsibilities not only to raise the distinctive perspective of credit unions within FSOC, but also to look more broadly at the threats facing the global financial system.

Office of Minority and Women Inclusion (OMWI)

Created in January in response to DFA, OMWI will monitor diversity of employment at NCUA and in credit unions. OMWI will also promote the use of minority and women contractors at NCUA.

Consumer Financial Protection Bureau (CFPB)

Because too many American families suffered devastating losses in the last decade as a result of predatory financial products, Congress created CFPB. CFPB is charged with writing new consumer rules and supervising consumer compliance at financial institutions with more than $10 billion in assets. NCUA has begun working with CFPB to transfer employees, share data, and plan for coordinated exams.

No doubt, DFA will result in many changes in the way financial institutions, including credit unions, operate. By providing comments during the rulemaking process, credit unions can assist NCUA in crafting the best possible results. In short, NCUA needs the input of credit unions to get this challenging job done right!

Debbie Matz

Debbie Matz

BOARD ACTIONS February 17, 2011

Board extends 18-percent loan interest rate ceiling

The NCUA Board voted to extend the 18-percent interest rate ceiling on loans made by federal credit unions (FCUs) through September 10, 2012. Please refer to *Why Extend the 18 Percent Ceiling?* on page 5 for more details.

Proposed incentive-based compensation rule required by law

As required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the NCUA Board voted to approve a draft interagency proposed rule establishing general requirements for incentive-based compensation arrangements for "covered" financial institutions. The Dodd-Frank Act requires the NCUA, FDIC, Federal Reserve, Federal Housing Finance Agency, OCC, OTS, and SEC to jointly prescribe regulations or guidelines with respect to incentive-based compensation practices at financial institutions with total assets of $1 billion or more.

Each agency must individually review and approve the proposed rule before they jointly issue and send it to the *Federal Register* for publication.

Most components of NCUA's proposed rule apply to credit unions with total assets of $1 billion or more. Where permitted by law, the NCUA Board voted to apply some components only to credit unions with total assets of $10 billion or more.

Proposal components that apply to credit unions with total assets of $1 billion or more include:

- A prohibition against incentive-based compensation arrangements that encourage executive officers, employees, directors, or principal shareholders (covered persons) to expose the credit union to inappropriate risks by providing excessive compensation;
- A prohibition against covered credit unions establishing or maintaining any incentive-based compensation arrangements for covered persons that encourage inappropriate risks by the covered credit union that could lead to material financial loss;
- A requirement that covered credit unions provide certain information to their appropriate federal regulator(s) concerning their incentive-based compensation arrangements for covered persons; and
- A requirement that covered credit unions maintain policies and procedures appropriate to their size, complexity and use of incentive-based compensation to help ensure compliance with these requirements and prohibitions.

Proposal components that apply to credit unions with assets of $10 billion or more include the following requirements:

- Covered credit unions with $10 billion or more in total assets will need to defer at least 50 percent of the annual incentive-based compensation of executive officers for a period of at least 3 years and adjust the deferred payments to reflect losses or risks to the credit union that become known during the deferral period.
- Board of directors of a covered credit union with $10 billion or more in total assets will need to identify covered persons (other than executive officers) who have the ability to expose the credit union to substantial losses and approve the incentive-based compensation arrangements for these covered persons after determining that the arrangements effectively balance the financial rewards to the covered person with the risk to the credit union. An example of a credit union employee, other than an executive officer, who could expose a credit union to substantial losses as "a material risk taker" might be a loan officer with approval authority below the executive officer level.

When all agencies involved in the rulemaking approve the incentive-based compensation proposal, it will be issued with a 45-day comment period.

NCUSIF begins 2011 with 1.28 percent equity ratio

The National Credit Union Share Insurance Fund (NCUSIF) equity ratio was 1.28 percent at January 31, 2011. NCUSIF ended the month with a $1.23 billion reserve balance.

NCUSIF reported net income of $11.4 million during January 2011. No credit union failures occurred in January and no insurance loss expense was recorded.

There were 369 federally insured credit unions designated as CAMEL code 4 or 5 as of January 31, with assets of $42.9 billion and shares of $38.2 billion. In addition, 1,819 CAMEL code 3 credit unions had assets of $154.5 billion and shares of $136.5 billion. Overall, 21.85 percent of all credit union assets were in CAMEL code 3, 4 or 5 credit unions.

The Temporary Corporate Credit Union Stabilization Fund (TCCUSF) total liabilities and net position was $377.1 million at January 31, 2011.

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

Proposal removes term "credit ratings"; offers alternatives

In another action required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the NCUA Board issued proposed rules to remove

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Perspective

FROM GIGI HYLAND, NCUA BOARD MEMBER

The title of this section of *The NCUA Report* seems particularly apropos to me this month—"Perspectives." Writing in mid-February from a peaceful office in Alexandria, Va., I am awestruck by the upheavals taking place half a world away in Egypt—a mass democracy movement taking to the streets; citizens peaceably, but insistently demanding better pay, working conditions, and certain inalienable rights; and a steady swell of change that defies the status quo and whispers of the ability to build something better. A force-feeding of perspective, if you will.

That perspective comes in many forms: perspective that people, working collaboratively, can accomplish common goals and achieve amazing things; perspective that each individual's contribution is as important as the next individual's; and perspective (a unique confirmation of Woody Allen's wisdom) that 80 percent of success is just showing up.

As 4,000 credit union volunteers and officials made their way to D.C. to lobby their representatives at the end of February, the perspective shifts to the challenges facing the credit union system: perspective that a comment letter to a regulatory agency can, and often does, make a difference on a regulation or policy; perspective that meeting a member's needs means the world to that individual; and perspective that working collaboratively a viable healthy future for credit unions can be achieved.

Success Through Community Involvement

FROM MICHAEL E. FRYZEL, NCUA BOARD MEMBER

Often, a key element to the success of a business is involvement in its community. Sponsoring a school team, advertising an event at the business' location, donating a raffle prize, providing a scholarship, or placing an ad in an event book are all gestures that require little effort and can reap great rewards.

Credit unions across this country do an outstanding job at being involved in the activities of their members. They express true concern about the civic and social events of their members and are actively involved in community events. Credit unions become part of the community and their presence becomes greater than being just another business.

A credit union's involvement in its community, outside the confines of its office, is welcomed and appreciated by members. Knowing their financial institution is concerned for their well being, aside from holding their deposits and making them loans, deepens the bond a member has with the credit union. Credit union members appreciate the good deeds their credit union does for them and the community. In turn, they remain a loyal customer of that institution.

How often do we hear complaints that financial institutions are cold and callus, impersonal and uncaring, in business only to make money? Credit unions defy that characterization because they are what other financial institutions wish they were. Their members become part of a family, a credit union family that exemplifies concern for each individual above and beyond the member's financial well being.

Each week, I read about credit unions in Michigan, Washington State, Virginia and all across the country doing something good for their community. Seeing that type of involvement should make every credit union officer, director, employee and member proud of the efforts being made by their financial institution.

A community becomes stronger when its businesses take an active civic role. A business becomes stronger when its community and its citizens recognize them as being a part of their lives. Yes, it takes time and effort to be a good corporate citizen, but it is also the credit union philosophy. Cooperatives formed for the benefit of their members are in a way like this country's Declaration of Independence, "of the people, by the people, for the people."

Are we sure one of the signers of the Declaration of Independence was not a credit union founder?

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

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Office of Capital Markets Report

WHY EXTEND THE 18-PERCENT CEILING?

At its February meeting, the NCUA Board voted to extend the 18-percent loan interest rate ceiling for federal credit unions through September 10, 2012.

Under the Depository Institutions Deregulation and Monetary Control Act of 1980, the NCUA Board must use two criteria to assess the need for a ceiling above 15 percent: (1) trends in money-market interest rates over the past six months; and (2) the threat of disintermediation to the credit union industry. The NCUA has interpreted the second criteria as a threat to safety and soundness from macroeconomic conditions — as evidenced by adverse trends in capital, growth, liquidity and earnings.

The Board set the ceiling at 21 percent in December 1980 and reduced it to the current 18 percent in May 1987. The 18-percent cap applies to all federal credit union lending except originations under the short-term, small-dollar program, which allows federal credit unions to charge up to 28 percent for loans of $200 to $1,000 under certain terms.

Trends in interest rates justify extending the ceiling. Money-market rates are lower than six months ago, but the recent trend is upward. Expansionary Federal Reserve policy has kept the Federal funds rate — an anchor in the money market — below 23 basis points (0.23 percent) since December 2008, but other short- and intermediate-term rates began to climb in the fourth quarter on market concerns about inflation.

For example, from November to December 2010 the average rate on six-month negotiable certificates of deposit climbed 6 basis points to 0.41 percent. The Treasury yield curve — which embodies expectations about the likely path of money-market rates — suggests the upward trend will continue. From October to December 2010, the yield on two-year Treasuries rose 24 basis points to 0.62 percent, and the yield on five-year Treasuries jumped 75 basis points to 1.93 percent.

Trends in credit union condition also support an extension. With interest rates on the rise, a lower cap would constrain many lenders — potentially resulting in a smaller loan volume. And a regulation induced decline in loan interest and volume would hurt earnings because loan income equals rate times volume. Nearly 32 percent of federal credit unions making loans at 15 to 18 percent report average rates on such loans above 17 percent, so the concern is more than hypothetical. Moreover, these institutions are not charging excessive interest rates. Risk premiums in markets for unsecured loans remain high relative to pre-financial crisis levels. Indeed, across all credit card issuers, the average credit card rate for borrowers with impaired credit is near 25 percent.

A particular worry in lowering the ceiling is the effect on institutions heavily dependent on 15- to 18-percent loans and their members. Currently 122 federal credit unions have volumes exceeding 10 percent of assets. On average, these lenders are much smaller than other credit unions and, therefore, less able to replace lost earnings by diversifying into new markets or product lines. The financial crisis and recession also hit these institutions hard. Today, 33 of the 122 operate in states with unemployment at or above the national average. Additionally, 50 have formal designations as low-income credit unions, so any reduction in credit from a cap below 18 percent would disproportionately affect borrowers of modest means.

Recent financial history and economic activity have produced many surprises. Accordingly, NCUA monitors financial market and credit union conditions closely — standing ready to revisit the interest-rate ceiling before September 2012 should circumstances warrant.

February 28, 2011, Washington, D.C. – NCUA Chairman Debbie Matz discusses credit union issues with Treasury Domestic Finance Under Secretary Jeffrey Goldstein.

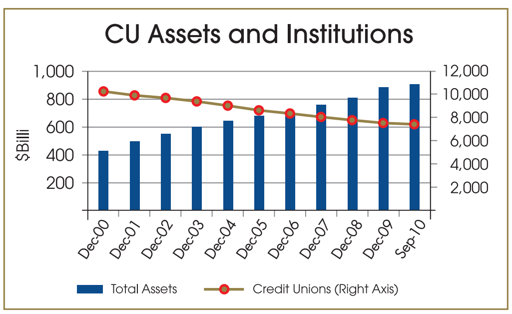
John D. Worth
Chief Economist

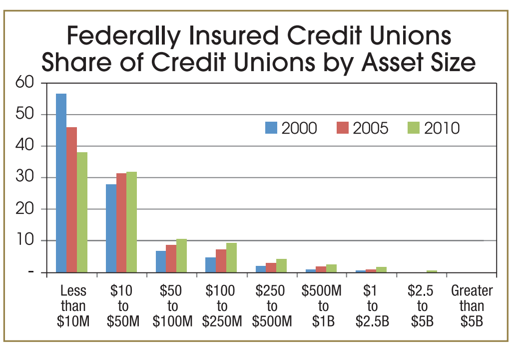
Chief Economist Report

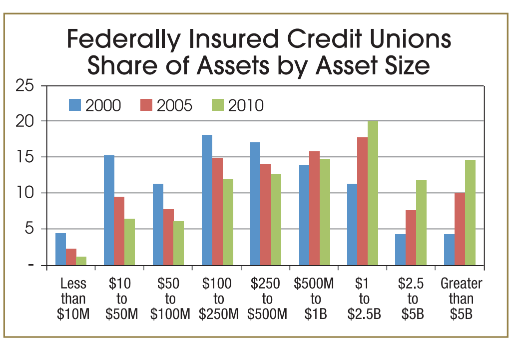
TRENDS IN CREDIT UNION SIZE AND CONSOLIDATION

A key factor in managing emerging risks in a dynamic environment is identifying and understanding existing and emerging trends. This month's column reviews the nature of consolidation and growth in the credit union industry over the past decade.

The number of credit unions has contracted at a steady pace over the past decade while assets and membership have grown. Between the end of 2000 and the third quarter of 2010, the number of federally insured credit unions declined by 28 percent or over 2,900. During the decade credit union membership grew by 17 percent, from 77 million to over 90 million members, while system-wide assets more than doubled, and average assets per institution increased by over 180 percent.







Over the decade, the composition of credit unions has shifted. As Figure 2 shows, very small credit unions — those with less than $10 million in assets — have declined as a share of all credit unions, falling from 57 to 38 percent. Meanwhile, the share of credit unions in larger asset classes has increased. The share of credit unions with $10 to $250 million in assets increased from 40 to 53 percent, the share of credit unions with between $250 million and $1 billion in assets more than doubled from 3 to 7 percent, and the share of credit unions with over $1 billion in assets increased more than five-fold, from less than 0.5 to over 2 percent.

Over the past decade, assets have become increasingly concentrated at the upper end of credit union size distribution. Figure 3 shows the share of total system assets held by credit unions in different asset classes over time. Credit unions with assets less than $500 million hold about 25 percent of system assets today, down from nearly 50 percent in 2000. Over the same period, credit unions with over $1 billion in assets grew from holding 20 percent of system assets in 2000 to holding nearly 47 percent today.

Clearly, some of this growth reflects increases in total nominal dollar assets and savings in the economy (as noted above, system-wide assets doubled in nominal terms over the decade). However, other measures also show a substantial increase in the concentration of assets among the largest institutions. For example, the share of assets of the 100 largest credit unions increased from 30 percent in 2000 to nearly 40 percent today. The share of assets in the top 10 credit unions rose from just under 10 percent in 2000 to just over 14 percent today.

Another measure of industry asset concentration, the Herfindahl-Hirschman Index or HHI, has doubled over the past decade. The HHI is a widely accepted measure of market concentration used by both the Department of Justice and the Federal Trade Commission. In 2000, the asset HHI for credit unions was 22 and it grew to 45 in 2010. By way of comparison, the asset HHI for banks was 163 in 2000, growing to 450 in 2010. While the credit union industry concentration continues to be quite low by absolute standards, doubling the index in a 10-year span clearly shows that industry concentration is rising.

Increasing concentration in the credit union industry reflects a number of ongoing and emerging trends and raises important challenges for credit unions as well as NCUA. The challenges for credit unions include managing growth and adapting to the managerial and risk management needs of a large, diversified institution. For NCUA, a key challenge is dealing with the potentially large impact that some institutions could have on the insurance fund and, in turn, on the rest of the credit union system.

Examination & Insurance Report

CREDIT UNION ONLINE—IS YOUR PROFILE UPDATED?

NCUA transitioned all natural person credit unions to an online application that integrated the 5300 Call Report and Report of Officials in September 2009. Credit unions responded favorably to Credit Union Online as it eliminated redundancy and created an efficient medium for required reporting.

As part of Credit Union Online, NCUA created a profile for each credit union that includes intermittently changing data. Prior to September 2009, the majority of this data was reported quarterly on the Call Report or annually on the Report of Officials. Below are a few friendly reminders about updating and maintaining your profile information.

- NCUA Rules and Regulations §741.6 requires the profile be updated within 10 days of the election or appointment of officials or within 30 days of any other change.
- Regulatory Information — When updating the annual meeting, member account verification, and financial statement audit information, credit unions should add the most recent date rather than editing the existing date on the system.
- Programs and Services — These fields should reflect the programs and services offered by the credit union. When applicable, these fields should be consistent with the financial information reported on the Call Report. For example, if a credit union reports they offer mortgage loans in the profile, in most cases, there will be mortgage loans outstanding on the Call Report.
- CUSO Information — The loans to, investments in, and aggregate cash outlay financial fields should be updated as they change. The total of these fields is reported as of the quarter-end date on page 17 of the Call Report.

Credit Union Online profile information is relied upon by credit union members, the public, and your regulator. The timely review and update of this information is appreciated. For any questions, please email credituniononline@NCUA.gov, contact your examiner, or call OCIO Technical Support at 800.827.3255.

REGION III REPORT (FROM PAGE 8)

credit union requests to the NCUA regional director. There are no provisions in the regulation for a CUSO, or even the originating credit union, to submit a waiver request on behalf of participant credit unions.

When does the "45 day" clock begin for a waiver request submitted by a federally insured state-chartered credit union (FISCU)? Part 723.12(d) states the NCUA regional director will respond to a waiver request "within 45 calendar days of receiving a complete request from the federal credit union or the SSA." A FISCU must submit the request to its SSA. After an SSA approves a request, the SSA forwards the request to the regional director. The "45 day" clock does not begin for a FISCU until NCUA receives both a complete waiver request package and SSA approval.

Each waiver request NCUA receives is unique. NCUA regional office Division of Supervision staff work closely with field staff in reviewing MBL waiver requests.

BOARD ACTIONS (FROM PAGE 3)

references to nationally recognized statistical rating organization (NRSRO) credit ratings in NCUA regulations and to substitute other standards of creditworthiness.

The proposed amendments would replace NRSRO ratings with either narrative standards or a credit union's own internal standard. Under the proposal, each credit union would be required to explain how the securities it purchases or counterparties with which it does business meet the applicable standards. Credit unions would be required to develop, maintain and apply criteria for assessing the creditworthiness of securities and counterparties.

The proposal is issued with a 60-day comment period.

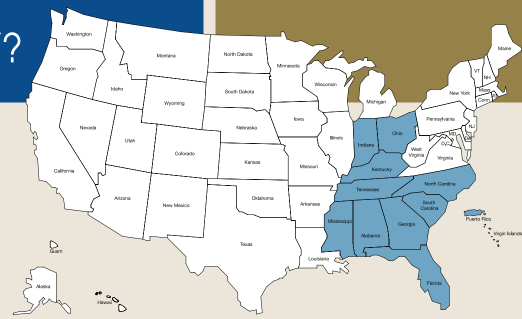
Corporate credit union chartering guidelines updated

The NCUA Board issued a final Interpretive Ruling and Policy Statement (IRPS) that provides the requirements and process for chartering a corporate federal credit union. NCUA issued the updated IRPS to ensure chartering guidance is available for those interested in forming a new corporate federal credit union.

The IRPS, Corporate Federal Credit Union Chartering Guidelines, is effective 30 days following publication in the Federal Register.

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*. NCUA rule changes are posted online at www.ncua.gov under *Resources/ Regulations, Legal Opinions and Laws*.

WHEN IS A MEMBER BUSINESS LOAN WAIVER NECESSARY?



REGION III

NCUA experienced an increase in the number and frequency of member business loan (MBL) waiver requests in 2010. Numerous factors affected the increase — economic conditions, credit unions with MBL portfolios near or exceeding regulatory limits, and recent elimination of the RegFlex exemption allowing eligible credit unions to forgo the regulatory required personal guaranty.

It is important credit unions understand what NCUA is looking for in evaluating a waiver request. The following Q&A addresses recent waiver request questions and provides information about how NCUA handles these scenarios.

What if a credit union exceeds a regulatory limit? A credit union should write its NCUA regional office explaining why it exceeded the regulatory limit and provide a plan for monitoring the affected loan(s) and bringing the loan(s) into compliance.

While reviewing a real estate secured loan renewal, a credit union obtains an updated or new appraisal and finds loan to value (LTV) now exceeds the regulatory limit. Must the credit union request a waiver? <u>Yes.</u> The original loan is maturing and the plan is to renew the loan; so, the credit union must submit a waiver request to exceed the regulatory limit. Whether or not "new money" is extended does not matter. Credit unions should explain and provide information supporting the LTV at the time of origination and provide a plan for loan monitoring.

During development and analysis of a work-out/modification plan for an existing commercial real estate secured loan, the credit union determines the LTV now exceeds the regulatory limit. The loan has not matured and the original loan was under the LTV limit origination. Is the credit union required to submit a waiver request? <u>It depends.</u> If the credit union disburses "new money," adding to the original loan, the credit union must submit a waiver request. A waiver request is required if "new money" is added for any reason — even unpaid interest (capitalizing interest) and late fees. If the loan balance at the time of modification does not change (no "new money"), the credit union is <u>not</u> required to submit a waiver request.

"Modifying" a loan before maturity solely to avoid making a new loan that would otherwise require a waiver may be considered circumventing the regulation. NCUA will take issue with loan renewals that are treated as modifications but should have been properly characterized as new loans subject to the LTV waiver requirement.

Credit unions should follow written policies and procedures for handling commercial real estate workouts or modifications. The written procedures should comply with NCUA Rules and Regulations Part 723 and with the FFIEC "Policy Statement on Prudent Commercial Real Estate Loan Workouts" issued October 30, 2009 (Letters to Credit Unions 10-CU-07).

Due to recent RegFlex changes, is a credit union required to submit a waiver for a loan that was granted prior to November 29, 2010, with no personal guaranty? <u>No.</u> If a loan was granted prior to November 29, 2010, with no personal guaranty, a RegFlex eligible credit union (at the time of loan origination) does not have to request a waiver for an existing loan.

Can a CUSO submit a waiver request for a participation loan on behalf of participant credit unions? <u>No.</u> Participant credit unions must individually submit a waiver request to the appropriate regional director in compliance with Part 723.11. In addition, state supervisor authorities (SSA) should forward state-chartered

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The NCUA
REPORT

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