The NCUA REPORT
NATIONAL CREDIT UNION ADMINISTRATION

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HIGHLIGHTS

Office of Examination and Insurance Report

LOAN PARTICIPATIONS HELP MANAGE BALANCE SHEETS, SERVE MEMBERS

To meet the lending demands of their members, credit unions may often hit roadblocks as members' borrowing needs grow past statutory or regulatory concentration limits. Federally insured credit unions (FICUs) are able to reduce their exposure to risk and continue to meet their members' needs by joining forces with other credit unions in participated loan relationships. Participated loan relationships are co-lending arrangements in which the originating lender sells an interest in the loan to the participant.

When properly administered and managed, a participated lending relationship can benefit both the selling credit union, as well as the purchasing credit unions. The originating lender is able to stay within regulatory and concentration risk limits, while maintaining the relationship with the member. The participant is able to diversify geographic and industry risk, along with expanding opportunities for interest income.

In June, there were 1,432 FICUs reporting participation loans with total balances of $12.8 billion. These balances have increased 31 percent since 2007, from $9.7 billion.

The participated loan adds another layer of complexity given multiple lenders for the transaction. This relationship requires the lenders to negotiate a suitable and mutually beneficial arrangement.

The originating lender must manage the loan relationship with the same standard of care as it would with any other loan it originates and services. The participants should perform independent underwriting and risk analysis in accordance with the standards they would use if they were originating and servicing the loan themselves. In addition to evaluating the financial condition of the borrower, participants should perform due diligence to see if the originating lender has the expertise and systems in place to adequately manage and monitor the loan relationship.

With multiple lenders, the success of a participated loan relationship hinges on a well-written master participation loan agreement that clearly states the roles and responsibilities of the originating lender and the participants. The master participation loan agreement should, at a minimum, consider the following factors:

- Identification of the roles and responsibilities of all parties involved;
- Verification that all parties have performed an independent financial analysis, and their decision to enter into the loan relationship was based on their own analysis;

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Chairman's Corner

NCUA BUDGET PROTECTS CREDIT UNIONS FROM HIGHER LOSSES

Debbie Matz
Chairman

This November, the NCUA Board will vote on the agency's 2012 annual budget. It's important for credit union leaders to understand why recent NCUA budget increases have been essential: to protect credit unions from higher losses and to prevent skyrocketing premiums if troubled credit union failures increased.

When I became NCUA Chairman in 2009, I was astounded to discover NCUA actually had fewer examiners in 2009 than in 2000. Yet the asset size, complexity, and risk profile of many credit unions had grown tremendously over the decade.

In fact, as the economic crisis hit America full force, the percentage of credit unions rated CAMEL 3, 4, or 5 quadrupled from the historical norm of 5 percent to 20 percent, or one in five credit unions. Several billion-dollar credit unions were on the verge of failing. If they had failed, the National Credit Union Share Insurance Fund (NCUSIF), and thus natural person credit unions, would have been on the hook for as much as $1.5 billion in preventable losses.

Chicago (Sept 14, 2011) – NCUA Chairman Debbie Matz discusses examiner allocation strategies with newly elected National Association of State Credit Union Supervisors Chairman Orla Beth Peck (left) and NASCUS President/CEO Mary Martha Fortney (right).

NCUA immediately took several steps to address these problems, each of which had budget implications. We moved from an 18-month exam cycle to a 12-month exam cycle, and we hired more examiners. Getting into credit unions more frequently to detect and prevent problems was critical, and we needed more "boots on the ground" to do so. Due to the more frequent exam cycle, travel costs increased significantly. NCUA also invested in expanded training for field examiners to deal with the growing number of complex and higher-risk activities at some credit unions.

We are, however, always mindful of increasing costs for credit unions. So, we strove to cut costs wherever possible, while preserving NCUA's core mission of safety and soundness.

This past June, we were able to revise the mid-year budget downward, saving credit unions a net $2 million in future budget costs. NCUA spending on items such as rent, supplies, communications, and utilities all flat-lined or decreased to make this $2 million savings possible. NCUA also began reallocating internal resources to deploy examiners where the greatest NCUSIF risks lay.

For perspective, compare NCUA's approach to the FDIC's. In the same time period, the FDIC dealt with troubled banks by increasing their annual budget 81 percent in 2009 and 55 percent last year. In effect, the FDIC more than doubled their budget in two years compared to NCUA's increases of 12-13 percent.

You may not have thought of it this way, but NCUA's budget is an investment in protecting your credit union's NCUSIF premium costs. For the $24 million increase in NCUA's budget last year, NCUA actions saved credit unions $1.5 billion by preventing troubled credit unions from failing. Last year, 28 credit unions failed, costing the NCUSIF $221 million—an amount lower than the entire NCUA operating budget. The 13 percent investment to increase NCUA's budget last year helped save you from larger NCUSIF premiums many times over.

I am pleased to see that NCUA's efforts are working. The latest Call Reports show encouraging improvements in the overall health of the credit union industry's financials, with a slight but welcome reduction in the number of troubled credit unions. This year, it's very possible there will be no NCUSIF premium, due to NCUA's swift actions to stem failures. The old saying holds true today—an ounce of prevention is worth a pound of cure.

Debbie Matz

Board Actions Sept. 22, 2011

NCUA BOARD ENHANCES TIMELINESS IN CORPORATE CREDIT UNION RULE

The NCUA Board convened its tenth open meeting of 2011 at the agency's headquarters, Sept. 22, and unanimously approved two items:

- Delegation of authority to the Director of the Office of Corporate Credit Unions (OCCU) to decide actions established under NCUA's corporate credit union rules, enhancing the effectiveness of the corporate rule by reducing timelines; and
- A final rule for net worth and equity ratio definitions conforming to public law.

The Board also received updates on the performance of the National Credit Union Share Insurance Fund (NCUSIF) and the Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund). The NCUSIF equity ratio at the end of August stood at 1.31 percent, up from 1.28 percent at the end of June. The Stabilization Fund's net position increased $2.1 billion over the last month.

Board Delegates Authority to OCCU; Enhances Response Time

During the adoption of the final corporate credit union rule (Sections 704.3 and 704.4), the Board amended authorities previously explicitly granted by regulation to the OCCU director to indicate NCUA approval. Subsequently, the Board delegated authority to address certain regulatory changes, but did not include authority relating to capital and prompt corrective action (PCA) which go into effect Oct. 20, 2011.

As the effective date approached, the Board approved the delegation of authority to the OCCU director to approve or disapprove the following seven actions:

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NCUA ISSUES 2012 BOARD MEETING SCHEDULE

The NCUA Board released its monthly meeting schedule for 2012. No meeting is scheduled for August. All open meetings on the following dates are scheduled to begin at 10 a.m.

- Jan. 26
- Feb. 16
- March 15
- April 12
- May 24
- June 21
- July 19
- Sept. 20
- Oct. 18
- Nov. 15
- Dec. 13

RULEMAKING CALENDAR

TITLE	REFERENCE	STAGE	LAST BOARD ACTION	EFFECTIVE OR COMPLIANCE* DATE	COMMENTS RECEIVED
Net Worth & Equity Ratio	700, et al	Final Rule	Sept. 22, 2011	Oct. 31, 2011	
Corporate Credit Unions	704	Proposed Rule	Aug. 29, 2011		7
CUSOs	712 & 741	Proposed Rule	July 21, 2011		TBD
Remittance Transfers	701	Interim Final	July 21, 2011	July 27, 2011	1
Sample Income Data to Meet the Low-Income Definition	701	Final Rule	June 17, 2011	July 25, 2011	
Community Development Revolving Loan Fund	705	Proposed Rule	May 19, 2011		4
Accuracy of Advertising & Notice of Insured Status	740	Final Rule	May 19, 2011	June 27, 2011 Jan. 1, 2012*	
Corporate Credit Unions	704 §704.2 & 704.15 § 704.21	Final Rule	April 21, 2011	May 31, 2011 Jan. 1, 2012 April 29, 2013	
Online Authentication	LCU 11-CU-09	Interagency Guidance		Jan. 1, 2012*	

Board Perspectives

THE SHORT-TERM, SMALL LOAN

BY GIGI HYLAND, NCUA BOARD MEMBER

Key financial ratios from second quarter 2011 Call Reports show that lending has increased for the first time in four quarters. Specifically, total loans grew 0.7 percent to $564 billion. This data reflects a significant uptake in short-term, small loans. The demand for these types of loans rose 52 percent in the second quarter.

Since its introduction, this product has gained growing market acceptance and enhanced the availability of short-term credit. At the end of June, 343 federal credit unions reported more than 33,000 Small Loans, averaging just below a 21 percent interest rate and just above $412 each.

Alternatives to the traditional payday lending model have been a topic of discussion within the credit union system for several years. The discussion reveals two valid perspectives: (1) offer consumers what they want—short-term, consumer-friendly, sustainable loans; (2) don't offer "alternatives" to payday lending because such products are not best for consumers.

If consumers are getting short-term, small loans from other providers in the marketplace, it means there is a demand for such products. In this situation, can credit unions do what credit unions do best—find ways to make loans to members in a manner that is fair to the consumer and to the credit union's business? If credit unions ignore the opportunity to provide short-term, small loans they may lose these potential members for good.

As I noted in last month's column, "Risk in Plain Sight," not all members will have credit scores that suggest they are a good credit risk, yet those members are the very ones who may need assistance the most.

In September 2010, NCUA finalized a short-term, small loan rule for credit unions. With strong consumer protections, the rule balances increased risk with access to affordable, fully amortized credit that is faster and easier to qualify for, as compared to more traditional lending products.

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SEPARATE JOBS—ONE GOAL

BY MICHAEL E. FRYZEL, NCUA BOARD MEMBER

Over the last few months, I have had the opportunity to speak to numerous credit union groups across the country. When doing so, one of the subjects I have addressed is the distinct and separate roles of three important groups to the industry: NCUA, trades, and credit unions.

The survival, growth and continued success of the credit union movement in the United States is a goal shared by each group, yet each organization has a different role in reaching it.

NCUA is, of course, no exception. Some blame NCUA for every ill that befalls credit unions as a result of the current financial crisis in our country and the world. They point to decisions made over the last three years, identify existing or proposed regulations, or claim the staff and the Board have attempted to overreach their statutory authority. Some will even blame the regulator for the failure of Congress to act on such legislation as an expansion of member business lending and alternative or supplemental capital. I somewhat understand this thinking. If things are not going the way you want them to, blame it on the 800-pound elephant in the room.

While always accepting responsibility for our share of what goes wrong, I have tried in my speeches to express what I believe credit unions, trades and NCUA each should do to pull in the same direction. Ronald Reagan once said, "Government's first duty is to protect the people, not to run their lives." I believe the job of NCUA is not to run credit unions, rather it is to work to assure, as best it can, the safety and soundness of the entire system, and to protect the integrity of the Share Insurance Fund.

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The NCUA Report is published by the National Credit Union Administration, the federal agency that supervises and insures most credit unions.

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Director's Column: Office of the Chief Economist

REVISING THE ECONOMIC OUTLOOK TO ACCOUNT FOR EMERGING RISKS

John D. Worth
Chief Economist

After a summer of economic and political turbulence in the U.S. and a fall marked by rising concerns about European economies, credit unions should take stock of the economic situation and reconsider their economic outlook. The economic situation and outlook should play a key role in strategic planning, business development, capital management, setting allowance for loan losses, and other activities. This column takes a look at recent developments and the outlook for the economy for the coming year.

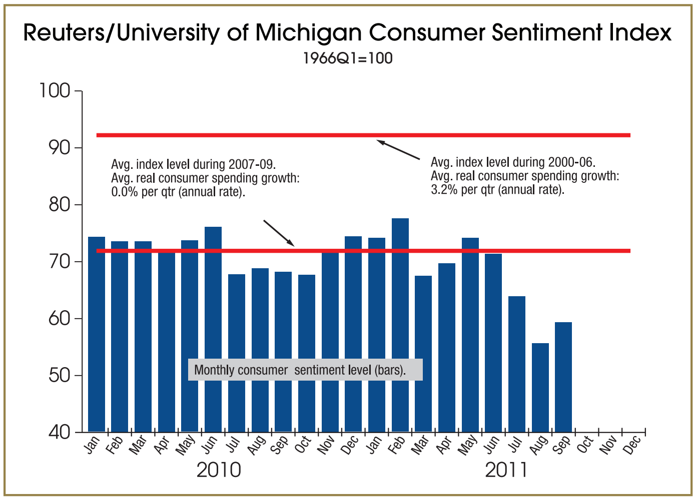
A Disappointing First Half of 2011

Economic output and employment growth during the first half of 2011 fell short of most analysts' expectations. The Commerce Department reported that real GDP grew only at an annual 1.3 percent rate in the second quarter, was essentially flat in the first quarter (0.4 percent).

Two important external events in the spring dragged down economic growth during the first half of 2011: rising oil prices and disruptions related to the Japanese earthquake and tsunami.

The sharp rise in oil prices reflected heightened instability in the Middle East and North Africa. Oil rose from an average of $80 per barrel in the second half of 2010 to nearly $100 per barrel during the first half of 2011. This increase quickly translated into higher retail gasoline prices, which hurt consumer confidence and cut the growth of real consumer spending.

The disaster in Japan limited the availability of key manufacturing components. As a result, manufacturing activity and sales slowed, especially in the auto industry, which had been recovering at a very healthy pace.



The combination of high energy prices and sagging employment prospects resulted in a sharp drop-off in already weak consumer sentiment. This weakness in consumer sentiment was exacerbated by the debt ceiling crisis and budget debate during July and August. The figure shows that consumer sentiment is not only well below pre-recession levels, but is actually below the average of recession levels. The recent economic slow-down in the recovery has lowered employment growth and lifted the unemployment rate. Employment grew at an average of just 95 thousand jobs per month over the three months ending in September. The joblessness rate, which had dropped a full percentage point to 8.8 percent between November 2010 and March 2011, rose to 9.1 percent in July and remained there throughout the third quarter. The sluggish employment growth reflects weak consumer demand.

Through the Fall, there has been growing concern about the quality of sovereign debt issued by some Eurozone nations and the potential for a sovereign debt default or a major asset write down by European banks that hold sovereign debt. The European situation creates substantial risks for the U.S. economy. These come through both direct channels--a Eurozone recession would hurt the U.S. exports and slow recovery--and indirect channels--U.S. banks have exposure to European banks that could face losses. The uncertain situation has increased financial market risk and volatility.

Outlook through 2012

Based on the weak first half of 2011, indications that the economy is off to a sluggish start to the second half of the year, and continuing uncertainty—focused on the evolving European debt crisis—most forecasters have cut their growth estimates for the rest of this year and next. This more pessimistic economic view contributed to the widespread decline in equity markets . The combined effects of the budget-cutting deal to resolve the debt-ceiling impasse and the S&P downgrade of U.S. Government long-term debt will likely result in a further drag on the economy. In the current budget environment, federal spending, temporary unemployment and tax-cuts, and support for states are less likely to be extended into 2012.

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OFFICE OF THE CHIEF ECONOMIST (FROM PAGE 5)

We view continued weak consumer sentiment as a key risk for the remainder of 2011 and into 2012. Without some improvement in consumer spending, the economy will not regain traction rapidly. We expect output to grow at a faster rate in the second half of 2011 than during the first half, but at a sluggish rate between 2 and 2.5 percent at an annualized rate. Auto sales are likely to be an important driver of growth. The rate of economic expansion should pick up in 2012—to 2 to 3 percent at an annualized rate, but the economy will still operate well below its potential to produce. Reflecting the weaker-than-previously-forecast growth, most analysts expect unemployment to remain at very elevated rates—above 8.5 percent—throughout 2012 and into 2013.

Consistent with the slow growth, both inflation and interest rates are forecast to remain in check. Recent statements by the Federal Reserve suggest short-term interest rates will hold steady at very low levels into 2013. Nevertheless, the current interest rate environment is highly unusual, and we believe that both the level of interest rates and the term structure will return to historical norms over time. For example, long-term rates are near historic lows and the spread between the 10-year and 3-month Treasury rates remain unusually high.

Importantly, given the highly unusual monetary and fiscal policy environment, adjustments in rates and term-structure may be abrupt, resulting in a compression on net interest margins for many institutions. The quick compression may pose a risk to credit unions that have an unusually large portfolio of long-term, fixed-rate assets or investments.

Our Bottom Line

The most likely scenario is that the United States will experience moderate growth, modest declines in unemployment, and modest moves in both inflation and interest rates throughout the rest of 2011 and in 2012. An emerging concern is that the usual policy tools are not available to help if the economy continues to stumble and that the sharp cuts in state and local government budgets, exacerbating the drag on the economy.

Given the uncertainty in the economic outlook, our advice for credit unions is:

- Prepare for slower-than-expected growth, including continued elevated unemployment and delinquencies, and limited improvement in the housing market.
- Prepare for rising delinquencies and slow deposit growth in credit unions with a large government employee field of membership.
- Take advantage of this low-interest-rate environment to make sure balance sheets are Asset Liability Management resilient.
- Stress-test your institution's balance sheet, earnings, and strategy to reflect the uncertain environment.

The economic road ahead may be uncertain, but credit unions can take steps to remain profitable and strong.

THE SHORT-TERM, SMALL LOAN (FROM PAGE 4)

NCUA's regulation allows federal credit unions to charge 1,000 basis points above the general interest rate ceiling, as set by the Board. Based on the current general interest rate ceiling, credit unions may charge up to 28 percent on Small Loans. If credit unions can control the expense of review and origination, the higher interest rate allows federal credit unions to offer a viable alternative to predatory payday loans.

To take advantage of this higher annual percentage rate, federal credit unions must make loans in accordance with the requirements of the rule, which include limitations on the permissible term, amount, and fees associated with a short-term, Small Loan. The loans must be fully amortizing. The rule also requires a federal credit union to set a cap on the aggregate dollar amount of these types of loans outstanding and to set a minimum length of membership requirement.

Consumers clearly utilize this type of product. The challenge for credit unions is balancing a consumer-centric product with appropriate due diligence to meet members where they are, rather than wait for members where they should be. Last year's NCUA rulemaking on this topic offers credit unions a means to achieve that balance.

SEPARATE JOBS—ONE GOAL (FROM PAGE 4)

The job of the trade associations is to continuously improve the system for their member credit unions and for all credit unions. Included in that role is to lobby the Congress for whatever new services they may need that will aid credit unions in doing their jobs better. The job of credit unions is to run themselves in a safe manner in accordance with their pledge to put the best interest of members ahead of all other concerns.

Early on in the financial crisis, NCUA proposed legislation needed to save and protect the system and then asked Congress for its passage. That is the type of legislation a regulator is mandated to pursue.

We each have our jobs to do, and we each have to do them well and in coordination with one another, without overlap but with cooperation. Credit unions have achieved success by providing the best financial services available to the 91 million Americans who count on them every day.

NCUA, the trade associations, and the credit unions now have to care for that success, carefully and respectfully. Knowing each of our roles will make sure we do.

Office of Small Credit Union Initiatives Report

TECHNICAL ASSISTANCE GRANTS AVAILABLE; HELP CREDIT UNIONS SERVE COMMUNITIES

Congress created and funds the Community Development Revolving Loan Fund (CDRLF) to provide low-interest loans and grants to support credit unions' efforts in improving financial literacy, creating new products, preventing foreclosures, expanding access to credit, and supporting low-income communities. The fund increases income, ownership, and employment opportunities for low-income residents. It stimulates economic growth and helps credit unions improve the quality of services to the community.

In May, NCUA issued a proposed rule to eliminate outdated procedures and increase transparency regarding access to these funds. When finalized, NCUA anticipates that this reduction in regulatory burden will increase demand for these loans, and enhance the availability of basic financial services in low-income communities.

Below, NCUA's Office of Small Credit Union Initiatives, which manages the fund, explains how credit unions may access CDRLF grants.

What is a Technical Assistance Grant (TAG)?

A TAG is money to help credit unions improve their operations and their financial condition, provide basic financial services to members, and stimulate economic activities in their communities.

NCUA's TAGs are reimbursable grants. To be reimbursed, credit unions must receive approval of the proposed expenditures beforehand.

Where does the money come from?

Congress appropriates funds to the CDRLF for loans and grants. The interest earned on loans is also available as a source of funds for grants.

Who is eligible?

Federally chartered credit unions that have a low-income designation from NCUA's Office of Consumer Protection are eligible. State-chartered credit unions must have a low-income designation from their state supervisory authority with NCUA concurrence.

How can my credit union apply?

Credit unions should apply electronically using the online application at: **http://www.ncua.gov/Resources/CreditUnionDevelopment/Finance.aspx**. All copies of bids, estimates, prices, and other supporting information along with the signed application need to be either emailed to **oscuiapps@ncua.gov** or faxed to (703) 519-4088.

How can my credit union use the grant funds?

Listed below are a few of the 2011 allowable uses and purposes for grants. In 2012, the initiatives will be focused on innovation and impact.

- Student internships
- Volunteer Income Tax Assistance (VITA) sites
- Staff and board training
- New technologies
- Business/strategic plans
- Financial education and financial literacy
  - Homeownership
  - Marketing
  - Outreach

The grant application describes specific uses for each initiative. Use of grant funds must coincide with the purpose of the grant as stated in the credit union's grant application. TAG initiatives support the community goals of the CDRLF, as well as providing additional resources to credit unions. Grants to help credit unions respond to current economic events and emerging needs may also be allowable.

How much can NCUA award my credit union?

NCUA may award grants up to $10,000. Each initiative has a maximum grant award, which is stated in the applicable guideline available at **http://www.ncua.gov/Resources/CreditUnionDevelopment/Finance.aspx.**

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- Corporate credit union retained earnings accumulation;
- A corporate credit union releasing non-perpetual capital accounts (NCA) to facilitate the payout of shares in a liquidation;
- A corporate credit union redeeming NCAs prior to maturity or prior to the end of the notice period;
- A corporate credit union releasing perpetual contributed capital (PCC) instruments to facilitate the payout of shares in a liquidation;
- A corporate credit union calling PCC instruments;
- The establishment of individual minimum capital requirements; and
- Actions required or authorized with respect to capital restoration plans.

The delegations of authority will enhance the effectiveness of the revised corporate credit union rule by empowering OCCU to act more timely on corporate requests.

Net Worth and Equity Ratio Rule Addresses Statutory Revisions

The Board issued a final rule to amend the definition of "net worth" as it appears in NCUA's PCA regulation, Part 702, and the definition of "equity ratio" as it appears in NCUA's Requirements for Insurance regulation, Part 741.

These amendments implement changes to the "net worth" and "equity ratio" definitions made by S. 4036, which President Obama signed into law Jan. 4, 2011 (P.L. 111-382). The rule also makes technical changes in Parts 700 and 701 to ensure clarity and consistency in the use of the term "net worth" as it relates to federally insured credit unions.

Section 2 of S. 4036 amends the Federal Credit Union Act by redefining "equity ratio" as it relates to the NCUSIF. Under the amended definition, the equity ratio will be calculated using the financial statements of the NCUSIF alone, without any consolidation or combination with the financial statements of any other fund or entity. The final rule amends the definition of "equity ratio" in NCUA's regulations to implement the change made by the new law.

Section 3 of the new law authorizes the Board to include §208 assistance in the computation of a federally insured credit union's net worth for PCA purposes. This final rule implements this change in NCUA's PCA regulation.

The final rule also contains a technical change to the definition of "net worth" to eliminate the double counting of net worth in a combination resulting in a bargain purchase gain.

The Board considered 15 comments to the proposed rule issued in March 2011. In response to comments received on the technical change, the Board noted that this change will comport with Generally Accepted Accounting Principles and is consistent with the Congressional objective in the 2006 Relief Act. The Board also noted that most mergers will be unaffected by this change, because most mergers do not include a bargain purchase gain. Moreover, analysis showed none of the recent mergers that did include a bargain purchase gain would result in a significant decrease in net worth because of this technical change.

For these reasons, the Board retained the technical change in the final rule that requires the subtraction of any bargain purchase gain from the acquired credit union's retained earnings before the latter amount is included in the acquirer's net worth.

Additionally, the Board recognized the difference in definition of "net worth" between PCA and member business lending regulations, but noted NCUA's regulations reflect the corresponding definitions in the Act and would therefore require a statutory change to modify.

The Board also revisited the language of the statutory amendments, considering comments received, and concurred with those who stated that §208 assistance as "net worth" should not be limited to only those instances when a merger is involved. The Board, therefore, clarified that §208 assistance can be counted in a credit union's net worth subject only to those limitations contained in the rule text.

This rule becomes effective Oct. 31.

NCUSIF and Stabilization Fund Summary as of Aug. 31, 2011

The NCUSIF equity ratio was reported at 1.31 percent for Aug. 31, 2011. This ratio is based on an insured share base of $782.4 billion at June 30, 2011 and reflects the additional one-percent deposit billed in September. The equity ratio will be recalculated at year end based upon the insured share base as of Dec. 31.

The NCUSIF ending reserve balance was $1.0 billion. This included $24.1 million in reserves for specific natural person credit unions (NPCUs), and $975.9 million in non-specific reserves for NPCUs. Insurance loss expense was $3.2 million for the month of August.

Gross income for August was $19.1 million, with expenses of $14.7 million, resulting in net income of $4.4 million. Cumulative net income for the year is $227.1 million.

Thirteen credit unions have failed thus far in 2011 at a cost to the NCUSIF of $46.8 million.

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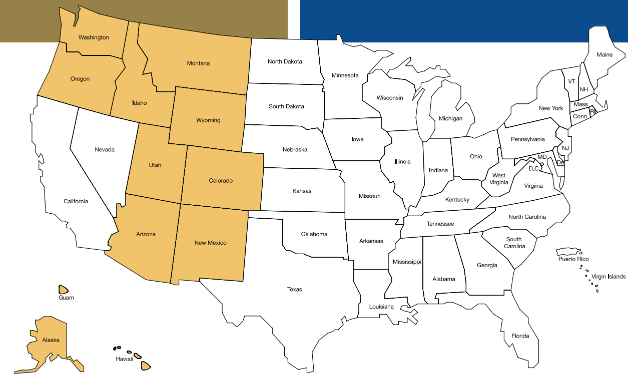
Region V Report

PRUDENT CREDIT RISK MANAGEMENT PROTECTS MEMBERS



REGION V

Managing risk is at the very core of a credit union's existence. If risks are managed well, a credit union can add increased value to their membership. If risks are managed poorly, a credit union diminishes this value and can even jeopardize its very existence. Credit risk, in particular, poses a significant challenge.

Strategically, credit union officials often turn to growth in new or existing loan programs as an effective way to enhance profit. However, some credit unions engage in such tactics without proper regard for the underlying potential risks. Sadly, this practice often results in new loan programs or objectives that are not controlled appropriately by reasonable guidelines or prudent limits.

The results of such programs follow a predictable path beginning with rapid growth, followed by a steady deterioration in loan quality. Delinquency is a lagging indicator and does not alert a credit union of a problem until after a substantial concentration of problem assets has been accumulated and loan growth has slowed or stopped. At this point, the accumulated concentration of problem assets may be overwhelming.

A review of recent credit union failures emphasizes the need to establish prudent limits and guidelines prior to implementation. Large concentrations of loans demonstrating high-risk characteristics consistently contribute to credit union failures across the nation. Often these concentrations developed in an uncontrolled manner, as management and officials were unengaged about the associated risks.

As an example, credit unions who do not periodically evaluate the credit score distribution of their various loan portfolios may be unaware of growing concentrations of loans to subprime borrowers. Also, credit unions that continue to grant high loan-to-value (LTV) real estate loans despite a weakening local real estate market may later discover a substantial portion of their portfolio is now unsecured. A weakened economy quickly reveals these problems and can make them unmanageable.

Credit union officials must remain informed about the underlying risks that exist in their loan portfolios. If not doing so currently, NCUA encourages credit unions to proactively perform credit risk analyses on their portfolios. Credit unions can accomplish this practice by collecting key underwriting data on a periodic basis such as the borrower's credit score, LTV ratio and debt-to-income ratio. Credit unions can use this data to evaluate changes in the credit risk

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Enterprise Risk Management Provides Evaluation Framework

Enterprise Risk Management (ERM) is a process which, if adopted, provides a credit union with a framework to evaluate their current level of risk and analyze the potential impact of new strategies. ERM is effective because it establishes a documented process to measure risk across the entire credit union and relates these risks to a consistent measurement such as risk to capital and earnings.

An ERM framework can be adopted by all credit unions to varying degrees. At its core, ERM requires consideration of the following key concepts:

- Establishing an initial baseline level of risk across the entire credit union through a documented risk-assessment process;
- Establishing a method to measure, monitor, and report changes to the baseline risk profile using a consistent measure of risk (*i.e.*, risk to net worth); and
- Adopting an ongoing process of risk assessment to measure risk, including evaluation of new strategies, relative to a credit union's defined risk tolerances.

To be clear, ERM is not a one-time project or audit, but rather a process. Generally, it requires the involvement and support of all credit union staff as information on controlling risks is collected and distributed throughout the organization. Ultimately, an ERM process will provide management and officials with a singular process to assess all risks to the credit union and their related controls on a regular basis.

Regardless of whether a robust ERM framework is in place, credit unions should work to gain a broader understanding of their overall risk profile. While credit risk generally represents a significant portion of a credit union's total risk, other risks must also be considered in order to determine what amount of credit risk should ultimately be accepted. In the end, however, credit unions that proactively measure, monitor and control the risks facing them will provide the most value to their membership, and will succeed through even the most difficult economic climates.

OFFICE OF SMALL CREDIT UNION INITIATIVES REPORT (FROM PAGE 7)

How are grant applications evaluated?

Subject to funds availability, NCUA awards grants to qualifying credit unions that meet the focus of the funding initiatives. Priority consideration is given to credit unions that have not received funds in the recent past and that are engaged in new projects that help the credit union thrive and assist their community.

How does the payment process work?

After receiving an approval letter, the credit union may purchase the goods or spend the funds, up to the amount approved. After making the expenditure, the credit union must submit copies of receipts and proof of payment to NCUA for reimbursement. Credit unions should submit all receipts for a single grant at one time. NCUA will review the receipts and process electronic reimbursement for approved expenditures. NCUA must receive all requests for reimbursement before the end of the commitment period listed in the grant award letter.

What is the reporting requirement after receiving an award?

Credit unions receiving awards must provide a summary of the impact of the TAG. The award letter states the time frame for submitting the summary. The submission deadline allows reasonable time for the credit union to determine the benefits of the technical assistance.

OFFICE OF EXAMINATION AND INSURANCE REPORT (FROM PAGE 1)

- Requirement that each loan participant has reviewed the loan documents prior to closing;
- Identification of loans sold with or without recourse, and whether the originating lender has guaranteed any payments;
- Requirement that the originating lender act in a prudent and sound manner; and
- Statement on how decisions will be made, whether any change in terms requires the consent of the participants, and whether the consent has to be unanimous or majority rule.

When properly administered, participation loan programs can be a useful tool for credit unions to serve their members and diversify risk. Most importantly, members benefit by being able to maintain a relationship with a lender familiar with their history, resulting in a reliable and consistent source of funding to support their needs. For more information on balancing the benefits and risks of loan participation programs, see NCUA Letter to Credit Unions No. 08-CU-26, November 2008, available at **http://www.ncua.gov/Resources/LettersCreditUnion2008.aspx**.

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profile over time, and ensure loans representing a high likelihood of default are proactively identified and appropriately reserved.

Further, NCUA expects credit union management and officials to be aware of what material concentrations exist within their balance sheets, to take appropriate steps to measure, monitor, and control such concentrations, and to establish a commensurate level of credit risk analysis to monitor significant concentrations. Examiners identifying significant concentrations of loans by type or characteristic, which may threaten earnings or capital, will address such situations by requiring credit risk analysis. Without such analysis, it would be very difficult to accurately determine the scope of any potential problems.

Ideally, credit unions should thoroughly evaluate all strategic initiatives—especially loan related programs—utilizing a comprehensive process to ensure such programs will not result in an overall unacceptable level of risk.

Office of Consumer Protection Report

EXPLAINING STATUTORY LIEN AUTHORITY

In the current economy, credit unions are enforcing statutory liens more frequently and much sooner than they have in the past. This practice has resulted in a dramatic increase in the number of member phone calls and complaints about a credit union's ability to take funds from a member's account.

The Federal Credit Union Act gives federal credit unions the power to impress and enforce a lien on the shares and dividends of any member equal to the amount of that member's outstanding financial obligation to the credit union. Federal credit unions rely on this power to collect on loans and charges due and payable by their members.

Generally, a federal credit union has priority over other creditors bringing claims against a member's accounts, provided the member receives written notice of the statutory lien provision in plain language at the time of account opening; or in the case of a loan, in the loan agreement signed by the member. In a loan agreement, the statutory lien provision is also known as a cross-collateralization clause. NCUA regulations address the disclosure requirements for federal credit unions regarding statutory liens in §701.39.

A federal credit union may only enforce a statutory lien when the member fails to satisfy an outstanding financial obligation due and payable to the credit union. This may be accomplished by debiting funds in the member's account and applying them to the extent of the outstanding financial obligation. A federal credit union may enforce a statutory lien without obtaining a court judgment or exercising the right of set-off.

There are some instances when a statutory lien may not be enforceable, such as:

- The credit union does not provide written notice to the member at account opening; or in the case of a loan, in the loan agreement;
- Loans secured by accounts governed by state law, such as accounts associated with a formal trust or power of attorney; and
- The existence and application of a federal or state law that takes precedence over a federal credit union's statutory lien authority.

These rules apply to *federal* credit unions, except as otherwise provided by federal or state law. Federal credit unions are responsible for determining if other federal or state laws apply when exercising their statutory lien authority.

BOARD ACTIONS (FROM PAGE 8)

As of August, 369 federally insured credit unions with assets of $34.8 billion and shares of $30.9 billion had CAMEL code 4 or 5 designations. Additionally, 1,791 CAMEL code 3 credit unions had assets of $147.2 billion and shares of $131.0 billion. Overall, approximately 18 percent of all credit union assets were in CAMEL code 3, 4 or 5 institutions. The percentage of assets in CAMEL code 1 and 2 credit unions has increased slightly in each of the past six months.

The Stabilization Fund total liabilities and net position stood at approximately $6.1 billion at the end of August, about $2.1 billion higher than the end of July.

Financial data reported in 2011 for both the NCUSIF and the Stabilization Fund are preliminary and unaudited.

All open NCUA Board meetings are tweeted live. Follow @TheNCUA on Twitter. Board Action Memorandums are available online at www.ncua.gov. NCUA posts rule changes online at www.ncua.gov under *Resources/Legal/Regulations, Legal Opinions and Laws*.

Office of Consumer Protection Report

TREASURY'S SAVINGS BONDS GO GREEN

The U.S. Department of the Treasury announced it will end over-the-counter sales of paper savings bonds Dec. 31, 2011. While credit unions will no longer sell paper bonds, electronic savings bonds will remain available for purchase through TreasuryDirect, a secure, web-based system operated by the Bureau of the Public Debt.

In 2010, financial institutions issued 18.1 million savings bonds. Ending the sale of paper savings bonds, in conjunction with the elimination of paper payroll bond sales earlier this year, will save approximately $120 million over the next five years in printing, mailing, and storing bond stock, and fees paid to financial institutions for processing bond applications.

The decision to solely issue electronic savings bonds is not only a cost-cutting measure, but a noteworthy green initiative on the part of the Treasury Department that is in line with NCUA's own green initiative. "GreeNCUA" was launched in the fall of 2009 after NCUA Board Chairman Debbie Matz made strengthening environmental efforts a priority for the agency.

The Treasury Department is offering a free toolkit to help credit unions easily communicate this change to consumers. The toolkit contains:

- Fliers for consumers;
- Short messages for account statements;
- Frequently asked questions for employees;
- Web banners; and
- An article for employee newsletters.

Credit unions may download the material at **www.treasurydirect.gov.**

Buyers view credit unions as trusted sources of information about savings bonds. The toolkit will help prepare tellers and staff to provide helpful members service about this change. Credit unions can best help by:

1. ***Educating consumers about the upcoming changes.*** Let consumers know they will no longer be able to buy paper savings bonds at your credit union or by mail order. Direct consumers to **www.treasurydirect.gov** where they can purchase, manage, and redeem electronic savings bonds online. Electronic savings bonds are secure and convenient to manage in a TreasuryDirect account, and consumers will no longer have to worry about misplacing, losing, or storing paper savings bonds. In addition, with a TreasuryDirect account, consumers can purchase electronic savings bonds as gifts and also convert paper savings bonds to electronic ones.
2. ***Not accepting applications for paper savings bonds after Dec. 31, 2011.*** Consumers have until the close of business on that day to submit their final purchase applications and funds. Final applications mailed directly to the Federal Reserve by consumers must be received by Dec. 31, 2011.
3. ***Continuing to redeem savings bonds.*** There are currently more than 670 million paper bonds worth $181 billion in the hands of the public. Please continue redeeming these paper bonds on behalf of your members. Also, please inform members that paper bonds that have not yet matured but are lost, stolen, or destroyed can be reissued in paper or electronic form.

For more information, visit **www.treasurydirect.gov.** Additionally, NCUA issued Letter to Credit Unions No. 11-CU-15, available at **http://www.ncua.gov/Resources/LettersCreditUnion2011.aspx**, providing guidance on ending over-the-counter sales of paper savings bonds.

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