

**Statement by NCUA Chairman Debbie Matz  
Proposed Corporate Rule – Part 704  
November 19, 2009**

Thank you, and my sincerest thanks to all the NCUA staff who worked so hard on developing this proposed rule. It has been a long and difficult journey to get to this point. As a result, we are presenting a very well thought-out proposed rule that would comprehensively reform the regulatory framework for corporate credit unions. I know the staff have put in a tremendous amount of time, effort, and research, and I appreciate the dedication, talent, insight, and willingness of everyone on the team to consider all viewpoints.

I believe this proposed rule reflects an unprecedented effort on NCUA's part to solicit and incorporate broad stakeholder input. We began by issuing an Advanced Notice of Proposed Rulemaking in January to seek input from the credit union system. We received almost 500 comment letters and carefully considered the recommendations they contained. We held three town hall meetings and a webinar to make sure we heard even more voices in this process. Over the 10 months since the ANPR was issued we have carefully studied the issues and recommendations and have approached revisions to the corporate rule with an open mind.

We have made a point of ensuring that this proposed rule is not prescriptive. It does not prescribe how many corporates will exist, where they will be located or what services they will provide. Those issues, we believe, should be resolved by natural person credit unions. Our main objective is to preserve service to 93 million credit union members by preventing the corporate issue from becoming a consumer issue.

As the staff outlined here today, the proposed rule addresses four major areas that are deficient in the current rule. Let me take just a few minutes to focus on why each area is so important.

## **1) Capital Standards**

The economic crisis has clearly reinforced the importance of effective capital standards for financial institutions. This lesson certainly applies to corporate credit unions which went into this crisis modestly capitalized and too dependent on contributed capital from natural person credit unions. The proposed rule, therefore, significantly strengthens capital requirements.

In addition to aligning corporate credit unions with Basel I capital standards, the proposed rule would subject corporates to a leverage capital requirement in an effort to capture risk that is not quantifiable, such as operating risk. These two requirements, working in tandem, will help ensure strong capital standards for the corporate system.

In addition, for the first time, prompt corrective action standards would be imposed on corporate credit unions, in the same ways that PCA standards apply to all other federally-insured financial institutions in the United States. A system of prompt corrective action is an essential element of a strong regulatory capital framework and must be applied to corporates.

The last time the Agency engaged in corporate rulemaking, some in the industry questioned whether a capital requirement for corporates was even necessary. I believe subsequent events have proven that credible capital standards are essential and must be integral to our new regime.

However, it will undoubtedly take some time for corporates to rebuild capital. Setting aside the ongoing impact of corporates' legacy assets, the first major hurdle will be whether or not natural person credit unions will be willing to provide additional contributed capital. Though the proposed rule phases in the leverage ratio over 3 years, I anticipate we will know well before then the extent to which natural person credit unions are willing to support their corporate's capital needs.

Another key consideration is the extent to which corporates can rebuild retained earnings. Based on feedback from our town hall meetings and other stakeholder input, we adjusted the phase-in of the retained earnings requirement to provide regulatory milestones of 3, 6, and 10 years. We did this to reflect the economic realities of the rate at which corporates can generate net income based on the proposed limitations on investment authority. The 3-year milestone reinforces that **corporates must begin working to build retained earnings from the outset.**

If after 3 years a corporate's retained earnings ratio is less than 45 basis points, the corporate must submit a Retained Earnings Accumulation Plan that meets NCUA's approval. But as long as the corporate is making positive progress and has a sound plan to rebuild retained earnings, NCUA will have flexibility in establishing appropriate milestones for the Retained Earnings Accumulation Plan.

I want to emphasize that we understand the challenges posed by the distressed legacy assets held by some corporates, and we are evaluating options to alleviate this problem. Removing large OTTI risks from corporate balance sheets will be pivotal to sustain the system.

We are still exploring ideas to allow affected capital holders to benefit if confirmed losses are less than recognized losses.

This proposed rule cannot remove legacy assets from the past, but it would prevent concentrations of high-risk assets in the future.

## **2) Asset Liability Management**

The new regulation proposes specific requirements for asset-liability management to ensure that the gap between average life of assets and liabilities does not present excessive risk. These limits intend to keep corporates from concentrating in asset-backed securities with expected lives as long as 20 years.

Another asset-liability management provision would prohibit a corporate from accepting funds from a single source that exceeds 10 percent of the corporate's assets. I understand this may lead to some challenges for corporates with large clients. However, it is important to manage the liquidity risk posed by too much reliance on a single lender or depositor. We will, of course, consider comments on how to best strike this balance while maintaining rigorous safety and soundness safeguards.

### **3) Concentration**

As many of you know, I voted against the corporate rule in 2002 principally because I did not think the crucial issue of risk concentration was adequately addressed. We will not make that mistake again.

It is indisputable that excessive concentration in one type of asset contributed greatly to corporate credit unions' losses. This lapse was more conspicuous when compared to the corporates' modest levels of capital.

Given the systemic role corporates play in payment systems and other services natural person credit unions rely on, it is essential to properly limit the risks that corporates can engage in.

I strongly support the proposed rule's explicit sector limits. Coupled with other restrictions on investments, and new asset-liability management constraints, the sector limits will provide for diversity of investments. These provisions will install concentration limits in certain sectors based on risk, and ensure that corporates with low capital have stronger limits.

I have also believed for many years that the investment authority being granted to corporates was overly broad and permissive, particularly in light of the complexity of the financial instruments that were available to them. I was insistent that the proposed rule thoroughly address this issue by placing additional limits on the types of authorized investments.

Restricting or limiting complex and volatile investments is important to ensure that investment authority will be more consistent with two key functions of the corporate business model; that is as a payment system and liquidity facility.

Our projections show that the new investment limitations and risk management provisions would have mitigated the losses from the current crisis. We believe they will also provide sufficient flexibility for corporates to operate at adequate profitability levels to meet the proposed retained earnings standards.

#### **4) Governance**

I also have a few thoughts about governance issues. Our experience has shown that when individuals serving on a credit union's board of directors lack the requisite experience or knowledge, governance problems result. Our staff spent a great deal of time contemplating various options to remedy governance issues.

The proposed rule would require that all corporate board members currently hold a CEO, CFO, or COO position at their credit union or other member entity. When considering eligibility standards for board members, this seemed to be the best proxy for experience, expertise, and appropriate motivation.

The future of the corporate credit union system, and the role the new regulatory framework plays in affecting that future, clearly have far-reaching implications. It is vital that we continue to get broad stakeholder input. Because this proposed rule is so lengthy and complex, there will be a 90-day comment period to allow sufficient time for stakeholders to fully review and comment on it. In January and February I plan to hold additional town hall meetings and a webinar to continue the dialogue during the comment period.

Notwithstanding all of our efforts, even with a strong regulatory framework, the future of the corporate system will depend on the needs and support of the natural person credit unions they serve.

Enhancing the quality and types of service available to 93 million credit union members, and making certain that their financial interests are well protected, is our ultimate goal.

Again, thank you. I support issuing the proposed rule for comment.

#### **QUESTIONS:**

##### **General (Scott):**

- 1) Will this rule provide the road map to recovery for corporate credit unions?
- 2) In addition to the town hall meetings and webinar I'm planning during the comment period, can you tell me about any other plans to obtain input from stakeholders?

##### **Capital (Paul):**

- 1) For the first time, this rule would impose risk-based capital requirements on corporates. Please explain the advantages of a risk-based approach.
  - a. Please provide a brief overview of Basel I and Basel II, and why this proposal follows Basel I.
  - b. Is this Basel I proposal exactly like what other financial regulators have adopted?
- 2) How difficult do you think it would be for corporates to achieve the capital requirements, given the current state of the corporate system?
- 3) Can you review some of the new tools that Prompt Corrective Action would provide for dealing with troubled corporates?

##### **CUSOs (Paul):**

- 1) What compliance burden would the proposed rule place on corporate CUSOs?

**Investments/ALM (Rick):**

- 1) If this rule had been in place before the financial crisis, what difference would it have made?
- 2) What effect will the proposed rule have on corporates' ability to build retained earnings?

**Governance (Ross):**

- 1) Can you explain how we plan to implement the governance changes in a way that would minimize the disruption to current boards of directors?
- 2) Does the proposal specify the format that disclosure of senior executive compensation must take?