Remarks by

The Honorable Debbie Matz
Chairman
National Credit Union Administration

at the

Association of Corporate Credit Unions Annual Conference

in

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Good morning, everyone. I appreciate the kind introduction by Brad Miller. Through these difficult times Brad has done an excellent job in making certain that your voices are heard at the Agency. Our decision-making is aided by ACCU's active interest in the very complex and difficult issues before us.

It's great to be with you today in my new capacity as chair of the NCUA board. As many of you know, I served on the NCUA board from 2002-2005.

Serving as a public steward for the credit union system is very fulfilling and very humbling.

So, when I received a call from the White House personnel office, and the caller told me that the President wanted to know if I'd be interested in going back to NCUA as Chair, I didn't hesitate before saying yes.

Given the impact of the recession on credit unions, and in particular the corporate credit union system, some of you might think I should have spent a little more time thinking about my answer.

I can truthfully say that I am glad I accepted this challenge. With the support of the talented and creative people within the credit union system I know that we can successfully address these challenges together.

All of us know too well the ravaging effect the downswing in the national economy has had on credit unions, and in particular on the corporate system.

Back in 2005, if we had to predict the worst case economic scenario that would confront credit unions in the coming years, we wouldn't have been close to how tough the reality has been.

No one could have anticipated the need for NCUA to conserve the two largest corporate credit unions. I believe that NCUA acted with appropriate speed and decisiveness in responding to those two troubled corporates. Even though I wasn't on the Board at the time, I firmly believe that NCUA's actions saved the credit union system from an even larger catastrophe.

The majority of natural person credit unions were directly exposed to corporate losses due to the uninsured shares they held in corporates. As a result, a large number of natural person credit unions would have failed – creating even more costs to the insurance fund and remaining credit unions.

To prevent such a devastating sequence of events, NCUA developed a broad strategy to stabilize and resolve the corporate crisis. This strategy consists of three phases: 1) Stabilization Phase – stabilize liquidity and raise awareness about the situation; 2) Reform phase – implement exit strategies for the extraordinary support programs and improve the regulatory framework; and 3) Resolution Phase – conduct an orderly resolution at the least cost to the credit union system.

Going forward, NCUA's key consideration in addressing the corporate situation is concern for the impact on natural person credit unions and the members they serve. The number one goal is to prevent, to the extent possible, the corporate issue from becoming a consumer issue.

It is imperative to safeguard the flow of funds through the corporate payment systems.

And, it is vital to continue stabilizing actions, such as the share guarantee program, because a sale of the bonds at depressed market values would result in untenable and unrecoverable costs to all insured credit unions.

I know one of the main concerns many of you have is how NCUA is treating capital. Many of you believe that there should be some mechanism within the corporate structure to allow the contributed capital accounts to be replenished if losses don't fully materialize as projected.

I've gotten the message loud and clear that this is a concern. So I have asked Scott Hunt and senior staff to participate with all interested corporates in a special meeting on this issue. It will be held at 2:00 P.M. on November 5 at NCUA headquarters in Alexandria, VA.

As we discuss possible approaches, let's keep in mind how valuable your capital is. It's the first line of defense to cover losses and protect the insurance fund. So we need to be careful to protect the value of your capital going forward.

The credit union system needs to be the example, not the exception, when it comes to following standards in financial reporting and the application of legal and regulatory requirements.

I hope you will agree that our actions to date have been successful in addressing the immediate stabilization and early resolution issues. Now, for the future of the corporate system, we must begin to develop a revised corporate regulatory framework.

Last year, NCUA issued an Advanced Notice of Proposed Rulemaking. This document essentially announced the agency's intention to propose a revised corporate rule, and it contained language offering various options.

Clearly, this is important to you, and there are some strong opinions. We received almost 500 comment letters, and we read every one.

To make sure we get even more voices heard in this process, I've already held three town hall meetings to hear directly from credit union officials about corporate and other issues.

I want you to know that listening will be a hallmark of my Chairmanship. I am approaching the revision to the corporate rule with an open mind.

We may agree or disagree, but as long as we maintain that spirit of cooperation, I believe we'll be able to improve this industry that we all care about so much.

As some of you may remember, I cast the lone vote against the corporate rule when it was revised in 2002. As a then-new member of the board, this was a difficult decision. I did not believe the crucial issue of risk concentration was adequately addressed. I also believed that the investment authority being granted was overly broad and permissive, particularly in light of the complexity of the financial instruments that were available to some corporates.

I bring this up—not to say I told you so -- but to underscore how important it is that these issues be addressed this time around.

A crisis can teach us many lessons. It can reveal fundamental flaws in strategies and projections. It can provide concrete proof of the impact of not addressing vulnerabilities. And if we look back objectively, it can show us how to avoid a similar crisis in the future.

To incorporate lessons learned from this crisis, the NCUA board will be voting next month at its November meeting to issue a proposed rule to strengthen the regulatory framework for corporate credit unions. The proposed rule is not yet final. We are still incorporating feedback from the town hall meetings. And I hope to get additional ideas from you. We are not going to prescribe the number of corporataes that should exist or what services they should provide. Corporate credit unions were created to serve NPCUs and it will be up to them to determine the future role of corporates in the credit union system.

I can assure you that however many corporates remain will operate under stringent safety and soundness regulations. Our proposal will provide a framework for safety and soundness but one that we believe will provide sufficient flexibility for corporates to survive. As of today, I can tell you that revisions to the corporate rule will address four main areas:

1. Investment Authority

As you know, the main culprit in the corporate credit union crisis was an over-concentration in one type of investment. The current rule does not contain explicit sector limits, with the only concentration limit being investments to a single obligor limited to 50% of capital.

The proposed rule would reduce the single obligor limit to 25% of capital. The proposal will also impose specific concentration limits by sector. The sector limits would be tied to the lower of a multiple of capital and a hard limit to assets. Very low credit risk investments, such as treasuries and agency securities, would not be subject to the sector limits.

We also envision additional limits on the types of authorized investments. The current corporate rule generally prohibits many of what traditionally were considered the riskiest types of investments. In fact, almost all of the distressed bonds were AAA and AA rated at the time of purchase. However, this is an important opportunity to ensure investment authority going forward is more consistent with the corporate business model and does not provide an opportunity for undue risk taking.

Thus, the proposal will prohibit certain types of currently authorized complex and volatile investments, such as collateralized debt obligations (CDOs) and net interest margin (NIM) securities. These investments have proven problematic for some corporates.

The proposal also limits subordinated positions in a structured security. This limit will reduce a corporate's credit risk by limiting the ability to purchase securities that are not the most senior security in terms of credit risk.

The proposed rule would eliminate Part II expanded authority, thus making A-minus the lowest possible rating for an investment. The proposal also requires that a corporate examine the rating from every Nationally Recognized Statistical Rating Organization, or NRSRO, that publicly rates a particular investment and use the lowest of those ratings. It further requires that at least 80 percent of a corporate's investments be rated by at least one NRSRO.

2. Capital Standards

The global financial community has come to appreciate the importance of effective capital standards for financial institutions. This lesson certainly applies to corporate credit unions, which went into this crisis modestly capitalized relative to their balance sheet composition.

The proposal would modify the corporate capital requirements to make them stronger and more consistent with the Basel I capital requirements. In addition, there would be new proposed PCA provisions similar to those currently applicable to all other federally insured financial institutions.

To be considered adequately capitalized, the proposal replaces the current 4% minimum total capital ratio with three minimum capital ratios to be adequately capitalized:

- 4% leverage ratio (5% for well-capitalized);
- 4% tier one risk-based capital ratio (6% to be well-capitalized); and
- 8% total risk-based capital ratio (10% to be well-capitalized).

Failure to meet any of these three minimum ratios would trigger a capital restoration plan requirement and would make available various new PCA provisions. The proposal limits the capital that a corporate may use to calculate the leverage ratio and the tier-one risk based capital ratio to "core" capital, which would generally include only the more permanent forms of corporate capital such as retained earnings and permanent contributed capital.

The current crisis demonstrated the pro-cyclical aspect of a corporate being too dependent on contributed capital. Too much reliance on contributed capital can exacerbate the downstream impact on natural person credit unions of any corporate losses. Thus, the proposal also requires that retained earnings constitute a certain portion of capital. For example, to be adequately capitalized a corporate must have at least 100 basis points of retained earnings.

It will take some time for corporate credit unions to rebuild capital. Accordingly, the new capital and PCA provisions will be phased in over time.

3. Asset-Liability Management (ALM)

The proposed rule establishes new limits on cash flow mismatches to ensure that the gap between the average life of assets and liabilities does not present excessive risk. An additional NEV stress test that applies credit spread widening to both assets and liabilities is required. In addition, the weighted average life of a corporate's investments cannot exceed two years.

These limits aid in keeping corporate credit unions from concentrating to the extent they did in asset-backed securities with longer expected lives.

The proposed rule also has specific provisions to address funding risk. The proposed rule places limits on both unsecured and secured borrowing, requires corporates to keep a sufficient amount of cash and cash equivalents on hand to support payment system obligations, and prohibits a corporate from accepting funds from a single source that exceed 10 percent of the corporate credit union's moving daily average net assets.

4. Corporate Governance

The current corporate rule does not place any experience or knowledge requirements on individual corporate directors, nor does it limit the representation of corporate managers and officials on the boards of other corporates. As we have seen, this can lead to governance problems.

The proposed rule requires that all corporate board members currently hold either a CEO, CFO, or COO position at their credit union or other member entity. When considering alternatives for an eligibility standard for board members, this seems to be the best proxy for experience, expertise, and appropriate motivation available.

To improve transparency, the proposed rule also requires that each corporate disclose on an annual basis the compensation of each senior executive officer. With respect to any corporate merger, a merging federally-chartered corporate must disclose to both NCUA and its members any material, merger-related increase in compensation for any senior executive.

The proposed rule also prohibits golden parachutes. This is to ensure operational management's incentives are better correlated with the long term interests of the organization.

I encourage everyone to again take advantage of the comment process for the upcoming proposed corporate rule the NCUA board expects to approve at its meeting next month. Ultimately, 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.

One of my priorities as NCUA Chair will be to help keep credit unions strong and healthy… and to make sure that Americans know that credit unions are a safe place to save and to borrow. This will certainly require a successful resolution of the corporate crisis.

I know these are trying times and that you and your staffs are working feverishly to continue to provide your members with the high quality service they have come to expect from you. The services you provide – payment systems, investment opportunities, and liquidity – are vitally important. These services permit NPCUs to provide affordable, reliable financial products to their 90 million members. That's what we're all about – and that's why it's crucial that we get the corporate rule right this time. The future of the credit union system depends on it.

One thing I can assure—those corporates which continue to operate will do so within a framework of safety and soundness that protects them and ultimately the entire system.

I look forward to working with you and getting your input as we proceed.