National Credit Union Administration
Chairman Debbie Matz

Remarks to the
Pennsylvania Credit Union Association

Atlantic City, New Jersey
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Thank you very much for that kind introduction. It is a great pleasure to join you here today, and to salute Pennsylvania's leadership among credit unions – both for your dedication to reaching out to communities large and small, and for your spirit of innovation in offering new products and services.

I was reminded of your creativity just recently, when two of your league officials – Jim McCormack and Rick Wargo – paid a personal visit to NCUA. As they briefed me on the latest developments among Pennsylvania credit unions, they told me about a remarkable success story.

As thousands of Pennsylvanians seek a better way to get from paycheck to paycheck, dozens of Pennsylvania credit unions are offering one of the nation's most innovative payday loan alternatives: the "Better Choice" program. Better Choice empowers Pennsylvania credit unions to offer short-term small loans at a mere fraction of the cost of predatory payday lenders. By providing these desperately needed loans for borrowers with low-to-moderate incomes, Pennsylvania credit unions are extending a lifeline to members who were drowning in debt.

It was impressive to hear what makes your program truly unique: To mitigate the risks of these unsecured loans, the Pennsylvania Treasury Department has deposited funds to help cover credit unions' allowance for loan losses. That's a key reason why, among the 82 credit unions offering Better Choice over the past 3 years, their losses from unsecured loans have been no higher than their losses from any other loans. Most important, Better Choice has saved more than 28,000 borrowers from paying nearly $10 million in excess fees. In the process, Better

Choice has helped those borrowers establish savings accounts worth more than $1.3 million.

Please join me in congratulating your Pennsylvania Credit Union Association colleagues and leaders for initiating this innovative public-private partnership. Congratulations on your success!

Now, many of you may be wondering about the new rule on payday loan alternatives, proposed last month by the NCUA Board, and how it could affect your operations through "Better Choice." The short answer is: The new rule will not affect your initiative at all. Any program that is operating under NCUA's current rules will be allowed to continue after the new rule is finalized. NCUA's proposal on small, short-term loans is in addition to, not instead of, successful programs that exist today.

In fact, Pennsylvania's success with "Better Choice" could inspire credit unions in other states to offer payday loan alternatives under NCUA's newly proposed rule. Our rule would allow federal credit unions to offer short-term, small loans in amounts of $200 to $1,000, with terms up to 6 months. This would enable borrowers to consolidate high-cost payday loans while keeping their payments manageable. To protect borrowers from accruing higher and higher balances, our rule would prohibit rollovers.

Because the cost and risk of providing these loans is high, our proposed rule would allow federal credit unions to charge an application fee of up to $20 and an interest rate of up to 28 percent APR. Or, if federal credit unions choose to include all fees in the APR, they could charge up to 36 percent.

However, to ensure that credit unions do not take on too much new volume and too much new risk, the final rule will likely include a cap on short-term, small loans. Given your experience providing payday loan alternatives in Pennsylvania, I would appreciate your taking the time to send us a comment letter with your thoughts on a reasonable way to calculate that cap. The comment period is open through July 6.

We realize, though, that even the most successful payday lending alternatives may not net many new members. In the future, innovative services that attract diverse groups of new members will be needed to help credit unions survive and thrive.

I know the issue of survival is critical to many of you in Pennsylvania. Jim and Rick shared with me their concern about the rapid disappearance of many Pennsylvania credit unions. This is a concern I share as well.

For decades, Pennsylvania led the nation with the largest number of credit unions. But just recently, your state was overtaken by Texas. Ironically, Texas did not overtake Pennsylvania because they're adding credit unions at a faster rate. In fact, it's because Pennsylvania is losing credit unions at a faster rate.

Pennsylvania has lost almost one in 4 credit unions since 2002 – the year I began my first term on the NCUA Board. Then, Pennsylvania was home to 730 credit unions. Today that number is down to 558.

Why such a rapid decline? Most of the credit unions that disappeared were very small. Yet even today, nearly half of Pennsylvania credit unions have less than $10 million in assets.

Of course, as we know, much of the value in small credit unions is that they remain very close to the communities they serve. In the best "people helping people" tradition, small credit unions can offer member services with a personal touch that many larger institutions cannot simulate.

But if those credit unions do not have long-term strategic plans, business plans, and succession plans, they will not survive.

During my first term at NCUA, I established the agency's Office of Small Credit Union Initiatives. This office provides small credit unions with helpful workshops, grants and technical assistance. The goal is to help small credit unions survive and grow, so they can continue to provide service to their members.

In fact, though, the most important indicator of the strength of the credit union industry is not the total number of credit unions, but the total number of members. My top priority is to protect the safety of those members' deposits by ensuring the soundness of their credit unions. This includes credit unions of all sizes.

So I am pleased to report today that overall, the state of Pennsylvania's credit unions is strong. When compared to the other 5 states and the District of Columbia in the Mid-Atlantic region – what NCUA refers to as Region 2 – Pennsylvania's credit unions are among the strongest.

Over the past year, Pennsylvania credit unions generated the region's highest rate of loan growth (9.29 percent). Amazingly, at the same time, Pennsylvania credit unions also reported the region's lowest delinquency ratio (1.15 percent).

Pennsylvania also compares favorably with most other states across America. Your earnings (0.64 percent return on average assets) were more than triple the national average. Better still, your rate of loan growth was eight times higher than the national average.

You can be especially proud of the fact that, as a result of your "I Belong" cooperative advertising program, Pennsylvania credit unions are increasing membership faster than most other states. At the start of this year, your membership growth rate was more than 50 percent higher than the national average. And, for the first time, your total membership is over 3.5 million.

As those new members bring in new funds, your rate of share growth also tops the national average by nearly 50 percent.

Those are all clear signs of strong public confidence in Pennsylvania credit unions.

Good management and sound lending standards have long been the norm in Pennsylvania. More than two-thirds of your credit unions – holding 91 percent of your state's total assets – have a strong CAMEL rating of 1 or 2.

Like every state, however, Pennsylvania has a worrisome number of credit unions that have weakened – sometimes severely – during these tough economic times.

NCUA is concerned about the growing number of Pennsylvania credit unions rated CAMEL 3. More than 30 percent of Pennsylvania credit unions are now in this vulnerable category; and those 168 CAMEL 3s are holding nearly 9 percent of Pennsylvania's credit union assets.

One of NCUA's top priorities is to make sure that today's CAMEL 3s do not become tomorrow's CAMEL 4s and 5s. Right now, fortunately, you have very few credit unions in the most serious problem categories.

If there is a silver lining amid our country's economic crisis, it is this: At a time when every other part of America's financial-service sector has seen its reputation tarnished, credit unions are still shining – with overall strong net worth, growing membership, and even continued growth in lending.

Yet no part of America's financial sector has been immune from economic pressure. The credit union industry now confronts an array of challenges that will surely test your resilience. As the federal agency that ensures the safety and soundness of the credit union system, NCUA is committed to helping you through these volatile times.

Nationwide, a great many credit unions remain under pressure. The number downgraded to CAMEL 4 and 5 almost doubled during the downturn – and those seriously troubled credit unions hold more than 5 percent of all insured shares. Even larger is the growing group of credit unions across the country rated CAMEL 3, which now account for nearly 14 percent of all federally insured shares.

Many credit unions – while still well-capitalized – will be draining capital this year, due to negative earnings. At the same time, delinquencies and loan losses continue to increase in many parts of the nation. Undoubtedly, these ominous trends will lead to an increase in credit union failures this year.

NCUA is becoming even more vigilant to ensure that negative capital trends and loan losses do not hit more credit unions in Pennsylvania. While your overall net worth ratio (10.6 percent) remains higher than the regional and national averages, your net worth ratio is falling at a faster rate (77 basis points). And by far the three fastest-growing types of loans at Pennsylvania credit unions – fixed-rate first mortgages, indirect loans, and member business loans – are also among the riskiest types of loans.

So NCUA is stepping up to the plate, in Pennsylvania as well as every other state. Our examiners are carefully monitoring the call reports of all federally insured credit unions, looking for red flags. These include increases in delinquencies in member business lending, indirect lending, and loan participations.

We are particularly concerned about credit unions that are not doing their own due diligence. Let me be clear: If you make member business loans, you must do your own underwriting, even if you use a vendor or a CUSO. If you make indirect loans, you must not delegate loan approval authority. And if you participate in loans, you still must do your own due diligence, even if the originator is another credit union.

As our examiners review the call reports, if they see that a federally insured credit union has suffered a significant increase in delinquencies in any of these areas, they will visit the credit union – even if an exam is not on the regular schedule, and even if it is a state-chartered credit union.

We are also looking very closely at any credit unions that are holding too many fixed-rate, long-term mortgages on your books. We have been warning, for months now, that higher interest rates are a question not of "if" – but of "when." We urge you to take action now to make sure your portfolio is strong enough to withstand the interest-rate risks that will soon hit your balance sheets.

NCUA is determined to take a realistic approach to the difficult economic trends, by taking precautions to prevent dangerous situations from arising before it is too late. We are taking the disciplined steps required to protect the credit union system as a whole. We must uphold rigorous standards, because we aim to protect the 90 million members who depend on the safety and soundness of the credit union system.

Now I would like to switch gears, and talk with you candidly about a subject that is on everyone's mind – the corporate credit union crisis.

As I know you are all aware, NCUA has taken decisive action to deal with the corporate crisis. And, yes, that term is fully justified: It was indeed a crisis. If we had not confronted the situation head-on, the nation's credit union structure would have faced a grave systemic risk.

I know that there has been a great deal of confusion about what has happened and what will come next. So let me take a few minutes to discuss these issues.

And let me start by assuring you that I fully recognize the legitimate anger that many of you feel. That anger has come through loud and clear during the comment period for the proposed new corporate rule.

I have heard directly from many of you about the pain you have felt. I know that many of you blame NCUA: After all, two examiners were on-site at US Central and WesCorp. NCUA definitely shares some of the blame – but there is plenty of blame to go around, especially among the managers and boards who exercised such poor judgment.

Much of the blame falls outside the credit union industry. Mortgage brokers made dubious loans that led to waves of foreclosures. Rating agencies handed out Triple-A ratings for mortgage-backed securities that are now merely “toxic assets.”

When the mortgage bubble burst in 2007 and 2008, the fallout caused an extraordinary decline in the global economy – and exposed the four giant corporates to extreme shock, because of their vast investments in residential-mortgage-backed securities. When the market for those bonds came to a halt, the corporates’ losses pushed them toward insolvency.

If the corporates had abruptly stopped operating, that would have threatened to end the services that they have long provided to natural-person credit unions. That is because three-quarters of natural-person credit unions have used the corporates as their primary agents for clearance and settlements.

In addition, about 90 percent of natural-person credit unions had investments in corporates. If the corporate system had collapsed, the natural-person-credit-union system would have suffered huge and insurmountable losses – shattering confidence in all of America's credit unions. Natural-person credit unions would have lost about $30 billion in net worth – about one-third of their net worth at the time. At least 800 natural-person credit unions would have collapsed.

In addition, your federal Share Insurance Fund would have had to levy huge assessments on the surviving credit unions, to cover the remainder of the losses. Many of those remaining credit unions might not have withstood the strain.

To preserve capital and confidence, NCUA had to put two of the largest corporates – US Central and WesCorp – into conservatorship. And we have also had to carefully monitor the operations of the other large corporates.

To stabilize the system, NCUA placed guarantees on shares at all corporates. As a result, credit union investments in the corporates are backed by the full faith and credit of the United States government.

It is important to understand that our aim was not to "bail out" the corporates. We aimed to stop them from bleeding, as their assets were hemorrhaging value. NCUA did what we had to do, to save the system by preserving public confidence.

Our proposed new corporate rule is focused on providing a framework for safety and soundness that protects the system.

The proposed rule has four main themes, aiming to change four critical areas in the current rule.

First: On capital standards: The new rule will strengthen capital requirements, aligning corporates with Basel One standards; subjecting corporates to a leverage capital requirement to help reduce risk; and imposing Prompt Corrective Action standards on corporates that match those that apply to all other federally insured financial institutions.

Second: On asset-liability management: It proposes specific ALM requirements to ensure that the gap between the average life of assets and liabilities does not present excessive risk. It also prohibits a corporate from accepting funds from a single source that exceeds 10 percent of the corporate's assets. This will avoid excessive reliance on a single lender or depositor.

Third: On risk concentration: It will limit risk by forbidding corporates from excessive concentration in a single type of asset. Promoting a diverse portfolio of investments will help avoid the kind of risk concentration that was permitted under the flawed corporate rule that was approved in 2002. Back then, I voted against that rule, for this very reason.

Fourth and finally: On governance standards: It will raise eligibility standards for corporates' board members, aiming to elevate their level of experience and expertise.

Strengthening these four areas will go a long way toward preventing another corporate crisis from ever occurring.

In light of all the comments we have received, we will be making further improvements to the rule, which we hope to finalize at our September Board meeting.

But first, we plan to respond to what your comments have told us is the highest priority: the need for NCUA to dispose of the toxic assets that caused the crisis. Isolating the so-called "legacy assets" is a necessary first step in avoiding further damage.

I understand why some of you do not want to recapitalize corporates as long as toxic assets remain on their books. And I understand why you are frustrated that NCUA has not yet announced a plan to remove these legacy assets. So, now I am going to share with you our plans to date.

Let me be clear: This is very much a work in progress. It is an enormous undertaking. There is no easy way to un-bundle more than $50 billion worth of assets, repackage them into marketable bonds, and move them from corporates' balance sheets without realizing losses.

This effort is so huge – and so important – that we are dedicating 30 of our top staff to work on it. In recent months, our team has been brainstorming countless ideas for safely resolving the corporate crisis at the lowest possible cost to credit unions. With every possible solution, more questions – and more legal and accounting issues – are raised.

Yet we now feel we are on the verge of a breakthrough. Our team is close to proposing a plan that would remove the riskiest legacy assets from ongoing corporates, while carrying forward the most valuable pieces of the corporate system. The plan would empower natural-person credit unions to choose which corporates they will support. And it would ensure that those corporates begin with clean balance sheets.

If the plan proceeds as we envision, it could even allow credit unions to recover future earnings from legacy assets that out-perform current loss projections.

Our team is still working to answer a host of questions – about underwriting, funding, and much more. But our team is cautiously optimistic that this careful process will generate the best possible solution. In fact, they hope to bring a comprehensive corporate resolution plan to the NCUA Board by this summer.

I want to unveil NCUA's plan to resolve the corporate crisis as quickly as possible. But I do not want to rush this vital process. So please bear with us until we are sure that we have refined the best possible solution.

In the meantime, let me assure you: Based upon your comment letters, we will not move forward with a final corporate rule until after the plan for legacy assets is announced. And while the legacy assets plan will ensure that corporates begin with clean balance sheets, the final rule will ensure that corporates maintain those clean balance sheets.

Speaking of clean balance sheets, at NCUA, we have been working diligently with two independent audit firms to ensure that the agency's financial statements will be presented with complete accuracy and transparency. By way of background, during the first half of 2009, NCUA was successful in getting Congress to create a separate fund – the Corporate Stabilization Fund – that allows NCUA to assess credit unions for corporate losses over a 7-year period, rather than having to do it all in 1 lump sum.

Shortly after NCUA established this new fund, the accounting profession issued new rules governing the presentation of commercial financial statements. To this day, accountants still have differences of opinion about how to interpret the new rules, and about whether or not they apply to federal regulators. This is a vital concern for credit unions, consumers, and all other stakeholders. The additional work has caused a delay in the release of NCUA's audited financials for both 2008 and 2009.

Over the past few months, you may have heard some speculation as to why our audits have been delayed. I would like to put an end to all that unfounded speculation: The delay in NCUA's audit is in no way related to the health of the National Credit Union Share Insurance Fund. Your federal Share Insurance Fund remains strong.

In fact, every month at NCUA's open Board meeting, we release a report on the financial conditions of both funds. At our most recent Board meeting, we reported that the Share Insurance Fund's equity ratio remains well within the normal operating range, while the Corporate Stabilization Fund remains well-positioned to cover the costs of corporate losses over time.

I bring this up to alert you to the difference between the 2 funds, and to help you understand the basis for possible future assessments. Last year's single sum was actually a combination of payments for the Share Insurance Fund and for the

Corporate Stabilization Fund. I want to assure you that we are very mindful of the effect these assessments have on your balance sheets. Let me also assure you: We consider this in every decision we make.

Next month, we plan to consider whether to separate the Share Insurance Fund assessment from the Corporate Stabilization Fund assessment. This separation would not increase the total amount of assessments – but it would clarify exactly what each assessment is for: The Share Insurance Fund assessment would cover losses at natural person credit unions, and the Corporate Stabilization Fund assessment would cover losses at corporate credit unions.

Separating these 2 assessments would improve the transparency of NCUA's assessment process – and at the same time, improve the accuracy of credit unions' budget estimates.

Looking ahead: There will be difficult choices about the future of corporates.

But NCUA's overriding objective remains constant: to create a solid framework for safety and soundness. That's the surest way to protect the nation's 90 million credit union members.

Ultimately, the future of the corporate system will be determined by all of you – the leaders of natural person credit unions.

Our vision of the resolution is this: After we dispose of the legacy assets and approve the final rule, corporates will be much better positioned to protect your capital.

We recognize that the search for alternative providers would pose hard choices, especially for smaller credit unions. As you confront such choices, NCUA is ready to work with you as a constructive partner.

For the credit union community, and for the economy overall, the recovery from our recent problems will take time. But we have survived the worst of the ordeal. And we have taken strong measures to make sure that credit unions, and the system that frames them, will remain sound.

Now that the system is ready to bounce back, your industry can begin to chart a confident course.

Building on your record of service and success, you are positioned to broaden your appeal to millions of potential new members. The energy and spirit of innovation in the credit union community give me confidence that the industry has a bright future.

After the global crisis tarnished the reputation of every other part of the financial-services sector, Americans' confidence in credit unions continues to grow.

Let us not forget: During the financial crisis, the credit union system was just about the only part of America's financial sector that did not buckle under stress.

With American families struggling, and with big banks turning their backs on Main Street, it was credit unions that stepped up to the challenge.

It was credit unions that reached out – that made loans – that provided advice and reassurance.

It was credit unions that set out to modify mortgages, so that their members could stay in their homes.

It was credit unions that helped millions of Americans regain a measure of financial stability, and thus regain their confidence.

That is the kind of positive impact you can continue to achieve, as the economy moves from recession toward recovery.

In a spirit of partnership – drawing on the faith that millions of Americans place in their credit unions – I am looking forward to working closely with you in the years ahead . . . to help you make the most of the opportunities that your industry enjoys, and to help you provide the benefits that American consumers deserve.

Thank you very much.

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