National Credit Union Administration

Chairman Debbie Matz

Remarks to the

National Association of Federal Credit Unions

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Thank you very much for that kind introduction. It is a pleasure to join you at your 43rd annual conference.

You know, whenever it comes time for me to deliver a speech that marks a significant milestone, NAFCU just seems like the natural audience. In 2005, I delivered my final speech as an NCUA Board member at NAFCU's annual conference. In 2009, I came to NAFCU's Congressional Caucus in Washington to deliver my very first speech after being sworn in as NCUA Chairman. Now, as I approach the end of my first year as Chairman, I appreciate this opportunity to speak with NAFCU again, to give you my assessment of the credit union industry. But there's no need to pull out your checkbooks. This assessment will not cost you any money.

Believe me: I have heard from many NAFCU members, asking about their insurance fund assessments. Today, I will talk with you about these assessments, and about how, together, we can keep them as low as possible. I hope this dialogue will benefit all of us as we work to keep credit unions safe and sound during these challenging times.

Keeping in close touch with groups like NAFCU is one of the most important aspects of my job. From the outset of my Chairmanship, I pledged to make NCUA a regulator that listens. And among all the people we hear from at NCUA, one of our most energetic correspondents is your own Fred Becker. Fred is tireless in his advocacy for NAFCU's agenda. NAFCU and NCUA may approach issues from different perspectives, and we may sometimes reach different conclusions, but I welcome hearing your viewpoint.

Your conference is convening at a moment when our nation's economy is just beginning to get back on its feet, after the most severe downturn since the Great Depression.

I know that all of you are working to do your part as the recovery gradually takes hold: to extend credit to families and lend capital to small business owners who seek to share in the American dream. Yet, as you are aware, borrowing is still tentative, and virtually every part of America's financial system remains under significant stress. Many credit unions, large and small, are feeling extraordinary pressure.

The uncertainty of the economy makes this an especially timely moment to reflect on how we operate – to reassess how you as an industry, and how NCUA as a regulator, fulfill our respective missions. As the federal agency that ensures the safety and soundness of the credit union system, NCUA is committed to helping you survive this tough economic cycle and emerge safely from these volatile times.

And so, I would like to talk with you today about three important factors.

First: the near-term challenges that confront the credit union industry, and some of the trends that are likely to make the coming years so critical for credit unions.

Second: the role of responsible regulation in maintaining the safety and soundness that your members count on.

Third, and most important: what you can do to keep credit union performance as strong as possible – so that NCUA can keep your assessments as low as possible.

Gaining a better understanding of these issues, and how they are interrelated, will clarify the steps we all need to take, to ensure the credit union system's strength and vitality.

First: As we consider the immediate challenges that credit unions confront, I want to underscore that NCUA is maintaining a rigorous focus on several trends that we believe are cause for serious concern.

While the overall credit union system is strong, there are signs of accumulating problems. The industry is enduring a rising number of costly failures; suffering a continuing decline in capital; and seeing an increasing number of credit unions that are falling into the troubled categories of CAMEL 3, 4 and 5.

Credit union failures continue to be an increasing problem. In all of 2009, credit union failures resulted in a charge of $124 million to the Share Insurance Fund. By contrast: At our most recent Board meeting, we announced that an additional $132 million must be reserved against anticipated losses – bringing the total provision for losses to $1.1 billion so far this year.

Contrary to what you may hear, NCUA's calculation of these reserves is not based merely on guesswork. It is carefully derived from information gathered from call reports and exams. We look at several indices to make this determination. Among those factors:

- We consider capital depletion. Many credit unions, while still well-capitalized, will be draining capital this year due to negative earnings.

- We examine trends in delinquencies and loan losses. In many parts of the nation, these losses continue to increase.

- We also weigh trends in financial and managerial strength, as measured by CAMEL ratings. There are now nearly 2,100 troubled credit unions, up from just 1,600 three years ago. What's most disturbing is the accumulation of assets in these troubled categories. Credit unions rated CAMEL 3, 4 and 5 now hold about 21 percent of all federally insured assets.

To put this trend into perspective: With more than $150 billion in shares in CAMEL 3, 4 and 5 credit unions, the risk to the Share Insurance Fund is more than three times higher than it was in December 2007, when the recession technically started.

It is particularly troubling that large credit unions are increasingly feeling severe strain. Of the 130 credit unions with more than $1 billion in assets, 30 are now rated CAMEL 3, 4 or 5.

That brings me to my second point: the role of responsible regulation in ensuring the safety and soundness of the credit union system.

The increasing vulnerability of credit unions is why NCUA has intensified our own due diligence – through stepped-up exams and strengthened regulation. As many of you know, our exam process has implemented a "red flag" system to detect problems before they become insurmountable. We are carefully monitoring the delinquency rates of those activities that pose the greatest risk to the system: indirect lending, member business lending, and loan participations.

Let me be clear: We are not telling you to avoid engaging in those activities. We are saying that, if you pursue them, you need to do your own due diligence – even if you are working with a CUSO or another credit union. If NCUA finds that your delinquencies are rising and your due diligence is inadequate, an examiner is likely to visit your credit union and suggest improvements to your underwriting.

In addition, we are tightening our exam schedule. When times were good, from 2002 to 2007, NCUA maintained a relatively relaxed pace, inspecting most credit unions every other year. We now aim to examine every credit union annually. We have found that 18-to-24 months is simply too long between exams. This allowed small problems to fester and grow into irreversible threats.

You may also have noticed that we are stepping up administrative actions. When examiners identify serious deficiencies, we are prepared to issue Letters of Understanding and Agreement – and, if necessary, Cease and Desist Orders or Conservatorships if credit unions do not abide by the higher standards stipulated. NCUA must take action wherever appropriate to prevent risky business practices from bringing down credit unions.

We are also tightening our regulations when appropriate. In proposing to scale back parts of the "RegFlex" rule, we will be eliminating some provisions that allowed for too much risk. We have found, for instance, that fixed assets over 5 percent are often a significant factor in credit unions that have failed. We have also seen credit unions lose 100 percent of their net worth by delegating too much of their investment authority to third-party brokers. And requiring credit unions to stress-test their own investments simply makes good financial sense.

We have also proposed a regulation to require that, within three months of being elected, board members learn how to read and understand a balance sheet. Again, this is simply a common-sense requirement.

We have stepped up our examinations and regulations because we want to keep credit unions healthy. Rigorous standards will help credit unions survive these tough times. We want you to be there for your members when they need services, seek credit, or ask for guidance about their financial future.

There is an additional factor behind our reasoning, as well: We want to catch problems early, so potential failures can be avoided, and so resources will not be drained from the Share Insurance Fund. I think you'll agree: It is better to take early preventive measures to keep credit unions out of danger, rather than to have to close them and use the fund to reimburse their members.

But I assure you: The Share Insurance Fund is strong and resilient – and that will not change.

In addition to regulating and supervising credit unions, NCUA is focused on careful management of the Share Insurance Fund's equity ratio – retained earnings of the fund, divided by insured shares. While our equity ratio remains within its normal operating range of 1.2 percent to 1.3 percent, it has declined since the start of the year.

In fact, we had budgeted to build up equity toward a ratio of 1.3 percent this year. But anticipated losses – based on CAMEL ratings and other trends – have forced us to increase our reserve for losses. As a result, the ratio has fallen to 1.22 percent. If these trends continue, we project that the ratio will drop below 1.2 percent by the end of this summer.

If that happens, the law requires NCUA to submit a plan to Congress showing how we would get back above the 1.2 percent benchmark.

At a time when so many credit unions are vulnerable, it is virtually impossible to manage the equity ratio with a fine measure of precision, while maintaining a reasonable margin of safety.

Some have called for NCUA to maintain the ratio a few basis points below the normal operating floor of 1.2 percent. This is one option for the NCUA Board to consider. This would slightly ease the assessments on credit unions for a limited time. But others argue that reducing the fund's safety margin much further would be irresponsible. I agree. Given the magnitude of losses that are now likely, I believe it is not practical to try to manage the ratio to just a few basis points above the statutory minimum of 1.0 percent. That would risk an immediate assessment required by law.

As you can imagine, it is very difficult in this environment to predict exactly what the ultimate losses will be. Therefore, it is far wiser to manage the Share Insurance Fund cautiously – maintaining a reasonable margin of safety today, rather than risk a loss of confidence tomorrow.

The fact of the matter is – the amount of assessments really depends on the industry's own performance. The level of assessments is a direct result of the decisions that you make, as executives and board members, in conducting your business. We hope our "red flag" reviews will prove helpful to you in making these decisions and minimizing losses.

But, bear in mind, the amount of assessments depends not only on your business decisions, but on the collective business decisions of your colleagues at other credit unions. This is the very nature of a cooperative system.

And that brings me to my third point: the steps that you can take to keep assessments as low as possible, by making your credit unions as successful as possible.

By managing risks effectively and by restraining costs reasonably, you will have greater resources to meet your members' needs. By providing innovative services safely, you can turn those red flags into green lights.

You can make high-quality home loans to members who are good credit risks – as long as you do not keep too many of those loans on your own books. You can make solid auto loans directly to members, or even indirectly through third parties – as long as you thoroughly do your own due diligence. And you can make enterprising member business loans up to the statutory cap – as long as you ensure that your members have sound business plans to make their ventures successful.

Your members, along with your fellow credit unions, are counting on you to do your part to operate safely – and to prevent further losses and higher assessments.

The increasing numbers of troubled CAMEL 3s, 4s and 5s underscore the need for your increased vigilance and for NCUA's stepped-up supervision. If you share my conviction that our Share Insurance Fund must be kept as strong as possible – and if you share my concern that credit unions' operating costs should be kept as low as possible – then you will recognize our shared responsibility to ensure prudent management.

Simply put: If credit union losses are lower, credit union assessments will be lower. Your constructive work with us, particularly during this time of economic stress, will safeguard the system while keeping assessments as low as possible. The stakes are too high, and the risks are too great, for any of us – as the industry or its regulator – to lose sight of our obligation to ensure safety and soundness.

The Share Insurance Fund is ready to protect your members in case of emergency. But the federal safety net does not provide a license to ignore excessive risks. By asserting sound business judgment, you can strengthen your ability to deliver the services that your members need, along with the personal touch that they want. This has always been the hallmark of credit unions. And this is the surest way to keep your credit union sustainable, so you can both serve your members today and reach new members tomorrow.

I believe that, despite the slow economic recovery, the nation's credit union system can move forward with renewed confidence.

Riding a wave of public support for credit unions' member-friendly values, your industry is positioned to broaden your appeal to millions of potential new members. Capitalizing on everstronger public trust, credit unions can reach out to the millions who are under-served by other federally insured financial institutions. By committing yourselves to serving all those who are in your fields of membership, federal credit unions can make good use of the newly approved NCUA regulation that makes it easier to apply for community charters. Moreover, you can attract new members with additional products – like short-term small loans, which can provide a responsible alternative to predatory “payday lending.” NCUA is now considering a new rule that will give credit unions greater flexibility to make such loans – another regulatory change that will help credit unions reach out to broader constituencies.

You as credit union leaders, and we at NCUA, both have our roles to play in making sure the system stays strong. As long as credit unions continue managing risk carefully, and as long as NCUA continues safeguarding the system rigorously, America’s credit unions will remain a resilient resource.

Working together, I feel confident that we can keep the credit union system safe, sound and growing – serving the needs of your members, building the strength of your communities, and contributing to the economic health of our nation. By doing so, we will ensure the continuing growth of the credit union spirit and the success of the cooperative ideal.

Thank you very much.