

# NCUA LETTER TO CREDIT UNIONS

## NATIONAL CREDIT UNION ADMINISTRATION 1775 Duke Street, Alexandria, VA 22314

**DATE:** June 2011 **LETTER NO.:** 11-CU-07

**TO:** Federally Insured Credit Unions

**SUBJ:** State of the Credit Union Industry

**ENCL:** Financial Trends in Federally Insured Credit Unions

### Dear Board of Directors:

Enclosed is a report analyzing credit union financial trends for the first three months of 2011, based on data compiled from first quarter call reports. This report is intended to inform you about national trends and risks which NCUA will continue to closely monitor and supervise.

The solid financial start to 2011 demonstrates the resilience of credit unions making solid progress during the economic recovery. Significantly, credit unions increased return on average assets by 23 basis points to 74 basis points during the first quarter.

However, negative trends related to loan growth and income sources remain. As a result, NCUA is focusing supervisory efforts on credit unions with elevated levels of credit risk, interest rate risk, and concentration risk.

**Credit risk** continues to constrain many credit unions' performance and will remain a focus of examinations in 2011. While overall delinquencies and net charge-offs declined in the first quarter, delinquencies in real estate, business, and participation loans remain elevated. Further, real estate and business loan modifications have increased. Although loan modifications are intended to assist members who are struggling financially to repay existing loans and avoid foreclosure, modified loans remain at risk for future delinquency. NCUA has issued several guidance letters about prudent loan modification policies and procedures. We urge credit unions to monitor the performance of modified loans very closely.

**Interest rate risk** remains a supervision concern, as many credit unions retain a significant amount of long-term, fixed-rate loans and begin to purchase investments with longer maturities. In contrast, shares are mainly in short-term accounts, such as regular share, share draft, and money market accounts. A majority of shares are also sensitive to interest rate changes. Due to the extended duration of the current low interest rate environment and the level of low-rate loan modifications held in portfolios, the interest rate risk present in credit union balance sheets will have a serious negative impact on earnings when rates begin to rise. Proactive structuring of balance sheets, including proper control over loan and share products, is essential to future success.

In March, NCUA proposed a very important regulation which will require that certain credit unions develop interest rate risk policies. These policies would require high-risk credit unions over \$10 million in assets as well as all credit unions over \$50 million in assets to identify, measure, monitor, and control interest rate risk. We believe these policies will help credit unions better prepare for market fluctuations and, in particular, the higher interest rates that are sure to follow. The comment period closed on May 23, and the comments are currently being considered in preparation of a final rule.

**Concentration risk** has recently become an area of greater emphasis for NCUA examiners. The high level of real estate loans as a percentage of total loans, compounded by continuing declines in real estate values across the country, highlight the need for sound concentration risk mitigation strategies and practices. A fundamental principle is that diversification minimizes risk. This is true in lending as well as in investments.

We realize that overcoming the effects of the economic downturn remains a challenge for most credit unions. This is why NCUA examiners are working diligently with credit union management and boards to mitigate existing and potential risks to maintain stable balance sheets. NCUA will continue to take proactive steps to protect the safety and soundness of the credit union industry.

Sincerely,

/s/

Debbie Matz  
Chairman

Enclosure