# Board Action Bulletin

***Prepared by the Office of Public and Congressional Affairs***

**NCUA BOARD MEETING RESULTS FOR JAN. 26, 2012**

# NCUA Supports Regulatory Relief in Loan Modification Proposal

***Board also Finalizes Interest Rate Risk Rule, Proposes Derivatives for Credit Unions to Hedge Interest Rate Risk***

**ALEXANDRIA, Va. (Jan. 26, 2012) –** The National Credit Union Administration (NCUA) Board convened its first open meeting of 2012 at the agency's headquarters here today and unanimously approved three items:

- A proposed rule and guidance on troubled debt restructuring (TDR) to facilitate mortgage modifications and assist credit union members in keeping their homes; and
- A tailored final rule to protect against credit union failures and losses to the National Credit Union Share Insurance Fund by requiring covered federally insured credit unions (FICUs) to develop a written policy on interest rate risk (IRR) management;
- An advance notice of proposed rulemaking (ANPR) to seek further public comments about the parameters under which federal credit unions (FCUs) may use derivatives to hedge interest rate risks.

### TDR Proposal Designed to Keep Credit Union Members in Their Homes

Prudent and sound loan workouts can be an effective tool for credit unions to use to help their financially distressed members. A need also exists to effectively balance appropriate loan workout programs with potential safety-and-soundness considerations. In the proposed rule and Interpretative Ruling and Policy Statement on TDRs, the Board seeks to find a balance between both of these important considerations in order to help keep more families in their homes.

"When credit union officials told me that an NCUA policy was forcing them, in some cases, to foreclose on troubled members seeking lower payments, I committed to change that policy, and my colleagues immediately joined this effort," said NCUA Board Chairman Debbie Matz. "In addition to benefiting members, this new TDR policy will also provide relief for credit unions."

Specifically, the TDR proposal:

- Establishes consistent standards for the management of loan workout arrangements that assist borrowers;

- Streamlines regulatory reporting requirements related to TDR loans by removing manual tracking and eliminating confusion between TDRs and other loan modifications; and
- Reaffirms the existing policy and practice within the credit union industry of placing loans on nonaccrual status when they reach 90 days past due.

Credit unions will be able to modify loans without having to immediately classify TDR loans as delinquent. Additionally, credit unions will not have to track each TDR loan's performance manually for six months, as is the current requirement.

In developing a written policy in this area, the proposed TDR guidance would allow credit union boards and management to consider similar parameters as those previously established in the Federal Financial Institutions Examinations Council (65 *FR* 36903).

NCUA issued the proposed TDR guidance with a 30-day comment period. "Normally we open proposals to longer comment periods to receive as many comments as possible," said Chairman Matz, "but we are committing to implement regulatory relief on TDRs as quickly as possible."

## Tailored Interest Rate Risk Rule Protects against Future Losses

The NCUA Board adopted a final amendment to the agency's insurance rules (Part 741) requiring certain FICUs to have a written policy to address IRR management as well as an effective IRR program for successful asset liability management. To assist credit unions, the final rule includes an appendix setting forth guidance on developing an IRR policy, and effectively implementing a program based on generally recognized best practices for safely and soundly managing interest rate risk.

Consistent with the proposed rule, NCUA tailored the final IRR rule to apply to credit unions at most risk for interest rate shocks. The final rule will not apply to credit unions with less than $10 million in assets. FICUs with assets between $10 million and $50 million must have a written policy if first mortgage loans plus total investments longer than five years is equal to or greater than 100 percent of net worth. FICUs with assets more than $50 million must comply with the new IRR rule.

The NCUA Board adopted the final rule at this time because many credit unions will face increased IRR in the future. At the moment, we are in a historically low interest rate environment that has produced abnormally large interest rate spreads. Many credit unions have taken advantage of these spreads in the short term by borrowing short to lend long. The Board's action is therefore premised on mitigating risks when interest rates inevitably rise.

Earlier this month, bank regulators and NCUA issued an Interagency Advisory on Interest Rate Risk Management. The advisory recognizes that when the current record-low rates finally rise, they may rise very quickly. Thus, the advisory recommends that all financial institutions implement new shock tests and other interest rate risk management measures to manage rate volatility.

Credit unions, however, credit unions face far higher exposures to interest rate risk than banks. While banks have steadily reduced their interest rate risk exposure since 1995, credit unions have increased their exposure by more than 50 percent. Today, credit unions hold nearly 31 percent of their assets in long-term, fixed-rate mortgages, compared to only 18 percent at banks.

For the average credit union with this high interest rate risk exposure, a rapid rise to pre-recession rates could reduce their net worth by as much as 20 percent.

"Clearly, exposed credit unions without appropriate interest rate risk policies pose unacceptable and preventable risks to the Share Insurance Fund," Chairman Matz observed. "Management and boards of these credit unions must be vigilant and well-prepared before rates rise."

As adopted, the final rule requires affected FICUs to have an IRR policy and program that incorporates five elements:

- Adoption of a board-approved IRR policy;
- Oversight by the board of management's implementation of the IRR policy;
- Development of risk-measurement systems to assess the IRR sensitivity of earnings and/or asset and liability values;
- Establishment of internal controls to monitor adherence to IRR limits; and
- Implementation of a decision-making process that is informed and guided by IRR measures.

The final rule also includes an appendix to provide guidance to FICUs in developing an IRR policy and program.

"Our standard for interest rate risk policies is not one-size-fits-all," added Chairman Matz. "We realize that exposed credit unions have different risk profiles. So while we are providing a template policy, we are also providing flexibility for credit union managers and board members to develop their own policy. And we are giving affected credit unions until September 30th to comply."

### NCUA Continues to Explore Options for Interest Rate Derivatives

NCUA continues to examine alternatives to permit more credit unions to use derivatives to hedge simple interest rate risks. Through the ANPR adopted today, the NCUA Board seeks additional public comments in relation to eligibility requirements to engage is certain derivatives based on at least three factors, including the need, financial condition, and ability to manage derivatives.

"Derivatives can be a useful tool for highly experienced professionals to manage interest rate risks," said Chairman Matz. "Our intent is to safely allow more credit unions to use derivatives responsibly as a hedge against interest rate risks. Credit unions that have high interest rate risk exposure on their balance sheet could offset some of those risks if they purchase the right types of derivatives."

Chairman Matz, however, cautioned that several types of derivatives can be extremely volatile – and choosing the right rates to hedge at the right time can be a very risky proposition. "The fact that we have issued two ANPRs on derivatives demonstrates the complexity of this issue."

The NCUA Board released an earlier ANPR on derivatives transactions by credit union in June 2011. The comments received on the earlier ANPR are discussed in the latest ANPR adopted today.

NCUA issued the ANPR with a 60-day comment period.

“I am confident that our actions today will save the Share Insurance Fund from preventable losses for years to come,” Chairman Matz concluded.

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