Board Action Bulletin

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NCUA BOARD MEETING RESULTS FOR JAN. 23, 2014

NCUA Board Advances Greater Protection and Modern Regulation

Risk-Based Capital Rule Proposed and Derivatives Rule Finalized

ALEXANDRIA, Va. (Jan. 23, 2014) – The National Credit Union Administration Board convened its first scheduled open meeting of 2014 at the agency's headquarters here today and unanimously approved four items:

- A proposed rule to better protect all credit unions and the Share Insurance Fund by strengthening risk-based capital requirements for federally insured credit unions.
- A final rule to modernize regulations by giving approved federal credit unions limited authority to mitigate interest rate risk by allowing the purchase of specified, "plain vanilla" derivatives.
- A renewal of the current 18 percent interest rate cap for most loans, and 28 percent for consumer-friendly alternatives to predatory payday loans, at federal credit unions through Sept. 10, 2015.
- The agency's 2014–2017 Strategic Plan and 2014–2015 Annual Performance Plan describing NCUA's strategic goals in the areas of safety and soundness, consumer protection and financial literacy, regulation and transparency, and workforce development and diversity, as well as the steps to be taken in the coming year to reach those objectives.

Risk-Based Capital Proposal Will Require More Capital for Riskier Credit Unions

The 3 percent of federally insured credit unions that take higher risks would be required to either reduce those risks or hold more capital under a proposed rule on risk-based capital requirements approved by the NCUA Board.

The proposed rule, which would revise the agency's Prompt Corrective Action regulations (Part 702), would modernize regulation and provide greater protection for the credit union industry. The proposed risk-based capital requirements also would be more consistent with NCUA's risk-based capital measure for corporate credit unions and the regulatory measures used by other federal financial institutions regulators.

"This proposed rule would not affect the vast majority of credit unions, but would provide greater protection for all credit unions," NCUA Chairman Debbie Matz said. "Under the proposed formula, 94 percent of credit unions would still be considered well-capitalized. The proposed rule is designed to ensure that credit unions taking excessively high risks will either reduce their risks or hold more capital to offset those risks."

The proposed rule would:

- Revise the risk weights for many of NCUA's current asset classifications.
- Require higher minimum levels of capital for federally insured credit unions with relatively high concentrations of assets in real estate loans, member business loans, delinquent loans, long-term investments, and other risky assets.
- Create a process for NCUA to require a federally insured credit union to hold higher levels of risk-based capital to address unique supervisory concerns.
- Eliminate several regulatory requirements, including provisions relating to regular reserve accounts, risk-mitigation credits and alternative risk weights.

Events over the past several years have prompted NCUA to issue the proposed rule. These events include the 2007–2009 recession that exposed weaknesses in capital retention and risk measurement, the Basel II and Basel III capital accords, and the Government Accountability Office's reviews of NCUA's capital standards.

"We have already learned from the failures of Cal State 9, Chetco and Telesis, which cost the credit union industry more than $350 million, that our 15-year-old minimum standard can be improved to better protect the industry," Matz said. "This modernized regulation would allow NCUA to enforce examiners' recommendations that credit unions holding higher risk on their books should hold more capital. We're proposing a flexible, forward-looking standard that recognizes the current realities of the industry and quantifies the risks of tomorrow and beyond."

Credit unions with less than $50 million in assets are excluded from the proposed rule.

NCUA will provide an online calculator that allows federally insured credit unions to see how the proposed risk-based capital rule would affect them individually. The agency will also post an instructional video explaining how the calculator works.

Matz noted the agency is planning an extended comment period on the proposed rule and a phase-in period of at least one year. Comments on the proposed rule, available online here, must be received within 90 days of publication in the *Federal Register*.

Final Rule on Derivatives Mitigates Risk and Modernizes Regulation

Certain well-managed federal credit unions will have another tool to mitigate interest rate risk with the Board's approval of the final rule on investing in derivatives (Parts 703, 715 and 741).

"The final derivatives rule is an important addition to our Regulatory Modernization Initiative," Matz said. "It's the product of nearly two years of careful deliberation. This new set of tools will allow qualified credit unions to mitigate rate changes in either direction."

The May 2013 proposed rule received 75 comments, and some of those comments resulted in significant changes to the final version, including an expanded list of permissible derivatives, simplification of the application process, and a reduction in the overall regulatory requirements.

The Board also decided not to preempt any state derivatives authority and not to include any fees associated with using derivatives in the final rule.

"The most significant change in the final rule was eliminating any fees for application or supervision," Matz said. "We want to encourage qualified credit unions to use derivatives to mitigate interest rate risk. We will be supervising derivatives very carefully. We want to be sure each qualifying credit union has the specialized expertise, policies and internal controls needed to support an effective derivatives program."

The final rule would allow federal credit unions with assets of at least $250 million and a composite CAMEL rating of 1, 2, or 3 to apply to use certain derivatives. Federal credit unions below this asset threshold may seek permission to apply from a regional director.

Specifically, the final derivatives rule includes:

- Limited authority to invest in simple interest rate derivatives for balance sheet management and risk reduction, including interest rate swaps, interest rate caps, interest rate floors, basis swaps, and Treasury futures. Newly authorized features include amortizing notional amounts for swaps, caps and floors; and forward start dates for swaps of 90 days or less.
- A requirement that federal credit unions apply and receive approval for the use of the derivatives investment authority.
- A requirement that credit unions engaging in derivatives activities have appropriate resources, controls and systems to maintain an effective derivatives program.
- Limits on total derivatives exposure by two methods: a measure of notional amount of derivatives and a fair value loss limit.

While the final rule does not apply to federally insured, state-chartered credit unions, it does require those credit unions permitted to use derivatives under state law to notify NCUA 30 days before engaging in derivatives activities.

The Board also approved up to $750,000 for possible consulting fees, should the level of applications to engage in derivatives activities exceed the agency staff's capacity.

The final rule, available online here, will become effective 30 days after publication in the *Federal Register*.

18 Percent Interest Rate Cap to Continue through September 2015

After reviewing the needs of credit unions and borrowers, as well as current market conditions, the NCUA Board voted to extend the current interest rate cap of 18 percent for most federal credit union loans through Sept. 10, 2015. Without the Board's action, the cap would have reverted to 15 percent on March 11, 2014.

"Permitting federal credit unions to make loans between 15 and 18 percent, enables them to offer payday loan alternatives so members are not dependent on predatory lenders to meet their short-term cash needs," Matz said. "Lowering the rate to 15 percent would have put greater pressure on credit union earnings and restricted access to reasonably priced short-term cash for many members.

“Consistent with the Federal Credit Union Act, we determined that market conditions existed to maintain the present interest rate cap for most federal credit union loans. At the same time, we were able to extend the 28 percent cap on the consumer-friendly alternative to predatory payday loans offered by federal credit unions.”

Actual increases in money market rates for the period preceding the Board’s action is a key condition for establishing the maximum loan rate. A review of money market rates in the preceding six-month period revealed increases in short-term Treasury rates and an increasing market expectation for higher rates in the future. Observed increases in select money market rates support NCUA’s action to extend the current interest rate cap on loans.

The current 18 percent ceiling has been in place since May 1987. The Federal Credit Union Act caps the interest rate on most credit union loans at 15 percent, but the NCUA Board has the discretion to raise that ceiling for an 18-month period.

The Board continues to monitor market rates and credit union financial conditions to determine if any change to the maximum loan rate should be made, and the Board may take action sooner than 18 months if circumstances warrant.

Strategic and Annual Performance Plans Set Targets

The NCUA Board approved a four-year strategic plan with goals that reflect ongoing agency strategic objectives, performance goals and key supervisory concerns.

The 2014–2017 Strategic Plan summarizes internal and external factors affecting credit unions and the agency and evaluates programs and risks. The strategic goals are:

- Ensuring a safe, sound and sustainable credit union system.
- Promoting consumer protection and financial literacy.
- Further developing a regulatory environment that is transparent and effective, with clearly articulated and easily understood regulation.
- Cultivating an environment that fosters a diverse, well-trained and motivated staff.

“When I came on as Chairman in 2009, I established six goals for the agency,” Matz said. “Those six goals are the foundation for the latest Strategic Plan. Our planning also addresses our top supervision priorities for the immediate future: interest rate risk and cybersecurity. We are focused on improving our performance towards achieving these goals.”

The Strategic Plan is supported by the 2014–2015 Annual Performance Plan, also approved by the Board. The Annual Performance Plan provides specific direction to implement the strategic objectives and highlights specific goals, indicators and targets to measure agency progress towards each objective for the coming year.

Copies of the agency’s Strategic Plan and Annual Performance Plan, along with public comments received on the draft Strategic Plan, can be found online here.

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