Board Action Bulletin

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NCUA BOARD MEETING RESULTS FOR OCT. 15, 2015

Targeted Risk-Based Capital Rule Will Better Protect Credit Unions

Nearly 99 Percent of Covered Credit Unions Remain Well-Capitalized; High-Risk Outliers Have Time to Plan

ALEXANDRIA, Va. (Oct. 15, 2015) – The National Credit Union Administration Board convened its ninth open meeting of 2015 at the agency's headquarters here today and approved three items:

- A final rule to modernize the risk-based capital requirements for complex credit unions and better protect the credit union system, shield the National Credit Union Share Insurance Fund from losses and fulfill NCUA's statutory obligations.
- A proposed rule to provide a measure of regulatory relief by giving federal credit unions more choices when investing in bank notes.
- Revisions to the agency's delegations of authority that will streamline the process for granting or amending community charters that involve a population of more than one million.

The Chief Financial Officer also briefed the Board on the performance of the Share Insurance Fund, which had a net income of $40.9 million through the first three quarters of 2015.

Risk-Based Capital Rule Fulfills Agency Obligations under Federal Law

The NCUA Board, by a 2–1 vote, modernized its risk-based capital rule (Part 702) to better protect the credit union system and the Share Insurance Fund from potential losses if complex credit unions with high-risk portfolios fail.

NCUA Board Chairman Debbie Matz said the new rule both fulfills the agency's obligations under the Federal Credit Union Act and targets high-risk outlier credit unions that pose significant potential risk of losses to the Share Insurance Fund. The targeted rule would apply only to federally insured credit unions with more than $100 million in assets. Therefore, 76 percent of credit unions will be exempt from the final rule.

Among the 24 percent of credit unions covered by the rule, only 1 percent will experience any change in their capital category, based on current balance sheets. Nearly 99 percent of the 1,489 covered credit unions will continue to be categorized as "well capitalized."

The rule will become effective on Jan. 1, 2019, to coincide with the full phase-in of risk-based capital rules at federal banking agencies.

"The Federal Credit Union Act requires NCUA to update its risk-based capital standards to be comparable with the federal banking agencies," Matz said. "NCUA's existing risk-based net worth rule is outdated, and analyses by both the Government Accountability Office and the agency's own Inspector General have found the existing rule failed to adequately mitigate credit union losses as a result of the financial crisis.

If the rule were implemented today, only 16 credit unions would fall into a lower capital category. Based on the current risks on their balance sheets, those 16 credit unions would have a combined capital shortfall of $67 million.

In the three years before the rule's implementation, those 16 credit unions will have three strategic choices to make: reduce the risk on their balance sheets, raise capital to cover those risks or use a combination of both strategies.

"Even though the capital outliers represent a small number of credit unions, they still pose a large threat to the system," Matz said. "In fact, the 16 outliers hold combined assets of nearly $10 billion—or almost as much as the entire Share Insurance Fund. If any one of those outliers were to fail, all credit unions would have to pay for the losses."

The new rule, Matz said, achieves significant regulatory improvements, including:

- Ensuring complex credit unions remain well-capitalized as they grow and expand into activities with greater risk.
- Identifying high-risk credit union outliers, now and in the future.
- Incorporating a modern approach for calculating the risk-based capital ratio and making the ratio comparable to other financial institutions.
- Improving the required capital levels and risk-weight approach for many types of assets.
- Incorporating an explicit standard that complex credit unions must effectively manage capital and create written plans.

Under the final rule, approximately 97 percent of the risk weights for credit unions are equivalent to or lower than the risk weights for banks. Additionally, 99 percent of complex credit union assets will have a risk weighting of 100 percent or less, and more than half will have a risk weighting of 50 percent or less.

The new rule does not include a supplemental capital provision, but Matz said the Board will propose a new supplemental capital rule for risk-based capital purposes as soon as possible. Matz said NCUA remains committed to counting supplemental capital as part of risk-based capital.

Matz said thousands of public comments were carefully reviewed and contributed to positive changes in the proposed rule.

"Public input was invaluable to us," Matz said. "We received more than 2,000 comment letters each on the revised proposed rule and original proposed rule, and we welcomed hundreds of participants at each of my listening sessions last year. We've carefully read every letter and made changes which are directly attributable to those thoughtful comments."

The final rule is available online here. Additional materials, including an impact analysis and a risk-based capital estimator tool for credit unions to determine the impact of the rule on their operations, are available online here.

Proposed Investment Rule Changes Would Give Credit Unions More Choices

NCUA's Board by a 2–1 vote approved a proposed rule (Section 703.14) that would eliminate an unintentionally burdensome investment requirement and provide federal credit unions with greater choices when investing in bank notes.

"This proposed regulatory relief is another example of NCUA responding to thoughtful suggestions from credit union stakeholders," Matz said. "We're cutting unnecessary red tape and giving credit unions more options and flexibility in their investment decisions."

Current NCUA regulations allow federal credit unions to invest in bank notes with original weighted average maturities of fewer than five years. However, the use of the term "original" has created confusion for some credit unions as to which securities are eligible for purchase. The proposed rule would eliminate the term "original" and allow credit unions to purchase bank notes that had maturities greater than five years but have remaining maturities of fewer than five years.

Comments on the proposed rule, available online here, must be received within 30 days of publication in the *Federal Register*.

Revisions to Delegations of Authority Will Streamline Chartering Process

Actions on community charter requests that would result in a population of more than one million people being served by a credit union will move more quickly under changes to the agency's delegations of authority approved by the NCUA Board by a unanimous vote.

Matz announced at the September Board meeting she would propose a policy change to streamline the process for approving community charters. She said the change could trim two months from the process for applications for communities with more than one million residents.

"We want to be sure these credit unions have the ability and commitment to serve their entire communities, particularly low-income residents and underserved areas," Matz said. "It's clear the Office of Consumer Protection can make these determinations, and staff will be monitoring credit unions to ensure they meet the needs of their communities. There is no longer the need for the NCUA Board to be involved in the approval process."

Under the approved changes, the Director of the Office of Consumer Protection will have the authority, with appropriate checks and balances, to approve all community charter actions. NCUA Board approval previously had been required for an action involving a population of one million people or larger. Once a community charter conversion or expansion occurs, the office will continue to follow up with a credit union to monitor its progress and ensure continued support for the entire community.

The changes became effective immediately with the Board's vote. The Board continues to reserve the right to hear appeals of any charter denials.

Positive Share Insurance Fund Trends Continue in Third Quarter

The National Credit Union Share Insurance Fund maintained positive trends in income and operating expenses during third quarter of 2015, primarily reflecting the continued improvement in the performance of federally insured credit unions.

"The continued strong performance of the Share Insurance Fund reinforces the strength of the credit union system overall," Matz said. "Staff who manage the fund deserve a great deal of credit for their efforts. A strengthening economy and credit union system have helped reduce losses. The numbers we want to see going up are continuing to rise, and the numbers we want to see going down are continuing to fall."

For the third quarter of 2015, the Share Insurance Fund had a net income of $24.7 million, and it ended the quarter with an equity ratio of 1.29 percent. The equity ratio is calculated on an insured share base of $936.3 billion and includes the recently billed capitalization deposit adjustment.

Third-quarter investment and other income was $56.8 million. Operating expenses were $49 million. The provision for insurance losses was reduced by $16.9 million.

Assets of troubled credit unions, those rated CAMEL code 4 or 5, were 0.7 percent of federally insured credit union assets for the third quarter.

For the third quarter of 2015, the Chief Financial Officer reported:

- The number of CAMEL code 4 and 5 credit unions declined 19.1 percent from the third quarter of 2014 to 233.
- Assets of CAMEL code 4 and 5 credit unions were $8.5 billion, a 39.3 percent drop from the third quarter of 2014.
- The number of CAMEL code 3 credit unions fell 10.6 percent from the third quarter of 2014 to 1,297.
- Assets of CAMEL 3 credit unions were $93.7 billion, a 10.5 percent reduction from the third quarter of 2014.

Seven federally insured credit unions failed during the third quarter, for a total of 11 for the year. Total year-to-date losses associated with credit union failures are $9.9 million.

The third-quarter figures are preliminary and unaudited.

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