NCUA
National Credit Union Administration

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Remarks of Debbie Matz
Board Chairman
National Credit Union Administration

Defense Credit Union Council's
Overseas Subcouncil
Dublin, Ireland

NATIONAL CREDIT UNION ADMINISTRATION

Remarks

Thank you, Arty. It is so nice to be back in Europe with the Overseas Subcouncil. While this is my first time speaking to your group as NCUA Board Chairman, I enjoyed participating in the Overseas Subcouncil in Munich when I worked for Andrews Federal Credit Union. I truly felt the pride and honor that all of you feel in serving members of the overseas military who serve our country so proudly and honorably.

The select few credit unions that serve our Armed Forces in foreign countries fulfill several mission-critical duties. You provide affordable credit to military members and their families overseas, even when they are in war zones. You provide financial education to them and their families overseas and stateside. And you encourage savings.

I'd like to thank all of you for achieving your mission, so that military members can achieve their mission. Over the years, I've met with many of you about the issues you're facing, and I appreciate your sharing your views with me. That's how I learn—hearing from you.

Before I hear from you today, I want to speak about issues I think you all care deeply about: How we can remove unnecessary regulatory burdens, and how—together—we can keep the credit union system strong.

Let's begin by looking at how credit unions are growing stronger.

State of the System: Defense Credit Unions

When I came on as NCUA Board Chairman in 2009, credit unions were still struggling to recover from the effects of the Great Recession which began in 2007. Today, I am very pleased to report that credit unions have recovered.

State of the System: Credit Unions Have Recovered

Current Metrics Reach Pre-Crisis Norms

Credit Union Data from Pre-Crisis to Post-Crisis	U.S. Credit Unions Year-End 2007	U.S. Credit Unions Year-End 2009	U.S. Credit Unions Year-End 2014
Return on Assets	0.63 %	0.20 %	0.80 %
Net Worth Ratio	11.4 %	9.9 %	11.0 %
Loan Growth	6.6 %	1.1 %	10.4 %
Delinquency Ratio	0.9 %	1.8 %	0.9 %
Net Charge-off Ratio	0.5 %	1.2 %	0.5 %
Membership Growth	1.3 %	1.5 %	3.1 %

This slide shows how credit unions' key metrics have returned to pre-crisis norms.[1] It's truly amazing to see how much the metrics have improved since 2009. For example, when you compare the middle column to the right column, you can see that nationwide:

- Return on assets has quadrupled from 20 basis points to 80 basis points.
- Loan growth is near a record at 10.4 percent.
- Delinquencies have been cut by in half to 0.9 percent.
- Charge-offs have been cut by more than half to 0.5 percent.
- Membership growth has more than doubled to 3.1 percent.

This remarkable success story is attributed to three key factors:

- Steady recovery of the U.S. economy;
- Prudent regulations and supervision by NCUA; and
- Diligent leadership by credit union boards and management.

State of the System:
Overseas Subcouncil CU Trends

Performing Better than Most National Averages

Credit Unions' Key Metrics	Subcouncil CUs Year-End 2009	Subcouncil CUs Year-End 2014	All US CUs Year-End 2014
Return on Assets	0.75%	1.09%	0.80 %
Net Worth Ratio	9.4%	11.1%	11.0 %
Loan Growth	1.3%	14.2%	10.4 %
Delinquency	1.4%	0.7%	0.9 %
Net Charge-offs	1.5%	1.0%	0.5 %
Member Growth	6.8%	10.1%	3.1 %

You should all be very proud of your role in this success story. Together, your seven credit unions which make up the Overseas Subcouncil are performing even better than most national averages.

Your aggregate return on assets is a healthy 109 basis points. Membership growth is spectacular, at more than 10 percent. Loan growth is a robust 14.2 percent. Charge-offs, however, at 1 percent are double the national average, but this is a sharp drop from where they were in 2009.

Issues on Our Radar (Which Should Also Be on Yours)

As President Obama said during his State of the Union Address this year, "The shadow of crisis has passed."
However, as the shadow of crisis fades, none of us can allow its lessons to fade. Sometimes, we forget the most important lesson of all: The best way to deal with a crisis is to avoid it in the first place.

[1] Chairman Debbie Matz's presentation slides are available at http://www.ncua.gov/News/Documents/SP201500505MatzSpeechDublin.pdf

Let's address four issues on our radar which I hope are also on your radar. The first three issues—cyber-threats, capital outliers, and interest rate risk—concern all types of credit unions. The fourth—possible rule changes governing financial services to military members—concerns mainly defense credit unions.

Increasing Cyber-Threats

The first issue is outside the areas of expertise for many of us: cyber-threats. To understand cyber-threats, we first need to understand the different types of hackers. We are already familiar with cyber-thieves who hack into a large retailer or financial institution. The thieves' ultimate goal is to steal money.

But the new types of hackers are much more dangerous—cyber-terrorists. What makes cyber-terrorists different from cyber-thieves is their objective. Terrorists want to cripple or destroy critical infrastructure in the U.S. We know many cyber-terrorists are connected to hostile nations. We know they're targeting smaller institutions to break into larger payment systems, with the goal of bringing down the entire U.S. financial system.

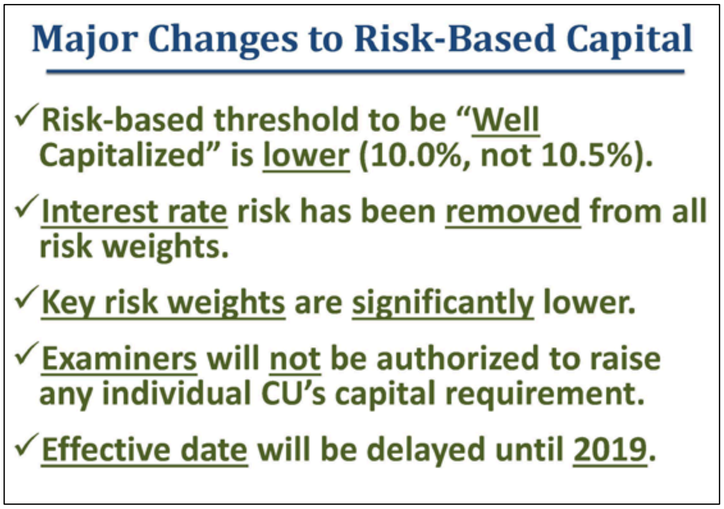
The different types of hackers have at least one thing in common: They're targeting credit unions, often as an entry point into larger systems. This year, NCUA examiners expect credit unions to implement risk mitigation controls to better protect, detect, and recover from cyber-attacks.

So, what can you do?

- Make sure your IT staff and vendors keep your system secure. This includes strong password policies, proper patch management, employee training, and network monitoring. If you don't know what these terms mean, get educated—not just you, but your credit union's employees and volunteers, as well.
- Share cyber security best practices in meetings within your professional groups. Participate in national information-sharing forums. Links to national forums are posted on our [Cyber Security Resources webpage]. NCUA's online cyber security resources can also help you find rules and guidance, including the most recently issued guidance by NCUA and the new national cyber security framework.

If IT is outside your comfort zone, here are some questions you could ask about cyber security:

- What are the potential vulnerabilities of hackers using the credit union as an entry point to gain access to larger interconnected systems?
- Has staff done due diligence to evaluate the cyber security of every vendor and every payment system with which the credit union has a digital relationship?
- How could the credit union change cyber security protocols based on guidance from the Federal Financial Institutions Examination Council?
- How could the new national cyber security standards further protect your credit union and its members?



Addressing Capital Outliers

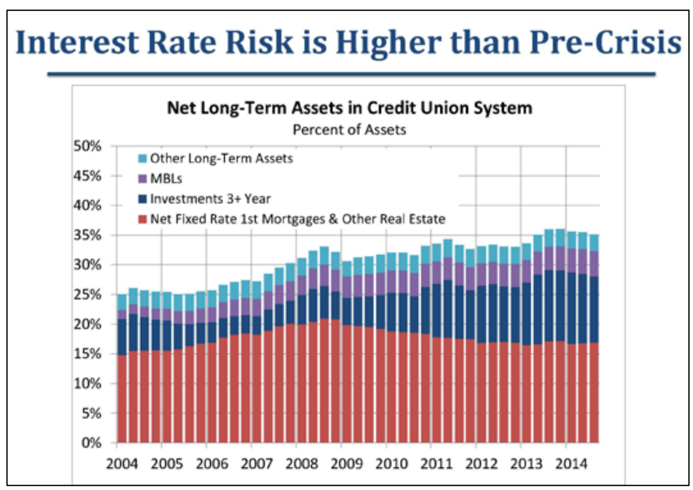
While cyber-threats come from outside the credit union system, the next two risks are inside the system. A few aggressive credit unions are taking excessive risks without holding sufficient capital to cover those risks. If those capital outliers ultimately suffer losses, then all credit unions—including yours—will have to pay.

To address this problem, NCUA proposed a revised risk-based capital rule in January, after considering all 2,056 comments. The comments are reflected in significant changes to the risk-based capital rule, several of which are shown on this slide. The new proposal targets just 27 outliers where the 7-percent net worth ratio is not enough to cover the actual risks on their balance sheets. These outliers hold assets of nearly $14 billion, more than the entire Share Insurance Fund at $12 billion.

Even though the outliers represent a small number of credit unions, they pose a large threat to the system. None of those outliers are in this room. Based on current data, if the new proposed rule on risk-based capital is finalized, your credit unions would remain well-capitalized. In fact, most covered credit unions should see their capital buffers increase.

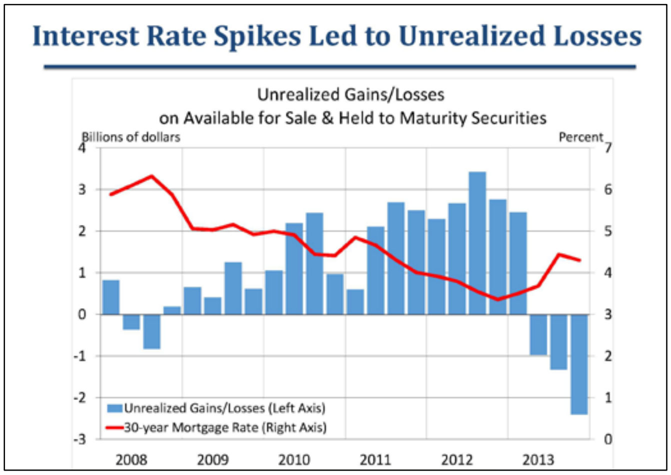
Mitigating Interest Rate Risk

Now I know you will also be happy to hear this: My intent is for the risk-based capital rule to be the last significant safety and soundness rule change for the foreseeable future.



We plan to address interest rate risk through supervision, rather than through risk-based capital or another rule. However, interest rate risk is still a concern. It's not just a concern for NCUA, but for all financial institutions' regulators.

In fact, interest rate risk is now higher than it was before the crisis. While most credit unions managed through interest rate hikes in the past, not every credit union is as well positioned today. Net long-term assets have risen from 25 percent of assets 10 years ago to 35 percent of assets today. This is a concern because credit unions now have less flexibility to adjust to rising rates.



For example, prior to the last rate cycle, before interest rates rose, only 15 percent of credit union investments were longer than three years. Today is a stark contrast: 46 percent of credit union investments are longer than three years.

Let's look at the different effects on credit unions during the last two cycles in which interest rates rose. You can see that a spike in long-term interest rates in 2008 caused credit unions to book unrealized losses of nearly $1 billion. But when long-term rates rose during the period from 2012 to 2013, the unrealized losses became much steeper. With the most recent rise in long-term interest rates, unrealized gains of $2.7 billion swung to unrealized losses of $2.4 billion. That's more than a $5 billion swing from positive to negative.

Seeing this slide was an "ah-ha" moment for me, and I hope it is for you. These unrealized losses could foreshadow actual losses if future rate hikes compress net interest margins.

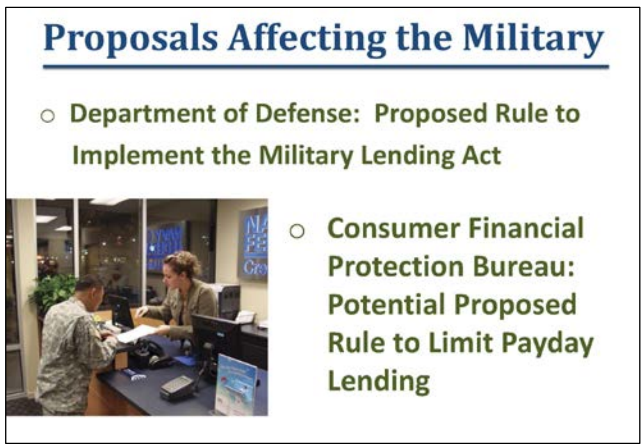
While no one knows exactly when and by how much rates will rise, the Federal Reserve's Federal Open Market Committee forecast anticipates that by 2017, the Fed Funds rate will rise by 300 basis points. NCUA examiners are urging credit unions to shock their balance sheets with interest rate hike assumptions up to 300 basis points, and plan well ahead for that contingency.

To help you prepare for interest rate changes, we've prepared an Interest Rate Risk Resources webpage on our website. When you visit this page, you'll find videos, charts, rules, and guidance.
To help you further, I've assembled some questions you could ask about interest rate risk at your next board or staff meeting. They include:

- How is the credit union measuring interest rate risk exposure?
- What has been learned from shock testing?
- What changes should be considered in the credit union’s balance sheet, product pricing, or investment strategy to avoid excessive interest rate risk?
- How should the credit union’s interest rate risk policy be updated to reflect the Fed’s new interest rate forecast?
- What internal controls ensure the credit union will follow the board’s interest rate risk policy?

If the answers to your questions suggest that interest rate risk may be exceeding your board’s tolerance, NCUA’s interest rate risk guidance describes several risk mitigation options. Choosing an appropriate risk-mitigation option will reduce the shock of rising rates.

Proposals Governing Financial Services to Military Members



The final issue on our radar targets your core mission: serving the military. Proposals from two federal agencies could require you to make major changes to your loan programs. First, a proposed rule from the Department of Defense would limit certain rates and fees you may charge to members of the military and their dependents.

The Defense Department’s proposal would establish a “Military APR” of 36 percent on payday loans, auto title loans, refund anticipation loans, installment loans, and credit cards. However, unlike the non-military APR you charge to other members, the Military APR would include fees, which are normally exempt under Regulation Z, which implements the Truth in Lending Act.

We have done the math and found that when fees are included, many credit unions’ short-term loans would exceed the 36 percent Military APR limit. Unfortunately, the Military APR limit would be violated even using what we know are reasonably priced products designed to provide affordable alternatives to predatory loans.
For example, NCUA in 2010 established the regulatory framework for Payday Alternative Loans, also known as PALs. PALs allow federal credit unions to charge an APR up to 28 percent and an application fee of no more than $20 to cover the processing cost. More than 500 federal credit unions, including Pentagon Federal Credit Union, offer PALs as a low-cost

alternative to predatory payday loans. The average PAL balance is $630 with a median interest rate of 24.6 percent. The member's average total cost for a 30-day PAL is just $33.

Yet, even PALs would exceed the Military APR limit of 36 percent if you add the application fee. Using the Defense Department's proposed calculation, the average PAL would carry a Military APR of 63 percent. Thus, the Defense Department's proposed rule could cut off military members' access to PALs or similar loans you may offer to military members. Yet ironically, non-military members would continue benefitting from these services.

NCUA supports the intent of the Defense Department's proposed rule: to implement consumer protections of the Military Lending Act and protect servicemembers and dependents from predatory lending. However, we are asking that the rule be implemented without the unintended consequence of outlawing affordable credit union loans to the very servicemembers the law was intended to protect. In fact, I feel so strongly about this issue that I took the unusual position of writing a comment letter. My comment letter asked the Defense Department to exempt PALs from the final rule.

Another proposal that could limit payday lending is being considered by the Consumer Financial Protection Bureau, otherwise known as CFPB. Loans with terms of 45 days or less would generally be subject to CFPB's "Ability-to-Repay" requirements. This means even for short-term alternatives to payday loans, lenders would have to determine that each applicant has "sufficient income to repay the loan after satisfying major financial obligations and living expenses." Lenders would also have to check each applicant's credit report or other measure of borrowing history—which few lenders, if any, normally do when making loans as short as 45 days.

We understand that subjecting short-term loans to such specific underwriting requirements would increase your time and cost to process these loans. However, CFPB's proposal would cover all lenders and all borrowers engaging in covered loans up to 45 days; so no one would be at a competitive disadvantage.

Now, you may be thinking, what about loans of more than 45 days? Well, CFPB was thinking ahead: A second part of CFPB's advance notice of proposed rulemaking would add similar consumer protections to certain longer-term loans. Their focus would be on loans of more than 45 days that cost the borrower more than 36 percent including all interest, fees, and add-on products, such as credit insurance. Those loans would likewise be subject to the Ability-to-Repay requirements. However, CFPB is considering an exception for loans that satisfy the requirements of NCUA's PALs regulation, if the lender complies with two additional conditions:

- If the lender verifies the consumer's income; and
- If the new loan does not result in the consumer having more than two covered longer-term loans from any lender during a six-month period.

As with the Defense Department's proposal, NCUA supports the intent of the CFPB proposal. With the proliferation of predatory lenders around military bases, rules to rein in predatory practices would save military members more of their hard-earned money. But again, we are working to ensure those rules avoid unintended consequences. Staff from NCUA's Office of Consumer Protection continues to meet with staff from both the Defense Department and CFPB. We are making every effort with these agencies to promote your credit unions' ability to provide needed services to military members. I encourage all of you to do the same.

NCUA Regulatory Relief

- ✓Adding Supplemental Capital
- ✓Expanding Fields of Membership
- ✓Removing Fixed Asset Limits
- ✓Permitting Asset Securitization
- ✓Easing Member Business Lending

Regulatory Relief

Now let's turn to what you really want to hear today: How can NCUA ease your regulatory burdens? I'm committed to making 2015 the "Year of Regulatory Relief."

Allowing Supplemental Capital

I've already heard many comments about supplemental capital. Stakeholders suggest under current law, NCUA could count certain forms of debt as supplemental capital for the risk-based capital ratio. For example, subordinated debt could be issued to members and non-members, but it would be uninsured.

I understand the need for supplemental capital in certain circumstances. As part of modernizing risk-based capital, I am committed to allowing supplemental capital to be counted in full. The effective date would coincide with implementation of risk-based capital in 2019.

But not everyone should have to wait until 2019 to benefit from supplemental capital. That's why I assembled a working group to focus on low-income credit unions which can already raise and count secondary capital. One goal was to increase access to secondary capital for low-income credit unions, and last month we achieved that goal through changes to our National Supervision Policy Manual that permit low-income credit unions to return capital to investors if it is no longer being used for net worth.
The working group's next goal is to discuss potential legislative and regulatory changes that could benefit all credit unions interested in raising supplemental capital. To make sure the

working group's discussions are inclusive and cost-effective, we're holding a series of conference calls with stakeholders around the country.

Expanding Fields of Membership

Last year, we proposed a rule designating seven categories of associations that federal credit unions could automatically add to their fields of membership. Last week, we added five more automatic qualifiers in the final rule. In all, 12 types of associational groups will now receive automatic approval for inclusion in federal credit unions' fields of membership.

I feel strongly that you should not be required to get approval from NCUA each and every time you want to add another group. Our goal is to make it easier for federal credit unions to expand their fields of membership. To do this, I created a Field of Membership Working Group to explore additional relief.

And we're not waiting for Congress to act. By the end of this year, we're planning to move forward with sensible rule changes within NCUA's legal authority.

Removing the Fixed-Assets Limit

Our newest proposed rule will eliminate the 5-percent cap on fixed assets. It will authorize federal credit unions to set their own prudent limits on fixed assets such as computers and buildings. I don't believe that spending hours putting together waiver applications is a good use of your time, or NCUA staff's time. Decisions to upgrade your technology, or your facilities, or other fixed assets, should be your decisions—and yours alone.

Permitting Asset Securitization

As the credit union system grows in size and complexity, many of you have begun adopting more sophisticated financial innovations. We intend to allow large, qualified credit unions to securitize their assets. Securitization would permit credit unions to tap new sources of liquidity and reduce interest rate risk by converting fixed-rate assets into cash. We're fine-tuning our proposed rule on asset securitization and hope to finalize it later this year.

Easing Member Business Lending

And now, last but definitely not least: I've heard loud and clear from credit unions that make member business loans. Requiring a personal guarantee on every member business loan can be frustrating and lose business for you. Although you can apply to your Regional Office for waivers from personal guarantees, we understand the waiver process sometimes prevents you from making timely business loans. That's why we plan to eliminate the member business loan waiver process altogether. Determining whether to exempt a borrower from a personal guarantee is a job for your loan officers, based on your prudent underwriting criteria.

In response to additional comments from credit union leaders who gave me thoughtful and compelling feedback, we also intend to lift unnecessary limits on construction and development loans.

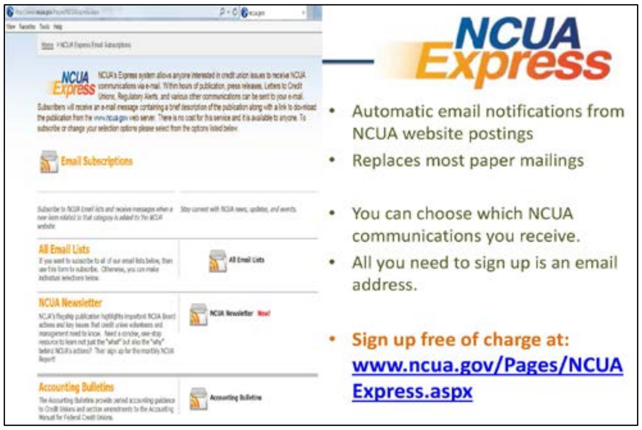
You may have noticed a theme here: We listen, and wherever sensible, we act. We've proven that, time and again. But we're not done yet.

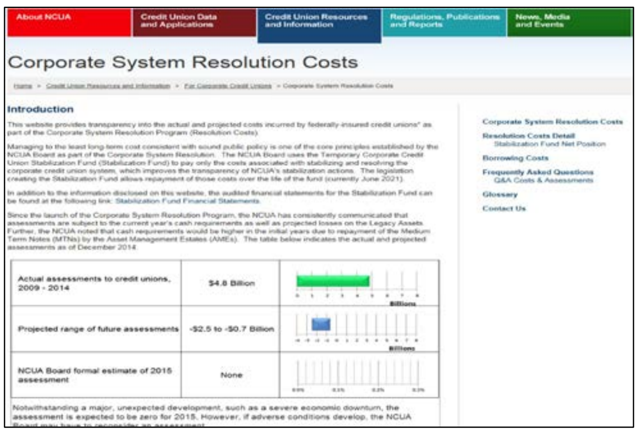
Communications Channels

Before I leave you, I want to touch on ways we can keep in touch. I'm always open to hearing your good ideas. I'm committed to removing any regulatory burdens under our control that do not compromise safety and soundness. So please, continue to send us comment letters, participate in our webinars, and feel free to directly contact me or my staff anytime.

In the meantime, we will continue to reach out to you. Every month, we post our newsletter called *The NCUA Report*. *The NCUA Report* explains what we are doing and why, in plain English.

And you don't have to hunt for it on our website. You can sign up at no charge for automatic e-mail delivery from our NCUA Express e-mail service. Virtually all of our public information is now available at no charge through NCUA Express. In addition to *The NCUA Report*, you can sign up for Letters to Credit Unions, Regulatory Alerts, press releases, and a host of other information.





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We're always working to improve our website, add content, and make it easier to navigate. While you're on our home page, you may notice we've updated our pages detailing costs of the Corporate Resolution. You'll find really good news there. With the current value of the NCUA Guaranteed Notes securing legacy assets from the failed corporates, we are projecting no more assessments. And by the year 2021, you may even receive a rebate.

Conclusion

Our number one goal is to keep the credit union system safe, sound, and sustainable into the future. With all of the initiatives I've discussed today, you will have greater freedom in pursuit of that goal.

If you embrace that freedom while embracing the responsibility it demands—if you're able to use new technology to achieve your timeless mission of serving members, and if you're able to avoid crises—then together, we'll succeed in strengthening and securing credit unions for generations to come.

Thank you.