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Remarks of National Credit Union Administration Board Chairman Debbie Matz

at the 46th Annual Conference of the National Association of Federal Credit Unions

July 12, 2013
Boston, Massachusetts

Remarks

Thank you for having me here today on this momentous occasion—Fred Becker's farewell to NAFCU. I wish Fred all the best on his retirement and congratulate him on his outstanding service to the credit union industry.

Fred will be hard to replace—like the man who was shot out of the cannon at the circus. Upon his retirement his colleagues said, "It's sure going to be hard to find another man of his caliber."

Actually, I shouldn't make artillery jokes, because as you know, Fred is a Navy man. Over the past decade, Fred has helped the industry navigate some treacherous waters. We may not have always agreed on the best course. But we have always agreed on the best destination: a safe and sound credit union industry, overseen by a fair regulator, reinforced by a strong Share Insurance Fund.

We have always had open lines of communication, which, of course, will continue with Dan Berger. Dan is a proven leader and an effective champion for credit unions on Capitol Hill. In fact, if you see Members of the House or Senate with bent ears, Dan probably did the bending. I know that Dan's knowledge of policy and politics will serve you well in the years ahead.

Before we look forward to the years ahead, it's worth looking back at where we've been. Visiting with NAFCU, I'm always reminded that my last speech as a Board member of NCUA in 2005 and my first speech upon becoming Chairman in 2009 were to you.

When we look back to 2009, not all that long ago, it's impossible to forget the crisis we were facing. NCUA had to do some things that were previously unthinkable:

- We had to conserve the two largest corporate credit unions;
- We had to get an emergency $30 billion line of credit from Treasury; and
- We had to get the borrowing limit for the Central Liquidity Facility raised to over $40 billion.

It was a time of extraordinary circumstances, which required extraordinary measures. And without them, the entire industry might have collapsed.

I'm not mentioning this to make you relive those anxious days and sleepless nights. I know I never want to. But I bring this up because it's really remarkable how far we've come, together, in just a short time.

Today, we've gotten through the crisis. The credit union industry is, in many ways, stronger than before:

- A trillion dollars in assets;
- Nearly 5 million new members in the last three-and-a-half years; and
- A return on assets of 83 basis points, up from 18 basis points in 2009.

As we move forward, two questions immediately come to mind:

- What does this new position of relative strength and security mean for you?
- And what does it mean for the role of the regulator?

Last year in Nashville, I pointed out that as your credit unions grow in assets and complexity, NCUA needs to increase our sophistication to keep up with you. And since then, I'm proud to say, we've matched those words with actions.

That's why we voted in May to propose giving qualified credit unions the authority to invest in derivatives. Many of you feel strongly that you need this tool. And we heard you.

We also heard you when Fred sent me a letter requesting that video tellers be permitted to serve as service facilities in underserved areas, just as a new branch would. Fred asked that we make it easier for credit unions to embrace technology and broaden service simultaneously.

We saw that this new technology can reduce real estate costs, control operating costs, and allow you to expand your reach to serve new members more efficiently. In other words, video tellers help you focus on your mission, instead of having to focus on real estate. Again, we heard you.

You told us that many of you wanted the ability to get blanket waivers for member business loans. You convinced us that it did not make sense to require a personal guarantee on every business loan, when you've had a long working relationship with the borrower.

It made even less sense to review one-off waivers for every single member business loan. That just held up loans, and made it harder for you to deliver timely service to your members. So we fixed that problem. Again, we heard you.

And we heard from you. I held Listening Sessions in every region of the country last year, and found that many credit unions did not even know they could apply for blanket waivers. So in February, we issued a Letter to Credit Unions to ensure that every credit union is aware of the blanket waiver option and knows how to apply. Now, once you receive a blanket waiver, you don't need to apply again.

All of these actions are part of my ongoing Regulatory Modernization Initiative. As I've said many times, I'm committed to ensuring—that so long as it's consistent with safety and soundness—you have the flexibility to serve your members, and those who could be your members.

For example, last year, we changed the way credit unions were approved for low-income designations. As you know, a credit union is eligible for a low-income designation if most of its members earn 80 percent or less of the area's median income. Congress recognized that in cases like this, the credit union is in a unique position to perform a real public service: the ability to foster economic growth and security in a community that needs it.

So to help low-income credit unions fulfill that mission, Congress removed their cap on member business loans. Congress also authorized them to raise supplemental capital for net worth in addition to retained earnings. Those are significant benefits for credit unions that qualify as low-income.

But for years, the only way to receive those benefits was for each credit union to conduct difficult calculations to determine that a majority of their members were, in fact, low-income. That was a lot of red tape, and we thought it was an unnecessary burden on credit unions.

So last summer we cut that red tape, and took the burden off of you. NCUA conducted the calculations for every federal credit union. Then we sent about 1,000 letters to let eligible credit unions know they qualified for a low-income designation. All they had to do was say yes.

It was almost a year ago that I stood in the White House, where we announced this initiative. And I'm proud to tell you today that the number of low-income credit unions has nearly doubled.

We expected maybe 200 responses from those 1,000 letters. Instead, we've added about 800 low—income credit unions serving 10 million members.

All told, today about 2,000 low-income credit unions are serving 17 million members nationwide. In fact, almost 40 percent of all federal credit unions now have the low-income designation. And we expect that number will continue to grow in the years ahead.

Now, all of these changes are grounded in the knowledge that the one-size-fits-all policies of the past are no longer appropriate in this new credit union landscape. Credit unions are united in a cooperative system. But they differ markedly by size, charter and, yes, appetite for risk. Despite the differences, all of you and NCUA need to move into the future together. And one of the most important things we need to do to ensure a sound future is to revisit credit union capital requirements.

Around the world, financial regulators realize that job one is preventing another global financial crisis. They recognize that capital forms the most fundamental protection for the broader economy against unexpected losses and failures at financial institutions.

With their eyes toward the future, banking regulators are in the process of implementing a capital standard known as Basel III. I have stood before you and committed that NCUA does not plan to implement Basel III for credit unions. Today, I reaffirm that commitment.

Basel III is not for this industry, but we still have a responsibility to ensure that our safety and soundness standards evolve along with credit unions. Most of all, we need to recognize the crucial role that capital plays in the cooperative credit union system.

If even a single credit union doesn't hold enough capital to cover its losses, all of you must pay for those losses through the Share Insurance Fund. You know this reality all too well, because all of you are still paying assessments for corporate credit union losses from the last crisis. So at NCUA, our challenge is to make sure that in the future, credit unions that choose to take on higher risks will be required to meet higher capital standards.

Yet today, the capital standard for credit unions is one-size-fits-all: 7 percent. For many people, seven is the number of continents or seas… the number of days in a week… or the number worn by my hero, Mickey Mantle…

But why is 7 percent of assets the standard for credit union capital? Congress set the 7 percent net worth minimum in 1998, as part of the Credit Union Membership Access Act. At the time, it was really just a best guess about what the future would require. Well, now we've seen the future. And now we know that this 15-year old, one-size-fits-all standard is simply not enough to protect our system during a serious crisis.

Only Congress can change the law, but NCUA can create a system that actually considers risk, so that credit unions deliberately taking on more risk must hold more capital than credit unions that choose to play it safer.

Frankly, in my view, the one-size-fits-all credit union capital regime is outdated and insufficient. It does not belong in the ever growing, increasingly complex credit union industry.

In the last few years, we've learned that the hard way. We all saw the devastating consequences of credit unions with higher risk portfolios that failed to hold sufficient capital.

How many of you remember Cal State 9? For those of you who don't, here's the sad story: Cal State 9 was a credit union that, ironically, held almost 9 percent capital in the midst of the housing boom. While 9 percent might seem like a solid cushion, it was not nearly sufficient to soften the blow of the housing bust.

With a large concentration of assets in indirect home equity lines of credit, when the bottom fell out of the housing market, Cal State 9's net worth began to plummet. It dropped from 8.7 percent to almost negative 7 percent in just one year. And it never recovered. That credit union had to be liquidated.

Another credit union in California made a similar mistake. Telesis concentrated 60 percent of its assets in real estate loans, especially in commercial real estate. At its peak, this credit union also held only 9 percent capital, despite such high exposure to commercial real estate. At the time, our examiners advised that Telesis needed at least 15 percent capital. But without a modernized risk-based capital rule, we could not enforce our examiners' recommendations.

When the commercial real estate market collapsed, so did Telesis. It could not sustain adequate capital to stay in business. So that credit union was liquidated in 2012.

You might hear these cautionary tales and think, "That won't happen to my credit union because we play it safe." But those two examples alone cost the Share Insurance Fund, and you, almost $300 million. Because credit unions pool their risks, all of you cover the losses for those credit unions that take on too much risk.

So remember: When capital standards are not calibrated to risk, and credit unions fail without sufficient capital, your credit union is impacted, no matter how soundly you operate. However, when credit unions maintain a capital level that prudently covers the risks on their balance sheets, they can withstand the worst of times.

For example, there is a federally insured credit union in Nevada that went into the financial crisis with almost half of its assets in real estate loans. Remember, Nevada was one of the worst hit real estate markets in the country. Normally, this would be a nightmare scenario. And if this credit union had only 7 percent capital, it would have been. But that nightmare never occurred because this credit union had the foresight to hold additional capital for an unforeseen event.

This credit union's 13 percent capital provided such a strong cushion that even at the height of the economic downturn in Nevada—even when the credit union's net worth declined over 30 percent, costing them tens of millions of dollars—their net worth ratio stabilized at just under 9 percent. In fact, in 2012, the credit union even turned a profit for the first time since 2008.

This is a compelling success story about a credit union with farsighted management being prepared for the worst. But unfortunately, not everyone emerged from the financial crisis with such a positive story to tell.

The lesson of these stories is that 7 percent is not the right number for everyone. Back in 1998, it was simply a best estimate of how much capital would be sufficient to protect the system. For many, if not most credit unions today, 7 percent may still be appropriate. However, for higher-risk credit unions, it can be a prescription for disaster when the next crisis hits.

So… What's the right amount of capital? Well, that answer varies from credit union to credit union. That's really no surprise, given the diversity of credit unions.

But just because it's complicated doesn't mean we should shrink away from finding a solution. On the contrary, it underscores just how important it is to get this right.

So, we are developing an approach that's targeted to the types of risk held by different credit unions—not one-size-fits-all, and not based solely on the past. Our new standard would update the risk-based capital requirement.

A net worth ratio of 7 percent would remain the floor, as required by the Federal Credit Union Act. However, credit unions with assets over $50 million would be subject to improved risk-based capital requirements, to better correlate required capital levels to risk. The result would be higher capital levels for credit unions with high concentrations of risky assets.

Now think back to those examples I discussed a few minutes ago.

If capital standards like the ones I'm describing had been in effect in 2008, Telesis would have held more than $20 million in additional capital. That capital cushion could have made the difference between Telesis going under and weathering the crisis and saving all of you from eventually paying $77 million to cover that credit union's losses. Even if Telesis had still failed, the additional capital would have at least absorbed a greater portion of its losses, saving all of you from covering that extra $20 million.

Think of that, and think about all the other high-risk credit unions that failed as a result of the financial crisis. None of us ever wants that to happen again.

So I have asked NCUA staff to build a new risk-based capital framework for a new economy. We need a flexible, forward-looking standard that makes sense for where you are today, and recognizes where you want to go tomorrow and beyond.

Of course, nothing is final yet. And don't worry: When we propose a new rule, you will have ample opportunity to comment.

As you've seen most recently with our rule on loan participations, we do listen carefully to your comments and make adjustments in final rules, wherever warranted, to produce good public policy. We wouldn't have it any other way, because it's important for us to get it right. With your help, we will. And with your help, the entire credit union industry will be stronger.

Remember, this isn't just about us. This is also about public trust. We're not the only ones who are still shaken by what happened in 2008 and 2009. That was a traumatic time for your members as well.

So when we talk about capital requirements, these conversations are not abstract. They affect members all across the country. Members depend on credit unions for their homes, their livelihoods, their children's educations. We need to ensure that their confidence in credit unions will always be well-placed.

Most of you were at the awards ceremony yesterday. You heard about your extraordinary colleagues who never lose sight of their mission of member service.

You heard about URW Community Federal Credit Union, which saw that local Latino residents were having trouble interacting with financial institutions. So the credit union hired Spanish-speaking staff to translate and make sure that everyone felt welcome.

You heard about Brad Hines, the Board Chair at GTE Financial Credit Union. While directing that credit union's remarkable turnaround, Brad led an initiative called "We Can Help," which helped over 10,000 members keep their homes or their vehicles.

You heard about Paul Trylko the CEO of Amplify Federal Credit Union, who personally takes the time, every single month, to teach a class for new employees about his "members first" philosophy.

Members first: That's the commitment we've all made. At NCUA, our primary commitment is to nearly 95 million members whose deposits we insure.

As we go into the future together, that commitment means we have to grow together. And it means we have to make sure that the people who place their trust in us know that we're doing everything in our power to protect them in the best way we possibly can. It's my honor to pursue this mission with all of you.

In closing, I want to wish Fred and Barb the very best in their retirement and the next chapter in their lives. Fred, you are leaving behind a credit union industry that is stronger than when you took command at NAFCU nearly 14 years ago. You should be proud of what NAFCU has accomplished under your leadership. I know your members are.

Thank you, Fred. And thank you all for having me here today.

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