Remarks of Debbie Matz

Board Chairman

National Credit Union Administration

at the

National Association of Federal Credit Unions

Annual Conference

Las Vegas, Nevada

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Introduction

Thank you, Dan. Over 81 years ago, on March 12, 1933, President Franklin Delano Roosevelt's voice entered America's living rooms for the first of his famous fireside chats. He began: "My friends, I want to talk for a few minutes with the people of the United States about banking."

With those words, FDR set in motion a series of initiatives to renew and revitalize America's financial institutions. And so 80 years ago last month, the Federal Credit Union Act became law. My responsibility is derived directly from the wording of that Act: to protect credit unions' safety and soundness and "enhance the public benefit that citizens receive from these cooperative financial services institutions."

Of course, FDR probably never envisioned our nation's credit union system growing to more than $1 trillion in assets, and offering sophisticated financial services to nearly 100 million Americans. This is an iconic system that I know you and many consumers believe offers better products than banks, better pricing than banks, and a sense of community and service missing from banks.

It seems likely that FDR could have envisioned an event like our recent Great Recession. After all, FDR had seen even worse. He knew what a bursting bubble could do to the economy, to people's lives, and to their life savings.

Yes, our Great Recession is technically over. By most important measures, credit unions are continuing a steady recovery:

- Net worth and loans are growing.
- Delinquencies and charge-offs are stable.
- Membership is at an all-time high.

So, as we look out at America's credit unions, we see encouraging trends.

But as a regulator always on the lookout for the safety and soundness of credit unions, it's NCUA's job to see more than that. It's our duty to maintain a modern, efficient and resilient regulatory framework for the credit union system. This means protecting institutions so they will remain integral to our economy for the next 80 years and beyond. That's why NCUA is constantly on the lookout for threats to credit unions—both inside and out.

Risks on the Horizon

Today, I want to talk about the two most significant threats to safety and soundness, and how we, together, can confront them. Specifically, I want to focus on cybersecurity and interest rate risk. I also want to update you on our approach to regulation, and discuss why it's necessary to modernize risk-based capital standards.

Cybersecurity

First, those of you who read our 2014 Supervisory Letter know that one of our top exam priorities is cybersecurity. Examiners are looking to see how credit unions are implementing risk-mitigation controls to better protect, detect, and recover from cyber-attacks. This is part of a nationwide effort to safeguard our systems and protect against attacks by cyber-terrorists, as well as hackers who are after cash in your members' accounts.

I encourage all of you to get educated and share best practices with each other. Also, I urge you to take full advantage of the resources on our special cybersecurity resources webpage at NCUA.gov.

Cybersecurity is an urgent challenge not only for credit unions, but for the entire financial services industry. And like so many of the collective challenges facing the industry, the chain is only as strong as its weakest link.

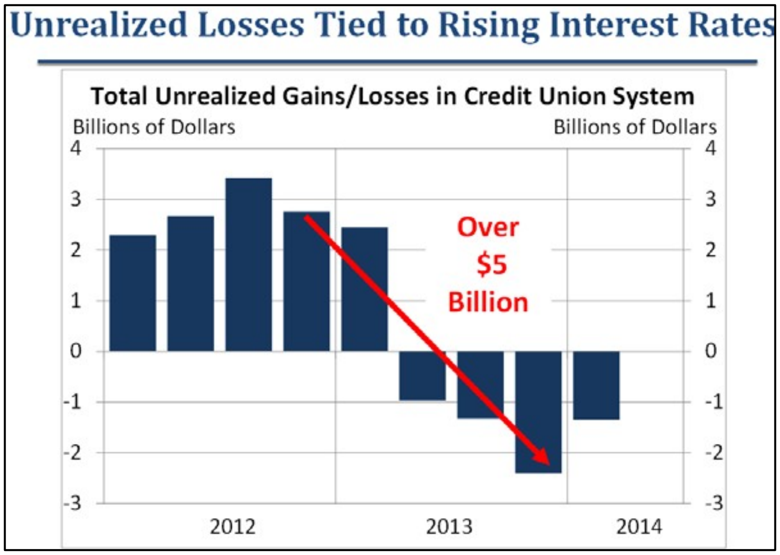
Interest Rate Risk

While a lapse in cybersecurity could be a weak link threatening the industry, the weakest link at some credit unions is interest rate risk, our other top supervisory priority. Credit unions cannot afford to ignore this increasingly serious risk, because ignoring rising rates is like pitching a tent on a beach at low tide. You don't want to pitch your portfolio's tent in a low-rate environment when rates are rising above historic lows, and market experts are warning that as rates rise, they may rise quickly.

I'm concerned that some credit union officials have suggested that interest rate risk is no longer an issue. A few even suggested that short-term rates will continue to hold at record lows, because they haven't risen yet.

Yet: That's the operative word. In fact, long-term rates have already gone up ever so slightly. Even that small bump in rates has caused unrealized gains on some of your balance sheets to become unrealized losses, a negative swing of $5.1 billion system-wide.

This slide shows how the unrealized gains swung to unrealized losses soon after long-term rates began to rise. The blue bars are the unrealized gains and losses. In one year, unrealized gains of $2.7 billion swung to unrealized losses of $2.4 billion.

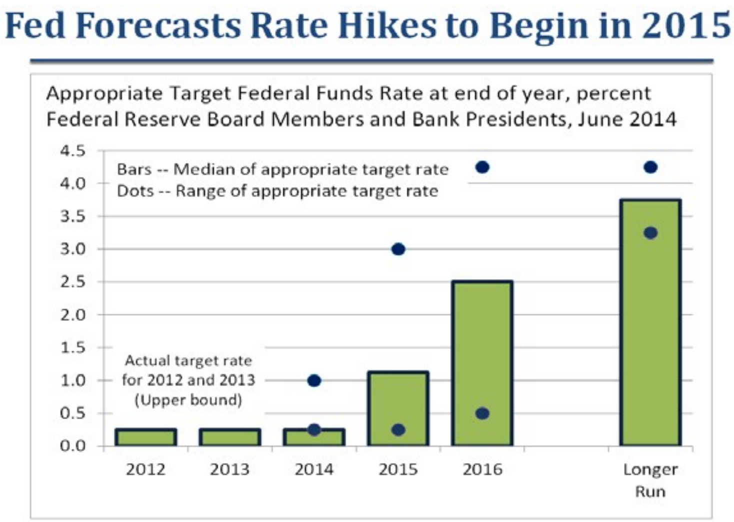


Not shown on this slide, but just as concerning, the number of credit unions with unrealized losses on assets available-for-sale has quadrupled. So, I think you can understand our concern. These unrealized losses foreshadow actual losses credit unions could face if future rate hikes compress net interest margins.

Even if the majority of credit unions manage their interest rate risk well, consider this: Over 100 large credit unions currently hold the highest interest rate risk exposure. These 100 high-risk credit unions are responsible for 25 percent of the entire system's assets. We're talking about $250 billion. Yet our Share Insurance Fund has assets of less than $12 billion. So, this issue affects every single credit union that pays into the Share Insurance Fund, including all of you.

Of course, none of us can say precisely when interest rates are going to increase. But I sure hope you noticed last month that the Federal Open Market Committee's consensus forecast was a Federal Funds rate of 1.13 percent by the end of next year. They also forecast the Fed Funds rate rising to 2.5 percent by the end of 2016. That's a potential increase of 225 basis points from the current short-term rate.

This slide shows the most recent projections of the Fed Funds rate, given the economic forecasts of the Federal Reserve Bank Presidents and Fed Governors. The green bars represent the median Fed Funds rate forecast; and the blue dots represent the highest and lowest predictions.



As Federal Reserve Board Chair Janet Yellen said last week, "If the labor market continues to improve more quickly than anticipated, then increases in the Federal Funds rate target likely would occur sooner and be more rapid than currently envisioned." Most Fed Open Market Committee members agree and see short-term rates increasing next year, and moving up even more in 2016.

The bottom line is conditions are changing. The tide is shifting. Make sure your tent is off the beach before the tide rolls in. Make sure your credit union is in a safe position.

When rates inevitably rise, every credit union will need to be properly prepared so no one drowns. I urge you to take action now to protect your balance sheets against interest rate risk, even if it means sacrificing some portion of your earnings this year. If you ignore the threat of interest rate risk into the coming years, your credit union may not survive. If you address that risk to protect your own credit union, you will also protect the entire credit union system from having to share the losses if your credit union fails.

Risk-Based Capital Rule

Speaking of protecting the system, it seems like I've heard from most of the system on the proposed risk-based capital rule. I want to assure you: We hear you loud and clear, and we will make significant changes in the final rule.

After one of our longest comment periods ever, I hosted three Listening Sessions. As a result, we are well on our way to producing a sound risk-based capital framework, one that will better mitigate existing risks so that credit unions hold capital commensurate with the risks in their portfolios. This is something we simply must do.

Many of you have asked why. Well, for starters, both our Inspector General and the Government Accountability Office have told us we must do this, and they report to Congress. In addition, the Federal Credit Union Act requires NCUA to maintain capital standards that are "comparable" to banking regulators.

And while Members of Congress shared some specific concerns about certain aspects of our proposed rule, most Members with whom I have spoken personally support our efforts to modernize the capital standards for credit unions. Even in the letter to me signed by 324 Members of Congress, they concluded that "[a]pplying risk-based weighting certainly has value, and we appreciate the NCUA for taking on this task."

Other regulators are already ahead of NCUA in updating risk-based capital rules.

While the worst of the crisis now appears to be receding into the rearview mirror, we cannot forget its lessons. First and foremost, we cannot forget that the federal government had to pump $26 billion into the credit union system to prevent it from collapsing. Without an infusion of $20 billion from NCUA's Central Liquidity Facility and an additional $6 billion from NCUA's line of credit at the U.S. Treasury, the credit union system as we know it would probably not have survived.

Even with this extraordinary assistance from the federal government, 102 credit unions still failed. Many of those credit unions appeared to have sufficient capital. That is, until they collapsed. Those failures cost the Share Insurance Fund three-quarters of a billion dollars. Through strong supervision, we were able to prevent an additional $1.5 billion dollars in losses from troubled credit unions that were on the brink of failing.

Again, we're not saying credit unions can't take on assets that promise greater returns in exchange for greater risk. We're just saying that if you do, you need to hold appropriate capital.

I think we agree that safety and soundness is important to us all. Finalizing this rule is critical to protecting credit unions' safety and soundness. And that certainly means incorporating your feedback.

From your letters and comments, we have identified four major areas of concern that I'd like to address.

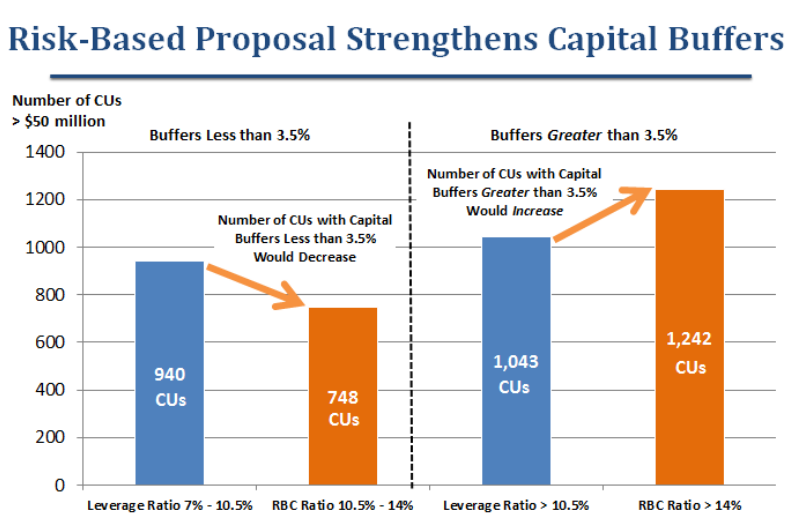
First, we understand that all risk weights need to be reviewed and some should be lowered. In fact, we're carefully reviewing the assumptions underlying key risk weights, and we will make changes as appropriate. We have already identified five candidates for revised risk weights. They include investments, mortgages, member business loans, credit union service organizations and corporates.

Second, the idea that all credit unions will be required to raise new capital, or that the rule will require $7 billion in new capital, is simply not true. This proposal would only require about 200 credit unions to add, at most, $700 million in capital, if they don't shed excess risk from their portfolios.

Those who argue that the proposal would require $7 billion are using a questionable assumption. They assume the 2,200 credit unions subject to the proposed rule would choose to raise additional capital to maintain their current buffer, a totally baseless assumption.

In fact—and I want to be very clear about this—using the proposed risk-based formula, the majority of credit unions would already have at least as much of a capital buffer, or an even higher buffer, than they do today.

Here are the facts: Currently, with only the 7-percent leverage requirement, credit unions' average net worth ratio is 10.5 percent, a capital buffer of 3.5 percent. Over 1,000 of the 2,200 credit unions above $50 million in assets today are in this category. They have a capital buffer of at least 3.5 percent above the leverage requirement.



However, if the proposed risk-based capital rule became final today, without doing anything, more than 1,200 of those credit unions would have a risk-based capital buffer of at least 3.5 percent. This means more than half of all credit unions subject to the rule would have a risk-based capital ratio of 14 percent or more. As I've said, the proposal is going to change, so their risk-based capital buffer will likely be even greater.

Third, and contrary to popular belief, examiners will not have authority to raise any single credit union's capital requirement. Only the NCUA Board could do that. Before the Board would even consider using this authority, an examiner would have to undergo a rigorous process to convince the Supervisory Examiner and Regional Director that such an extraordinary action is warranted. It might surprise you that this process already exists today in NCUA's current risk-based net worth rule. But it has never been used.

Fourth, when the new rule is finalized, the implementation period will be extended beyond the 18 months initially proposed. With all the changes we're contemplating, let me emphasize that the risk-based capital proposal is just that—a proposal. That's why we put it out for comment. All of those comments have been read, heard, and in many cases will be reflected in the final rule.

And, yes, there will be a final rule. It will be much improved from the proposed version. It will protect you from credit unions that take on high risks but have insufficient capital.

I know you will be pleased to hear that risk-based capital is the final significant NCUA rulemaking arising from the financial crisis. Prudent regulation includes learning the lessons from the past to establish a modern regulatory framework for the future. That's exactly what we're accomplishing.

Deconstructing the "Dirty Dozen"

Now, many of you may know that NCUA reviews one-third of all our regulations every year, to determine if they should be changed. At the end of three years, having reviewed every regulation, we start over again. This effort, coupled with my Regulatory Modernization Initiative, has resulted in actions that have cut red tape, given you new flexibility, and made it easier to serve your members.

I know you've been focusing on these efforts. You've seen the list called, "NAFCU's Dirty Dozen: 12 Regulations to Eliminate or Amend." I certainly understand how you could see a list like that and say, "Wow, NCUA is really heavy handed."

But a closer review shows a more complicated and, frankly, more collaborative story. We went through that list, and here's what we found: Of the 12 regulations mentioned, one of them, improvements to the Central Liquidity Facility, is controlled by Congress, not NCUA. Only six of the remaining 11 regulations are controlled by NCUA. So we're really talking about only a half-dozen that we have any power to change.

Through my modernization initiative, past Listening Sessions, and our ongoing review of all regulations, we had already been looking at those six regulations to determine whether we can or should modify them. Let me update you on where we stand with the six that are under NCUA's jurisdiction.

First, we improved the flexibility for federal credit unions seeking to expand their field of membership. We set the pre-approved urban field of membership at 2.5 million people, which is the designation used by the U.S. Office of Management and Budget for a Metropolitan Division. For rural districts, we implemented a sliding scale to account for growing populations. In addition, we proposed a rule this year that would empower you to automatically add seven categories of associations. Now we're looking through your comment letters to consider other association categories that may qualify for automatic approval.

Second, we're expanding investment authorities. While language in the Federal Credit Union Act controls much of what is or is not permissible, we approved a final rule in January authorizing qualified credit unions to invest in derivatives. It's a new tool some of you said you needed to help manage interest rate risk, and we heard you. We followed up last month with a proposal to authorize qualified credit unions to securitize their own assets for sale as investments. This authority would provide another tool for large credit unions to mitigate both interest rate risk and liquidity risk for large credit unions.

Third, we're eliminating a redundant requirement for appraisals. We proposed a rule last month to remove the NCUA appraisal provision that is superseded by the Consumer Financial

Protection Bureau's mortgage rules. At the same time, we proposed a change designed to assist members who are underwater in their mortgages.

Fourth, later this year, we'll be looking to add flexibility for credit unions that offer member business loans. We plan to propose a rule to modernize the member business lending regulation.

Fifth, next year we're scheduled to update the advertising rule for federal credit unions. We'll be working to incorporate the latest technology—including social media—into the proposal, as another example of our ongoing review of all NCUA regulations.

Sixth—and I've saved the best for last—at this month's open NCUA Board meeting, we plan to propose a rule that would effectively eliminate the five-percent cap on fixed assets. The proposal would cut the red tape and streamline the process for federal credit unions to occupy land or buildings. Our intent is to allow federal credit unions to manage their own fixed-asset purchases without having to seek permission or waivers from NCUA. When you want to update your facilities, upgrade technology, or make other purchases that have no impact on safety and soundness, NCUA should not micro-manage your individual business decisions.

As always, with each proposed rule, your voices will be heard for comments and concerns.

Now I do have one final concern I want to share with you: There are some who prefer to cast the relationship between NCUA and credit unions as adversarial. This could keep us from working together to address our shared interests.

Just as with cybersecurity, interest rate risk, and other collective challenges, every credit union is in the same boat. Because every credit union pays into the Share Insurance Fund, and NCUA manages the Fund, we all have a stake in making sure nobody runs the risk of sinking the ship.

Conclusion

And that brings me back to where I began: the 80th anniversary of the Federal Credit Union Act. I know it's tough to leave the Venetian Hotel, but at some point during this meeting, I'd encourage you to walk down the Strip to the New York, New York Hotel. Out front, you'll find a 510-foot-tall replica of the Empire State Building. You'll find tourists taking pictures in front of it. Why? Because it's an icon.

Shortly before legislators finalized the Federal Credit Union Act in 1934, workers completed the original Empire State Building. Franklin Delano Roosevelt was one of the speakers at its dedication. On the building's 80th birthday, a new generation of workers began renovations to modernize its windows, elevators and climate control systems. Today, the Empire State Building is every bit the icon that it was 80 years ago, but it is a far more modern, efficient, resilient and, therefore, valuable building.

By honoring the Federal Credit Union Act, and by updating the regulations that implement the Act to reflect today's marketplace and risks, those same words—modern, efficient, resilient, and valuable—will be used to describe our nation's credit union system.

That is our shared goal. And I'm confident it will be our shared success. Thank you.