Wednesday, April 15, 2015

Remarks of Debbie Matz
Board Chairman
National Credit Union Administration

Credit Union Association of the Dakotas
Annual Summit
Las Vegas, Nevada

NATIONAL CREDIT UNION ADMINISTRATION

Remarks

Thank you for inviting me back to your Annual Summit. I had the pleasure of speaking to your 2012 Summit in Rapid City. As many of you know, South Dakota holds a special place in my heart and my husband's. In fact, at my confirmation hearing, Sen. Tim Johnson, who was the Committee Chairman, complimented me by referring to me as an "honorary South Dakotan."

Yet, as much I love South Dakota, I've always wanted to visit North Dakota—one of the few states I hadn't been to. Last year when Robbie Thompson invited me to your 2015 Summit, which I thought was scheduled to rotate to North Dakota, I immediately said, "Yes."

So, you can imagine my surprise when Robbie got back to me and said, "We're so pleased to have you speak to our 2015 Summit, but it's going to be in Las Vegas."

But all's well that ends well. I am happy to say, thanks to a special joint invitation from Robbie and Senator Heidi Heitkamp (D-N.D), I spent the better part of last week in North Dakota. And it was a wonderful visit. I visited Railway and VUE credit unions, and participated in a roundtable meeting with Senator Heitkamp at Capital Credit Union. Thank you for being such gracious hosts.

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—from hearing from you. Before I hear from you today, I want to speak about some things I think you all care about 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 in both of your states are growing stronger.

State of the System: South Dakota [1]

When I spoke in South Dakota in 2012, credit unions there were still struggling to recover from the effects of the Great Recession of 2007 to 2009. In 2012, net worth and loans were shrinking.

Today, as of the most recent Call Report:

South Dakota
Credit Union Trends

Improving Net Worth, Loans, Delinquency & Charge-Offs

Credit Unions' Key Metrics	South Dakota Year-End 2009	South Dakota 1st-Qtr. 2012	South Dakota Year-End 2014	United States Year-End 2014
Return on Assets	0.22 %	0.71 %	0.69 %	0.80 %
Net Worth Ratio	9.3 %	9.2 %	10.1 %	11.0 %
Loan Growth	8.5 %	(-1.5 %)	8.0 %	10.4 %
Delinquency	1.1 %	0.8 %	0.7 %	0.9 %
Net Charge-Offs	0.4 %	0.3 %	0.2 %	0.5 %
Member Growth	(-1.4 %)	1.7 %	1.7 %	3.1 %

[1] Chairman Debbie Matz's presentation slides are available in full size at www.ncua.gov/News/Documents/MatzSlidesDakotasSummit20150415.pdf

- Net worth is up to 10.1 percent.
- And loans are growing at a robust 8 percent.

North Dakota Credit Union Trends

Performing Better than Most National Averages

Credit Unions' Key Metrics	North Dakota Year-End 2009	North Dakota 1st-Qtr. 2012	North Dakota Year-End 2014	United States Year-End 2014
Return on Assets	0.82 %	1.09 %	1.09 %	0.80 %
Net Worth Ratio	10.7 %	10.1 %	11.1 %	11.0 %
Loan Growth	8.9 %	2.4 %	10.4 %	10.4 %
Delinquency	1.0 %	0.5 %	0.4 %	0.9 %
Net Charge-offs	0.3 %	0.1 %	0.1 %	0.5 %
Member Growth	0.2 %	3.0 %	1.3 %	3.1 %

Even while South Dakota's median loan growth ranks ninth out of all 50 states, delinquencies and charge-offs are declining. This is a very positive sign that you are using sound underwriting on your new loans.

State of the System: North Dakota

In North Dakota, credit unions are performing much better than most national averages. Virtually all of North Dakota's key metrics rank in the top 10 nationwide. In particular, it's astounding that with loan growth of 10.4 percent, charge-offs are only one-tenth-of-one percent. Again, this is a tribute to sound underwriting during a time of rapid growth.

Let me take this opportunity to thank the directors and management teams in both of your states for setting prudent policies to ensure your credit unions operate within safe limits. Let's thank all the directors with us in the room today. And for running successful operations to ensure your credit unions meet your members' needs, let's thank all the managers with us in the room today.

Issues on Our RADAR…

…which should also be on yours

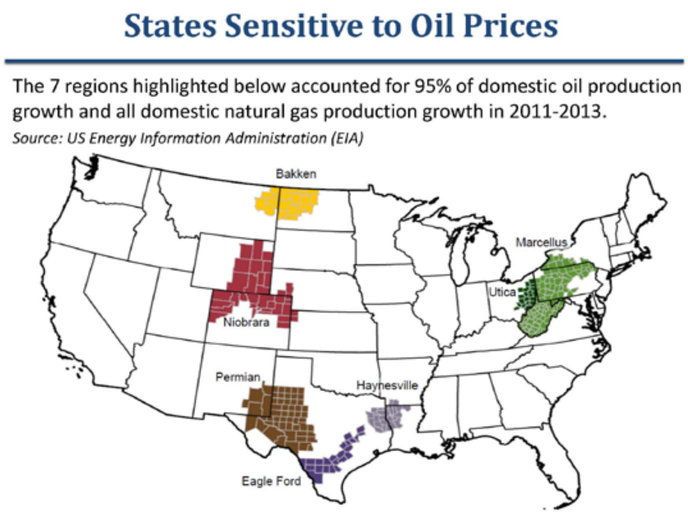
- Plunging Oil Prices
- Falling Farm Prices
- Cyber Threats
- Capital Outliers
- Interest Rate Risk

Congratulations to all of you who worked so diligently to help your credit unions recover from the Great Recession.

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.

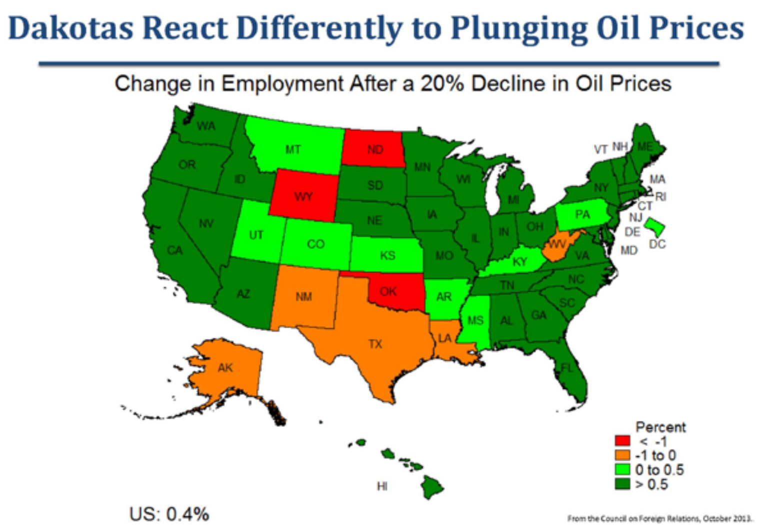
So, let's address five risks that could cause a potential crisis in the future. The first two risks—plunging oil prices and falling farm prices—could hurt many of your members in the Dakotas. The next three risks—cyber-threats, capital outliers and interest rate risk—are nationwide threats.



Plunging Oil Prices

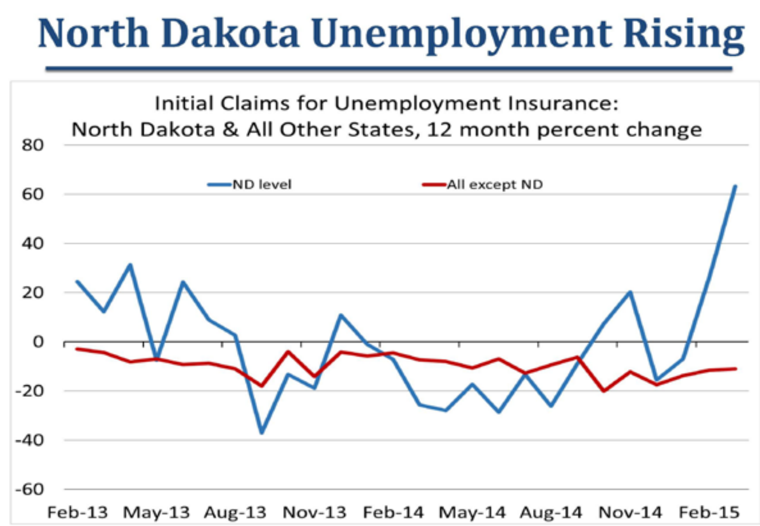
For those of you from North Dakota, the next couple of slides may look ominous. This slide shows how a large part of North Dakota helped produce America's oil boom in 2011 through 2013. Also, keep in mind where America's six other oil booms are located.

The next slide shows how a 20 percent drop in oil prices led to employment losses in nearly all of those locations. States in orange felt moderate employment losses from the first 20 percent drop in oil prices. States in red, including North Dakota, suffered significant employment losses, more than a full percentage point statewide. According to a Federal Reserve estimate, if oil prices don't rebound this year, 10,000 of the 38,000 workers in the Bakken fields could be laid off.



The first wave of layoffs has already begun. The rapidly rising blue line on the next slide shows first-time claims for unemployment insurance in North Dakota are already up 60 percent over last year. Credit unions serving these workers could face higher delinquencies and charge-offs.

If you seized opportunities to serve the Bakken communities during the oil boom, you most likely built contingencies into your business plan, knowing that oil prices can be very volatile. Now is the time to review that business plan and make the appropriate adjustments. This could mean changes in your underwriting, your reserves, or your balance sheet composition.



At the same time, South Dakota and most other states would benefit if oil prices continue to fall. Credit unions that are not tied to the oil industry could see an inflow of deposits along with loan demand. Members would have more discretionary income to save, or to spend on homes, cars, and other durable goods.

Falling Farm Prices

Unfortunately, both North and South Dakota are exposed to falling farm prices. The U.S. Department of Agriculture forecasts that net farm income will fall 32 percent this year. This would be the second straight year with a double-digit decline, and the lowest net farm income since 2009. This crash is not due to the U.S. crop forecast. It's due primarily to cheap competition from fast-growing countries like Brazil and China.

I realize those of you from agricultural credit unions have a proud tradition of serving farmers through thick and thin. I know you will keep a close watch on this new trend in farm prices, and work to help your members get through this rough patch. For example, by modifying loans with NCUA's more flexible rule on Troubled Debt Restructuring, you may be able to lower members' mortgage payments through these lean years.

Increasing Cyber Threats

The next risk 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. 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 US 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 cybersecurity best practices in meetings within your professional groups.

- Participate in national information-sharing forums. Links to national forums are posted on our Cybersecurity Resources site. NCUA's online cybersecurity resources can also help you find rules and guidance, including the most recently issued guidance by NCUA, and the new national cybersecurity framework.

If information technology is outside your comfort zone, here are some questions you could ask about cybersecurity:

- 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 cybersecurity of every vendor and every payment system with which the credit union has a digital relationship?
- How could the credit union change cybersecurity protocols based on guidance from the Federal Financial Institutions Examination Council?
- How could the new national cybersecurity standards further protect your credit union and its members?

Addressing Capital Outliers

While the first three risks come from outside the credit union system, the fourth risk is 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.

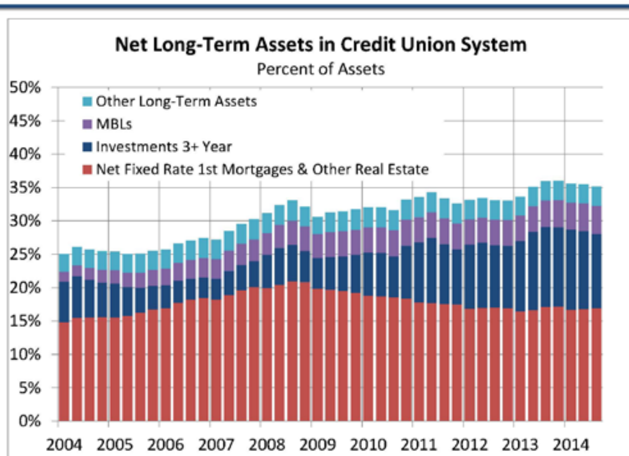
To address this problem, NCUA proposed a revised risk-based capital rule in January, after listening carefully to your comments. Out of 2,056 comment letters, one especially caught my eye—the video comment produced by your Credit Union Association of the Dakotas. After seeing and hearing from farmers in the Dakotas, and your credit unions which serve them, I became even further resolved to preserve the business model for agricultural credit unions.

Your comments are reflected in significant changes to the risk-based capital rule, several of which are shown on the 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 just over $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 the Dakotas. Only 10 credit unions in North Dakota would be covered by the rule, and all 10 would remain well-capitalized. Only six credit unions in South Dakota would be covered by the rule, and all six would retain their current capital classifications. In fact, the majority of covered credit unions should see their capital buffers increase.

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.

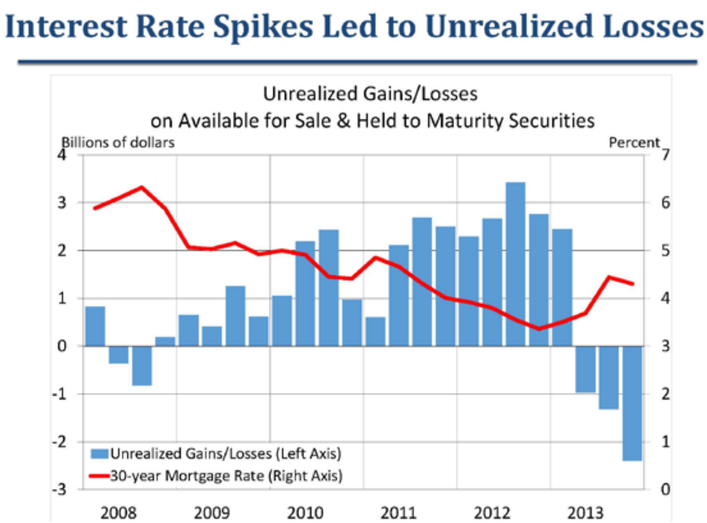
Interest Rate Risk is Higher than Pre-Crisis



Mitigating Interest Rate Risk

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 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.

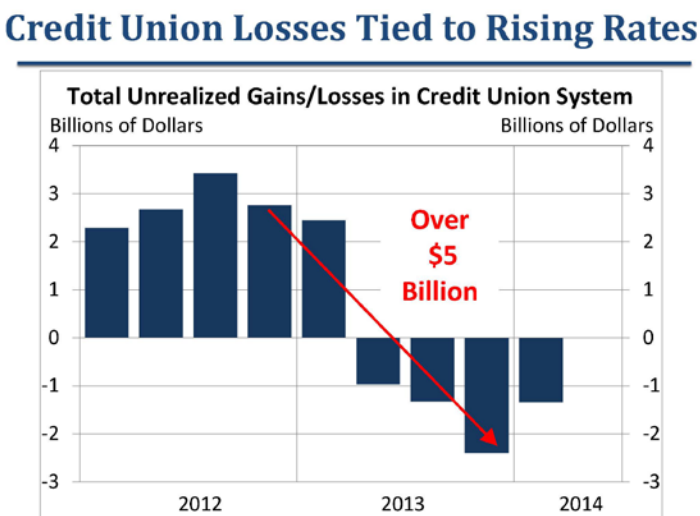


For example, prior to the last rate cycle, before interest rates rose, only 15 percent of credit union investments were longer than three years. Today is a stark contrast; 46 percent of credit union investments are longer than three years.

Let's look at the different effects on credit unions during the last two cycles in which interest rates rose. The 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 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 "a-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 Open Market Committee's consensus forecast anticipates that by 2016, the Fed Funds rate will rise by 225 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 a new [Interest Rate Risk Resources](#) page on our website. When you visit this site, you'll find videos, charts, rules and supervisory guidance.

To help you further, I've assembled some questions you could ask about interest rate risk which you can ask at your next board or staff meeting:

- How is the credit union measuring interest rate risk exposure? Are they even measuring interest rate risk exposure?
- What has been learned from shock testing? We recommend shocking your balance sheet by at least 300 basis points.
- 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. Most importantly, choosing an appropriate risk mitigation option will reduce the shock of rising rates and increase your credit union's chances of survival in the future.

Regulatory Relief

So let's turn to what you really want to hear today: How can NCUA ease your regulatory burdens?

NCUA Regulatory Relief

- ✓ Exempting Small Credit Unions
- ✓ Adding Supplemental Capital
- ✓ Expanding Fields of Membership
- ✓ Removing Fixed Asset Limits
- ✓ Easing Member Business Lending

I'm committed to making 2015 the Year of Regulatory Relief. To begin, we proposed a rule to raise the asset threshold for defining "small" credit unions to $100 million. In South Dakota, 42 out of 48 credit unions would be eligible for regulatory relief from certain NCUA rules, and in North Dakota, 28 out of 38 credit unions would be eligible for regulatory relief.

But even more relief is on the way.

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. Last week we achieved that goal through changes to the 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. This month, we plan to add even more automatic qualifiers.

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].

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.

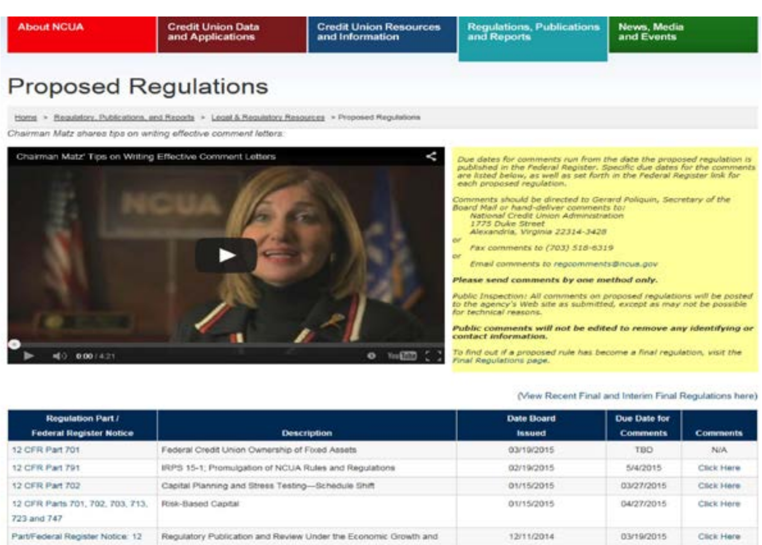
Removing the Fixed-Assets Limit

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.

Easing Member Business Lending

And now, last but definitely not least: I've heard loud and clear from credit unions that make business loans that requiring a personal guarantee on every 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 business loan waiver process altogether.

Determining whether to exempt a borrower from a personal guarantee is a job for your loan officers, based on prudent underwriting criteria. And in response to additional comments from credit union leaders in the Dakotas—you again gave me thoughtful and compelling feedback—we 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.

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, and I'm committed to removing any regulatory burdens under our control that do not compromise safety and soundness. So please, continue to send us

Contacting the Office of the Chairman

Feel free to contact our office with questions or comments.

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comment letters, participate in our webinars, and feel free to directly contact me or my staff anytime.

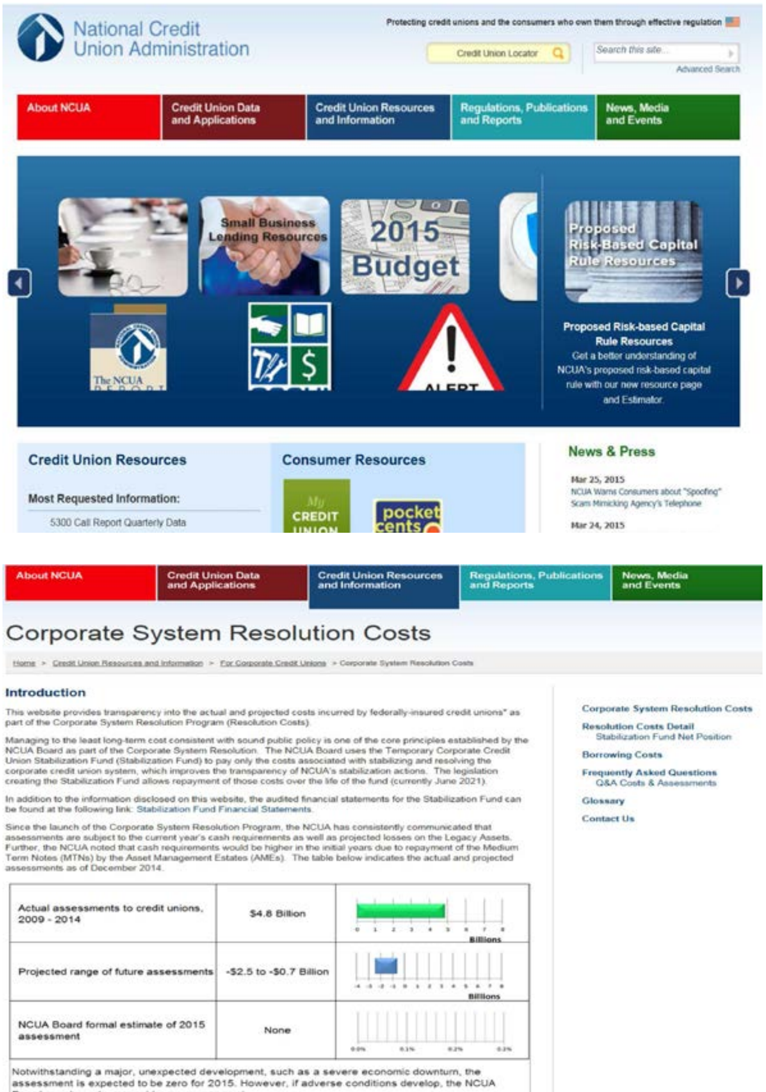
In the meantime, we will continue to reach out to you. Every month, we post our newsletter called *The NCUA Report*. *The NCUA Report* explains what we are doing and why, in plain English.

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.

You can also choose to receive all NCUA e-mails, or select only the information in which you're most interested. To sign up, just go to our home page, type NCUA Express in the search window, then click the NCUA Express icons. Please encourage all of your directors and managers back home to sign up for NCUA Express as well.

We're always working to improve our website, add content, and make it easier to navigate.

Corporate Resolution Costs



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.

NATIONAL CREDIT UNION ADMINISTRATION