

BOARD ACTION MEMORANDUM

TO: NCUA Board

DATE: March 11, 2011

FROM: J. Owen Cole Jr., Director
Office of Capital Markets

SUBJ: Proposed Rule
Part 741

ACTION REQUESTED: NCUA Board's approval of proposed rule to require a written interest rate risk policy and an interest rate risk management program as a requirement for insurance for all federally insured credit unions (FICUs). The rule excludes FICUs below \$10 million in assets and FICUs \$10-50 million with a percentage of first mortgages and investments greater than 5 years that is less than 100% of net worth. 12 C. F. R. Part 741.

ACTION REQUESTED: March 17, 2011.

OTHER OFFICES CONSULTED: Office of General Counsel, Office of Examination and Insurance, Office of Small Credit Union Initiatives, Office of Corporate Credit Unions, and Regional Directors.

VIEWS OF OTHER OFFICES CONSULTED: Concur.

SUBMITTED TO THE INSPECTOR GENERAL FOR REVIEW: Yes.

BUDGET IMPACT, IF ANY: None.

RESPONSIBLE STAFF MEMBER: Mark D. Vaughan, Director, Division of Capital Markets and Jeremy Taylor, Senior Capital Markets Specialist, Office of Capital Markets.

SUMMARY: The proposal revises NCUA's rules and regulations Part 741.3(b) to add a written interest rate risk policy and an interest rate risk management program as a requirement for insurance for all federally insured credit unions (FICUs). The proposal provides guidance to FICUs on how to establish an interest rate risk policy and effective program. The rule excludes FICUs below \$10 million in assets and FICUs \$10-50 Million with a percentage of first mortgages and investments greater than 5 years that is less than 100% of net worth.

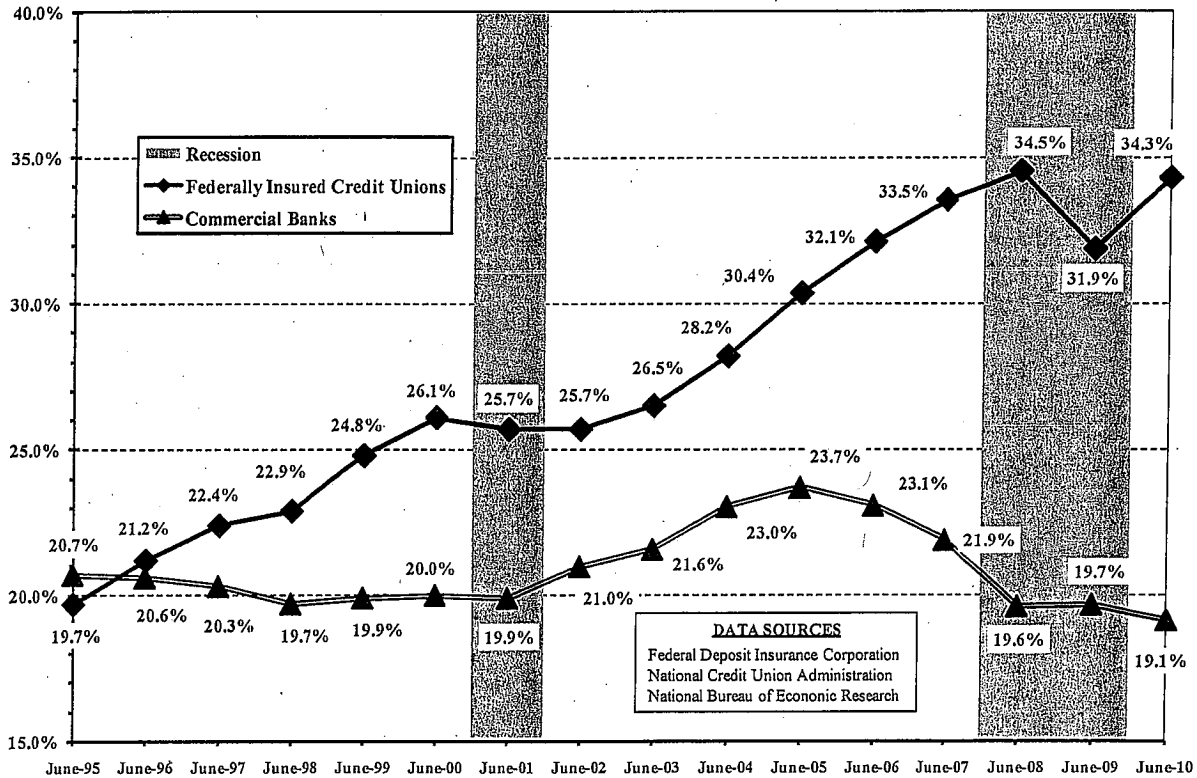
RECOMMENDED ACTION: Recommend the Board approve and issue the proposed rule with a 60-day comment period.

ATTACHMENT: BAM Attachment
Proposed Rule.

Attachment to Part 741 BAM

Both the interest-rate environment and credit-union exposure to interest-rate shocks highlight the need for stronger risk management. Short-term interest rates remain low by historical standards, but intermediate and long-term rates began to rise in the late 2010 on market concerns about inflation. More importantly, the inflation/interest rate outlook is unusually uncertain as a result of new Federal Reserve policy strategies, record projected federal deficits, and Middle East turmoil. These factors collectively suggest the possibility interest-rate levels and volatility could rise sharply. Against this economic backdrop, credit-union exposure to interest-rate risk has risen – both absolutely and relative to banks. [Please see figure.] In 1995, the ratio of residential real-estate loans to total assets – a key measure of exposure – was comparable for banks (20.7 percent) and credit unions (19.7 percent). By June 2010, however, the credit-union ratio was approaching 35 percent – up roughly 15 percentage points in 16 years and roughly 15 percentage points higher than the bank figure.

Residential Real Estate Loans as a Percentage of Total Loans
Federally Insured Credit Unions (FICUs) vs. Commercial Banks, 1995-2010
 (All Figures for June; FICU Loans Include Real-Estate-Backed Business Loans)



Under the proposed rule, federally insured credit unions (FICUs) meeting two criteria must maintain a written interest-rate-risk policy: (i) total assets exceeding \$50 million, and (ii) total assets from \$10 to \$50 million plus CARIRS exceeding 100 percent. CARIRS – Capital-at-Risk from an Interest-Rate Shock – is the sum of first mortgages and investments with maturities exceeding 5 years, scaled by net worth. The numerator captures current/potential interest-rate-risk exposure stemming from fixed-rate and adjustable-rate first mortgages. The denominator captures the capital available as a buffer. The two criteria extend the rule to almost all FICU assets while exempting most small FICUs. [Please see table.] Specifically, 43.4 percent of FICUs accounting for 95.5 percent of FICU assets will be subject to the written-policy requirement. Meanwhile, 92.7 percent of FICUs with assets below the FICU median (50th percentile, \$17.6 million in assets) will be exempt. Of the 3,402 FICUs not covered by the rule, 81.7 percent are exempt by small size alone (total assets under \$10 million), and 18.3 percent by a combination of small size (assets from \$10 to \$50 million) and low CARIRS (below 100 percent).

Scope of Written Interest-Rate-Risk Rule (Part 741) Covered vs. Not Covered Federally Insured Credit Unions (FICUs) <i>Partitioned Using December 31, 2010 Call-Report Data</i>	
Total Number of Federally Insured Credit Unions (FICUs)	7,339
Total Assets of all FICUs	\$ 914,474,864,992
COVERED: Written Interest-Rate-Risk Policy Required of FICUs with Assets > \$50 Million and FICUs in \$10-to-\$50 Million Asset Range with CARIRS > 100% <u>C</u> apital- <u>a</u> t- <u>R</u> isk from <u>I</u> nterest- <u>R</u> ate <u>S</u> hocks (CARIRS) = [First Mortgages + Investments (>5 Years)] / Net Worth	
Covered by Written Interest-Rate-Risk Policy Requirement	
Number of Covered FICUs	3,184
<i>Number Covered as a Percentage of All FICUs</i>	43.4%
Total Assets of Covered FICUs	\$ 873,558,473,185
<i>Covered Assets as a Percentage of All FICU Assets</i>	95.5%
NOT Covered by Written Interest-Rate-Risk Policy Requirement	
Number of FICUs NOT Covered	4,155
<i>Number NOT Covered as a Percentage of All FICUs</i>	56.6%
Total Assets of FICUs NOT Covered	\$ 40,916,391,807
<i>Total Assets of NOT Covered FICUs as a Percentage of All FICU Assets</i>	4.5%
Impact on Small Federally Insured Credit Unions (Below Median Asset Size)	
Number of FICUs Holding < \$17.6 million in Assets	3,669
Number of FICUs Exempt from Rule b/c Assets < \$10 Million	2,781
<u>Number of FICUs (\$10-\$17.6 million in Assets) Exempt from Rule b/c CARIRS Ratio < 100%</u>	<u>621</u>
Number of FICUs Holding < \$17.6 Million in Assets NOT Covered by Rule	3,402
<i>Percentage of FICUs Under Median Asset Size NOT Covered by Rule</i>	92.7%
NOTES (1) Data obtained from credit-union call reports. (2) Median is the "middle" number in a distribution (i.e., 50th percentile). The median is a better measure of central tendency than the average when the distribution is highly skewed.	