NCUA LETTER TO FEDERAL CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION
1775 Duke Street, Alexandria, VA 22314

DATE: **August 2008** **LETTER NO.: 08-CU-20**

TO: **Federally Insured Credit Unions**

SUBJ: **Evaluating Current Risks to Credit Unions**

ENCL: **Supervisory Letter – Evaluating Current Risks to Credit Unions**

Dear Board of Directors:

NCUA examiners were recently provided guidance addressing the current risks to credit unions. This letter provides all federally insured credit unions with the same guidance via the attached Supervisory Letter, which was issued in August 2008 to examiners.

The Supervisory Letter discusses several of the current risks facing the credit union industry, provides NCUA field staff with guidance for assessing mortgage portfolio risk management, and recommends best practices for conducting risk focused supervision and monitoring. Effectively addressing and resolving risk issues requires open and clear communication between NCUA field staff and credit union management and continues to be a core element of the Risk Focused Examination program.

Some of the key points addressed in the Supervisory Letter include:

- Credit union balance sheets and operational strategies have changed over the past decade. There is presently much higher reliance on long-term loans which are funded by more volatile sources. New delivery channels and increased use of outsourcing have allowed for rapid changes to the structure of the balance sheet and the risk profile of credit unions.
- Recent high profile credit union failures resulted from rapidly changing balance sheet structures arising from third-party relationships, combined with a lack of prudent risk management policies and practices. Several of the lessons learned from these failures are included throughout the Supervisory Letter.
- Declining real estate values result in the potential for elevated levels of credit risk on credit union balance sheets. While credit unions do not widely offer non-traditional mortgage products or participate in subprime lending, the declines in real estate value and accompanying increase in foreclosures affect credit unions across the country.

- The issues impacting the mortgage market are spreading to other lending products. While the Supervisory Letter primarily addresses the potential risks in real estate lending, many of the principles discussed can be applied to other loan products.

NCUA has issued numerous letters providing guidance to credit unions and NCUA staff regarding the associated risks given various economic, interest rate, or credit cycles. The core guidance in these letters represents sound risk management practices and is applicable in the current environment. The attached Supervisory Letter includes many of these core principles.

Sincerely,

/s/

Michael E. Fryzel
Chairman

Enclosure