Closing the Stabilization Fund and Setting the Share Insurance Fund Normal Operating Level

Board Briefing

September 28, 2017

Summary of July 2017 Proposal

- In July 2017, the Board issued a Notice and Request for Comment on its plan to close the Stabilization Fund in 2017 and set the normal operating level at 1.39 percent.
- Proposal recommended:
  - Closing the Stabilization Fund in 2017.
  - Adopting policy for setting the normal operating level.
    - Objective is for Share Insurance Fund to withstand a moderate recession without the equity ratio falling below the 1.20% statutory minimum.
  - Increasing the Share Insurance Fund's normal operating level to 1.39

Statutory Minimum	1.20%
Plus: Equity for Potential Impact of a Moderate Recession on the Insurance Fund	0.13%
Plus: Equity for Potential Declines of Value in Claims on Corporate Estates	0.04%
Plus: Projected Equity Ratio Decline in 2018 and 2019	0.02%
Equals: Recommended Normal Operating Level	**1.39%**

Summary of Comments

- Most either support or did not expressly oppose closing the Stabilization Fund in 2017
  - Some are concerned closure would effect total distributions and/or recoveries to former capital holders or result in less transparency.
  - A few did not support closure, claiming the NCUA can make distributions directly from the Stabilization Fund.
- Almost all commenters agree with a distribution as soon as possible.
- About half of the commenters oppose any increase to the normal operating level, with a common justification that 1.30 percent was sufficient during the last crisis.
  - Most want a "full refund" of either all equity in the Stabilization Fund or all assessments paid.
  - Some contend using Stabilization Fund equity to increase the Share Insurance Fund's equity ratio is improper.
  - Many commenters assert that any increase to the normal operating level should be temporary.

Closing the Stabilization Fund in 2017

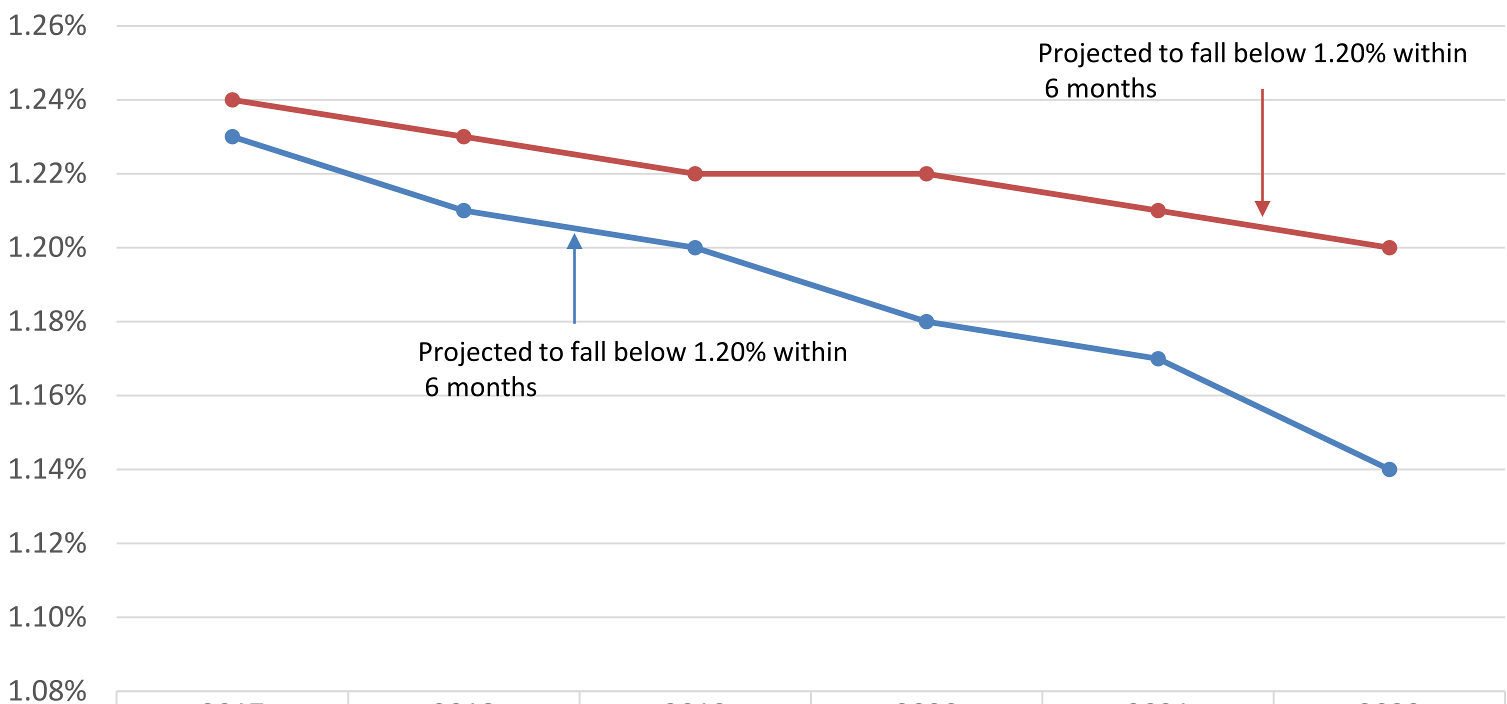
- Statutory criteria have been met
  - Treasury borrowings have been repaid as of October 2016
  - Stabilization Fund has a positive net position as of June 2017 of $2.0 billion
- Closure in 2017 has no effect on the claims against the asset management estates of depleted member capital investors
- Decision to close does not in and of itself affect the total amount available for distribution from the Share Insurance Fund
- Distributions directly to credit unions are not permissible under the FCU Act
  - Distribution to the Share Insurance Fund is permissible only upon closure
  - Distributions to credit unions will be governed by the FCU Act's provisions for Share Insurance Fund distributions
- Transparent reporting of asset management estates and Legacy Assets will continue

Closing the Stabilization Fund in 2017

- Stabilization Fund has fulfilled its purpose of spreading out and containing the corporate resolution costs within the credit union system
  - No additional assessments are projected
  - Remaining obligations of the Corporate System Resolution Program can now be borne by the Share Insurance Fund without inordinate risk, provided additional equity is maintained
    - Unpaid principal balance of Legacy Assets now $11.2 billion
    - NGN investor outstanding principal balance is $6.2 billion
    - Share Insurance Fund assets total $13.2 billion
- Stabilization Fund can be prudently closed in 2017
  - Time to end this temporary, crisis-era arrangement
  - Should lead to distributions to credit unions in 2018

Equity Ratio Projections

If the Stabilization Fund is not Closed in 2017



	2017	2018	2019	2020	2021	2022
Base	1.23%	1.21%	1.20%	1.18%	1.17%	1.14%
Base Plus	1.24%	1.23%	1.22%	1.22%	1.21%	1.20%

- Fully contributed equity ratio uses 1% of current insured shares (denominator) as the contributed capital deposit.
- Year-end equity ratio uses the projected contributed capital deposit, which is based on insured shares as of the prior June or December.

Evaluation of Post-Closure Normal Operating Level

- By closing the Stabilization Fund, the Share Insurance Fund will be responsible for the remaining Corporate System Resolution Program obligations
- The normal operating level must be sufficient to absorb risks to the Share Insurance Fund from the obligations of the Corporate System Resolution Program and potential credit union industry losses under an economic downturn
- The Share Insurance Fund needs to be able to withstand a recession without the equity ratio falling below the 1.20 percent statutory minimum over a five-year period[1]

1. Five-year horizon was used to cover the cycle of an economic downturn and the lifecycle of the NGN program.

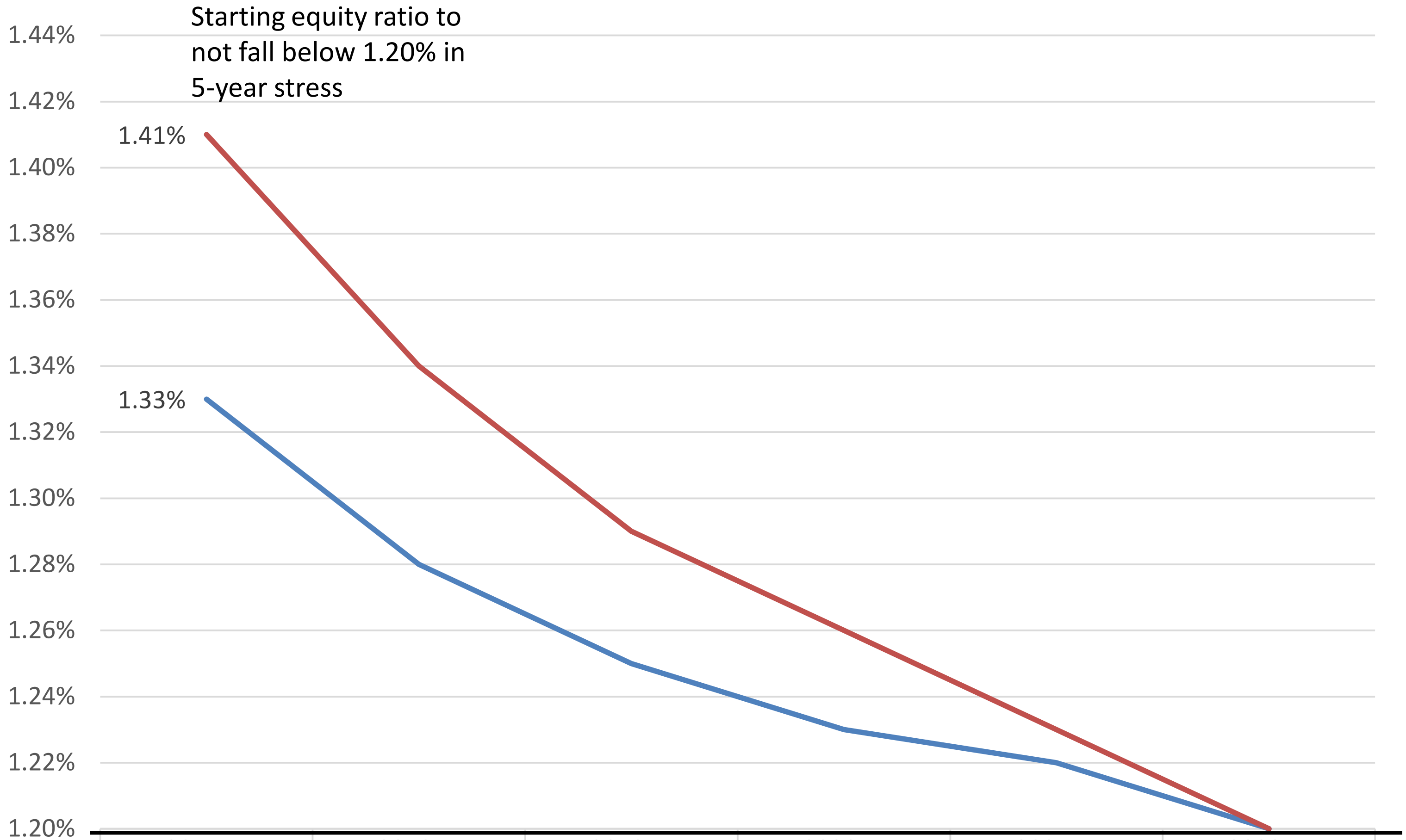
Evaluation of Post-Closure Normal Operating Level

- Modeled losses over five years in Adverse (moderate recession) and Severely Adverse (severe global recession) economic scenarios from the Federal Reserve Board
  - Project the performance of the Share Insurance Fund based on three primary drivers: insurance losses, insured share growth, and yield on investments
  - Quantify potential decline in value of the Share Insurance Fund's claims on the asset management estates

Scenario	Adverse	Severely Adverse
Equity for Share Insurance Fund Stress	1.33%	1.41%
Plus: Projected Equity Ratio Decline in 2018 and 2019	0.02%	0.02%
Plus: Equity for Potential Declines of Value in Claims on Estates	0.04%	0.11%
Equals: Recommended Normal Operating Level	**1.39%**	**1.54%**[1]

1. This exceeds the statutory maximum normal operating level of 1.5%.

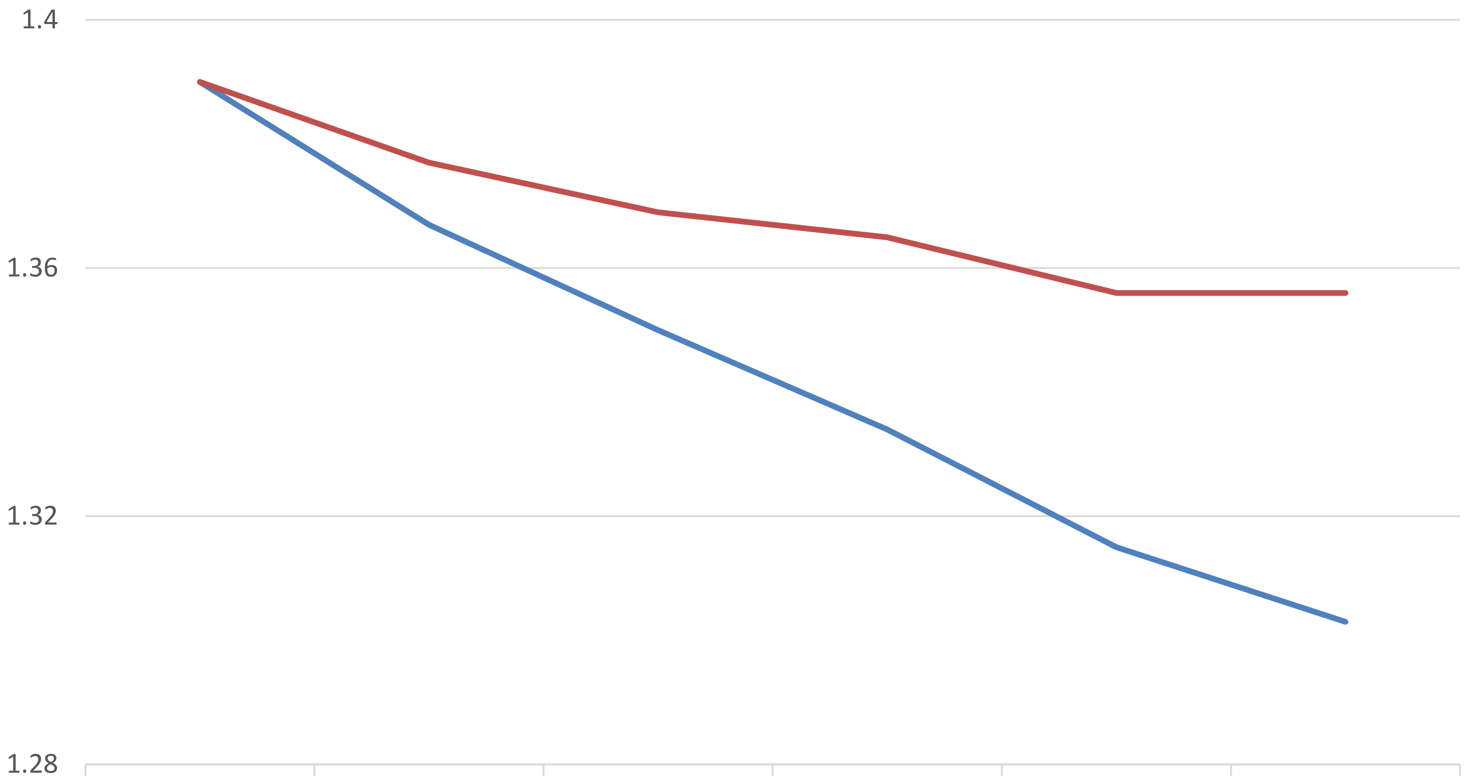
Economic Stress Analysis (1.20% Floor)
(without corporate resolution program exposure)



	2017q4	2018q4	2019q4	2020q4	2021q4	2022q4
Adverse	1.33%	1.28%	1.25%	1.23%	1.22%	1.20%
Severely Adverse	1.41%	1.34%	1.29%	1.26%	1.23%	1.20%

5-Year Equity Ratio Projections

From Proposed Normal Operating Level (Post-Stabilization Fund Closure)



	2017	2018	2019	2020	2021	2022
Base	1.39	1.367	1.35	1.334	1.315	1.303
Base-Plus [1]	1.39	1.377	1.369	1.365	1.356	1.356

1. This projection includes assumptions that are slightly more optimistic than current trends. In this projection, yield on investments is slightly higher than current yields, insured share growth is the 3-year average share growth less one standard deviation, and insurance losses are the average of the three lowest annual losses over the last five years. See the November 2016 Board presentation for additional information on this equity ratio calculation.

Asset Management Estate Cash Flow Summary

All Scenarios ($ in Billions)[1]

- Legacy Asset and NGN cash flows run through applicable estate payout priorities[2]
- Decline in NCUA receivable from estates plus projected recovery on US Central capital note
  - Adverse: $400 million or 4 basis points; Severely Adverse: $1.1 billion or 11 basis points

Estate	NGN Cash Flows (Net)[3]			Depleted Capital Recovery[4]			NCUA Net Receivable from Estates[5]		
	Base	Adverse	Severely Adverse	Base	Adverse	Severely Adverse	Base	Adverse	Severely Adverse
US Central	2.0	0.9	0.3	0.7	0.0	0.0	0.9	0.9	0.5
WesCorp	0.6	0.3	0.1	0.0	0.0	0.0	0.9	0.5	0.3
Members	0.4	0.2	0.1	0.5	0.1	0.0	0.2	0.2	0.1
Southwest	0.4	0.2	0.1	0.6	0.2	0.1	0.0	0.0	0.0
Constitution	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	**3.4**	**1.5**	**0.5**	**1.8**	**0.3**	**0.1**	**2.0**	**1.6**	**0.9**
Differences from Base	--	*(1.9)*	*(2.9)*	--	*(1.5)*	*(1.7)*	--	***(0.4)***	***(1.1)***

1. Numbers may not add due to rounding. 2. Payout priorities are outlined in 12 CFR § 709.5. 3. NGN cash flows (net) includes guaranty fees, guaranty payments, guaranty reimbursements, residuals, and post-securitized Legacy Asset proceeds. 4. If depleted member capital is repaid to US Central, a portion will be distributed to the other estates that had capital at US Central. 5. US Central receivables reflect the $0.1 billion due to NCUA and the $0.8 billion estimated to be recognized on the US Central capital note.

Recommended Normal Operating Level

Scenario	Adverse	Severely Adverse
Equity for Share Insurance Fund Stress[1]	**1.33%**	1.41%
Plus: Equity for Potential Declines of Value in Claims on Estates[2]	0.04%	0.11%
Plus: Projected Equity Ratio Decline in 2018 and 2019[3]	0.02%	0.02%
Equals: Recommended Normal Operating Level	**1.39%**	1.54%[4]

To withstand a moderate recession without the equity ratio falling below 1.20%, the equity ratio should account for the following:

- A 13 basis point decline in the equity ratio due to the impact on the three primary drivers of the Share Insurance Fund's performance
- A 4 basis point decline in the value of the Share Insurance Fund's claim on the asset management estates
- A 2 basis point decline in the equity ratio expected to occur prior to when the remaining NGNs begin to mature in 2020 and remaining exposure to the Legacy Assets can begin to be reduced. This helps ensure the 4 basis points of additional equity to account for the potential decline in value of the claims on the asset management estates is maintained in the Share Insurance Fund until Legacy Assets can be sold.

1. From 2017 equity ratio level under the Adverse and Severely Adverse scenarios on slide 9. 2. From bottom row of NCUA net receivable from estates in Adverse and Severely Adverse scenarios on slide 11. 3. See the Base-Plus projection on slide 10. 4. This exceeds the statutory maximum normal operating level of 1.5%.

Share Insurance Fund During Crisis

- The corporate credit union losses depleted the Share Insurance Fund's retained earnings and impaired credit unions' 1% contributed capital deposit by 69 percent in 2009
  - These losses were reallocated to the Stabilization Fund upon its creation in mid-2009
- The Share Insurance Fund's equity ratio fell below 1.20 percent in both 2009 and 2010
  - Two premiums totaling $1.7 billion were necessary to restore the equity ratio (10.3 bp in 2009 and 12.4 bp in 2010)
  - Without the premiums, the equity ratio would have fallen to 1.07%
- From 2008-2012, 112 natural person credit unions failed
  - Actual losses associated with natural person credit unions exceeded $800 million

Estimated 2018 Distribution with Closure of the Stabilization Fund and 1.39% Normal Operating Level

- The FCU Act provisions and § 741.4 of NCUA's regulations govern distributions to credit unions
  - Distribution to the extent the calendar year-end equity ratio exceeds the normal operating level

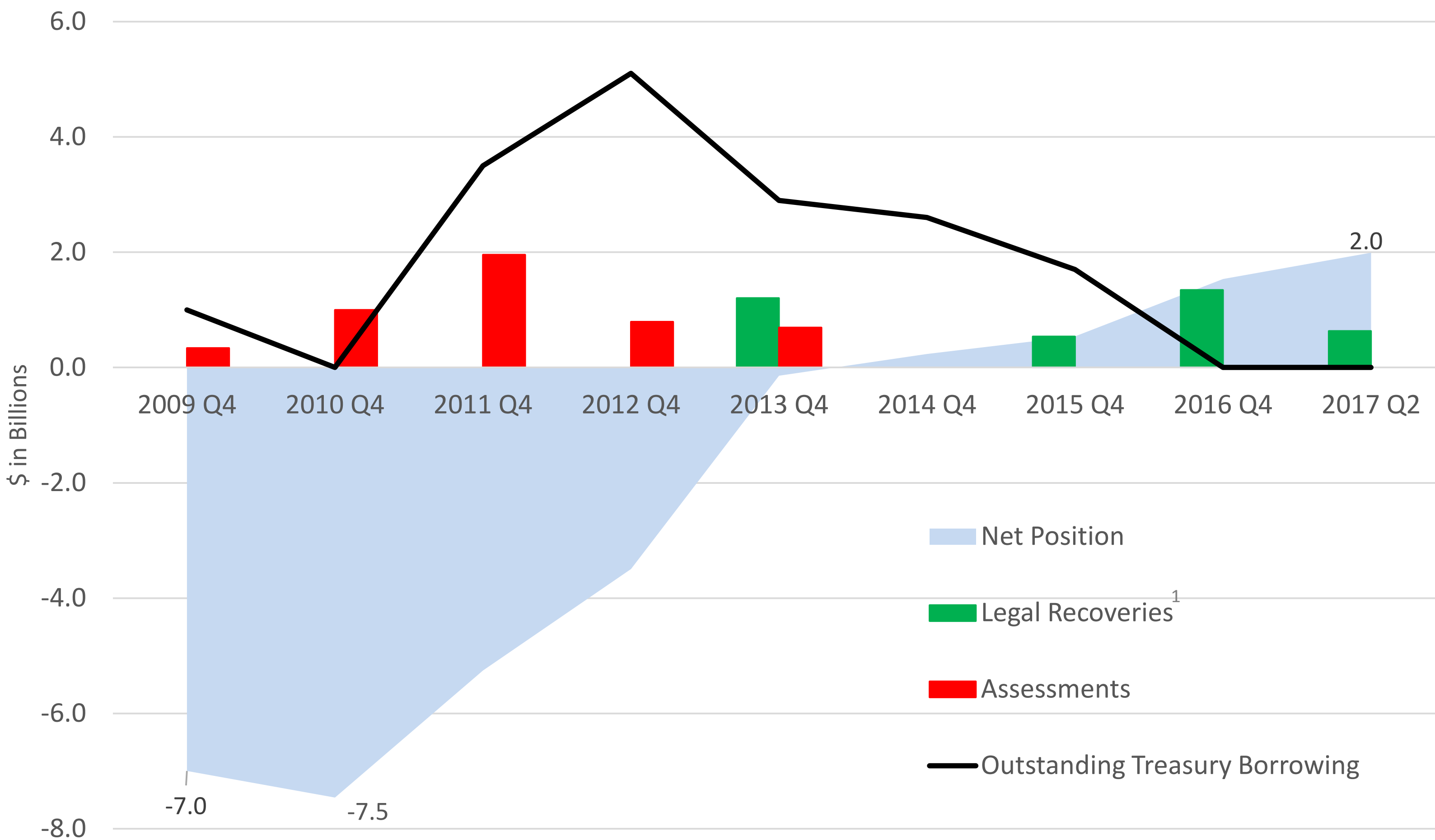
Distribution Component	Amount
Projected Equity Ratio as of 12/31/17	1.45% – 1.47%
Minus: Normal Operating Level	1.39%
Equals: Distribution in Excess of Normal Operating Level	0.06% – 0.08%
Estimated Distribution in 2018	**$600 – $800 million**

Distribution Reconciliation[1]

Potential Total Distributions to Insured Credit Unions		
A	Projected Distribution in 2018	$0.6 to $0.8
B	Plus: US Central Capital Note Balance	$0.2
C	Plus: Equity for Potential Decline in Claims on Estates	$0.4
D	Plus: Accounting / Economic Differences[2]	$0.2 to $0.3
E	**Total of Potential Total Distributions (A + B + C + D)**	**$1.4 to $1.7**
F	Less: Distributions Paid in 2018	$0.8 or $0.6
G	**Total of Potential Distributions Possible after 2018 (E – F)**	**$0.6 to $1.1**
Funds Retained in Share Insurance Fund to Avoid Future Premiums		
H	Amount Needed to Return Equity Ratio to 1.33%	$0.8
I	Plus: Projected Equity Ratio Decline	$0.2
J	Plus: Discounting Methodology Differences[3]	$0.2 to $0.3
K	**Total Funds Retained to Avoid Future Premiums (H + I + J)**	**$1.2 to $1.3**
Projected Distributions and Funds Retained in Share Insurance Fund (E + K)		**$2.6 to $3.0**

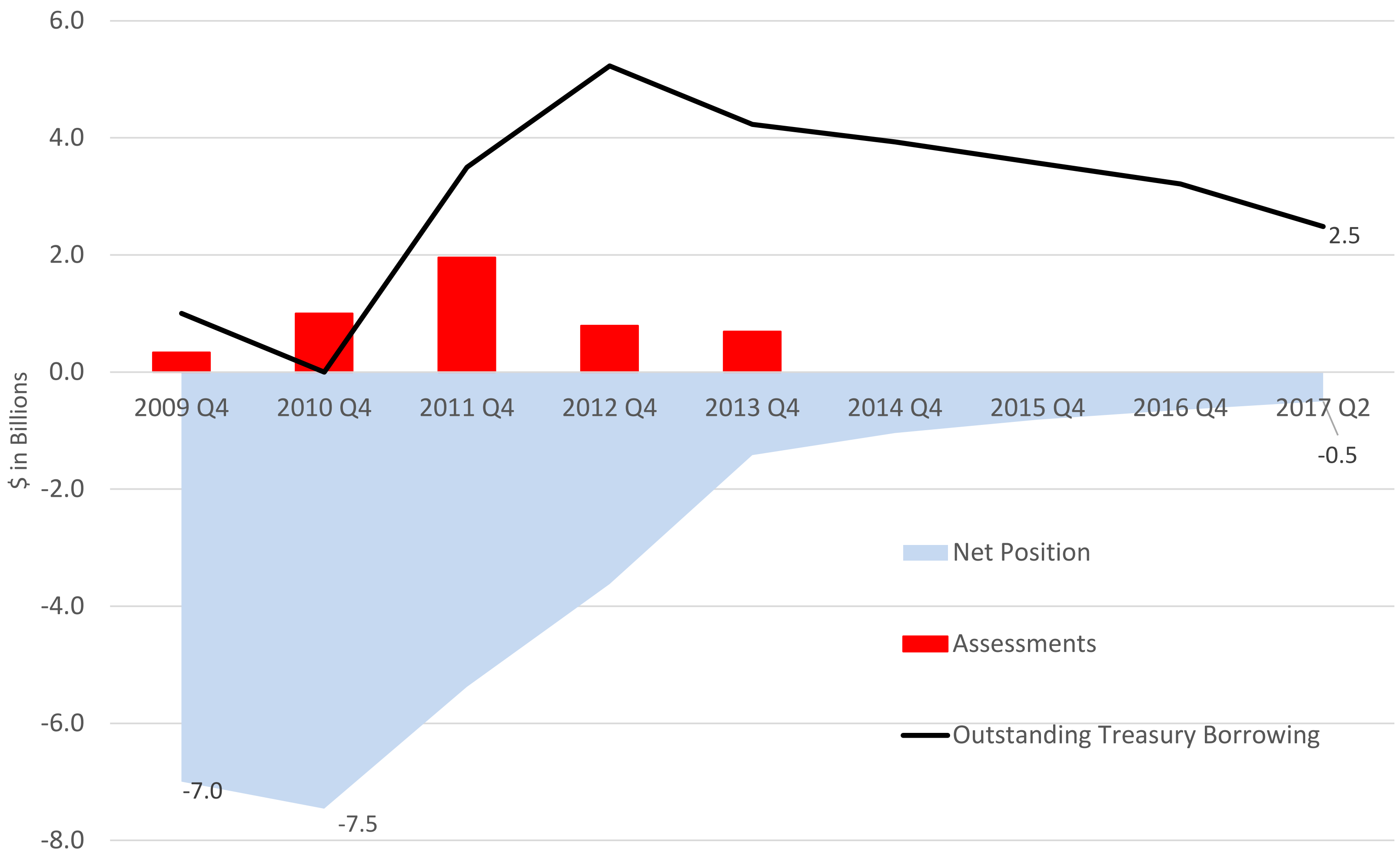
1. Point in time estimates in billions as of March 31, 2017, based on best available information. Does not include legal recoveries received in May 2017 or potential future legal recoveries. 2. Cash flows that are not recognized under GAAP (e.g., future cash flows related to interest and guaranty fees). 3. Projected net remaining assessments were shown on an undiscounted basis (or nominal basis) to align with actual assessment amounts projected.

Actual Performance – Legal Recoveries Repay Treasury Borrowings and Drive Net Position Positive



1. Total net legal recoveries are presented in this graph, although a small portion was retained by the asset management estates that no longer owed the Stabilization Fund.

Performance without Legal Recoveries



Recommended Actions

- Close Stabilization Fund in 2017
- Set the Normal Operating Level at 1.39 percent
- Adopt Policy for Setting the Normal Operating Level
- Publish a Public Notice in the *Federal Register*
- Amend Delegation of Authority SPE 36
- Authorize the Executive Director and the NGN Oversight Committee to take Actions Necessary to Close the Stabilization Fund

What to Expect in 2018

- Actual amount of distribution will be determined in March 2018, after year-end insured shares are reported.
- Estimated distribution is $600 million to $800 million. Actual results may vary due to:
  - Extraordinary losses and/or failures in credit unions
  - Unusual or abnormally high insured share growth
  - Economic conditions that involve greater volatility in one or more market indicators as compared to the stress scenarios modeled
  - Extraordinary losses on the Legacy Assets resulting in higher than anticipated guaranty payments from NCUA
- NCUA will issue additional information regarding amount and accounting for any distribution in second quarter 2018.