

## BOARD ACTION MEMORANDUM

**TO:** NCUA Board

**DATE:** December 15, 2020

**FROM:** Office of Examination and Insurance  
Share Insurance Fund 2021 Normal Operating Level (NOL) Board Briefing

**SUBJ:**

**ACTION REQUESTED:** None. Briefing on the Normal Operating Level (NOL) to be retained at 1.38 percent and discussion of next steps.

**DATE BOARD BRIEFING:** December 17, 2020

**OTHER OFFICES CONSULTED:** Office of Chief Economist  
Office of the Chief Financial Officer

**BUDGET IMPACT, IF ANY:** None

**SUBMITTED TO INSPECTOR GENERAL FOR REVIEW:** No

**RESPONSIBLE STAFF MEMBERS:** Myra Toeppe, Director, Office of Examination & Insurance; Andrew Leventis, Chief Economist, Office of the Chief Economist; Victoria Nahrwold, Acting Associate Director, Office of Examination & Insurance

**SUMMARY:** In accordance with the Policy for Setting the Normal Operating Level, the NCUA periodically reviews the equity needs of the Share Insurance Fund. Using contemporary (2020) data, staff calculated the normal operating level according to the Board-approved methodology. The calculation resulted in the following for the different categories affecting the normal operating level.

### *Potential Impact of a Moderate Recession on the Share Insurance Fund*

The effects of a moderate recession on Share Insurance Fund performance comes from the economic scenarios developed by the 2020 Federal Reserve Board CCAR/DFAST, extended using additional data by Macroeconomic Advisors.

As in 2019, NCUA developed quantitative links from variables projected in the Federal Reserve scenarios to project insurance losses, share growth, and the Share Insurance Fund yield. The 2020 estimated impact of a moderate recession on the Share Insurance Fund is a 16 basis point reduction in the equity ratio.

### *Potential Decline of Value in Claims on Corporate Estates*

In accordance with the NCUA's ongoing effort to sell legacy assets that no longer securitize the NCUA Guaranteed Notes (NGNs), updated data through June 2020<sup>1</sup> shows a reduction in risk related to the Share Insurance Fund's claim on the corporate estates in a moderate recession. As

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<sup>1</sup> The updated data for the NGN program is available here <https://www.ncua.gov/services/Pages/share-insurance/ngn-program.aspx>.

a result, staff now estimates the value of the Share Insurance Fund’s claim on the corporate estates would decline by an estimated one basis point in a moderate recession.

Projected Decline in the Equity Ratio

Key variables for equity ratio projections through year-end 2020 include insured share growth, the yield on investments, and insurance losses. The estimates for the projected decline in the equity ratio through December 31, 2021, have increased to two basis points primarily due to the following:

- Reduced investment income due to lower interest rates earned on Share Insurance Fund’s investment portfolio.
- An increase in the 5-year average for insurance losses used as one of the key assumptions in the projection. The increase in the 5-year average is due to the elevated losses experienced in 2018.

Factors to Consider for the 2021 NOL Calculation

The NGN notes will mature in 2021 and corporate asset management estates are expected to be liquidated. Therefore, this factor will no longer be relevant after 2021.

The projected equity ratio decline through the end of the following year was originally formulated as a backstop to provide extra protection for the equity ratio to address the time it might take to liquidate corporate asset management estates. With the corporate asset management estates so close to liquidation, the original intent of this factor may no longer be necessary

Given the issues to consider, E&I calculated two options for the 2021 NOL with a third option to leave the ratio unchanged. Table 1 describes each option.

**Table 1**

Option A	Option B	Option C
Set NOL using all three risk factors noted in policy	Set NOL using only the following factors: <ul style="list-style-type: none"> <li>• Modeled performance of SIF over a five-year period assuming moderate recession</li> <li>• Potential decline in value of SIF claims on corporate asset management estates in a moderate recession as modeled by BlackRock</li> </ul>	Leave NOL unchanged (1.38%)

Table 2 illustrates the results of each option.

**Table 2**

<b>Component</b>	<b>2020</b>	<b>2021 (option A)</b>	<b>2021 (option B)</b>
Statutory Minimum	1.20%	1.20%	1.20%
Potential Decline in SIF Performance	0.15%	0.16%	0.16%
Potential Decline of Value in Claims on Corporate Estates	0.02%	0.01%	0.01%
Projected Equity Ratio Decline through Dec. 2021	0.01%	0.02%	NA
<b><i>Equals: NOL</i></b>	<b><i>1.38%</i></b>	<b><i>1.39%</i></b>	<b><i>1.37%</i></b>

**RECOMMENDED ACTION:** None. The NCUA Board will retain the Normal Operating Level at 1.38 percent.