**BOARD ACTION MEMORANDUM**

**TO:** NCUA Board

**DATE:** August 26, 2011

**FROM:** Director, Office of Examination and Insurance

**SUBJ:** 2011 Stabilization Fund Assessment

**ACTION ITEM:** NCUA Board approve a 2011 Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund) assessment of 0.25 percent of each federally insured credit union's insured shares as of June 30, 2011, for an estimated total of $1.956 billion, according to §217(d)(1) of the FCU Act.

**ACTION DATE:** August 29, 2011

**OTHER OFFICES CONSULTED:** Office of General Counsel, the Office of Corporate Credit Unions, and the Office of the Chief Financial Officer.

**VIEWS OF OTHER OFFICES CONSULTED:** Concur.

**SUBMITTED TO THE INSPECTOR GENERAL FOR REVIEW:** Yes.

**BUDGET IMPACT, IF ANY:** Stabilization Fund receipt of approximately $1.96 billion recognized as income and available to fund payment of corporate credit union stabilization fund liabilities.

**RESPONSIBLE STAFF MEMBERS:** Larry Fazio, Director of Examination and Insurance; Mary Ann Woodson, Chief Financial Officer

**SUMMARY**: Staff recommends the NCUA Board approve an assessment of 0.25 percent of insured shares, totaling approximately $1.96 billion. The funds generated by the assessment along with borrowed funds from the Treasury will be used to pay the principal and interest on maturing Medium Term Notes (MTN) issued by corporate credit unions and guaranteed by the Stabilization Fund and the guaranteed notes issued to the bridge corporate credit unions. These actions are consistent with the purpose of the enabling legislation.

## Background

Since the last Stabilization Fund assessment approved in June 2010 the following changes relate to the assessment process:

1. In the fall of 2010, with the concurrence of the U.S. Treasury the closing date for the Stabilization Fund was extended from September 23, 2016 to June 30, 2021.

2. On January 4, 2011, Senate Bill 4036 was signed into law adding a new provision authorizing NCUA to make premium assessments of federally-insured

credit unions to pay pending or future TCCUSF expenses directly, in addition to the existing authority to make assessments to repay Treasury advances. Exercise of this direct assessment authority requires the NCUA Board “take into consideration any potential impact on credit union earnings that such an assessment may have” and requires the assessment be paid not later than 60 days following the assessment.

3. In November 2010, NCUA provided an estimate for credit union budgeting purposes of 20 to 25 basis points of insured shares for the 2011 Stabilization Fund assessment. The majority of this estimate was based on the projected near term net cash flow needs of $2.94 billion in total for 2011 and 2012.

Stabilization Fund – Funding Needs and Loss Estimates

Based on June 30, 2011, data, NCUA projects $8.2 billion in net cash obligations due and payable through October 2012, made up of the following:

Table 1

| Net Cash Needs – to October 2012 | $ Billions |
|---|---|
| **Uses of Funds – to October 2012** | |
| Corporate medium term note guarantee | 5.52 |
| Notes payable to bridge corporates – net of NGN proceeds | 2.94 |
| Other obligations | 0.49 |
| Total projected uses of funds | **8.95** |
| **Sources of Funds – to October 2012** | |
| Monetization of other corporate assets | 0.75 |
| Total projected sources of funds | **0.75** |
| Net pre-2012 obligations to be funded | **8.20** |
| | |
| Less: Treasury borrowing | 5.50 |
| **Total Pre-2013 Projected Cash Needs** | **2.70** |
| Projected Total 2011 & 2012 Stabilization Assessments - 06/30/2011 insured shares | **34.5 basis points** |

Through a competitive bid process, NCUA engaged the firm Blackrock to conduct quarterly modeling of losses and cash flows on the legacy assets of the corporates securitized in the NCUA Guaranteed Notes (NGNs). Based on Blackrock’s model projections, actual performance of the legacy assets, and updated projections in monetizing the other assets in the asset management estates, the cumulative total projected Stabilization Fund costs for the corporate resolution program as of June 30, 2011, are a range of $5.2 billion to $9.5 billion. As reflected in table 2 below, by deducting the $3.3 billion already assessed in 2009 and 2010, and including the 2011 assessment, **the projected remaining assessments over the life of the Stabilization Fund are $1.9 billion to $6.2 billion.**[1]

Table 2

| Stabilization Fund | Previous Estimate[2] | Current Estimate |
|---|---|---|
| Range of Total Projected Assessments | $8.3B to $10.5B | $5.2B to $9.5B |
| Less 2009 and 2010 Assessments | -$1.3B | -$1.3B |
| =Range of Post 2010 Remaining Projected Assessments | $7.0B to $9.2B | $3.9B to $8.2B |
| Less 2011 Assessment | -$2.0B | -$2.0B |
| =Range of Post 2011 Remaining Projected Assessments | $5.0B to $7.2B | $1.9B to $6.2B |

Impact of 2011 Assessment

The June 30, 2011 call report data discloses continued marginal improvement in the operating results of federally-insured credit unions. Credit unions reported a relatively strong return on average assets (ROA) of 0.86 percent, excluding accruals some reported for the projected 2011 NCUSIF premium and Stabilization Fund assessment.[3] The proposed 25 basis point assessment reduces annualized ROA by 21 basis points.[4] However, profitability does vary across asset sizes, with smaller institutions having lower ROA levels, albeit higher net worth levels as noted in table 3 below.[5]

Table 3

| FICU Assets | < $10M | $10M- $100M | > $100M | All |
|---|---|---|---|---|
| ROA (adj.) | -0.02% | 0.47% | 0.92% | 0.86% |
| Projected ROA after Assessment | -0.26% | 0.24% | 0.69% | 0.62% |
| No./Pct. Projected to be unprofitable from assessment | 281 / 10.6% | 423 / 13.3% | 107 / 7.7% | 811 / 11.2% |
| Net Worth Ratio Before/After | 14.55% / 14.40% | 11.46% / 11.32% | 9.90% / 9.75% | 10.14% / 9.99% |

The assessment reduces the aggregate net worth ratio from 10.14 percent to 9.99 percent, with 15 basis points being the average decline. Additional information on the impact of the assessment using June 30, 2011 data is as follows:

- Annualizing June 30, 2011 results, 811 (15%) out of the 5,437 FICUs reporting positive net income at June 30, 2011 may experience negative core income for

[1] These projections do not include any potential recoveries from settlements or litigation, which are inherently inestimable. Any such recoveries would reduce the cumulative total costs.

[2] The prior loss estimates were as of December 31, 2010, and based in part on the modeling done on the legacy assets by Barclays Capital.

[3] Under GAAP, credit unions should not accrue for NCUSIF premiums or Stabilization Fund assessments. In addition, the current staff outlook indicates a NCUSIF premium in 2011 is not likely necessary.

[4] In 2010, the combined NCUSIF premium and Stabilization Fund assessment of 25.82 basis points reduced the return on average assets (ROA) by 22 basis points and exceeded net income in 695 of the 7,339 (9.5%) reporting credit unions.

[5] The impact of the assessment on corporate credit unions is less significant due to the lower percentage of insured shares. The assessment for all corporate credit unions is 0.0076 percent of corporate credit union assets.

2011 due to the Stabilization Fund assessment.[6] Core net income excludes any accrual for potential NCUA assessments,[7] gain on sale of investment and fixed assets, non-operating gains, and merger-related gains.

- There are 81 (1.18%) of the 6,858 FICUs reporting net worth greater than 7 percent as of June 30, 2011 that may experience a decline in net worth to less than 7 percent from the assessment, subjecting them to the earnings retention requirement of Prompt Corrective Action (PCA).
- Some 24 FICUs (0.3%) may experience a decline in net worth to below 6 percent, requiring them to prepare a net worth restoration plan.
- Only 3 FICUs (0.04%) with a net worth ratio over 2 percent may experience a decline to less than 2 percent resulting from the assessment.

Given the largely fixed near term cash needs of the Stabilization Fund, the ability for most credit unions to afford an elevated assessment this year, no anticipated need for an NCUSIF premium in 2011, and renewed economic uncertainty looking forward into 2012, staff recommends the NCUA Board approve a 2011 Stabilization Fund assessment of 25 basis points. A 25 basis point assessment is projected to total $1.96 billion.

Recording the Assessment

The Office of the Chief Financial Officer will prepare the Stabilization Fund assessment invoices and distribute them to all credit unions with the assessments due by September 27, 2011. Since NCUA Board approval of this assessment establishes the liability, credit unions should expense the assessment in September and report the entire expense on the September 30, 2011 call report.

2012 Outlook

The volatile recent economic events pose additional challenges on what was already a difficult forecasting environment. However below is staff's outlook for NCUSIF premiums and Stabilization Fund assessments for 2012.

Assuming the total cash needs of the Stabilization Fund through assessments remain near $2.7 billion, the 2012 assessment would be approximately $700 million; this is an assessment rate of 9 basis points based on June 30, 2011 insured shares.[8]

The forecast of the NCUSIF is more dynamic. Continued elevated credit risk, economic instability and uncertainty with yields on NCUSIF investments increase uncertainty with NCUSIF premium forecasts. Table 4 below contains the most recent NCUSIF equity ratio projections.

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[6] Generally accepted accounting principles require credit unions to expense the assessment when approved by the NCUA Board (the third quarter of 2011). The immediate impact of the assessment on net income as of June 30, 2011 results in approximately 1,648 FICUs recording negative net income after the assessment for the period. The negative impact of the assessment declines with each subsequent quarter.

[7] As of June 30, 2011, credit unions recorded $270.7 million in Stabilization Fund assessment expense and $128.8 million in NCUSIF Premium expenses in anticipation of future assessments and premiums.

[8] For context, if insured shares grow by 5% by the time of the 2012 assessment, a $700 million assessment would be 8.5 basis points.

Table 4

| Scenario | Projected Equity Ratio | | |
|---|---|---|---|
| | **12/31/11** | **06/30/12** | **12/31/12** |
| Optimistic | 1.28% | 1.27% | 1.27% |
| Base | 1.27% | 1.25% | 1.24% |
| Pessimistic | 1.26% | 1.24% | 1.23% |

Should the number of credit union failures remain near the current pace (the optimistic scenario), an NCUSIF premium will not be necessary in 2012. Even in the pessimistic scenario forecast, a 2012 premium of $607 million (about 7 basis points of insured shares) would return the NCUSIF's equity ratio to a full 1.30% of insured shares. Thus, the current forecasted range for NCUSIF premiums in 2012 is from 0 to 7 basis points.

**Combining the projections, the total for the 2012 Stabilization Fund assessment and NCUSIF premium is currently projected to be a range of 8 to 18 basis points.** NCUA will update and formalize the related 2012 budgetary guidance for credit unions in November.

**RECOMMENDED ACTION:** The NCUA Board approve a Stabilization Fund assessment of 0.25 percent of each federally insured credit union's June 30, 2011, insured shares for an estimated total of $1.96 billion for the payment of pending and future expenditures of the Temporary Corporate Credit Union Stabilization Fund, according to §217(d)(1) of the FCU Act.