Corporate System Resolution
NCUA Stabilization Actions
Frequently Asked Questions (FAQs)

1. What does this FAQ cover?

This document focuses on NCUA's efforts to stabilize the credit union system; to ensure access to adequate liquidity so that lending activity and payments systems processing continued uninterrupted; and to reach the least costly outcome for federally insured credit unions.

2. In short, why did NCUA have to take action to stabilize the corporate system?

Primarily, action had to be taken due to the immediate impact of the economic downturn on many of the corporates. The result was that the corporates' historic role of liquidity providers to consumer credit unions was significantly impaired. In addition, the losses on their investments in private label mortgage-backed securities threatened the future viability of a number of the corporates. As the severity of these problems emerged, NCUA's primary focus was to ensure that the critical services corporates provide to consumer credit unions could continue without disruption. The services that consumer credit unions receive from corporates are critical to their ability to provide financial products and services to the credit union system's 90 million members.

The investment losses at two of the largest corporates became so significant that they threatened the corporates' continued financial survival. Because of the potential impact on consumer credit unions, NCUA had to step in and take action to ensure that corporates continued to operate.

The credit union system must maintain access to an adequate level of funds in order to meet consumer funding needs (payments transactions, loans, etc.). Failure to meet those funding needs would be devastating not only to credit unions, but to confidence in the overall economy.

3. Why did this economic downturn have such a devastating impact on corporates?

The crisis in the real estate market affected the economy and the availability of liquidity. Corporates had historically relied on their ability to sell or borrow against their mortgage-backed securities as a means of maintaining adequate liquidity. This practice became unworkable as the value of the mortgage-backed securities plummeted as the underlying mortgages became more and more stressed.

Corporates, in their role as liquidity providers, need to be able to grow and shrink based on the liquidity needs of consumer credit unions. In one five-month period, shares in corporates grew by about 90 percent. There have been other occasions when shares have declined by as much as 30 to 40 percent over an equivalent time period. Historically, growth and contraction has not been a problem for corporates. Traditionally the corporates' investments were highly liquid and could readily be converted to cash to fund share withdrawals.

In 2007 and early 2008, the level of consumer credit union share deposits in corporates remained relatively stable. During that time frame, the first signs of the economic downturn were developing and credit unions were seeking a safe harbor for their funds. Consumer credit unions saw corporates as the safest place to put their money. In February 2008 consumer credit union deposits in corporates were at just under $91 billion.

In late 2007 and early 2008, the unrealized losses on securities held by corporates increased significantly. As consumer credit unions became aware of the growing trend in unrealized losses, many began to withdraw funds from the corporates. By December 2008, consumer credit union deposits in corporates were $59 billion, a 35 percent decline from February. Since corporates could not sell their mortgage-backed securities without being forced to realize significant unrealized market value losses in accordance with GAAP, they were increasingly relying on borrowed funds to meet the share withdrawals. As the value of the mortgage-backed securities being used as collateral for the borrowings continued to decline, many corporates were finding it impossible to fund withdrawals made by consumer credit unions.

To ensure that adequate liquidity remained available to the credit union system, NCUA took unprecedented actions. NCUA's goal was to keep liquidity flowing so that payments system transactions - such as members' checks - could be funded, demand for consumer lending could be met, and the reliance on outside sources of liquidity could be reduced.

4. What steps did NCUA take to maintain consumer credit union confidence?

The key to maintaining adequate liquidity in the corporates during the economic crisis was to maintain the confidence of the consumer credit unions; consumer credit unions needed to know that their funds in all corporates were safe. An outflow of consumer credit union share deposits, without adequate liquidity to fund them, would result in some corporates being forced to sell mortgage-backed securities at significant losses.

To avoid the possibility that the corporates would not be able to meet consumer credit union liquidity needs, on January 28, 2009, the NCUA Board adopted the Temporary Corporate Credit Union Share Guarantee Program (Share Guarantee). The Share Guarantee provides a NCUA guarantee of all shares in the corporate, excluding paid-in capital (PIC) and membership capital (MC) accounts.

The Share Guarantee had the desired result. The outflow of funds from corporates stopped. Consumer credit union confidence in the safety of their funds was restored. Some of the funds that had been withdrawn from the corporates returned. A month after the announcement of the Share Guarantee consumer credit union share deposits at the corporates grew to $80 billion. Throughout 2009, consumer credit union shares in the corporates fluctuated between $70 billion and $80 billion. As a result, corporates were not forced to sell their mortgage-backed securities and recognize the unrealized losses.

5. Were there other steps taken by NCUA to address liquidity?

Another program that NCUA used to address liquidity was the Temporary Corporate Credit Union Liquidity Guarantee Program (Liquidity Guarantee). This program was created by the NCUA Board on October 16, 2008. The Liquidity Guarantee provided a NCUA guarantee for new unsecured debt obligations issued by corporates. For a nominal fee, corporates were allowed to issue debt obligations guaranteed by the NCUA for liquidity purposes. Issuance of debt is a normal business activity. However, the economic crisis caused a major disruption in the global credit markets blocking access to liquidity. The NCUA Liquidity Guarantee made debt issuances by corporates possible during the economic crisis. The Liquidity Guarantee benefitted corporates as it provided them additional avenues to generate liquidity. Consumer credit unions benefitted since their corporates were able to gain access to funds so they could meet their members' liquidity needs.

6. How was the Central Liquidity Facility (CLF) used in maintaining adequate corporate liquidity?

As the liquidity crisis unfolded, NCUA also used direct resources and the authority it has to provide liquidity. The CLF is a government corporation created to improve the financial stability of credit unions by meeting their liquidity needs. The CLF was created by Congress, and it is overseen by the NCUA Board. The CLF has the authority to make loans to consumer credit unions, but is not permitted to loan to corporates. To make loans, the CLF borrows from the Treasury Department's Federal Financing Bank.

As the liquidity crisis grew, the immediate concern was ensuring adequate liquidity for the needs of consumer credit unions. The corporates had historically met that need. It was essential that a "back-up" liquidity source be put in place. CLF had not had a significant amount of activity in recent years. The CLF's full statutory borrowing limit was approximately $41 billion, but a borrowing cap of $1.5 billion was in place. Due to three factors -- the projected liquidity needs of consumer credit unions, the inability of the corporates to meet those liquidity needs without selling mortgage-backed securities at a loss, and the amount of private label mortgage-backed securities held by the corporates, --$1.5 billion was not an adequate amount to meet liquidity needs.

In September 2008, NCUA obtained Congressional authorization for the CLF's full statutory borrowing limit of $41 billion. As noted earlier, the CLF could not directly provide funds to the corporates. NCUA developed several programs to use the CLF as a means of easing the demand for liquidity in the overall credit union system and injecting funds into the corporates.

7. What programs did the CLF put into place?

The Credit Union System Investment Program, known as CU SIP, was created by the NCUA Board in November 2008. While the Liquidity Guarantee was able to assist corporate credit unions in obtaining funds in the financial markets, there was also a desire to more actively use CLF funds to ease the liquidity burden. As we noted, CLF cannot lend directly to corporates. Thus, CU SIP was developed through NCUA's coordination with the Treasury Department and the Federal Reserve Board of Governors as a means for consumer credit unions to borrow funds from CLF and then invest the proceeds in guaranteed notes issued by corporates. The infusion of funds by consumer credit unions through the CU SIP enabled corporates to retire secured external borrowings subject to collateral calls, thus easing the liquidity burden at the corporate level. The consumer credit unions benefitted as the guaranteed notes paid a spread of 25 basis points. The corporates benefitted as the invested CU SIP funds were used to retire external borrowings. CU SIP raised a total of $8.2 billion.

The Credit Union Homeowners Affordability Relief Program, known as CU HARP, was created by the NCUA Board in November 2008. The mechanics of CU HARP are similar to those discussed for CU SIP. Under CU HARP, consumer credit unions borrow from the CLF and invest the proceeds in guaranteed notes at a corporate. The consumer credit union benefitted as the guaranteed note paid a bonus coupon up to 100 basis points if the credit union provided documented interest rate relief for distressed borrowers. As such, the consumer credit union was able to assist their members who were at risk of losing their homes. The corporate benefitted as the invested CU HARP funds helped to ease the liquidity burden. CU HARP raised a total of $164 million.

8. How did "other-than-temporary-impairments" (OTTI) charges on securities impact the corporate situation?

OTTI charges are the recognition of losses in securities when it is probable that the underlying cash flows supporting repayment are inadequate to return all principle invested. OTTI charges are required to be reflected through current earnings. In the absence of adequate earnings, OTTI charges are then absorbed by capital.

In late 2008, as the economic crisis continued to intensify, the analysis of the investment portfolio of U.S. Central reflected increasing OTTI charges. In January 2009, the estimated OTTI was $1.2 billion. This amount was approximately equal to the U.S. Central's total capital. Once U.S. Central Federal Credit Union (U.S. Central) recognized the OTTI charges, the corporate would have been, in effect, insolvent. Once a financial institution nears insolvency, business partners, investors, and customers question the institution's viability -- that is, its ability to continue to operate effectively.

9. Why was the solvency of U.S. Central a key concern for the industry?

The credit union system is a three-tiered system. The retail corporates obtain services from U.S. Central. One of the key services that U.S. Central provides to the retail corporates is assistance in critical aspects of payments systems processing. It was critical to consumer credit unions, their members, and the overall American economy that payments system transactions and processing could continue uninterrupted. Therefore, it was essential that action be taken to ensure U.S. Central's ability to continue in its payments systems processing role for the credit union industry.

On January 28, 2009, in an effort to maintain the stability of the entire credit union system, the NCUA Board injected a $1 billion capital note into U.S. Central. Basically, $1 billion was deposited in U.S. Central to absorb losses in excess of U.S. Central's capital. This was done initially out of the National Credit Union Share Insurance Fund, (NCUSIF). With passage of the legislation creating the Temporary Corporate Credit Union Stabilization Fund, (Stabilization Fund), the NCUA Board reassigned the capital note to the Stabilization Fund and the NCUSIF was repaid. This was the least costly alternative for the credit union system. Additionally, the capital infusion allowed U.S. Central to continue to provide essential services to its member retail corporates, which in turn passed those services down to consumer credit unions and their 90 million members.

10. What action did NCUA take when losses at U.S. Central and Western Corporate (WesCorp) accelerated?

Conditions related to OTTI at both U.S. Central and WesCorp continued to deteriorate in early 2009. The expected losses were in excess of the capital for both corporates. Member confidence in the ability of U.S. Central and WesCorp to remain viable and continue to provide services began to deteriorate.

The losses threatened the ongoing viability of both corporates and the services their members were dependent upon. WesCorp provides service to approximately 1,100 consumer credit unions that serve millions of consumers across the United States. The potential loss of WesCorp's services would raise significant problems for each of those 1,100 consumer credit unions and their members. However, even more critical would be the possible disruption of services at U.S. Central. The 26 retail corporates obtain services from U.S. Central that they pass along to their members, which are consumer credit unions. One of the most important services U.S. Central provides is assistance with payments system processing. A disruption in the payments systems processing at U.S. Central would potentially affect nearly every consumer credit union, and would have devastating repercussions for tens of millions of consumers. Essentially, such a disruption would have placed the credit union system in what is considered "systemic" risk.

Therefore, on March 20, 2009, the NCUA Board placed U.S. Central and WesCorp into conservatorship. The conservatorship action was taken to ensure uninterrupted service to the 26 retail corporate credit union members of U.S. Central and the 1,100 consumer credit union members of WesCorp, as well as to conserve and protect the assets of the institutions. Under conservatorship, NCUA operates the two corporates. The board of directors of both U.S. Central and WesCorp were replaced by NCUA representatives. The CEOs and some key personnel with responsibility over the areas that caused the existing problems had their employment terminated. NCUA continues to oversee the operations at both corporates as we work to bring about a permanent and least costly solution to the problems related to the mortgage-backed securities.

11. Why is my credit union being forced to pay for the losses at the corporates?

In describing the situation, it is helpful to look at the impact of the problems as a cascading series of effects throughout the credit union system.

As background, it is important to understand that, just like share deposits in consumer credit unions, share deposits in corporates are insured by the NCUSIF up to $250,000[1]. Corporates maintain a deposit with the NCUSIF in an amount of 1 percent of insured shares, just like consumer credit unions. However, many consumer credit unions have traditionally maintained deposits in corporates that were significantly higher than the insured limit. In fact, most of consumer credit unions' shares in corporates are uninsured. This is a key factor for understanding the impact of the corporate losses on consumer credit unions.

Losses at a corporate that affect insured shares were covered by the NCUSIF, just as in consumer credit unions. Thus, this is a cost all insured credit unions would pay. In addition, as we just noted, most shares in corporates are not insured. However, the uninsured shares belong to federally insured consumer credit unions.

[1] In June 2010, the NCUA Board voted to pay insured shares from the Stabilization Fund in the event a corporate credit union is liquidated.

Thus, uninsured shares are not protected, and they would have to absorb losses in the event of failure. These losses to federally insured consumer credit unions on uninsured shares would create failures of consumer credit unions. This would cause more losses to the NCUSIF to pay for the insured shares of members of the consumer credit unions that failed. As a result, all federally insured consumer credit unions, not just those with deposits in corporates, are susceptible to losses at the corporates.

12. How large were the potential losses?

In the fall of 2008 when it became apparent that there would be increasing losses on the mortgage-backed securities held by corporates, there were approximately $63 billion of mortgage-backed securities in the corporate system. Based on market estimates at that time, it was projected that there would be an approximate loss of $30 billion if all the securities were immediately sold. If NCUA had not taken to ensure adequate liquidity and to stabilize the corporate system, there was the very likely possibility of a catastrophic loss scenario – namely, the forced sale of the mortgage-backed securities.

There was a total of only $2.4 billion in retained earnings in corporates to cover the $30 billion in losses that would be incurred with the sale of the securities. After absorbing all the retained earnings, the remaining losses would have to be absorbed, predominantly by consumer credit unions directly through the loss of their contributed capital accounts and then uninsured deposits.

Once retained earnings are absorbed to cover losses, the remaining losses are next applied to the paid-in capital (PIC) and membership capital (MC) accounts held by consumer credit unions at the corporates. In late 2008, consumer credit unions held approximately $4 billion in PIC and MC accounts. Once retained earnings were depleted, the PIC and MC accounts would be absorbed next. The consumer credit unions holding PIC and MC would be required to write off those accounts. But this is only the first order of cascading losses.

With the capital accounts at the corporates fully depleted, the corporates would be insolvent. As we noted earlier, most consumer credit union shares in corporates are uninsured. If the corporates were liquidated as a result of the losses, only an approximate $1.2 billion of the total $64 billion of total consumer credit union shares would have been insured.

13. What exactly is the cascade of losses that NCUA has mentioned in presentations?

In the first cascading event, all retained earnings and capital accounts at the corporates would be eliminated. All of the $4 billion in PIC and MC accounts at consumer credit unions would be eliminated. The NCUSIF would incur direct losses of $1.2 billion paying out on insured shares. Consumer credit unions would have nearly $63 billion in uninsured shares at insolvent corporates. It was projected that between 885 and 1,200 consumer credit unions would fail due to this first cascading event, at a cost of $4.7 billion to $11.7 billion to the NCUSIF.

The failure of these insured consumer credit unions would also have had a severe impact on the NCUSIF, the second cascading loss event. It is estimated that the cost to resolve these failures would approach upwards of $10.5 billion. These losses to the NCUSIF, in addition to the losses noted above, would pass on to federally insured credit unions with an impairment of the 1 percent deposit that all insured credit unions hold in the NCUSIF, as well as premiums to restore the fund. This, in turn, would create up to an additional 1,300 consumer credit union failures at costs of additional billions of dollars.

By the time NCUA resolved all the failed consumer credit unions, the impact on the credit union system would have been catastrophic. Total capital in the credit union system would have been reduced by $40 billion, and as many as 30 percent of federally insured credit unions would potentially have failed. In addition, consumer confidence in credit unions would probably have been irrevocably damaged. This, in turn, could have created additional financial problems for those credit unions that were already now in a weakened state from paying their portion of the costs.

The significant reduction in capital in the survivors would have reduced the number of financially sound consumer credit unions. As such, there would be fewer viable merger candidates for the severely weakened consumer credit unions. That would increase the cost to the NCUSIF to resolve problems, and would lead to further costs.

The impact of the losses and the failure of so many consumer credit unions would undoubtedly result in a severe reduction in member confidence. Member concerns with the safety and soundness of the credit union system could then very well lead to a run on shares - further compounding the problem of low levels of liquidity and leading to more consumer credit union failures.

In such a scenario - which seemed to have a strong likelihood of occurring in late 2008 - the cascading nature of the losses at the corporates and the impact on consumer credit unions would probably have resulted in the demise of the credit union system. As such, it was essential that NCUA take action to prevent this danger from occurring. The key to reducing the costs was to find a means by which corporates could meet member liquidity and service needs, without having to sell the mortgage-backed securities and to incur the market losses. The various programs adopted by the NCUA Board were the key to avoiding a catastrophic loss scenario and the resulting devastation of the credit union system.

14. What was the cost of NCUA's actions?

There were costs associated with these measures. These costs were borne by the NCUSIF and, ultimately, all federally insured credit unions through premiums and assessments from the new Stabilization Fund. But the cost was much less than it would have been had the securities been sold. NCUA's goal has been, as much as possible, to limit the losses and their impact on the credit union system.
The costs related to NCUA's efforts to stabilize the corporate system exceeded the NCUSIF's retained earnings and impaired 69 percent of the NCUSIF contributed capital deposit that insured credit unions hold as an asset on their books. In total, the cost to credit unions was 99 basis points of insured shares. In addition, many consumer credit unions also were required to write down the paid-in capital and membership capital accounts they held at corporates.

15. What action did NCUA take to mitigate the cost of the stabilization efforts?

When everything is taken together, there exists adequate capital in the credit union system to absorb the corporates' losses in holding, rather than selling, the securities. However, the combination of these expenses, if they were taken all at once, could have very significant consequences. First, there would probably be a contraction of lending and other services that consumer credit unions provide to their members. Second, the impact of large sudden losses on the financial statements of consumer credit unions, along with the contraction of services, could destabilize consumer confidence. During the financial crisis it was vital that credit unions continue to be a source of consumer confidence and continue to make credit available to support an economic recovery. And, finally, some consumer credit unions, already with low levels of capital, could become insolvent if they were required to recognize the losses all at once.

The NCUA sought legislation to mitigate the immediate impact of the losses on credit unions. Through the agency's efforts, in May 2009, President Obama signed a measure into law to create the Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund). The Stabilization Fund is separate from the NCUSIF. It will be used to pay expenses associated with the problems in the corporate system. The Stabilization Fund is in essence a borrowing facility and assessment authority to be used to resolve the corporate system issues.

The Stabilization Fund may borrow from the Treasury up to $6 billion at any one time, on a revolving basis. The Stabilization Fund must repay the Treasury, with interest, the full amounts that it borrows. However, the NCUA Board has discretion about the timing of each repayment, as well as about the amount of principal to be included with each repayment. NCUA will borrow from the Treasury to pay for corporate losses and it will then pay back the Treasury, over time, with funds from assessments on federally-insured credit unions. Under the law, the Stabilization Fund must close down after seven years, unless the Secretary of the Treasury provides an extension of the Fund's life. By creating the Stabilization Fund, NCUA has been able to manage the assessments to credit unions over time, rather than to require them to be paid all at once. Spreading payments over time will help to prevent many credit union failures although it will hamper earnings potential during the repayment period.

As noted in the previous slide, the primary benefit of the Stabilization Fund is that it enables the assessments to credit unions to be made over time, rather than all at once. Again, the costs associated with the stabilization efforts are far less than a scenario where the securities are sold. However, the costs will pose challenges for many consumer credit unions.

16. What is the benefit to consumer credit unions of using the Stabilization Fund?

By using the Stabilization Fund, the financial impact on consumer credit unions will be less immediate. Consumer credit unions will have much more time to adjust their operations to weather the financial storm. Far fewer consumer credit unions will face insolvency through this approach. As such, more consumer credit unions will survive and continue to provide services to their members.

The smaller impact on individual consumer credit unions' balance sheets should ease the concerns of individual credit union members. Maintaining member confidence in the stability and viability of the credit union system is critical to avoiding a potential run on shares at consumer credit unions. A run on shares could intensify the liquidity concerns discussed in previous questions.

As we noted earlier, it is vital to the health of the American economy that consumer credit unions continue to provide loans to their members. By minimizing the immediate financial impact of the system's losses, NCUA's actions will allow more funds to remain available to meet members' credit needs.

Finally, managing the assessment over several years provides time for consumer credit unions to review the final revisions to NCUA's new corporate rule. Looking to the future, the decision by consumer credit unions to use the services of the corporates – and provide funds to recapitalize the corporate system – will depend on their understanding of the business model based on the new regulatory changes.

17. What is NCUA doing to ensure that this type of crisis never happens again?

It is impossible to write regulations that can address every potential problem and risk. The financial markets are continually evolving and new risks are continually arising. Moreover, if regulations for financial institutions were drafted with the goal of preventing all risk, financial institutions would not be able to operate. Risk, after all, is part of capitalism, and risk-taking accounts for our systems dynamism. However, there are lessons that were learned from the current economic crisis that can and must be addressed in shaping sensible regulatory changes for the future. It is imperative that the regulations governing corporates, as much as possible, prevent a similar crisis from occurring again.

The actions taken by NCUA to date have focused on stabilizing the corporate credit unions and mitigating the costs. Before corporate and consumer credit unions can move forward, it is necessary to have any revisions to NCUA's corporate rule in place, so that there will be a full understanding of the regulatory framework under which corporates will operate in the future.

In January 2009, the NCUA Board issued an Advance Notice of Proposed Rulemaking seeking comments and recommendations for any necessary changes to the corporate credit union regulation. The corporate credit union regulation is in Part 704 of NCUA's Rules and Regulations, often referred to simply as "Part 704." Those comments and recommendations were reviewed and, based on commenter input; a proposed rule was drafted and issued for public comment in December 2009. The comment period for the proposed rule ended on March 9, 2010. More than 800 comment letters were received, with over 2500 pages of comments.

A number of town hall meetings and webinars with representatives of the credit union industry were held throughout the process of drafting the proposed corporate rule. The meetings and webinars provided the opportunity for an informed dialogue about the issues confronting corporates and the concerns of consumer credit union representatives. The comments and feedback will be used to make final changes to the proposed rule. The final rule was approved by the NCUA Board on September 24, 2010.

18. What does the future hold for corporates?

That question will be answered by consumer credit unions - who will need to take a look at the corporate credit union business model under the new regulatory framework and determine whether it meets their own business needs. Some consumer credit unions may find that their needs are best met through their continued relationship with a corporate. Other consumer credit unions may find it best suits their needs to obtain these services elsewhere. Some corporates will need additional capital to be able to operate as viable financial institutions. Consumer credit unions will be able to "vote" on the future of the corporate system by either choosing to provide funds to recapitalize their corporate, or not. Whatever the future of the corporates, NCUA will continue to take action when necessary to ensure the safety and soundness of the credit union system.