NATIONAL CREDIT UNION ADMINISTRATION (NCUA)

# CLOSED BOARD MEETING

Thursday, October 16, 2008

Alexandria, Virginia

N/A Outside Scope

MR. SKILES: I think since we have been talking about the rule primarily, Dave needs to cover the costs.

MR. MARQUIS: Good morning. In our review of the various resolution options that require use of the authority provided under Section 208, basically



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the guarantees we were talking about, for each option we determined the insurance reserving requirement and the impact on natural person credit unions. This includes the potential partial and the full guarantee on uninsured shares. I will briefly explain the process and the impact on the natural person credit unions and the share insurance fund.

Financial Accounting Standard Board interpretation 45 is the applicable accounting standard used by staff in determining the appropriate reserving. The standard requires that financial guarantees are initially recognized and measured at fair value. The fair value should represent what would be required to be paid to a third party in an arm's length transaction for the party to take over responsibility for the guarantee.

For most arm's length transaction, the fair value at inception is usually equal to the premium received. Since this type of guarantee provided by NCUA does not contain a market-based premium, we relied upon valuation modeling to determine the fair value.

The accounting standard does not prescribe how to determine fair value. The methodology and

model we utilized applies variables to the expected liability based on loss events, a range of probability of default and the related cost of capital.

During the last share insurance fund audit, NCUA staff in the Risk Management Department in my office, NCUA staff worked with valuation experts from our accounting firm to develop a model for determining the fair value of any such NCUSIF loan guarantees. The basic design of that model was utilized to develop a process to determine the fair value of the guaranteed transactions contained in this resolution plan.

Due to the lack of specific or stable information for key variables, a forecasting and risk analysis program was utilized to provide analysis of all probable model results. Steve Farr did that for us. The risk modeling software allowed us to run multiple trials of any set of scenarios and review the statistical results. For each of the resolution options considered, the model produced a distribution of possible results. We focused our attention on three particular numbers within that distribution.

One, the maximum fair value, the average fair value, which we utilized as our estimated

minimum, and the number covering 90% of the fair value calculations. And we referred to this number as our expected fair value,

791.12(a)(8),791.12(a)(9)

The complexity in determining the fair value of these transactions should not be understated or underestimated. Our methodology contained a high degree of professional judgment with variables that



(5)

changed daily including the value of mortgage assets. The actual reserve level will change over time as the variables change. Additionally, the review by our external auditors require a level of additional judgment that cannot be fully predicted.

With that said, the recent announcement and pricing of FDIC's temporary liquidity guarantee program provides us a level of third party assurance that our estimates are reasonable and err on the conservative side. The reserve for financial guarantees will reduce the equity level of the Fund and the net worth earnings for natural person credit unions.

791.12(a)(8),791.12(a)(9)



(6)

791.12(a)(8),791.12(a)(9)

And each credit union's cost, of course, is different based on their assets and their share insurance deposits. And when I talked about the variables, I mean Steve has a model that we use, a pack of software that we worked with the CPAs last year to model things like this.

791.12(a)(8),791.12(a)(9)

That changes as more information comes in, the losses become more probable or event changes, like in the corporate system if the value of the mortgage backed securities were to change or erode even further, our reserve would have to go up. And if they got improvements without it because they were paying down a billion dollars a month and that got better, our reserve would go down.

MR. FRYZEL: Any questions?

National Credit Union Administration

Approved by the NCUA Board on 1/28/09
Secretary of the Board

**BOARD ACTION MEMORANDUM**

**TO:** NCUA Board **SUBJ:** Corporate Credit Union System

**FROM:** David M. Marquis, Executive Director **DATE:** January 27, 2009

**ACTION REQUESTED:** NCUA Board immediately approve the following:

1. Issue a $1 billion capital note to U.S. Central Federal Credit Union (USC) and institute an emergency interim uninsured share guarantee for all corporate credit unions (CCUs) expiring on February 28, 2009.
2. Establish a voluntary guarantee program for uninsured shares of all CCUs to expire on December 31, 2010.
3. Issue an Advanced Notice of Proposed Rulemaking (ANPR) on restructuring the CCU system.
4. Implement a communication campaign and approve the associated budget, including immediate issuance of a letter to all credit unions.
5. Declare a premium assessment to restore the NCUSIF equity ratio to 1.30 percent, to be collected during 2009.

**DATE ACTION REQUESTED:** January 28, 2009

**OTHER OFFICES CONSULTED:** Offices of Corporate Credit Unions, General Counsel, Examination and Insurance, Capital Markets and Planning, Public and Congressional Affairs, and Chief Financial Officer.

**VIEWS OF OTHER OFFICES CONSULTED:** Concur

**BUDGET IMPACT, IF ANY:** Based on current information, estimate of $4.7 billion expense to the NCUSIF, subject to the participation rate in the voluntary excess share guarantee program.

**RESPONSIBLE STAFF MEMBERS:** Executive Director David Marquis and Acting Director of Office of Corporate Credit Unions Scott Hunt.

**BACKGROUND:** By regulation, corporate credit unions are only allowed to invest in highly rated securities, and their interest rate risk exposure is constrained by net economic value limits. Corporate credit unions have used these securities as part of their overall balance sheet management in meeting their member liquidity needs. Historically, the securities could be readily sold in the market or used for collateralized borrowing to obtain liquidity, and the values of the securities have experienced little or no loss. However, beginning mid-year 2007, credit issues associated with sub-prime mortgages began to surface. By the end of 2007 and early



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into 2008, what started out as a sub-prime mortgage problem spread to Alt-A loans, option ARM loans, and finally to prime mortgage loans.

Economic conditions since 2007 are like nothing experienced since the Great Depression. With the economy remaining in severe distress, housing prices continue to decline and mortgage defaults continue to rise. Credit markets have been disrupted world-wide, resulting in depressed pricing, inactive trading of debt securities, and a severe contraction of wholesale lending. Like other financial institutions in the United States and around the world, corporate credit unions have not been immune to the effects of these conditions. Due to the inactive market, mortgage-related securities have experienced severe price devaluation, and thus corporate investment portfolios have diminished significantly as a basis for collateralizing borrowings, increasing liquidity pressures.

Beginning in 2007, NCUA implemented supervisory actions for affected CCUs to restrict purchases of mortgage related securities, restrict terms of investments to not exceed 4 months, establish commercial paper and medium-term note programs, and acquire third party stress test modeling of their mortgage related securities. However, selling securities during this period was problematic as there has been no active market for most mortgage-backed and asset-backed securities. Should a CCU sell its securities, such transactions may occur only at "fire sale prices" resulting in losses that could far exceed the current unrealized losses and the $8.7 billion in corporate total capital.

Additional NCUA actions to date to address the situation include approval of USC's conversion of membership capital to paid-in capital, implementing the temporary corporate credit union liquidity guarantee program, obtaining a lift of the appropriations cap on Central Liquidity Facility (CLF) lending to natural person credit unions, negotiating assistance from both the Federal Reserve and Treasury, and sending letters of support to the Federal Home Loan Banks. Using CLF lending authority in concert with the Treasury, NCUA also initiated the Credit Union System Investment Program (CUSIP) and Credit Union Homeowners Affordability Relief Program (CUHARP). These programs provide additional liquidity resources to CCUs, with the first offering funding nearly $5 billion in January 2009. The next offering is scheduled to fund in early February 2009.

Staff also conducted a comprehensive analysis of all available resolution strategies and delivered its findings and recommendations to the NCUA Board in October 2008. The analysis concluded that the lowest cost option to the NCUSIF is to stabilize the corporate system by maintaining liquidity in the corporate system thereby preventing liquidation of securities and preserving the vital payment systems function. The NCUA Board authorized PricewaterhouseCoopers (PWC) to conduct an independent review of staff's findings and recommendations. NCUA received PWC's full report on January 16, 2009.

**CURRENT SITUATION:** The corporate system is experiencing a severe strain on liquidity due to approximately $64 billion held in mortgage and asset backed securities for which there is currently no active market. As of November 30, 2008, there are approximately $18 billion in

unrealized losses on securities held by the corporate system, exceeding by $9.3 billion total corporate credit union (CCU) capital of $8.7 billion. Given the depressed prices due to an inactive market, these unrealized losses could overstate the actual credit losses to be absorbed by corporate credit unions should the securities be held to maturity.[1]

Unrealized losses exceeding capital results in increased scrutiny and criticism of the corporate system, lower member confidence, fewer liquidity sources, lower borrowing limits, and greater "haircuts" for those that do lend to CCUs, specifically the Federal Home Loan Banks. As of November 30, 2008, the following six CCUs have reported unrealized losses greater than their total capital:

| CCU (in millions) | Total Capital | Unrealized Losses (AFS and HTM) | Difference | Size of Securities Portfolio |
|---|---|---|---|---|
| U.S. Central[2] | $2,681.4 | $9,658.5 | -$6,977.1 | $27,184.3 |
| Western | $1,994.9 | $3,663.6 | -$1,668.7 | $20,605.8 |
| Members United | $866.0 | $1,935.8 | -$1,069.8 | $3,751.4 |
| Southwest | $752.1 | $1,391.8 | -$639.1 | $3,653.5 |
| Corporate One | $264.8 | $307.3 | -$42.5 | $2,400.2 |
| Constitution | $116.5 | $316.8 | -$200.3 | $719.4 |

As a result of generally accepted accounting principles (GAAP), a portion of the unrealized losses will need to be recorded as realized losses as other than temporary impairment (OTTI) charges with issuance of the CCUs' year-end audited financial statements in February.[3] These OTTI charges will reduce the capital position of the affected corporate credit union(s), further undermining the already diminished confidence of natural person credit unions (NPCUs) in the corporate system, reducing or eliminating the availability of credit from external lenders such

[1] If the economy were to further experience a prolonged and material deterioration, the credit losses would increase. The credit exposure is difficult to calculate as it is predicated on estimates about the economy and performance of underlying collateral. Thus, in a separate Board Action Memorandum (BAM), staff is proposing the NCUA Board approve retention of a firm with expertise to conduct an independent, in-depth expected credit loss analysis of bonds backed by residential mortgages in the corporate credit union system. This analysis is to be completed within 6 weeks and will provide a more precise estimate of the expected losses of holding these securities to maturity taking into account economic trends. This will provide NCUA with a more precise measure of the potential loss exposure to the NCUSIF and the credit union system, and will better inform our supervisory approach to each CCU holding these investments.

[2] Were the USC losses distributed in kind to their member corporate (a.k.a. pass-through corporate), these corporate credit unions would show significant capital impairment.

[3] If the fair value of an available-for-sale or held-to-maturity debt security is less than its amortized cost basis at the measurement date, the investment is impaired. U.S. generally accepted accounting principles (GAAP) require that the reporting entity assess the impaired security to determine whether the impairment is other-than-temporary. Other-than-temporary impairments are recognized in earnings if it is probable that the investor will be unable to collect all amounts due according to the contractual terms of a debt security. As of the balance sheet date that the impairment is recognized, the fair value of the investment would then become the new cost basis. [FAS 115, para. 16; FSP 115-1/124-1].

as the Federal Home Loan Banks (FHLB) and the Federal Reserve Banks (FRB), and potentially triggering default provisions of existing CCU borrowings.

NCUA learned on January 22, 2009, that USC has determined an OTTI charge of $1.2 billion will be necessary. This charge will reduce their capital position from $2.7 billion to $1.5 billion. The OTTI charge will eliminate retained earnings and impair the majority of paid-in-capital, leaving only membership capital accounts which most external parties such as the FRB and nationally recognized statistical rating organizations (NRSROs) do not recognize as primary capital. Based on the best information we are able to obtain at this time from the six CCUs with unrealized losses exceeding capital, the OTTI charges expected to be recorded on 2008 year-end financial statements are as follows:

| CCU (in millions) | Retained Earnings | Paid-in Capital | Core Capital | OTTI Charge* | Remaining Core Capital | Membership Capital |
|---|---|---|---|---|---|---|
| U.S. Central | $697.3 | $750.0 | $1,447.3 | $1,200.0 | $247.3 | $1,234.2 |
| Western | $805.3 | $213.1 | $1,018.8 | TBD | TBD | $926.1 |
| Members United | $300.5 | $79.4 | $379.9 | $40.9 | $339.0 | $486.1 |
| Southwest | $359.0 | $0 | $359.0 | $26.8 | $332.2 | $393.1 |
| Corporate One | $123.1 | $25.7 | $148.8 | $5.1 | $143.7 | $116.0 |
| Constitution | $50.3 | $0 | $50.3 | TBD | TBD | $66.2 |

**OTTI is currently being calculated by the corporate credit unions in consultation with their auditing firms. Given numbers are subject to change.*

(b)(8)

N/A Outside Scope

5. Declare a premium to restore the NCUSIF's equity ratio to 1.30 percent, to be collected during 2009.

The initial and full potential costs to the NCUSIF of the recommended courses of action and effect on the net worth ratio and return on average assets of NPCUs is as follows:

| Action | Reserve | Premium to Restore NCUSIF Equity Ratio – Impact on NPCU Net Worth & ROA |
|---|---|---|
| NCUSIF Capital Note in USC | $1.0B | -13BP / -14BP |
| Guarantee all CCUs | $3.7B | -43BP / -48BP |
| Communication Campaign Budget | $250K | -0BP / -0BP |
| Total | $4.7B | -56BP / -62BP |

This ultimate expense to the NCUSIF would be borne proportionately by all federally-insured credit unions through a partial write-off of their existing 1 percent NCUSIF deposit, as well as the assessment of a premium, sufficient to return the NCUSIF's equity ratio to 1.30 percent. Combined, the projected average cost for each credit union would result in a 62 basis point decline in annual return on assets and a 56 basis point decline in the net worth ratio. As a result, over 60 percent of NPCUs are expected to be unprofitable in 2009. The projected impact on the PCA status of NPCUs is as follows:

| PCA Category | Before | After | Change |
|---|---|---|---|
| Well Capitalized | 7,763 | 7,651 | -112 |
| Adequately Capitalized | 66 | 149 | 83 |
| Under Capitalized | 46 | 68 | 22 |
| Significantly Under Capitalized | 15 | 19 | 4 |
| Critically Under Capitalized | 14 | 17 | 3 |

The declaration of a premium by the NCUA Board is required by law when the equity ratio falls below 1.20 percent.[10] In addition, the premium declaration is important so the NCUSIF can book a receivable for the premium at the same time the liability is recorded. This will ensure the NCUSIF's published equity ratio stays above the minimum required by law. Absent declaration of a premium, the NCUSIF's equity ratio would drop to slightly below 0.50 percent. To provide an adequate cushion to avoid having to charge another premium in quick succession if there are other losses within the credit union system, staff recommends restoring the fund to 1.30 percent, the maximum level by law to which NCUA can charge a premium.[11] The NCUA Board does have flexibility in determining the timing of collecting the premium and deposit replenishment within reason. It is staff's intention to collect the premium and replenish the deposit during the September 2009 billing cycle. This will allow time to determine the actual liability associated with CCUs opting for the voluntary guarantee as well as the expected loss estimates by the independent valuation firm, enabling a more precise reserving. Based on this information, the actual billing to credit unions in September will reflect these adjustments to the reserve.

[10] Per section 202(c)(2)(C)of the FCU Act, 12 U.S.C. 1782 (c)(2)(C).
[11] Per section 202(c)(2)(B)of the FCU Act, 12 U.S.C. 1782 (c)(2)(B)(ii).

**RECOMMENDED ACTION:** The NCUA Board approve the following:

1. Approve issuing a $1 billion NCUSIF capital note, based on the terms and conditions specified in the attached note, to U.S. Central Corporate Federal Credit Union. Delegate authority to the Executive Director to sign the note on behalf of NCUA.

N/A Outside Scope

8. Declare a premium assessment sufficient to restore the NCUSIF equity ratio to 1.30 percent. The NCUSIF premium may be adjusted based on an independent assessment of expected losses and collected from insured credit unions in 2009. Delegate to the Chief Financial Officer, with concurrence of the Office of Examination and Insurance, the authority to make necessary reserve computations and establish the necessary reserves for the guarantee program and NCUSIF capital note.

N/A Outside Scope

Attachments

A – Legal Opinion re: NCUA Authority for Uninsured Share Guarantee and NCUSIF Capital Note

B – NCUSIF Capital Note for USC

C – LUA for CCU with Unrealized Losses Exceeding Capital

D – LUA for CCU with Capital Exceeding Unrealized Losses

E – Share Guarantee Terms Notice

F – Advance Notice of Proposed Rulemaking

G – Announcement Letter to all Credit Unions

NATIONAL CREDIT UNION ADMINISTRATION (NCUA)

CLOSED BOARD MEETING

Wednesday, January 28, 2009

Alexandria, Virginia

MR. FRYZEL: I call the meeting to order. The Board has voted to hold a meeting with less than seven days notice and to close consideration of it to public observation. I certify that the Board did not receive a request to reconsider its decision to close discussion of this item. The item of discussion for this meeting is supervisory activities involving US Central and the corporate credit union system. Making the presentation this afternoon is Dave Marquis, Scott Hunt, Bob Fenner, Owen Cole, John Kutchey, John Ianno, Paul Peterson, Ross Kendall, Larry Fazio and Mary Ann Woodson. All right, staff.

791.12(a)(8),791.12(a)(9)

N/A Outside Scope

MR. KUTCHEY: I will cover the cost implications here for us. The initial projected cost to the NCUSIF for the share guarantee, assuming that all corporate credit unions participate, is $3.7 billion. This estimated liability is based on the current information available on the corporate credit union systems' assets as reported by the corporate credit unions. This is also the initial amount of the NCUSIF liability that we will record if the Board approves the action today. This amount is likely to change as external factors influencing the performance of the securities change. This amount is also influenced by the level of liquidity in the corporate system and the result of any type of independent credit analysis the Board may also authorize.

MR. MARQUIS: Now we will cover the capital infusion and John Ianno and John Kutchey will explain the actual capital note and the cost issues associated with that.

MR. Ianno: The note basically places $1 billion in capital into US Central. 791.12(a)(8),791.12(a)(9)

791.12(a)(8),791.12(a)(9)

I will turn it over to you at that point. That is really all I can say about it.

MR. HUNT: I guess I just want to frame why a billion dollars, I guess is the best way to say it.

All along, OCCU has been monitoring corporates, especially in regards to the performance of their securities. As Dave mentioned in the opening remarks, as of November 30 we are looking at about $18 billion in unrealized losses both on the AFS portfolio and the HTM portfolio. Within that amount, of chief concern is what is the actual credit impairment and then credit impairments would therefore, in tune, require what is called an other than temporary impairment charge. In essence, we would realize these losses and they would erode regulatory capital. On or about Thursday of last week, Frances Lee, the CEO of

US Central, as well as his Chairman, Joe Hurbst, came to the central office and met with staff as well as the Board and informed us that that estimate, which had preliminarily been a whispered number of about $300 million, had actually formulated into about $1.2 billion.

I will say, for the record, it is still preliminary. They have not finalized that number with their auditor. But nonetheless, it was an estimate that now deems the action we are here before you with a sense of the significance.

Within that number, though, I want to clarify for the Board that that represents the market value of the securities, not the credit impairment. The actual underlying credit impairment, that is if we would hold all such securities to maturity, the losses are in the range of $400 to $700 million. So, when we assign a billion dollars as the capital infusion, what we are trying to balance on one end is what the ultimate credit losses would be on current estimates if we hold to maturity against a 1.2 OTTI charge, and also as well as the cost that will flow through to the NCUSIF and ultimately to the natural person credit unions.

So we believe, at this time, with the estimates that we have given, that is a fair estimate of capital infusion. To give it other context, right now US Central has approximately $1.4 billion in otherwise known as tier one capital, which would be undivided earnings and paid in capital. So the $1.4 less the $1.2 OTTI charge will leave only $200 million left in tier one.

As I will talk to you in a few minutes, we will talk about a credit analysis that we will ask the Board for concurrence on us to contract with and that will give us a better estimate of the underlying credit impairment from an independent outside source, again, to refine this ultimate estimate of what the cost and charge would be to the NCUSIF.

MR. KUTCHEY: On that, I will outline the cost of this transaction for the Board. The cost to the NCUSIF for this action will be the full amount of the capital note, which in this case is $1 billion. Unlike the prior action where the cost is estimated, we do not foresee the amount of the NCUSIF charge changing under this scenario. Given the capital instrument is perpetual and its location in the order of pay out priority under a loss scenario, the full

amount of the capital note will need to be expensed. The full expensing provides a benefit however to the NCUSIF in terms of our liquidity needs. Since this is a cash transaction, cash infusion into the corporates, anything less than the full expensing of the amount will result in a corresponding reduction in the amount of cash in the NCUSIF. Therefore, the full expensing allows us to fully replenish the cash in the fund.

MR. MARQUIS: Also, I guess one other point maybe in the Q&A is that I think our calculation in one of our spreadsheets shows that as US Central, depending on the final number, will have to roll that capital charge against the corporate credit union's capital accounts so that will be a loss to them, too. And I think we have about 17 corporates that will drop below 2%. They will stay above 1% but that will require all of them to submit a capital rest---those 17 a capital restoration plan to us. So their capital is being absorbed to cover the loss.

N/A Outside Scope

N/A Outside Scope

MR. MARQUIS: Finally, the last item is to highlight the budget impact to the Share Insurance

Fund and the premium assessment outlook at this point in time. Larry, John, Mary Ann.

MR. FAZIO: Well, the actions that we are asking the Board to take to issue the $1 billion capital note to US Central Federal Credit Union and to guarantee uninsured shares in all the corporate credit unions, as John explained earlier, is going to require the NCUSIF to record an expense and a reserve of $1 billion, as was explained for the capital note, and $3.7 billion for the guarantee.

The $3.7 billion dollar portion of the reserve charge that we are going to have to record that is applicable to the guarantee is based on the assumption that all corporate credit unions elect to participate in the voluntary guarantee program after the emergency interim guarantee period lapses. This reserve charge would be reduced to the extent corporate credit unions do not participate in the voluntary guarantee program.

In addition, the $3.7 billion charge is statistically derived. It is an estimate based on the most current information known at this time but it is definitely subject to change. The reserve charge could be adjusted upon receipt of the recommended loss

analysis that we are proposing to go of the corporate credit union's bonds via PIMCO and is also subject to changes in the economic factors that affect the performance of the corporate credit unions and their holdings.

Because of this charge, the NCUSIF's equity ratio is going to fall below the statutory mandated minimum level of 1.20%. Thus, a premium is required to restore the equity ratio by law, Section 202 of the Federal Credit Union Act to at least 1.2%. Therefore, we are asking that the Board declare a premium assessment to restore the NCUSIF's equity ratio to a level above 2%. In particular, we are suggesting that the equity ratio be set at 1.30%. The maximum level to which, by law under Section 202 of the Federal Credit Union Act, that the Board can charge a premium and raise the equity level of the fund too. This will provide the largest cushion available against needing to charge another premium and will ensure the share insurance fund has adequate resources to address continuing economic challenges that we are still facing, affecting both natural person and corporate credit unions.

The Board's declaration of a premium allows the NCUSIF to record this as income by establishing a receivable, preserving the NCUSIF's equity ratio on our financial statements. The NCUA Board has some discretion over the specific timing of collecting the premium but our auditors indicate it needs to occur in the same year. So we will have to actually collect it before the end of 2009 elapses. So we recommend the billing of credit unions for the premium occur later in the year to allow credit unions to conduct cash management planning and time for the expected loss numbers from PIMCO to come in to more fully inform the actual level of reserving what we anticipate relative to the credit losses, as well as to get a better sense for where the economy goes during the year.

The premium will be borne proportionally by all credit unions and is estimated to represent 56 basis points of credit unions' net worth and 62 basis points of their income or return on average assets ratio. John will now address some specifics about the projected impact on credit unions, in particular the impact on PCA status and then Mary Ann will discuss some operational considerations relative to the premium assessment.

MR. KUTCHEY: All right. At this time I would like to start my comments by letting you know, just as a point of comparison, the last two material economic downturns that we have experienced since the share insurance fund has existed has been in the early 1980s and early 1990s. And again, just as a point of reference for the Board, the ending net worth or net capital level at that point in time was roughly 6.3 or 6.4% for the entire industry. For us to fall as an industry to that level at this point, roughly $34 billion in net worth would have to exit the system in order for us to get down to that level. So again, it is just a point of comparison for you.

As far as the impact on PCA, at this point in time there are 141 credit unions subject to PCA, totaling about $11 billion in assets. With this action alone, 112 additional credit unions would now fall under PCA, totalling approximately $52 billion in assets. Worthy of note there is that $43 billion of that total are credit unions that will still be above 6%. So in total there will be $9 billion in assets below the 6% threshold with this action.

We also ran a couple of stress test scenarios if we have to come back another time for

additional capital injections. We ran that scenario to see what the impact would be on credit unions and the number that would be subject to PCA. Under that scenario, there would be 342 total credit unions, which is an increase of 201, totalling $61 billion in assets. But again, $51 billion is above 6% so the below 6% number stays fairly consistent in both of those scenarios at approximately $10 billion in assets. And that is the impact on natural person credit unions.

MS. WOODSON: And just with respect to some of the mechanics, we can only charge a premium twice a year, so it is to our advantage to try to wait until we have the credit analysis so we can make sure that we have what we want to bill down as close as possible to what we think it will be one time rather than twice. Staff would also intend that we do our billing in September. We do billings twice a year for the credit unions first in March and then in September. So we would like to, if possible, to marry this up with the September billing cycle, which would allow us to have the time we need to understand the information in the credit analysis and what else is going on in

terms of further economic deterioration during the year.

With respect to the $1 billion cash injection to USC, we have to notify Treasury five days in advance typically before we can move a billion dollars. We have done some checking and we could move a billion dollars as soon as this Friday if that is the Board's decision.

Finally, if we find that later on in the year we have to do some additional capital infusions, we may be in a position where we would have to sell some of our investments, which really would just require some accounting changes in how we calculate our investments. But we can do it. We would just change our portfolio from held maturity to available for sale. It is just a technical change.

MR. MARQUIS: That concludes staff's comments and we are ready answer your questions.

MR. FRYZEL: Thank you gentlemen and Mary Ann. Mr. Hood, are you still there?

MR. HOOD: Yes, Mr. Chairman, I am still with you and I will be supporting the staff's recommendations. I want to, first and foremost, thank all of our staff for their hard work and diligence.

N/A Outside Scope

And possibly is there savings of some sort to the NCUSIF charge. John, help me here because this is yours, but what we tried to implore is that the estimates we are giving the Board today of the total $4.7 billion is predicated on the losses in securities; not predicated necessarily on the amount of shares that are being guaranteed.

MS. HYLAND: It is predicated on the credit losses, the range of credit losses currently anticipated.

MR. HUNT: Right, so to say 12 are in and 12 are out or some combination, 14 and 14, it is really a confidence that they are all sticking together. It does not reduce their cost by having others withhold thinking we are not really part of the problem or some other idea that they try to generate.

MS. HYLAND: When you described the premium assessment, you indicated that there is, from an accounting standpoint, a need to charge what we are doing against our liabilities but not necessarily---this is probably a question for Larry---collect the money except we need to collect it this year sometime. How do you anticipate explaining to credit unions in

light of credit unions already diminishing ROA, in many cases negative ROA, that premium assessment?

MR. FAZIO: That is a good question. Part of our communication plan is obviously to indicate that there is an absolute need to do this. I mean we are at the point where we have got to stabilize the system and the action to stabilize the system actually is the least cost to the entire system. The system is going to end up paying for whatever losses that come about through this, the corporate credit unions. And so, as they pay for any losses of any natural person credit unions through the share insurance fund, they are all part of the Fund. It is all connected. It is a mutual model and so the losses are passed through the Fund to all natural person credit unions, as are any return of funds. So losses are passed through for the need to charge a premium or a reduction in our ability to pay a dividend is another way that it is an opportunity cost, I guess you would say.

And so the message I think needs to be, well, our intention for the message is that this is the least cost way for the entire system. It is a cost we have to incur now. The hope is that maybe we will be able to get some of that back over time as the

economy improves, but know that by doing this we are actually saving you money, a lot of money, in the long run, you in the natural person credit union system.

MR. MARQUIS: I also, just to add to that, as we look at the credit unions that potentially fall below well capitalized, one of the things we will have to take into consideration as they develop a net worth restoration plan is that the ROA piece that is depleted from our charge has to be taken into account that it is a one-time event. It is an event. It is not something that is ongoing on their balance sheet as their problem per se. So I mean we will take that as a factor in determining what is an acceptable restoration plan, all else being equal, in terms of their balance sheets being okay as an entity themselves on the natural person credit union side.

N/A Outside Scope

Section of the attached Board Action Memorandum dated January 27, 2009. 1) Approve issuance of a $1 billion NCUSIF capital note to US Central Corporate Federal Credit Union, I am sorry. There is another type-o. US Central Corporate Federal Credit Union;

N/A Outside Scope

N/A Outside Scope

8) Authorize a premium assessment sufficient to restore the NCUSIF equity ratio to 1.30% to be collected from insured credit unions in 2009; and

N/A Outside Scope

MR. FRYZEL: Is there a second?

MR. HOOD: I second.

MR. FRYZEL: Thank you. All those in favor signify by saying "aye."

MS. HYLAND: "Aye."

MR. HOOD: "Aye."

MR. FRYZEL: "Aye." Motion carries unanimously. Do we have a motion in regards to the hiring of Pacific Investment Management Company?

MS. HYLAND: Yes, you do. I move that the Board approve and delegate authority to the Acting Director of the Office of Corporate Credit Unions to contract with Pacific Investment Management Company, LLC, PIMCO, to conduct an initial credit analysis at a cost of up to $5 million and, if deemed necessary, up to three subsequent credit analyses at a cost of up to

%1.5 million each of corporate securities for which the scope and cost are as described in the attached background information. The Acting Director of the Office of Corporate Credit Unions is delegated the authority to negotiate and execute a final agreement with PIMCO with the concurrence of the Office of General Counsel and the Executive Director.

MR. FRYZEL: Is there a second?

MR. HOOD: I second.

MR. FRYZEL: Thank you. All those in favor signify by saying "aye."

MS. HYLAND: "Aye."

MR. HOOD: "Aye."

MR. FRYZEL: "Aye." Motion carries unanimously.

N/A Outside Scope

National Credit Union Administration

Approved by the NCUA Board on 1/28/09
Secretary of the Board

**BOARD ACTION MEMORANDUM**

**TO:** NCUA Board

**SUBJ:** Corporate Credit Union System

**FROM:** David M. Marquis, Executive Director

**DATE:** January 27, 2009

**ACTION REQUESTED:** NCUA Board immediately approve the following:

1. Issue a $1 billion capital note to U.S. Central Federal Credit Union (USC) and institute an emergency interim uninsured share guarantee for all corporate credit unions (CCUs) expiring on February 28, 2009.
2. Establish a voluntary guarantee program for uninsured shares of all CCUs to expire on December 31, 2010.
3. Issue an Advanced Notice of Proposed Rulemaking (ANPR) on restructuring the CCU system.
4. Implement a communication campaign and approve the associated budget, including immediate issuance of a letter to all credit unions.
5. Declare a premium assessment to restore the NCUSIF equity ratio to 1.30 percent, to be collected during 2009.

**DATE ACTION REQUESTED:** January 28, 2009

**OTHER OFFICES CONSULTED:** Offices of Corporate Credit Unions, General Counsel, Examination and Insurance, Capital Markets and Planning, Public and Congressional Affairs, and Chief Financial Officer.

**VIEWS OF OTHER OFFICES CONSULTED:** Concur

**BUDGET IMPACT, IF ANY:** Based on current information, estimate of $4.7 billion expense to the NCUSIF, subject to the participation rate in the voluntary excess share guarantee program.

**RESPONSIBLE STAFF MEMBERS:** Executive Director David Marquis and Acting Director of Office of Corporate Credit Unions Scott Hunt.

**BACKGROUND:** By regulation, corporate credit unions are only allowed to invest in highly rated securities, and their interest rate risk exposure is constrained by net economic value limits. Corporate credit unions have used these securities as part of their overall balance sheet management in meeting their member liquidity needs. Historically, the securities could be readily sold in the market or used for collateralized borrowing to obtain liquidity, and the values of the securities have experienced little or no loss. However, beginning mid-year 2007, credit issues associated with sub-prime mortgages began to surface. By the end of 2007 and early



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into 2008, what started out as a sub-prime mortgage problem spread to Alt-A loans, option ARM loans, and finally to prime mortgage loans.

Economic conditions since 2007 are like nothing experienced since the Great Depression. With the economy remaining in severe distress, housing prices continue to decline and mortgage defaults continue to rise. Credit markets have been disrupted world-wide, resulting in depressed pricing, inactive trading of debt securities, and a severe contraction of wholesale lending. Like other financial institutions in the United States and around the world, corporate credit unions have not been immune to the effects of these conditions. Due to the inactive market, mortgage-related securities have experienced severe price devaluation, and thus corporate investment portfolios have diminished significantly as a basis for collateralizing borrowings, increasing liquidity pressures.

Beginning in 2007, NCUA implemented supervisory actions for affected CCUs to restrict purchases of mortgage related securities, restrict terms of investments to not exceed 4 months, establish commercial paper and medium-term note programs, and acquire third party stress test modeling of their mortgage related securities. However, selling securities during this period was problematic as there has been no active market for most mortgage-backed and asset-backed securities. Should a CCU sell its securities, such transactions may occur only at "fire sale prices" resulting in losses that could far exceed the current unrealized losses and the $8.7 billion in corporate total capital.

Additional NCUA actions to date to address the situation include approval of USC's conversion of membership capital to paid-in capital, implementing the temporary corporate credit union liquidity guarantee program, obtaining a lift of the appropriations cap on Central Liquidity Facility (CLF) lending to natural person credit unions, negotiating assistance from both the Federal Reserve and Treasury, and sending letters of support to the Federal Home Loan Banks. Using CLF lending authority in concert with the Treasury, NCUA also initiated the Credit Union System Investment Program (CUSIP) and Credit Union Homeowners Affordability Relief Program (CUHARP). These programs provide additional liquidity resources to CCUs, with the first offering funding nearly $5 billion in January 2009. The next offering is scheduled to fund in early February 2009.

Staff also conducted a comprehensive analysis of all available resolution strategies and delivered its findings and recommendations to the NCUA Board in October 2008. The analysis concluded that the lowest cost option to the NCUSIF is to stabilize the corporate system by maintaining liquidity in the corporate system thereby preventing liquidation of securities and preserving the vital payment systems function. The NCUA Board authorized PricewaterhouseCoopers (PWC) to conduct an independent review of staff's findings and recommendations. NCUA received PWC's full report on January 16, 2009.

**CURRENT SITUATION:** The corporate system is experiencing a severe strain on liquidity due to approximately $64 billion held in mortgage and asset backed securities for which there is currently no active market. As of November 30, 2008, there are approximately $18 billion in

unrealized losses on securities held by the corporate system, exceeding by $9.3 billion total corporate credit union (CCU) capital of $8.7 billion. Given the depressed prices due to an inactive market, these unrealized losses could overstate the actual credit losses to be absorbed by corporate credit unions should the securities be held to maturity.[1]

Unrealized losses exceeding capital results in increased scrutiny and criticism of the corporate system, lower member confidence, fewer liquidity sources, lower borrowing limits, and greater "haircuts" for those that do lend to CCUs, specifically the Federal Home Loan Banks. As of November 30, 2008, the following six CCUs have reported unrealized losses greater than their total capital:

| CCU (in millions) | Total Capital | Unrealized Losses (AFS and HTM) | Difference | Size of Securities Portfolio |
|---|---|---|---|---|
| U.S. Central[2] | $2,681.4 | $9,658.5 | -$6,977.1 | $27,184.3 |
| Western | $1,994.9 | $3,663.6 | -$1,668.7 | $20,605.8 |
| Members United | $866.0 | $1,935.8 | -$1,069.8 | $3,751.4 |
| Southwest | $752.1 | $1,391.8 | -$639.1 | $3,653.5 |
| Corporate One | $264.8 | $307.3 | -$42.5 | $2,400.2 |
| Constitution | $116.5 | $316.8 | -$200.3 | $719.4 |

**As a result of generally accepted accounting principles (GAAP), a portion of the unrealized losses will need to be recorded as realized losses as other than temporary impairment (OTTI) charges with issuance of the CCUs' year-end audited financial statements in February.[3] These OTTI charges will reduce the capital position of the affected corporate credit union(s), further undermining the already diminished confidence of natural person credit unions (NPCUs) in the corporate system, reducing or eliminating the availability of credit from external lenders such**

[1] If the economy were to further experience a prolonged and material deterioration, the credit losses would increase. The credit exposure is difficult to calculate as it is predicated on estimates about the economy and performance of underlying collateral. Thus, in a separate Board Action Memorandum (BAM), staff is proposing the NCUA Board approve retention of a firm with expertise to conduct an independent, in-depth expected credit loss analysis of bonds backed by residential mortgages in the corporate credit union system. This analysis is to be completed within 6 weeks and will provide a more precise estimate of the expected losses of holding these securities to maturity taking into account economic trends. This will provide NCUA with a more precise measure of the potential loss exposure to the NCUSIF and the credit union system, and will better inform our supervisory approach to each CCU holding these investments.

[2] Were the USC losses distributed in kind to their member corporate (a.k.a. pass-through corporate), these corporate credit unions would show significant capital impairment.

[3] If the fair value of an available-for-sale or held-to-maturity debt security is less than its amortized cost basis at the measurement date, the investment is impaired. U.S. generally accepted accounting principles (GAAP) require that the reporting entity assess the impaired security to determine whether the impairment is other-than-temporary. Other-than-temporary impairments are recognized in earnings if it is probable that the investor will be unable to collect all amounts due according to the contractual terms of a debt security. As of the balance sheet date that the impairment is recognized, the fair value of the investment would then become the new cost basis. [FAS 115, para. 16; FSP 115-1/124-1].

as the Federal Home Loan Banks (FHLB) and the Federal Reserve Banks (FRB), and potentially triggering default provisions of existing CCU borrowings.

NCUA learned on January 22, 2009, that USC has determined an OTTI charge of $1.2 billion will be necessary. This charge will reduce their capital position from $2.7 billion to $1.5 billion. The OTTI charge will eliminate retained earnings and impair the majority of paid-in-capital, leaving only membership capital accounts which most external parties such as the FRB and nationally recognized statistical rating organizations (NRSROs) do not recognize as primary capital. Based on the best information we are able to obtain at this time from the six CCUs with unrealized losses exceeding capital, the OTTI charges expected to be recorded on 2008 year-end financial statements are as follows:

| CCU (in millions) | Retained Earnings | Paid-in Capital | Core Capital | OTTI Charge* | Remaining Core Capital | Membership Capital |
|---|---|---|---|---|---|---|
| U.S. Central | $697.3 | $750.0 | $1,447.3 | $1,200.0 | $247.3 | $1,234.2 |
| Western | $805.3 | $213.1 | $1,018.8 | TBD | TBD | $926.1 |
| Members United | $300.5 | $79.4 | $379.9 | $40.9 | $339.0 | $486.1 |
| Southwest | $359.0 | $0 | $359.0 | $26.8 | $332.2 | $393.1 |
| Corporate One | $123.1 | $25.7 | $148.8 | $5.1 | $143.7 | $116.0 |
| Constitution | $50.3 | $0 | $50.3 | TBD | TBD | $66.2 |

**OTTI is currently being calculated by the corporate credit unions in consultation with their auditing firms. Given numbers are subject to change.*

(b)(8)

N/A Outside Scope

**5. Declare a premium to restore the NCUSIF's equity ratio to 1.30 percent, to be collected during 2009.**

The initial and full potential costs to the NCUSIF of the recommended courses of action and effect on the net worth ratio and return on average assets of NPCUs is as follows:

| Action | Reserve | Premium to Restore NCUSIF Equity Ratio – Impact on NPCU Net Worth & ROA |
|---|---|---|
| NCUSIF Capital Note in USC | $1.0B | -13BP / -14BP |
| Guarantee all CCUs | $3.7B | -43BP / -48BP |
| Communication Campaign Budget | $250K | -0BP / -0BP |
| Total | $4.7B | -56BP / -62BP |

This ultimate expense to the NCUSIF would be borne proportionately by all federally-insured credit unions through a partial write-off of their existing 1 percent NCUSIF deposit, as well as the assessment of a premium, sufficient to return the NCUSIF's equity ratio to 1.30 percent. Combined, the projected average cost for each credit union would result in a 62 basis point decline in annual return on assets and a 56 basis point decline in the net worth ratio. As a result, over 60 percent of NPCUs are expected to be unprofitable in 2009. The projected impact on the PCA status of NPCUs is as follows:

| PCA Category | Before | After | Change |
|---|---|---|---|
| Well Capitalized | 7,763 | 7,651 | -112 |
| Adequately Capitalized | 66 | 149 | 83 |
| Under Capitalized | 46 | 68 | 22 |
| Significantly Under Capitalized | 15 | 19 | 4 |
| Critically Under Capitalized | 14 | 17 | 3 |

The declaration of a premium by the NCUA Board is required by law when the equity ratio falls below 1.20 percent.[10] In addition, the premium declaration is important so the NCUSIF can book a receivable for the premium at the same time the liability is recorded. This will ensure the NCUSIF's published equity ratio stays above the minimum required by law. Absent declaration of a premium, the NCUSIF's equity ratio would drop to slightly below 0.50 percent. To provide an adequate cushion to avoid having to charge another premium in quick succession if there are other losses within the credit union system, staff recommends restoring the fund to 1.30 percent, the maximum level by law to which NCUA can charge a premium.[11] The NCUA Board does have flexibility in determining the timing of collecting the premium and deposit replenishment within reason. It is staff's intention to collect the premium and replenish the deposit during the September 2009 billing cycle. This will allow time to determine the actual liability associated with CCUs opting for the voluntary guarantee as well as the expected loss estimates by the independent valuation firm, enabling a more precise reserving. Based on this information, the actual billing to credit unions in September will reflect these adjustments to the reserve.

[10] Per section 202(c)(2)(C)of the FCU Act, 12 U.S.C. 1782 (c)(2)(C).
[11] Per section 202(c)(2)(B)of the FCU Act, 12 U.S.C. 1782 (c)(2)(B)(ii).

**RECOMMENDED ACTION:** The NCUA Board approve the following:

1. Approve issuing a $1 billion NCUSIF capital note, based on the terms and conditions specified in the attached note, to U.S. Central Corporate Federal Credit Union. Delegate authority to the Executive Director to sign the note on behalf of NCUA.

N/A Outside Scope

8. Declare a premium assessment sufficient to restore the NCUSIF equity ratio to 1.30 percent. The NCUSIF premium may be adjusted based on an independent assessment of expected losses and collected from insured credit unions in 2009. Delegate to the Chief Financial Officer, with concurrence of the Office of Examination and Insurance, the authority to make necessary reserve computations and establish the necessary reserves for the guarantee program and NCUSIF capital note.

N/A Outside Scope

Attachments

A – Legal Opinion re: NCUA Authority for Uninsured Share Guarantee and NCUSIF Capital Note
B – NCUSIF Capital Note for USC
C – LUA for CCU with Unrealized Losses Exceeding Capital
D – LUA for CCU with Capital Exceeding Unrealized Losses
E – Share Guarantee Terms Notice
F – Advance Notice of Proposed Rulemaking
G – Announcement Letter to all Credit Unions

NATIONAL CREDIT UNION ADMINISTRATION (NCUA)

CLOSED BOARD MEETING

Thursday, March 19, 2009

Alexandria, Virginia

MS. HYLAND: I appreciate you answering that question. Thank you, Chairman. No further questions.

MR. FRYZEL: As a follow-up to Board Member Hyland's question about the impact on natural person credit unions, is there any additional cost that we would have to asses to natural person credit unions?

MR. TREICHEL: I think maybe Dave and Steve might best answer that relative to the Insurance Fund puzzle piece of this.

MR. MARQUIS: Steve will answer that question in terms of the mathematics of the change in the reserve that we are going to have to make here eventually, but it has nothing to do with the conservatorship per se; it has to do with the knowledge we gain through the extra due diligence that we have done.

MR. FRYZEL: Steve.

MR. FARRAR: I could go into the changes in the reserving that we are looking at as a result of the PIMCO information if you want to do that now.

MR. FRYZEL: Bottom line, tell us what the difference is in basis points that we are going to have to assess?

MR. FARRAR: 791.12(a)(8) Their values that they were putting on the investments, the market values particularly, was not anywhere close to what we got from PIMCO. So as we originally believed that we had about 791.12(a)(8) worth of exposure specifically assigned to WesCorp, when you look at it based on the numbers that we have now and that WesCorp presents about 791.12(a)(8) worth of risk at the base level, that that really defined how much risk there is at WesCorp and we only had 791.12(a)(8) using their financial information as of year-end. So putting that into our formula and everything, we came up with the fair value of our exposure on the guarantee is up to $4.9 billion from the $3.7 billion. So it did go up $1.2 billion and it is all related to WesCorp. The actual liability for U.S. Central went down slightly because once you do the present value of the cash flows we could justify that there was a little bit loss exposure there and the present value and market values of all the other securities for all the other corporates matched fairly close. So that liability

reduced, but it is all related to the increase in our exposure at WesCorp.

MS. HYLAND: Just to correct you, it is $5.9 billion, correct? You said 4.9.

MR. MARQUIS: It is $4.9 but you add the billion dollars for the U.S. Central and it brings it to $5.9, yes, ma'am.

MR. FARRAR: Exactly.

MS. HYLAND: Okay. Thank you.

MR. HOOD: 791.12(a)(8)

MR. FARRAR: 791.12(a)(8) million was what we kind of had in there when the first number of, in the first number we calculated we had 791.12 (a)(8) billion that we had assigned for risk at U.S. Central and 791.12 (a)(8) billion for all of the other corporate credit unions and WesCorp made up half of that, so it was 791.12(a) (8) million.

MR. MARQUIS: So what has happened also is now that we have the extra information, some of the 3.7 that was the general guarantee has now been sorted out to the places it belongs to and then plus a billion.

MR. FRYZEL: So if we just did U.S. Central there would be no additional assessment to the Share Insurance Fund?

MR. MARQUIS: Conservatorship, no. Irrespective of conservatorship, this issue still has to be dealt with.

MS. HYLAND: But the Chairman's question is if we are discussing U.S. Central and based on the PIMCO, if I understand his question correctly. Based on the PIMCO information that we have on U.S. Central, would that change our analysis of the apportionment of the premium charge that we voted on on January 28? Was that where you were going?

MR. FRYZEL: Yes.

MR. FARRAR: Yes, it did change. What happened was is the only information we had when we first did the allocation of the fair value of what exposure U.S. Central presented was just market value information. We did not have present value of cash flow, which takes in account the credit losses. So the figure we were really operating on for there mostly was the exposure of a market loss

791.12(a)(8),791.12(a)(9)

NATIONAL CREDIT UNION ADMINISTRATION (NCUA)

CLOSED BOARD MEETING

Thursday, March 26, 2009

Alexandria, Virginia

N/A Outside Scope

MR. MARQUIS: Scott, was there any communication yet with RiskSpan?

MR. HUNT: You are speaking specifically as it relates to where do we go with OTTI?

MR. MARQUIS: Yes.

MR. HUNT: That is something we have got on the agenda between now and hopefully Friday. We are going to reach out to Clayton and some of the potential and possibly RiskSpan relative to helping the conservatorship boards finalize the methodologies to supplement the information that we have relative to our outside vendor and the other analyses we did. And, after we get through this call, we need to gather the two conservatorship boards and have those discussions relative to those methodologies.

And that has been a big topic in these calls we had, is when are you going to let us know how you came up with your number and provide some transparency relative to that. And in the conference call yesterday I told them that our focus is this March accounting period and the March financial statement and that around, on or about April 20th is when we will finalize the March numbers and, at that point in time, that we will provide them some talking points relative to how we got to that number.

But when I provide that summary, I indicate to them every indication we have range-wise right now is that there will be a material deficit here at WesCorp and that we are just fine tuning what that

number is and our methodologies. So they are expecting, which correlates to the MCA and the PIC being eroded.

MR. MARQUIS: Okay, thank you. Questions on WesCorp?

MR. FRYZEL: Scott, you mentioned that the audit is continuing. Do we have a date as to when they might complete the audit?

MR. HUNT: Not at this time because we are in initial discussions. The first question is just that will our action alone cause BDO Siedman to pull and they spoke with their risk management side within the firm and they said no. What they responded back to us was that they think the likelihood is they need additional testing. Quite frankly, what they are looking at is the OTTI. They are getting signals, obviously, through the impairment of our Fund that the OTTI number is significant here at WesCorp in light of some of the analysis they have already been doing. So their desire is to better understand that process before wrapping it up. So, as Mark indicated, the two boards have to get together, or at least the WesCorp board specific to this question, get together, look at

how we are going to formulate OTTI going forward and that would be a process finalizing with BDO.

On a good note, aside from the OTTI, BDO did indicate that, in general, all accounting records and processes seemed very sound but we do not have that final date at this time.

791.12(a)(8)

MR. FRYZEL: Now, are we looking at a comparison of their numbers to what we got from PIMCO?

MR. HUNT: We have done some preliminary analysis on that. 791.12(a)(8) 791.12(a)(8) some of that is limited to the scope of bonds. Of course, we asked PIMCO to do a comprehensive review and those bonds that were modeled by 791.12(a)(8) on an external basis. And I say that because WesCorp has purchased 791.12(a)(8) model to use on an internal basis, but those that 791.12(a)(8) ran were a very limited number of bonds. But those comparisons did show that 791.12(a)(8) credit impairments, while not as conservative as PIMCO's, were paralleling within the reasonable realm of estimates with PIMCO's.

MR. FRYZEL: So the reason why they would not be showing or telling us that their loss was greater than we figured it to be was because of the limited number of securities they looked at?

MR. HUNT: That would be one explanatory variable, yes. The bonds actually fully modeled by 791.12(a)(8) were only 37 out of the 900 and some securities held by WesCorp.

MR. FRYZEL: And did we previously have information on those 37 that were done? Had WesCorp given us information as to the values of those?

MR. HUNT: We have not gone back. I guess it is likely that those same 37 on the most recent run, we do not have information for prior periods. We have to go through the process WesCorp had of sending certain bonds to external parties and the 37 that were sent, to my knowledge, was the greatest number sent to 791.12(a)(8) for full modeling. So we could not go back in time and say the same 37 as of December were modeled in September, were modeled in June to have that comparison.

MR. MARQUIS: Scott, you are saying those were done, what, like the January timeframe for December?

MR. HUNT: Yes, thereabouts, yes. Effective December.

MR. MARQUIS: Okay.

MR. FRYZEL: And at some point did WesCorp tell us what the value of those securities were?

MR. HUNT: Of those 37? I just want to be clear so I answer, or the OTTI figure for December?

MR. FRYZEL: On those 37.

MR. HUNT: Those 37, the preliminary analysis I think we are showing in the neighborhood of a $200 million credit impairment and 791.12(a)(8) was in the neighborhood of a $700 million credit impairment.

MR. FRYZEL: Where was PIMCO?

MR. HUNT: PIMCO is in the neighborhood of $900 million.

MR. FRYZEL: What is the 200 million figure?

MR. HUNT: That is the projected credit impairment projected by WesCorp.

MR. FRYZEL: Where did they get that number?

MR. HUNT: From their internal modeling. One of the drivers of that is a 791.12(a)(8) model that is controlled by WesCorp.

MR. FRYZEL: So they used a 791.12(a)(8) model internally to come up with the 200. Then they asked 791.12(a)(8) to do their own and they came up with 700?

MR. HUNT: That is our understanding.

MR. FRYZEL: And how was this transmitted to us, this information relating to their 200 figure? Was that in writing to us?

MR. HUNT: That was not provided, as far as this comparison, as information. One of my staff

actually gathered while on site during the most recent exam process.

MR. TREICHEL: That was fairly recent.

MR. HUNT: Within two to three weeks because the exam at WesCorp was in process just before the conservatorship action.

MR. FRYZEL: So there is documentation that tells us that WesCorp was saying the loss was going to be 200 million?

MR. TREICHEL: There is documentation it is in but the comparisons were made through pulling our information together.

MR. FRYZEL: What are you looking at that is telling you WesCorp said those losses were going to be 200 million?

MR. TREICHEL: The results of their modeling. Again, we took the 37 that we know went to 791.12(a)(8) and then we went back and mapped them against the total portfolio analysis done by WesCorp to extrapolate those differences.

MR. FRYZEL: All right. So you are telling me, Dave, that they have a listing of the 37 and the value of each of them. WesCorp had that on paper?

MR. MARQUIS: Scott, I assume you are saying they have that on paper from 791.12(a)(8) and then they have ….

MR. HUNT: Yes. It is an analysis they conducted.

MR. FRYZEL: I am sorry, what did you say, Scott?

MR. HUNT: It is an analysis they conducted. I mean they have a report of all bonds and then it maps out their projected losses and values. Of course, WesCorp did it for the entire portfolio as part of their internal analysis. Some of those bonds went out to 791.12(a)(8) and we started with again, working backward. Using 791.12(a)(8) and then mapping them against the results that WesCorp did. WesCorp did not, to my knowledge, take it on themselves to say here is the 37 by 791.12(a)(8) and let us do this analysis and comparison. We did that as part of our exam process.

MR. FRYZEL: Scott, what I am trying to get as is that we have PIMCO telling us that these 37 securities were worth $900,000, let us say.

MS. HYLAND: That the credit losses on those were $900 million.

MR. HUNT: A credit impairment of $900 million.

MR. FRYZEL: Now, you have got 791.12(a)(8) with their own analysis saying 700 and now you are telling us that your analysis of the WesCorp documents are saying that WesCorp said it was going to be 200.

MR. HUNT: Yes.

MR. FRYZEL: So are you able to tie this all together? You are saying to the Board that our numbers are this, 791.12(a)(8) are that and WesCorp's was different?

MR. HUNT: For those 37 securities.

MR. FRYZEL: For those 37.

MR. TREICHEL: There are basically three different estimates of the impairment on those 37 securities.

MR. FRYZEL: But we could say in confidence that WesCorp said the impairment was 200 million, whereas their evaluating firm said 700 million and PIMCO said 900 million?

MR. HUNT: Again, that is the information we pulled from the exam. Our staff on site pulled this analysis together and summarized that data, yes. We have a summary to that effect.

MR. TREICHEL: It was in one of the tabs.

MR. HUNT: Yes. It was in the tab of the conservatorship order. I am trying to pull that up as we speak. If necessary, I guess, I could submit that summary to the Board. Is that a possibility to make sure we have the exact numbers that we want to use?

MR. FRYZEL: That would be a good idea.

MR. MARQUIS: There was a chart in the Board package.

MR. HUNT: Okay. I will follow-up up with that to do so.

MS. HYLAND: Chairman, can I ask the question in just a little different way?

MR. FRYZEL: Yes, sure.

MS. HYLAND: Scott, I guess what I would like to get to is the Chairman's concern as well but here is the deal, very bluntly. All of the Board members have received thousands of emails within the last 24-hours expressing concern about the conservatorship and stabilization action. And I think as each of us go out into the credit union community to speak, obviously one of the questions is squarely what the Chairman is asking. There has been a lot of distrust about the PIMCO numbers. Why PIMCO? Why only PIMCO and why did

you conserve now? And I think what we are trying to get at is that differentiation between what WesCorp had versus what WesCorp's external vendor had versus what PIMCO had and I think the blunt question is can we say that, when we go out to speak to help people understand these actions, can we use these numbers? Are we confident enough in the discrepancy between what WesCorp did internally, with what WesCorp's vendor did on those 37 bonds and with what PIMCO did to be able to very clearly enunciate to the credit union community part of the rationale for the conservatorship action?

MR. HUNT: And I guess I will say my staff in particular, Rick Mayfield, was on site at WesCorp to evaluate the WesCorp methodology and also take a look at the 791.12(a)(8) and he has been privy to the PIMCO analysis and, as we best summarized it, is if you look at 791.12(a)(8) and PIMCO as being external parties, i.e., having no position necessarily in the bonds per se. They are only looking, again, when we asked them what is the credit impairment, on that basis alone, again, while there is a disparity, as I said, one is in the neighborhood of 700 million and one is at 900 million, they are within a reasonable realm of estimates those

two parties believe are the credit impairments. Now, when you look at WesCorp, considerably lower in the neighborhood of 200, again, this is all based on those 37 securities.

My understanding through that analysis that Rick did and others is that because we are projecting the future much is determined on your assumptions going forward and I think it is fair to say there is probably a higher degree of optimism in WesCorp's analysis on a going forward basis than these other two firms.

For example, they build into their estimates more hope that many of the programs out there between the Fed and the Treasury will have a positive impact on the mortgage market. Whereas the other two firms may not have built, or maybe to a lesser extent. It is just one example, to get through it. But on the end of the day I think it is going to be in the optimistic or realistic or pessimistic view of the underlying qualities of the mortgages and how they run through the securities being held at WesCorp.

MR. HOOD: I understand that completely but again, is there some document that, if we are asked, we can definitely state at this point in time this is

what WesCorp stated, this is what [inaudible, overlapping]

MR. HUNT: One of the reasons that the conservatorship board is contemplating adding an additional vendor to take a look at it [inaudible, overlapping]

MR. MARQUIS: Wait a minute.

MS. HYLAND: Mark and Scott, can you hear Vice Chairman Hood's question?

MR. TREICHEL: All I heard was due process I think.

MR. HOOD: Ms. Hyland, if you could communicate that, I would greatly appreciate it. Thank you.

MS. HYLAND: Vice Chairman Hood, I am holding you up to the microphone, as it were. Would you want to try to repeat the question and see if our folks can hear you?

MR. HOOD: Yes. Gentlemen, again, I just wanted to follow-up to make sure that there is a source document where it mentions that $200 million figure. We as Board members have been inundated and barraged with letters from thousands of credit union members questioning our recent actions. And one of the

things that we would like to be able to say, I know I personally, is that this was the actual number that WesCorp used at a particular point in time. Is there a file of this somewhere or is there a document that states this?

MR. TREICHEL: That is my understanding. That information would have come from Rick Mayfield, the contact here during the examination and he is not here on site. He is there.

MR. MARQUIS: He is right here.

MS. HYLAND: He is actually right here.

MR. HUNT: In the central office and I think he could best answer what document he saw relative to that $200 million estimate.

MR. HOOD: Great. Thanks. And to follow-up, we have been focusing then exclusively on the 37 bonds. What about the other 863? Has there been an assessment or will there be an assessment on those for credit impairment?

MR. HUNT: Yes. Mark has said for the conservatorship board here at WesCorp, we are going to hold a meeting specifically addressing that to have a more comprehensive review by an external party. That

is what we are going to discuss as a conservatorship board.

MR. HOOD: I am somewhat concerned, gentlemen, if this is what the number has just been on just 37 bonds and now we are going to look at an additional 863, do we need to really look more in terms of what our overall stabilization dollar amount should be?

MR. TREICHEL: I would say no. PIMCO did look at all of the bonds and we did factor in our determination relative to the stabilization costs. It was WesCorp that had some filters that prevented bonds from going externally for review and, as WesCorp and as the conservatorship board here, we will ensure that any bond that needs to be looked at externally is looked at externally relative to the methodologies that WesCorp has now that we are in control.

MR. HOOD: Great. Thank you.

N/A Outside Scope

MR. MAYFIELD: Yes. I believe the question was those 37 securities, where we received the source document. WesCorp actually provided the document and it was titled their Alt A analysis. And in that, the 37 securities that actually failed their filters actually were sent out to 791.12(a)(8) did an analysis on those 37 securities. WesCorp also did an analysis on those 37 securities. 791.12(a)(8) came back with a projected loss of $727 million on those 37 securities and WesCorp's internal projections were $206 million. So over $500 million difference and PIMCO, when I pulled up those exact same securities, came up with a projected loss right at (b)(8) million.

So 791.12(a)(8) was a lot closer to PIMCO than they were to WesCorp. To take that another level, on the USC analysis, 791.12(a)(8) was actually the most generous as far as showing the least amount of losses. So they were on the far spectrum as far as low losses, as far as the outside analysis and US Central had a total of four. So in the spectrum of the five you had 791.12(a)(8) on the far left with the least amount of losses and actually PIMCO was to the right more bunched up with Clayton and then Andrew Davidson was somewhere in the middle.

MR. MARQUIS: Why did they only have 37 as opposed to the other 900?

MR. MAYFIELD: They have a filtering process that did not allow a lot of securities to actually fail.

MS. HYLAND: They, WesCorp?

MR. MAYFIELD: Yes WesCorp. Fail to where they actually were sent out. And that filtering process is full of flaws.

MR. HOOD: So was [inaudible]?

MR. MAYFIELD: It was not necessarily, it was but it was a, there was a process to where they did it. It was not totally arbitrary but they actually had this filter that would keep a lot of the bad securities out.

MS. HYLAND: What type of filters were those? What would justify pulling some of those securities, or a lot of those securities out of what they would give to their external vendor?

MR. MAYFIELD: There is a lot of bond-speak with this unfortunately, but essentially they were using the current liquidations for this last month and the average for the prior three months to create some kind of a loss curve that they would apply. Now, there

are two problems with that. If the delinquencies spiked recently, they would not be showing in the current liquidations. So, there are a lot of future losses that they would not reflect. So that is the one problem there.

Number two, they had very optimistic assumptions of what the current, how the next two or three years would be. So they are saying things are going to get extremely, are going to turn around extremely quickly and dramatically, too. So the housing market is going to get, as of today is just going to get this much better and, not only that, stuff in the pipeline, not as much of that is going to go bad as one normally would expect.

MS. HYLAND: So there were two factors that they were counting on; that the housing market would skyrocket and go up very quickly.

MR. MAYFIELD: Yes.

MS. HYLAND: And number two that the foreclosure activity would cease dramatically.

MR. MAYFIELD: With the current pipeline. So the 90-day plus, not as much would go to liquidation as we have observed in the recent year because the so-called roll rates, where loans actually go from 60-day

to 90-day to foreclosure to liquidation have been almost 100% with these types of collateral. They try to make assumptions like from 60-day to liquidation of 60%. So they had really low assumptions, too, which really kept the expected losses way down so they did not fail the test because of that. They were overly optimistic. One could argue unrealistically optimistic.

MR. MARQUIS: So they were not looking at the external economics like economy.com that were at least bouncing those assumptions off of what those external folks were saying. Which would have probably given them a different result

MR. MAYFIELD: They were not even going to that extent. It was pretty bad.

N/A Outside Scope

the PIMCO report works and how it was presented to us and do some comparative analysis for you.

MR. COLE: Good afternoon. Mr. Hood, I apologize. I am using a Power Point presentation here and I will try to describe these such that you will be able to clearly follow along with my comments but the reason I did that, we have a few visuals that I think help kind of conceptualize in non-practitioner terms the kinds of securities at issue here. But let me just begin by saying, of course, the Chairman directed us at last week's meeting for staff to summarize the report that PIMCO had written and to put it into what I would call non-practitioner, easy to understand terms with an eye toward perhaps even being able to release that to the public. And obviously that would have to go through PIMCO and we are actively doing that. I am working with Steve Farrar and Rick Mayfield from the Office of Corporate Credit Unions to put together that written summary.

MR. HOOD: Okay.

MR. COLE: And what we will try to cover this morning is what I call the 30,000 foot view of what the PIMCO report is doing for us and we want to talk a little bit about the factors that go into the analysis

and the impetus for the review, obviously, the factors that drive the results and then we will touch upon the conclusions of the PIMCO report as well. And I promise you we will not punish you with too much bond terminology or bond math, although I will say that I have Rick here with me today and he has been very involved in the forensic work of looking at the portfolios and understanding to the extent that we have this divergence between what we can see in terms of deteriorating market information and the financial representations made by the corporates regarding how well or how good these portfolios are.

So let me start with really the big question here. Why did NCUA engage an outside firm? Why the need for an outside firm? And I think obviously you are getting thousands of emails that are following up on that question. But really the key driver here is that we recognized the impetus being a divergence in what staff was seeing in the way, we have got ratings downgrades. We have got growing unrealized losses and we have institutions putting kind of a brave face on what these portfolios are doing and how they are expected to perform. And increasingly over time we began to lose confidence in their judgment that things

were fine and that there were not going to be losses and that they could ride it out.

And we recognized that we needed an independent review. One of the things that should be said about these securities, and Rick touched on it earlier, these are tremendously complex instruments. I do not think there is a financial instrument that is more complex than a mortgage backed security. And when you layer on top of the fact that you have a complex underlying asset, then you have a complex bond structure, the expectation that the regular investor or that the ordinary person can quickly master what it is that they are looking at and evaluating, it just simply is not true. There are only a handful of firms in the world that can probably do the extensive analysis that we have engaged PIMCO to do. PIMCO is clearly one of them.

Some of the firms that we reached out to in that initial process of trying to find someone, we had references from other federal agencies, for example. Some of those firms said, oh, we cannot do that and referred us to the folks that are sort of generally known as having that capability. And PIMCO was a name that came up several times. In the end, the magnitude

of the issue and our need to get an unbiased and unrealistic handle on what was really going on with these portfolios drove our recommendation to the Board for us to engage an outside party. And I think that the objectivity clearly is a huge issue and it is one that will, Rick and I were talking earlier, if you are a firm involved in the US financial markets everybody can accuse you of having a conflict. You are doing business with someone or you are an expert involved on either one side of a transaction or another. You are not going to find anybody in this business that cannot be involved in some manner, shape or form with what is happening in the capital markets.

We did select someone however who was not doing business with the corporates. That was very important. This is not someone that has been engaged by them. And so, in addition to being highly qualified, we did want to select a firm that it could be said they did not sell bonds to these institutions. They were not currently engaged by these institutions. They are truly independent and to the extent that one can have a non-bias, we think that that is true.

MS. HYLAND: Owen, can I ask you why don't you think any corporate selected PIMCO as an external

vendor? Why wouldn't a US Central actually select PIMCO? Was it the price tag? Why not if they are so renowned in what they do?

MR. MAYFIELD: Actually I have an answer for that. Actually PIMCO really does not advertise a service at all. Most of the time, when they do services like this, and they have done many of them, it is always top secret. The organizations do not want them to know. So this is actually, PIMCO realized, based on the problems we had to get in touch with them and actually get an interview with them, that they really needed to get out there a little bit more and be able to be found. But they have done like 30-something of these types of analyses in the last few years. They are being engaged by

791.12(a)(4)

I am sure there are other federal agencies that are engaging them that we do not know about. So, but that is one of, I do not think they were able to get to them and I think that is one of the biggest problems. It was tough for me to get a hold of those guys.

MR. COLE: And of course, PIMCO is a money manager and one of the largest, they run one of the largest bond funds in the world but they are not out

there marketing themselves as a service that can do this. We, by way of referral and actually it was our contacts at 791.12(a)(4) who suggested that PIMCO would be certainly one that we should speak with.

One of the things that we also realized is we have, of course, the 26 corporates. You have different portfolios comprised of different kinds of bonds. You have different techniques used and methodologies used by these corporates. We really did not have an apples to apples comparison. And in particular, if we look at the big firms that we are dealing with here, WesCorp and US Central, that hampered us somewhat. We could not make reliable comparisons about the relative risk that resided in these portfolios because we were using what they were doing on their own behalf as our intelligence about the portfolio. So by contracting an outside firm who was using a consistent methodology for every single security, this gives us a true apples to apples comparison and it really allows us to make two very important conclusions; the relative amount of risk that we are talking about and where that risk is

located. And we can do that, I think, with a lot more confidence by virtue of having used an outside vendor.

The third point about the outside firm, actually I have already sort of touched on this, is the real problem sector here is residential mortgage backed securities. This is a highly complex instrument and requires a tremendous amount of expertise to do extensively in-depth analysis. We know it is the problem sector because the housing bubble pretty much is resulting in the value declines and the forthcoming losses that we expect. Approximately 58% of corporate credit union assets are concentrated in residential mortgage backed securities. So we needed a firm that had the expertise to do extensive analysis on our MBS.

MR. FRYZEL: They only looked at the mortgage backed securities?

MR. COLE: We only had them look at assets, the residential mortgage based securities…

MR. MAYFIELD: Private label; not the agency. So that is a distinction there and CDOs that were backed by residential mortgage type securities.

MR. COLE: Ones that are, yes, collateralized debt obligations, which are basically bonds for which the underlying is bonds, right?

MR. MAYFIELD: Yes.

MR. COLE: But it is all related. The way to think of it is any asset for which the underlying is a mortgage loan, a residential mortgage, that is what we wanted to have analyzed.

MR. FRYZEL: What comprises the other part of their portfolio?

MR. COLE: Student loans, whether or not they are private label or FELP. So obviously the FELP are better because they are the government guaranteed, credit cards, autos, commercial mortgage backed securities. There is also some corporate debt in there too.

MR. FRYZEL: We did not feel any reason to be concerned about the value of those?

MR. MAYFIELD: It was less of a value, the valuation, as far as pricing, is more transparent in those sectors, which kind of makes that a lot easier. Those sectors have not been hit with the problems that the residential sector have been hit with. So it might have been premature to do those sectors at this point in time. Loss estimates in those sectors are a lot lower. They are typically better structured. You did not have the weak underwriting to the extent that you

did with residential mortgages. And we did not see the downgrades in those sectors either. It was clear, expect for maybe corporate type bonds, Lehman or something like that too, but that is more of a on/off switch as far as default or not and that is a little bit tougher. I guess they can do an analysis and figure out what the probability of default is and then apply that to a loss but we, I think we felt that residential mortgage is really, and it was the vast majority too. So it was more of a risk-based approach from that standpoint.

MR. COLE: And I would add that some of the other sectors were much more simplistic deal structures and shorter lives. So it was obvious that certain parts of the portfolio were not in a concern at this time. And that is not to say that we could not in a subsequent analysis open that up, but really the residential mortgage backed security sector is clearly the lion's share of the risk for these institutions.

Let me go to the next slide and talk a little bit about the PIMCO analysis, the level of detail, and I know you have heard me use the term 'granularity' which is market slang but really that is getting to the detail, the specificity of the data

because, as we have said many times, we need to be able to drill down to a level of detail where we can really get a handle on the performance of the underlying assets. What PIMCO did was with every single security, and again, they do not know which corporate owns which bond, I should mention. They just got a big stack of identification numbers and went through each security on an individual basis. They priced every security using their own internal pricing guidelines and that gave us the consistent treatment across every single security. They were all evaluated in the same way using the same methodology so that we know that we have got an apples to apples comparison across bonds and across portfolios and ultimately across corporates.

The breakdown of every security to the most detailed level, which I have referred before, and ideally you want to get down to the individual loan level. And when we are talking about residential mortgage backed securities, basically what you have as an investor is you have got a pool of loans, a pool of mortgage loans and you have an ownership interest in that pool. That is an oversimplification but you care very much about how that pool of loans, that

portfolio, if you will, performs. And the type of detail that PIMCO was drilling down to ascertain what type of loan. And this is a really important factor in terms of the expected losses. We know that, for example, nontraditional loan types, Alt-A, payment options ARMs, subprime, etc. and especially in recent years really are the lion's share of the problem. And this is what is driving the poor performance, if you will, of the portfolios in question for WesCorp and US Central.

They also have information regarding the servicer of the loan and the originator and sometimes those are the same but frequently they are not. And what is important about the servicer and originator information, you have 791.12(a)(4) information where you learn about the effectiveness of a servicer and the effectiveness of an originator's underwriting standards 791.12(a)(4). So here PIMCO knows if I can see which, for all of these bonds, and I can see who was it that was originating and continues to service these loans, that tells me, that gives me useful information about what I might expect going forward, what sort of problems have we already seen as a result of paper that is originated

and serviced by those entities. 791.12(a)(4) And I think a pretty sophisticated component frankly compared to what one might rely upon in the way of secondary information.

The current status of delinquency, 791.12(a)(4) 791.12(a)(4) all of these loans underlying the securities, you have the actual loan performance information being reported and, as an investor, you are getting information as it is occurring. You have, and this is what we do know about the bonds so far, 791.12(a)(4),791.12(a)(8) And that is really the trend, I think.

The big divergence that we had particularly with WesCorp is how can you ignore the last couple of years of data in what is happening with these and then suggest that somehow that will cease and that going forward the performance will be good. You have got to take into account the current status of delinquency to make a reasonable projection going forward, and they do that for every loan.

And then lastly, 791.12(a)(4) 791.12 (a)(4) property location. Where were these loans granted? And we will see for a lot of these securities

concentrations in the high cost markets, places like California and other areas of the country where the alternative mortgage products proliferated because that was the way that the market dealt with increasing home prices and unaffordable traditional loans. So all of these factors are part of how they evaluate each individual security and very important elements to projecting losses going forward.

The next slide.

MS. HYLAND: Owen, before you go to the next slide, I just want to ask, how specific were they? Where they at the census tract level or the zip code level in their analysis?

MR. MAYFIELD: As deep as they can go. Sometimes they cannot get, if they can get the zip code level, they do that. 791.12(a)(4)

MR. HOOD: Great. Thank you.

MR. COLE: So this brings us to PIMCO being able to establish where is the loan to value ratio on the underlying today? 791.12(a)(4)

791.12(a)(4)

and, given default, what the recovery implications are and ultimately how much money we are talking about losing. So once they have isolated all of the information about the loans and they have, of course, information about the current housing market, they can arrive at a revised loan to value ratio. You have a loan to value ratio at the inception of the loan and we know now that is not a very useful piece of information. Much has changed. And we know that as home prices fall, as values fall, that becomes a major driver in the likelihood of default. And if you think of it this way, if I am in a market where home values are plunging, at some point I have what we term negative equity. I have got, I owe more on my loan than my house is worth. I have got an economic incentive to default because I am being asked to pay for something that far exceeds what I could get if I sold the property. The other thing that is going on is just economic distress. That maybe I want to perform on my loan but the terms of the loan are so onerous that I am being driven into default anyway.

So those current LTV numbers, we refresh that for here and today and now we have got to look forward and say, so what does that mean for the

remaining loans that underlie these securities? Well, I have got to have an understanding about the probability of default and I also have to understand what my recovery prospects are. And that really gives us the starting point for what PIMCO's analysis generates from here.

PIMCO's modeling involves both internal and external models. They use a lot of market source inputs but they also have their own proprietary systems. 791.12(a)(4) We asked PIMCO to generate, using their model, three scenarios for us. One would be base case, the most likely expected credit losses on these portfolios. And then also for an optimistic and a pessimistic. And I have parenthetically here for base case they, by way of example, their economic forecast in part comes from 791.12(a)(4) which is a resource that many use including the agency. They are not using all unique proprietary sources of information but rather what we found is when we look

at their assumptions and we look at other market providers of information, no surprise, there is a lot of similarity. So PIMCO is not some unique stand apart entity with an independent view about what is going on in the marketplace but rather they are using market source information like others.

But that base case is what they feel is the most likely to occur in the way of expected losses and optimistic and pessimistic, I guess I would describe those as what if the housing market is not as bad as what we say it is. I mean the baseline is it's bad. So optimistic would be it is not as bad and pessimistic is well, what if it is worse. And even the Federal Reserve recently issued its economic information and they have a baseline forecast for housing that says home prices will go down an additional 14% but then they have an adverse scenario to go with that. Their pessimistic view is home prices could go down in excess of 20%. And PIMCO's forecasts are very similar to that. And again, we are not seeing that PIMCO is using assumptions and forecasts that differ markedly from other providers of information.

The thing to remember about this modeling is that what we are really trying to gauge here is we are

modeling the projected behavior of the loans. We are trying to predict which of these loans will default and, to the extent that they default, how much can we recover? How much money are we going to lose if these loans do not perform? It is a very sophisticated multifactor modeling process. And it is that. It is an estimate and we are using professional judgment and some assumptions to generate those results. I think that is why it is important to remind ourselves, hey, we have got a base case and we have got kind of a plus and minus scenario, optimistic/pessimistic because nobody knows the future with certainty and what you have to do is use reasonable and supportable techniques to create kind of a range of outcomes that you think are highly probable. And so, for our part, looking at what PIMCO has done, we have a high confidence factor in their approach because of the specificity of detail, the broad range of factors that they use, and the fact that their economic assumptions are in line with other very credible sources.

I am going to go to the next slide and talk about kind of what are the really big factors for this analysis in terms of assumptions, the drivers. We have talked about the fact that we needed to ascertain

current loan to value ratios and get a handle on loan performance. Well, what is going to drive loan performance? Two things. One, our economic scenario and we have said many times, the ultimate bottom for the financial markets is home prices. That is kind of the big factor here. So the housing market and home prices, we have to have a forecast for that. And then secondly, given the direction of that market, we have to have loss estimates on mortgages. And what PIMCO does is they are going to break this down into, they are going to segment the total universe of mortgage loans into discrete types and then further they are going to look at different years or origination, because what we have discovered is 2005, 2006, 2007 was sort of, the housing bubble was reaching its peak and actually in '06 it was starting to burst and in '07 it really had burst. What you find is that, and we refer to those as vintages in the same way you think of wine, we have some very bad merlot that was created in '05, '06 and '07. And so that is probably the single biggest determinant for the loss estimates that were generated by this analysis, is those estimates for various mortgage types.

The last thing I want to mention here, and it is less of a factor but they devoted a fair amount of discussion to it is they very much want to capture the policy initiatives that are going on at the federal level regarding mortgage relief and home affordability, etc. There are a bunch of programs that have already been adopted. There are others that are being contemplated. We cannot ignore those because we know that many of those, the objective is stabilize the market, avoid additional foreclosures, try to arrest the declining, the effect that that has on declining home prices. All of that is good if you can stabilize the market and improve liquidity and prevent home prices from falling. That is a benefit that accrues to everyone.

The offset though is that part of these programs that may be detrimental to bond holders is they are talking about reducing payments and, in effect, as an investor you are having your cash flows reduced. That means that you are getting less on your security than you otherwise would. So there is sort of a mitigating, an offsetting effect here to these government initiatives but I did want to mention that they do have a policy dimension to this analysis.

Let me now go to their discussion of the home price outlook. As we have said, we know that where the housing market goes and home prices will largely determine whether things are getting worse and worse. And their outlook is that they do expect further market declines and that is consistent with virtually every forecast at the present time. I do think that some are saying that the housing market may find its bottom here later this year, 2009. But PIMCO suggests that, look, if we look at the market information that exists, there are a lot of things in the marketplace that tell us information about what the market expects home prices to do. We can look at, for example, prices. We can look at credit spread information. We can look at indexes on credit instruments. There is a lot of information out there. And PIMCO's take on that is the market is telling us, if you understand what those indicators mean, that the bottom is implied to be sometime in 2010. So we are maybe a year away from the bottom. What that means for us is there is no abrupt turnaround. There is no abrupt recovery here in the values of these securities and there is probably going to be a pretty slow recovery even when we do find a bottom. So the risk

position that we have by virtue of being heavily invested in residential mortgage backed securities is going to persist for some time. And that is very consistent with most of the forecasts.

I am going to, Rick and I, I know Rick will help me on this. We want to use a visual to kind of describe what is it about the structure of a mortgage backed security? We have talked about the fact that, hey, these were triple A when we bought them. That meant that our expectation was no risk of loss or certainly a very remote risk of loss. What is it that has happened that has resulted in us prospectively having very significant losses? And here we are just going to, the first slide, looking at a residential mortgage backed structure, as I mentioned before, you have got a pool of loans and they get segmented into kind of two parts to the deal. The blue being the senior piece, the triple A portion of the security and then there is typically a subordinate piece and that subordinate piece is, by design, going to absorb prepayment risk or defaults so that the senior class has more protection from those events.

In the good times, before this cycle manifested itself, the expectation was, you know,

typically on a residential mortgage backed security the incidence of losses would be maybe somewhere in the range of 1%. And so you do not really need a tremendous amount of that subordinate class but those would be rated lower. They would carry a higher interest rate and there is an investor for that part of the deal, but we are going to be investing up here in the senior portion of the deal structure because we are relegated to triple A. Because we are not allowed to take credit risk. So this turns out to be something of a fallacy, of course, because what happened in the last say four years is that the proliferation of nontraditional loans and the quality of underwriting just fell apart. And so we are still buying with the mindset of this traditional structure of I have got protection from a subordinate class. I am up here in the senior portion of the deal. I do not have to worry about credit losses. I probably have to worry about interest rate risk, maybe liquidity but I am not going to have credit losses.

And the other thought here is that losses, to the extent that they do occur, are applied from the bottom up. They are going to, however many layers of subordination you have, the riskiest class is the

bottom. They are wiped out first and then the losses go up through the deal structure. What we have discovered is, for WesCorp and US Central, those losses are well up into the portion of the bond that they own.

If I go to the next slide, I want to talk about one kind of mortgage backed structure in particular that is sort of a disproportionate share of our pain. Here we have the blue being the senior level, and that is where we are generally involved and that is where primarily US Central limited its investments. Then I have got this red slice here called the senior mezzanine, which is also initially rated triple A but it is the riskiest portion of the triple A, if you will. And you get extra yield for buying the riskiest part of the triple A. And then below that, again, subordinate classes, which would have been rated much lower than triple A or double A prospectively. But again, the same concept. To the extent that I do have credit losses, those get applied to all those subordinate classes first and that is a form of protection and that is where my triple A comes from. And what we have seen is because the rates, and we will look at foreclosure rates here shortly,

because they were so much higher than what the deal underwriters and the rating agencies were forecasting, all of that subordinate, that sort of green level down there, is gone for a lot of these deals. And WesCorp owned a considerable amount of senior mezzanine level bonds because there was some extra yield there, simply.

And now we are at a point where the losses that are going to hit that senior mezzanine level are just around the corner, and I think part of our divergence with them was they were suggesting they are not going to be losses on these bonds and, as we started looking at the downgrades and the levels of foreclosure that were ramping up, we were saying this trend is going to overwhelm us. How can we have this disconnect.

MS. HYLAND: Owen, can I stop you just for a second to make sure I am clear.

MR. COLE: Sure.

MS. HYLAND: Two questions. One is a rating agency question, which is how do you have triple A in both senior tranche and a senior mezzanine tranche and that question relates to my second question. Because what I understand is that the mezzanine tranche takes

you into those Alt-A, subprime mortgages which intuitively you would not think would tie back to triple A. Can you help me, Rick? Help me understand that.

MR. MAYFIELD: Well, the problem is rating agencies really dropped the ball on this because they, if we look at the prior slide and you see that senior piece, that is triple A. And their assumption is if you cut the bottom piece off of that triple A it is still triple A. Because they are basing it on the first loss. So the first loss usually would come at the same time whether you have the entire piece or just the first loss piece of the lower piece. So that is how the rating agencies got there.

In discussions with PIMCO last week when I was there, and we were talking about the rating agencies in general and that is one of the problems why the rating agencies have been so slow, because they rated that one big piece and they did not look at the behavior of this guy down here. So they had to go back and remodel some of these things and go through new assumptions and figure out how they are going to rate this separately from that top piece because they were rated together to start off with.

As far as the asset types, unfortunately, the type of assets that we have seen these types of structured in are Alt-A and option ARMs. That is the most of them, unfortunately. And the reason we saw them is you had more savvy investors go, there is more risk in this than we want. We want more subordination. They cut that piece off and they found buyers for that.

MR. COLE: If I could, Rick, because I want to make sure I clarify something for Ms. Hyland. Those alternative mortgages underlie all of these classes. So even the senior piece has the Alt-A and payment option ARM, etc. But it is how did we get to triple A, well we put in all kind of credit enhancement to kind of give it extra protection.

MR. MAYFIELD: And the loss expectations or their base assumptions were so low compared to where they are now. And the problem with Alt-A and option ARMs, it is multiples of five, six, seven times worst than what they expected. So they built the subordination based on the expected. So subprime bonds are doing a little bit better because they expected larger losses and they performed on a multiple basis better. So they might have been twice or three times

as bad as the baseline projections as opposed to some of these other collateral types that are option ARMs and Alt-A. They are performing five, six, seven times as bad as they expected.

MS. HYLAND: So one more question. Based on what Owen's comment just was, if you have Alt-A and option ARM in that entire portfolio and in the blue, what pushes those particular securities down into a senior mezzanine tranche then to merit having all of those additional credit enhancements? Do you understand my question? Am I expressing it correctly? I think you just said that you can still find option ARMs in the blue senior tranches. Is that correct? Or not as much?

MR. MAYFIELD: You are going to have typically one type of loan in the entire pool.

MS. HYLAND: Right.

MR. MAYFIELD: So you are going to have Alt As. That is going to be all Alt As in that pool or all option ARMs. So when those start taking losses as a group or individual loss, they are going to end up starting at the bottom and working their way up. Once they get to that red part, that is when they start taking losses. Now, if you own the traditional senior

for each dollar loss, that is fine, but if you own the bottom guy, normally if you would have taken a dollar loss, it would be maybe nine or ten times as much because you have, that is considered levered. That is considered levered tranche and that is the problem. Once it hits, it comes in fast and violently as far as the losses go.

As an example, I actually ran some numbers today because just based on this. On the PIMCO analysis, this type of tranche, that red tranche right there is accounting in the base case for about 5 billion of their losses. So it is not only the collateral type. It is the structure that really caused the big problem. And that is the big disconnect between them and the other corporates. They have such a large concentration in a highly risky collateral type and then, on top of that, the riskiest portion of that triple A. It is somewhat of a perfect storm from that standpoint unfortunately if you are buying triple As.

MR. COLE: Let me move on to the sector loss estimates, and of course, Rick was just eluding to the fact that losses have far exceeded the expectations of the market. But we have segmented the universe of

mortgages into four buckets here, if you will, and then given you a look of expected losses for the years 2005, 2006, 2007. So you have pay option ARMs. And the way that you would read this is that for 2005, under pay option ARMs, your expected losses are in a range, cumulative losses between 14 and 19%. Jumping over to subprime, ironically enough, about the same level. The 2005, 14 to 19%. And you can see underwriting got worse if I go from '05 to '06, '07. In every category you see a pretty radical increase in the expected losses. And of course, it all came to a head midway through '07 with kind of the implosion of the subprime market and we now know that actually the prime market was poised to have just as big, if not a worse problem. Why? Well, because the nature of the underlying loans and the collapse of home prices. It is really driving the performance of these bonds.

These, incidentally, these are PIMCO's range estimates. And, if you will, we took our entire portfolio and we just kind of slotted into these respective buckets. These are pretty close to what other dealer research firms are using. Not terribly different from what the rating agents, the rating agents have been slow. They are catching up. So their

expected loss estimates are a little bit lower but they have increased the loss expectations considerably from where they were. The rating agents sort of have some egg on their face because obviously at the outset, when the bonds were issued, the expected losses were very, very low.

To give you a frame of reference, credit unions, the historical average expected loss for all credit union loans would be one-tenth of 1%; 0.10. and here we are looking at some of these categories, 20%. So these are knee-buckling rates of loss compared to the historical performance and market expectations of just a few years ago. It really does account for why we have seen such a dramatic decline in portfolio performance.

The last part of their executive summary they talk about possible actions. And there is, I have greatly simplified this, but a couple of really, really critical takeaways. Mark Treichel hit on it earlier this morning. They are basically saying we have got to continue to hold. Selling bonds does not make sense for us. It is not, because there is still tremendous illiquidity. The market is still probably pricing in too much negativity. If we sell bonds now,

the losses will be greater than if we just hold onto them. And so I know that we have got folks on the outside suggesting PIMCO is positioning itself to buy our bonds but their advice is hold them. Do not sell.

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Their summary, and again what is important for us today is look, even under PIMCO's optimistic scenario the bottom line here is that the expected losses impair most of US Central's total capital and they more than exceed WesCorp's total capital. And

again, selling bonds just is not an acceptable option for us right now. We are going to have losses. We have got to hang on to these bonds.

And I would be happy to answer any questions.

MR. FRYZEL: Mr. Hood, do you have any questions?

MR. HOOD: No, Mr. Chairman.

MR. FRYZEL: Okay. Ms. Hyland.

MS. HYLAND: My question is what are we going to do with all this information? And it may be a question for Bob again. Where are we in our negotiations with PIMCO in terms of release of information? We have obviously issued FAQs on our web site. Is there any anticipation that a webinar of this type would be used to explain? What is our plan?

N/A Outside Scope

# PIMCO

## Corporate CU Portfolio Analysis

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# Why An Outside Firm?

- Independent Review
  - Objectivity
  - Consistency across all CCUs
  - RMBS "The problem sector" (Approximately 58% of CCU assets)

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# PIMCO Analysis

- Priced every security with internal pricing guidelines "apples to apples"
- Breakdown every security to most detailed level (ideally individual loans)
  - Loan type (e.g., Alt-A, Option ARM, etc.)
  - Servicer/Originator
  - Current status of delinquency
  - Property location

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# PIMCO Analysis

- Current LTV ratio
  - Major driver for probability of default
  - Also drives rate of recovery
- Now, "Starting Point" is established

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# PIMCO Modeling

- Internal and external models are used
- Market and internal assumptions
- Three scenarios:
  - Base Case (Moody's Economy.com)
  - Optimistic
  - Pessimistic

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# Assumptions

- Economic Scenario
  - Housing market
  - Home prices
- Mortgage Loss Estimates
  - Loan types
  - "Vintage"
- Impact of government initiatives

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# Home Price Outlook

- Market expects further declines
- Implied bottom in 2010
- Slow recovery

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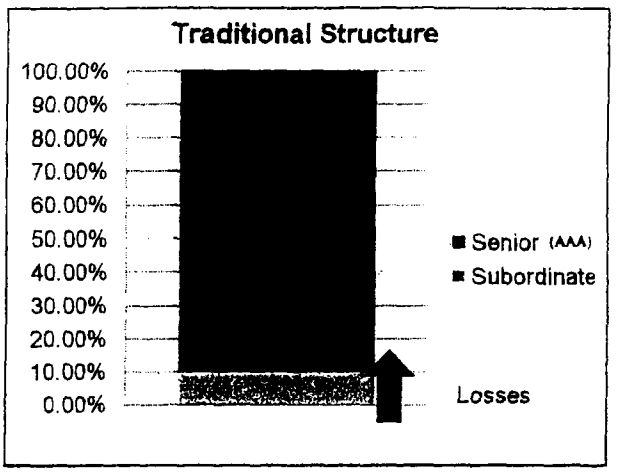
# Residential MBS

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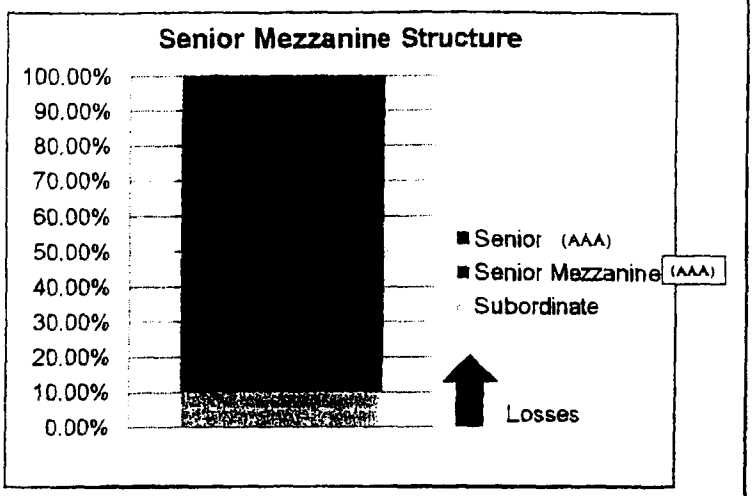
# Residential MBS

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# Sector Loss Estimates

PIMCO's Expectation for Ultimate Cumulative Losses
(on average as a % of Original Balance)

| Pay Option | | | Subprime | | |
|---|---|---|---|---|---|
| 05 Vintage | 06 Vintage | 07 Vintage | 05 Vintage | 06 Vintage | 07 Vintage |
| (b)(4) | | | | | |

| Alt-A | | | Prime | | |
|---|---|---|---|---|---|
| 05 Vintage | 06 Vintage | 07 Vintage | 05 Vintage | 06 Vintage | 07 Vintage |
| (b)(4) | | | | | |

# Possible Actions

(b)(5),(b)(8)

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# Summary

- Under "optimistic" scenario:
  - Losses impair most of USC's total capital
  - Losses exceed all of WesCorp's total capital
- Selling bonds isn't an acceptable option

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