

NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION 1775 Duke Street, Alexandria, VA 22314

DATE: September 2010 **LETTER NO.:** 10-CU-19
TO: Federally Insured Credit Unions
SUBJ: Corporate Credit Union System Resolution

Dear Board of Directors:

Since the onset of the recent problems in the corporate credit union system, the National Credit Union Administration (NCUA) has taken extraordinary measures to protect America's 90 million federally insured credit union members. During the past two years, NCUA implemented a number of actions as part of our comprehensive three-part process of stabilization, resolution, and reform.

NCUA's stabilization efforts have been successful in maintaining member confidence. The level of shares in corporate credit unions ("corporates") has remained relatively stable. The vital electronic payments and liquidity services that corporates provide to credit unions like yours have continued uninterrupted. Through a cooperative effort between member credit unions and NCUA, we have been successful in ensuring that consumers are not impacted by billions of dollars in losses from impaired residential mortgage-backed securities ("legacy assets") at a handful of corporates. This cooperative effort will continue as we move through the resolution and reform phases of our overall process.

The stabilization phase provided NCUA with the time and resources to dedicate toward our plan to resolve the long-term threats posed by the legacy assets. NCUA carefully evaluated a wide range of options in order to choose the least cost long-term solution consistent with sound public policy.

On September 24, 2010, the NCUA Board approved a comprehensive strategy to fully resolve the ongoing solvency, liquidity, and reputation risks associated with corporate credit unions holding legacy assets. This letter provides an overview of key aspects of the plan.

Governing Principles

The following principles will govern NCUA's resolution strategy:

- ✓ Prevent interruption of payments services to consumer credit unions and their 90 million members;

- ✓ Preserve confidence in the credit union system;
- ✓ Manage to the least long-term cost consistent with sound public policy; and
- ✓ Facilitate an orderly transition to a new regulatory framework for the corporate credit union system based on consumer credit union choice.

Isolating Legacy Assets

The initial step in the resolution process is to isolate the legacy assets rather than selling them into the market at “fire sale” prices. Without NCUA action to isolate the legacy assets, any plan to remove them from the corporate credit unions’ balance sheets would have forced corporates to realize the full market losses, substantially increasing the cost to consumer credit unions.

Credit unions have already incurred almost \$12 billion in credit losses from the legacy assets. **NCUA’s plan will save credit unions from incurring additional market losses** from the legacy assets.

Conservatorships

Based on a comprehensive analysis of the entire corporate system, resolution actions involve placing under federal conservatorship a total of five corporate credit unions, two of which have been under NCUA’s direct control since 2009. On September 24, as the first phase in isolating the legacy assets, NCUA placed three additional corporates into conservatorship. The conservatorship actions at Constitution, Members United, and Southwest Corporate Federal Credit Unions, in conjunction with the prior conservatorship actions at Western Corporate Federal Credit Union (WesCorp) and U.S. Central Federal Credit Union (U.S. Central), now place the vast majority of the legacy assets under NCUA control.

The NCUA Board took these actions as the necessary first step in our resolution efforts. Only by taking control of these corporates will NCUA achieve the dual goal of isolating the legacy assets while protecting the vital services to the thousands of consumer credit unions which rely on the corporate network.

Share Guarantee

For consumer credit unions with deposits in any corporate, it is important to remember that the Temporary Corporate Credit Union Share Guarantee Program (“TCCUSGP”) remains in effect through December 31, 2012. NCUA’s conservatorship actions do not change this program.

NCUA determined that the five corporate credit unions currently in conservatorship are not financially viable institutions because they are critically undercapitalized with high concentrations of distressed long-term assets. Without permanent government guarantees, those five corporates have no reasonable prospects of returning to independent operations.

Ongoing Services

NCUA's plan is to ensure the essential services provided by the conserved corporates continue, via a bridge corporate, without interruption during a transition period of approximately 24 months. U.S. Central and WesCorp have been providing services under NCUA conservatorships since early 2009; NCUA will take proactive measures to ensure the other conserved corporates will also continue to serve their members.

The transition period will allow member credit unions to determine their future service provider(s). However, credit unions need to start the planning process now to dedicate adequate time for due diligence reviews of any new providers and for training staff on new platforms.

Funding Legacy Assets

After isolating the legacy assets, NCUA plans to fund these assets with a market-based solution. NCUA is working with Barclays Capital Inc. New York, New York ("Barclays") to securitize the legacy assets. Barclays, an international investment firm, brings their experience from similar transactions with other federal regulators.

Securitization

The securitization process is complex. However, in summary, the legacy assets will be combined into new securities that will be issued in the financial markets as NCUA Guaranteed Notes. The new securities will have a guarantee from the NCUA, backed by the full faith and credit of the United States, and accounted for in the Temporary Corporate Credit Union Stabilization Fund ("Stabilization Fund"). NCUA and Barclays will be providing detailed information regarding the securitization process as we move forward.

Until settlement of the securities issued in the securitization transactions, there is still a risk of a liquidity event that could trigger the need to sell the underlying legacy assets outright to the market and realize significant additional market losses.

For the securitization process to be successful in insulating member services from the effects of corporates' distressed assets, the continued support and cooperation of consumer credit unions is vital. To that end, it is imperative that, at least in this interim period, credit unions maintain excess liquidity within the corporate system.

Credit Union Participation

Should your credit union be interested in purchasing any of the NCUA Guaranteed Notes when they become available, NCUA will expect you to have an adequate due diligence process in place to evaluate the instruments prior to purchase. As with all investments, you need to ensure that, at a minimum:

- ✓ You fully understand the nature of the instrument including cash flow behaviors, guarantees, etc;
- ✓ The investment fits within the written investment policies established by your board of directors; and

- ✓ The investment fits within the business strategy and risk tolerance levels of your credit union.

Letter to Credit Unions 10-CU-18 provides sound guidance with regard to prudent investment due diligence processes. Please see this newly issued guidance which can be found at <http://www.ncua.gov/Resources/LettersCreditUnion2010.aspx>.

Contact information to purchase these investments can be found via the NCUA Corporate System Resolution webpage at <http://www.ncua.gov/Resources/CorporateCU/CSR/Resolution.aspx>.

Corporate Regulatory Reform

NCUA's longer-term goal is to fully implement a new regulatory framework to ensure a safe and sound corporate system. On September 24, the NCUA Board approved a final rule which requires higher capital standards, lower concentration risks, sound asset/liability management strategies, and transparent governance for all corporates.

This month you will receive a separate letter describing the new corporate rule. This rule is an important first step toward comprehensive regulatory reform. Before the end of this year, NCUA will propose additional improvements to the corporate rule. The NCUA Board is committed to implementing a regulatory structure that will support a corporate business model where excessive risk taking is prevented and sound operations are rewarded.

Next Steps

There is no doubt the final structure of the corporate network will look different going forward. Within the new regulatory framework, consumer credit unions will be empowered to make informed business decisions that will ultimately determine the future of the corporate system. This may require additional capital contributions from member credit unions. However, NCUA believes this decision should be made by individual member credit unions after careful consideration of internal risk tolerance levels and each specific corporate's value proposition in light of the regulatory changes.

Also during the transition period, NCUA will facilitate meetings with credit unions and other interested parties to discuss the disposition of the operations and infrastructure of the five failed corporates. Those operations and infrastructure do have significant value. Some possible outcomes may be the chartering of new corporate credit unions to purchase and assume these activities, or allowing credit unions or other entities to submit proposals to acquire the operations and infrastructure.

Information Available

Additional resources regarding the corporate credit union network are part of a new "toolbox" of information on the NCUA website. This valuable information can be accessed using the following link: <http://www.ncua.gov/Resources/CorporateCU/CSRMain.aspx>.

Earlier this month, NCUA mailed an informational DVD to each federally insured credit union. The DVD includes separate tracks which outline the corporate structure, the

economic crisis that led to the corporates' problems, as well as NCUA's stabilization, resolution, and reform efforts. If you have not already viewed these video presentations, please take the time to watch them as a group and discuss them with your management team. These video presentations are also available on NCUA's website using the following link: <http://www.ncua.gov/Resources/CorporateCU/CSR/Presentations.aspx>.

Since the concerns with the corporates first developed, the NCUA Board's commitment has been to prudently resolve legacy assets and implement regulatory reform to ensure a safe and sound system for the future. The conservatorship and regulatory actions taken this month bring us one step closer to fulfilling that commitment. Going forward, we envision a reliable corporate network that, if deemed by credit unions to offer value, will conduct financial transactions without disruption wherever consumers need to access their funds.

If you have any questions related to this letter, contact NCUA's Corporate Resolution Call Center (1-800-755-1030) your NCUA regional office, or supervisory examiner.

Sincerely,

/S/

Debbie Matz
Chairman

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