NCUA LETTER TO CREDIT UNIONS

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

DATE: **September 2010** **LETTER NO: 10-CU-17**

TO: **Federally Insured Credit Unions**

SUBJ: **National Credit Union Share Insurance Fund Premium**

ENCL: **NCUSIF Premium Analysis**

Dear Board of Directors:

On September 16, NCUA took a necessary action to maintain the strength and public confidence in the National Credit Union Share Insurance Fund (NCUSIF) by authorizing a premium of 0.1242 percent of insured shares. This premium is at the lower end of the projected range of 10-to-25 basis points which the NCUA Board announced at a public meeting in November 2009.

The decision to charge this premium was <u>not</u> taken <u>lightly</u>. NCUA understands that 2010 has been a challenging year for credit unions. But I can tell you unequivocally: This premium is <u>absolutely necessary</u> to replenish the NCUSIF to a level that will <u>protect</u> America's 90 million federally insured credit union <u>members</u>. Members who have kept their savings within the federal coverage limit have <u>never lost</u> a <u>penny</u> – and we intend to <u>keep</u> it that way.

This action will also protect federally insured <u>credit unions</u>. During these turbulent economic times, a strong and well-capitalized insurance fund will <u>prevent reputation risk</u> by reassuring consumers that their money is <u>safe</u> in <u>credit unions</u>.

The premium will raise the retained earnings of the NCUSIF by $933 million and provide necessary funding to cover higher losses at consumer-owned credit unions.

Please understand that the <u>most important factor</u> in determining the premium level is the credit union industry's financial performance. If credit union <u>losses</u> are <u>lower</u>, credit union <u>premiums</u> will be <u>lower</u>.

Throughout this year, NCUA has strived to make this process more <u>transparent</u>. At several public NCUA Board briefings, staff detailed all the factors that contribute to the NCUSIF premium. We posted those factors on the NCUA website and further described them in numerous public appearances and webinars. Now, those factors are attached to this letter for you to review at your convenience.

When you combine the NCUSIF premium with this year's Corporate Stabilization Fund assessment, the total of 26 basis points falls within the lower half of the range of 15-to-40 basis points which the NCUA Board projected for those two payments combined.

As you can imagine, it is very difficult to predict over a year in advance what the ultimate losses will be in both consumer credit unions and corporate credit unions. But by making this process fully transparent from the beginning, NCUA's intent was to allow credit unions to budget an appropriate amount for 2010.

NCUA will continue this open process in the future. At the public NCUA Board meeting in November of 2010, we plan to estimate a combined range for the NCUSIF premium and Corporate Stabilization Fund assessment in 2011.

NCUA will also continue to do everything in our power to minimize credit union losses. That's why federal examiners are working so diligently with credit unions to mitigate their risks. That's why NCUA is stepping up enforcement actions – to control the costs of troubled credit unions before those charges must be passed on to all credit unions. With safe management and sound supervision, credit unions will emerge from this economic cycle strong and resilient.

The rest of this letter demonstrates how you can calculate the premium payment amount for your credit union and measure its impact on the NCUSIF as well as your balance sheet.

Payment Information for Your Credit Union

You will receive an invoice for the premium in late October or early November. The payment will be due by November 22, 2010. If your credit union has assets of at least $50 million, your invoice will also include an amount for an adjustment in contributed capital. Credit unions using the accrual basis of accounting should calculate the amount of the premium and record the premium on the September 2010 Call Report. Report the premium as a Member Insurance expense (Call Report Account Code 310).

The following equation illustrates how to calculate your premium:

$	Insured Shares [1]
x 0.001242	Premium Factor
$	Premium Expense

[1] Use insured shares (Call Report Account Code 069A) reported as of June 30, 2010 for credit unions with assets of $50 million or greater; or insured shares reported as of December 31, 2009 for credit unions with assets less than $50 million as of June 30, 2010.

Impact on the Insurance Fund

As of August 31, 2010, the NCUSIF's equity ratio is 1.176 percent, assuming a fully contributed capitalization deposit level. Because this ratio falls below the normal operating range of 1.20 to 1.30 percent, NCUA must prepare a restoration plan to Congress. The restoration plan must demonstrate how NCUA will charge premiums to restore the equity ratio within the normal operating range. This year's premium will initially increase the equity ratio near 1.30 percent. However, projections over the next year indicate that the ratio could decline back below 1.20 percent.

The equity ratio is impacted by several factors, including:

1) ***Insurance Fund Losses*** – The higher the required loss reserve for failing credit unions, the greater the downward pressure on the equity ratio. In the last two years, the number and costs of credit union failures have risen significantly. At the same time, the general loss reserve based on trends in CAMEL ratings has also increased, as far more credit unions now are rated CAMEL 3, 4 or 5.

2) ***Growth in Insured Shares*** – The higher the level of insured share growth, the more downward pressure it puts on the equity ratio. This is the same impact that asset growth has on your credit union's net worth ratio. In recent years, the flight to quality by consumers has raised the level of insured share growth, which reduces the equity ratio.

3) ***Investment Earnings*** – Net income generated by NCUA's investments partially offsets the insurance fund losses and operating expenses. In recent years, the yield on investments has been extremely low, which places downward pressure on the equity ratio.

NCUA has projected these factors forward through 2011 using various scenarios for insurance losses, share growth, and earnings levels. The following table summarizes projected equity ratios under three scenarios. The "Base" case shows current expectations:

Scenario	**Equity Ratio**		
	12/31/2010	**06/30/2011**	**12/31/2011**
Optimistic	1.28%	1.25%	1.22%
Base	1.25%	1.20%	1.17%
Pessimistic	1.22%	1.17%	1.12%

Impact on All Credit Unions

The NCUA Board is keenly aware of the impact of any additional charge on credit unions during this challenging economic period. When determining the amount of the premium, NCUA seriously considered the effect on credit union earnings and net worth.

The 2010 NCUSIF premium will reduce net worth ratios of credit unions by not more than 12 basis points and reduce the annualized return on assets by 10.4 basis points on average. Based on mid-year results, this premium would cause approximately 7.5 percent of credit unions that otherwise would have been profitable in 2010 to report negative earnings. This assumes no other mitigating action from management.

NCUA also projects 60 credit unions will experience a decline in their net worth ratio to below 7.0 percent of assets, making them subject to the statutory earnings retention requirement of Prompt Corrective Action (PCA). Another 19 credit unions will need to prepare a Net Worth Restoration Plan (NWRP) due to net worth declining below 6.0 percent of assets.

As I emphasized in the June assessment letter, **NCUA examiners are instructed not to downgrade a credit union's component or composite CAMEL ratings because of the effect of the premium.** NCUA will be as flexible as the law allows in reviewing and approving an NWRP for every credit union that falls into PCA solely due to the premium.

Future Premiums and Dividends

Premiums and dividends are both important parts of the NCUSIF's structure. Premiums are required when the equity ratio falls below 1.20 percent. Dividends are required when the equity ratio rises above the normal operating level, which is presently set at 1.30 percent. Through this system, federally insured credit unions support each other when credit unions are suffering losses, and share the benefits when credit unions are performing well.

The need for future premiums or dividends will depend on credit unions' ability to weather difficult financial times, and mitigate risks throughout all economic cycles.

NCUA staff members are available to answer your questions and work with you to protect the safety and soundness of your credit union.

Sincerely,

/s/

Debbie Matz
Chairman

Enclosure