Decreasing the Share Insurance Fund Normal Operating Level for 2019

Board Briefing

December 13, 2018
What is the Normal Operating Level?

• Under the FCU Act, the normal operating level is the point at which excess equity is returned to credit unions in the form of a Share Insurance Fund distribution
  – Can be set from 1.20 to 1.50 percent (12 U.S.C. 1782(h)(4))
  – Distribution to credit unions required if the Fund’s equity exceeds the normal operating level, and other statutory conditions met (12 U.S.C. 1782(c)(3) & 1790(e))

• The NCUA Board has historically set the normal operating level as the target equity ratio for the Share Insurance Fund

• The Board last set the normal operating level at 1.39% in 2017 based on the new methodology approved by the Board in September 2017
Normal Operating Level

• Objectives
  – Prudently manage the Share Insurance Fund to the mutual benefit of the credit union community and taxpayers
  – Preserve public confidence in federal share insurance
  – Maintain a counter-cyclical posture to ensure that credit unions will not need to impair their 1% capital deposit or pay premiums when they can least afford it
• Withstand a moderate recession without the equity ratio falling below 1.20% and resulting in either a mandatory premium or a fund restoration plan
Policy for Setting the Normal Operating Level

• The calculation is based on projections related to the following factors:
  – Performance of the Share Insurance Fund in a moderate recession on three primary drivers: insurance losses, insured share growth, and yield on investments;
  – Potential decline in value of the SIF’s claims on the corporate asset management estates in a moderate recession as modeled by BlackRock; and
  – Projected equity ratio decline through the end of 2019 without an economic downturn.

• Modeled performance of the Share Insurance Fund over five years, and decline in value of SIF’s claims on corporate AMEs, in Adverse (moderate recession) economic scenario from the Federal Reserve Board.
### Recommended Normal Operating Level

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<tr>
<th>Component</th>
<th>Sep-17</th>
<th>Sep-18</th>
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<tbody>
<tr>
<td>Statutory Minimum</td>
<td>1.20%</td>
<td>1.20%</td>
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<tr>
<td>Plus: Potential Decline in Insurance Fund Performance</td>
<td>0.13%</td>
<td>0.13%</td>
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<tr>
<td>Plus: Potential Decline of Value in Claims on Corporate Estates</td>
<td>0.04%</td>
<td>0.02%</td>
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<tr>
<td>Plus: Projected Equity Ratio decline in 2018 and 2019</td>
<td>0.02%</td>
<td>0.03%</td>
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<td><strong>Equals: Normal Operating Level</strong></td>
<td>1.39%</td>
<td>1.38%</td>
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Actual Results May Vary Due to Various Factors

• Projected declines in the equity ratio, even under no economic stress
• Extraordinary losses and/or failures in credit unions that are not market-related, such as those from fraud or other asset “bubbles”
• Unusual or abnormally high insured share growth materially different from the historical correlation
• Economic conditions that involve greater volatility in one or more market indicators as compared to the stress scenarios modeled
Recommended Action

- Approve decreasing the Normal Operating Level from 1.39 to 1.38 percent effective December 13, 2018.
What to Expect Next

• The Share Insurance Fund’s equity position at December 31, 2018, will be available by February 15, 2019, when the audited year-end financial statement is published.

• Insured shares as of December 31, 2018, are expected to be available by February 15, 2019, once all year-end call reports are submitted and the data is validated and scrubbed.

• Once all required data is available, the actual Equity Ratio as of December 31, 2018, will be calculated and the results compared to the normal operating level.
  – If the Equity Ratio is above the normal operating level, and the other statutory criteria are met, there will be a distribution sufficient to bring the Equity Ratio down to the normal operating level. This would occur no later than the end of the second quarter of 2019.
  – If the Equity Ratio is below the normal operating level but above 1.30 percent, no premium can be assessed according to the FCU Act; premiums can only be assessed when the equity ratio is below 1.30 percent.