NAVY FEDERAL Credit Union

Office of the President

1 September 2017

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Notice of Proposal – Closing the Temporary Corporate Credit Union Stabilization Fund and Setting the Normal Operating Level

Dear Mr. Poliquin,

Navy Federal Credit Union is pleased to provide comments on the National Credit Union Administration's Proposal to Close the Temporary Corporate Credit Union Stabilization Fund (TCCUSF) and set the Normal Operating Level for the Share Insurance Fund (SIF).

We support returning excess TCCUSF premiums to credit unions. In 2009, the NCUA Board took extraordinary steps to stabilize the SIF by creating the TCCUSF. In total, credit unions were assessed 22.69bps for the SIF and 60.63bps for the TCCUSF.[1] At the time, the NCUA Board deemed these actions necessary to preserve the capitalization deposit of the SIF and stabilize the federal share insurance system. However, it is important to recognize these funds came from credit union members and the funds still belong to credit union members, not the TCCUSF, not the SIF and, not NCUA.[2]

Since the financial crisis, the economic outlook has improved materially and NCUA has recovered $3.2 billion from legal settlements. In hindsight, credit unions were over-assessed which has resulted in $1.9 billion of excess funds sitting in TCCUSF.[3] The financial crisis has ended and the stability of the federal share insurance system has been restored; it is time to close the TCCUSF. The TCCUSF simply exists to warehouse legacy assets and liabilities which can be readily absorbed by the SIF. Since NCUA has taken the position that direct rebates to credit unions are not permissible from TCCUSF[4], we support closing the TCCUSF and returning all excess funds, via the SIF, to the credit unions that paid them.[5]

[1] Totals reflect the cumulative premiums and assessments paid by credit unions from 2009 through 2013.
[2] This is why these funds are reflected as assets on credit union balance sheets.
[3] Projected amount after recognition of May 2017 legal recoveries (July 2017 NCUA Board Briefing).
[4] We continue to believe NCUA has the legal authority to distribute funds directly from the TCCUSF.
[5] We recognize 4bp must be retained in the SIF to reserve for NCUA's Guaranteed Notes (NGNs) until they mature in 2021, after which, any remaining funds from this 4bp should be returned to credit unions.

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Keeping excess funds trapped and idle in the coffers of NCUA does not help credit unions or their members. Returning these funds will have direct benefits because it will increase capital which further stabilizes credit unions and, most importantly, these funds can be used to create new loans, take deposits and provide other services for credit union members. However, to ensure transparency, NCUA should not co-mingle the closure of the TCCUSF with an increase in the equity ratio of the SIF. The closure of the TCCUSF and the return of excess funds should be separate transactions from any premium charges levied to increase the equity ratio of the SIF.

We do not support using proceeds from the TCCUSF to increase the Normal Operating Level (NOL) in the SIF from 1.30% to 1.39%. NCUA's approach is tantamount to levying a SIF premium on credit unions above the statutory limit of 1.30%, and, we do not believe NCUA needs to retain a NOL level of 1.39% to ensure the stability of the SIF.

The Federal Credit Union Act states the NCUA Board may only charge a SIF premium to the extent "the premium charge does not exceed the amount necessary to restore the equity ratio to 1.3 percent".[6] By transferring excess funds from the TCCUSF into the SIF, NCUA is circumventing an assessment above the 1.30% mark set by Congress. While it may appear to be a matter of expedience to orchestrate the return of funds in this fashion; it clearly will cause doubt, possibly mistrust, in the actions of NCUA. NCUA would be better served to adhere to both the form and spirit of the limitations identified in the Act. We recommend NCUA return all excess funds from the TCCUSF that are not expressly needed to cover the potential liability from the NGNs (i.e., the 4bp identified as necessary to reserve for claims on AMEs). Based on the current equity ratio of 1.26%, NCUA should retain sufficient funds to maintain an equity ratio of 1.30% (i.e., the current ratio of 1.26% plus 0.04% to reserve for claims on AMEs).[7] Should NCUA believe it needs additional funds over the current 1.26% for the SIF, it should follow its traditional method for premium charges which are bound by the 1.30% cap. Lastly, the 4bp reserved for resolving future AME claims should only be held until these claims have been resolved. Once the claims have been resolved, any remaining funds should be returned to those credit unions that paid them. In short, we recommend NCUA return all excess funds to credit unions immediately, and as a separate transaction, evaluate whether additional funds are needed to raise the SIF equity ratio to the statutory limit of 1.30%.

We do not believe a 1.39% NOL is necessary to meet NCUA's goals of maintaining public confidence in federal share insurance. NCUA based its estimate on stress tests of assets and a forecast of potential losses from higher risk credit unions. NCUA's approach fails to consider any action that may be taken by the agency to resolve problem credit unions, or, actions taken by credit union executives to manage risk as a recessionary environment unfolds. It also appears NCUA failed to consider the majority of the losses to the SIF were driven by the riskier business practices of the Corporate Credit Unions; practices NCUA has eliminated thereby reducing the risk to SIF. Instead, NCUA took its theoretical analysis and used it to reverse engineer a baseline for the NOL; it is a giant leap from a theoretical exercise to levying an

[6] 12 U.S.C. § 1782(c)(2)(B)
[7] This would also ensure NCUA does not create an effective assessment above the 1.30% statutory limit.

incremental 9bp assessment.[8] Additionally, NCUA extended its risk horizon from two years to five years. NCUA claims this is necessary to "cover the cycle of an economic downturn and the lifecycle of the NGN program". This period is excessive, particularly given the Great Recession only lasted 18 months. NCUA's current two year risk horizon is more than enough to weather an economic downturn; a five year horizon is excessive and results in an overfunded SIF. While NCUA wants to maintain a counter-cyclical posture, it does not need to ensure the SIF is overfunded at all times. If economic conditions warrant future assessments, even during recessionary periods, NCUA has the statutory authority to spread these assessments over 8 years to avoid undue burdens on credit unions during times of duress. This is why Congress enacted this provision; it clearly addresses NCUA's counter-cyclical concerns. Raising the NOL over 1.30% via a process that is effectively an assessment violates both the intent of Congress and ignores other tools available to NCUA to manage the equity ratio of the SIF. As noted above, these funds belong to our members and should be used for their benefit, not for NCUA's. Raising the NOL to 1.39% will hold back over $900 million from credit union members, funds that could support almost $13 billion of new loans to members. Given the other tools available to NCUA to ensure public confidence in federal share insurance, it is not in the best interest of credit union members to withhold this capital from the industry.

We urge NCUA to carefully consider how excess premiums are returned to credit unions to ensure credit unions that paid into the TCCUSF are prioritized over equity holders of the failed Corporate Credit Unions. The projected $1.1 to $1.8 billion shortfall[9] in reimbursements to credit unions is the direct result of the NCUA's decision to treat each AME as an individual estate in liquidation rather than treating all AMEs as a collective estate. NCUA's approach is inconsistent with both the purpose of the TCCUSF and how NCUA managed the resources of the failed Corporate Credit Unions.

The purpose of the TCCUSF was not to provide greater insurance to equity shareholders of the failed corporate credit unions than they would have been entitled to under the SIF. Instead, the purpose was to provide stability and certainty for the credit union system. Resolving each AME individually can result in prioritizing payments to equity shareholders of certain failed corporate credit unions over those credit unions who contributed to the TCCUSF; this effectively provides greater loss mitigation to equity holders than would have been available absent the TCCUSF.

Resolving each AME individually is inconsistent with how NCUA managed the AMEs to mitigate the collective risk these failed credit unions imposed on the system. Rather than treat each estate individually, as would be the case in a standard liquidation of a failed credit union, NCUA treated the failing Corporate Credit Unions during the Great Recession as one estate. "As part of the Corporate System Resolution Program, the Board repackaged portfolios of asset-backed securities and corporate bonds (legacy assets) into NCUA Guaranteed Notes (NGNs) and funded the securitization of these assets through corporate assessments and borrowing against a

[8] Reflects the difference between the current equity ratio of 1.26% and the equity required for share insurance fund stress of 1.33%, plus, the additional 2bp to cove projected equity ratio declines in 2018 and 2019.
[9] Based on NCUA's July 20, 2017 Net Projected Recovery on the $5.6 Billion of Depleted Corporate Capital up to the full amount of the $4.8 billion in assessments paid to date by natural person credit unions.

line of credit at the U.S. Treasury." This repackaging, unlike other liquidations, bundled the assets of the different failed Corporate Credit Unions into collective securities. This collective management of AME assets means liquidation of these AMEs should be managed collectively as well. Just as assets were pooled in the management of the AMEs in order to achieve the goals of the Corporate System Resolution Program, so too should assets be pooled in the liquidation of the AMEs to ensure those who paid into the TCCUSF are fully reimbursed ahead of equity shareholders in the failed credit unions. Any other result would effectively transfer funds from credit unions that paid the special premiums necessary to create the TCCUSF to the equity shareholders of the failed corporate credit unions.

NCUA recognizes the standard regulations governing distributions from the SIF are ill-equipped to address how funds should be distributed given the unique circumstances presented by the Great Recession and the Corporate System Resolution Program. We recommend NCUA treat any excess funds as a single AME for the purpose of applying the payout prioritization set out in Section 709.5. This will ensure credit unions that contributed to the TCCUSF will be repaid before any equity shareholders of failed corporate credit unions. Our detailed commentary on this topic can be found in Attachment I.

In summary, Navy Federal supports returning excess TCCUSF premiums to credit unions; however, we do not support raising the NOL from 1.30% to 1.39%. Raising the NOL by withholding funds from the merger of the TCCUSF into the SIF has the same economic outcome as levying a premium on credit unions; a premium that exceeds the maximum identified in the Federal Credit Union Act. NCUA has other tools to achieve its stated goals of ensuring public confidence in federal share insurance while also establishing a counter-cyclical posture. NCUA does not need to carry an overfunded SIF to accomplish these goals, particularly at the expense of credit union members who would be better served by having additional capital in their credit union where it can be used to support loans and other services. If NCUA chooses to adopt an increased NOL as a condition of merging the funds, then Navy Federal does not support a merger at this time. Lastly, we urge NCUA to treat the AMEs as a collective in order to ensure credit unions that paid into the TCCUSF are prioritized over equity shareholders of the failed Corporate Credit Unions. Treating the AMEs as a collective better serves the industry and does not give equity shareholders additional protections than otherwise afforded by the SIF.

If you have any questions, please feel free to contact Vince Pennisi, Chief Financial Officer at (703) 255-8740.

Sincerely,

Cutler Dawson

Cutler Dawson
President/CEO

VP/vp
Attachment

Attachment I

This attachment is provided as a supplement to Navy Federal's response regarding NCUA's Proposed Notice of Proposal – Closing the Temporary Corporate Credit Union Stabilization Fund and Setting the Normal Operating Level.

Specific comments on the resolution of AMEs

NCUA should act to ensure those credit unions that paid to create the TCCUSF are fully reimbursed before any equity shareholders of the failed corporate credit unions. As drafted, NCUA's proposal fails this test. We recommend the return of any excess funds from the TCCUSF should be determined by treating the five AMEs as a single estate for liquidation purposes. As explained herein, this approach is consistent with the pooling of the AMEs' assets to launch the NCUA Guarantee Note Program, Congress's intent in creating the Stabilization Fund, and the reality that NCUA's prior rules and regulations were not designed to accommodate the types of programs created during the Great Recession.

BACKGROUND

During the 2008 financial crisis, the stability of the corporate credit union system was threatened by the near simultaneous failure of several large corporate credit unions that held high-risk portfolios of asset-backed securities. The Stabilization Fund and Corporate System Resolution Program were created to stem this risk.[10] The Fund served this purpose by providing a temporary entity that would "accrue the losses of the corporate credit unions during the credit crisis and to recover such losses over time," while the Program was the overall "multi-stage plan" implemented by the NCUA "for stabilizing the corporate credit union system."[11] The Fund also allowed it to maintain a "safe and strong" National Credit Union Share Insurance Fund ("Insurance Fund") by providing an alternative for funding the liquidation of failed credit unions during the financial crisis that did not require drawing on the Insurance Fund and the associated, statutorily required, assessments on other credit unions.[12]

The Stabilization Fund and the Corporate System Resolution Program, however, did require substantial contributions from solvent credit unions. In all, the NCUA assessed $4.8 billion in special

[10] President Barack Obama, Presidential Signing Statement, Helping Families Save Their Homes Act and the Fraud Enforcement and Recovery Act (May 20, 2009) (explaining that the Stabilization Fund was meant "to address problems in the corporate credit union sector" by "reduc[ing] near-term costs for credit unions, which will enhance their ability to continue making credit available").

[11] NCUA Office of Inspector General, NCUA 2014 Financial Statement Audit For Temporary Corporate Credit Union Stabilization Fund at 1 (Dec. 31, 2014) ("Stabilization Fund Audit"); see also NPRM at 7 (explaining that the Corporate System Resolution Program is "a special purpose initiative to stabilize the corporate credit union system funded principally through advances from the TCCUSF.").

[12] *See* NCUA Chairman Michael E. Fryzel, Testimony to the House Subcommittee on Financial Institutions and Consumer Credit (May 20, 2009) (explaining that the "primary purpose" of the Stabilization Fund is "to spread over multiple years the costs to insured credit unions associated with the corporate credit union stabilization effort"); id. (explaining that "the current structure of the NCUSIF requires that credit unions take all these insurance expense charges at once, which would result in a contraction of credit union lending and other services.").

premium assessments to federally insured credit unions ("FICU"). This money, in combination with loans from the U.S. Treasury, was used to provide short- and long-term funding for the management and winding down of the failed credit unions' portfolios. To maximize the Fund's recovery of the losses it suffered as part of accruing the losses of the credit unions,[13] the portfolios were co-mingled and managed together. Specifically, NCUA pooled the assets of the failed credit unions' AMEs to re-securitize those assets and sell them through the NCUA Guarantee Notes (NGN) Program.[14]

As the NGN Program's end approaches, the NCUA has begun to plan for the winding down of the Stabilization Fund and the NGN Program. It explained in its December 15, 2016 Corporate System Resolution Program Update that it would apply the liquidation prioritization set out in 12 C.F.R. Part 709 to each AME individually: "The priorities are applied per estate, not in aggregate. There is no cross collateralization."[15] This will result in the shareholders of several of the failed credit unions—namely, US Central, Members United, and Southwest—receiving between $900 million and $1.7 billion in returns before the Stabilization Fund has been fully repaid.[16]

COMMENTS

I. NCUA's Approach Overlooks An Important Source Of Unfair Treatment Associated With The Plan To Wind Down The Corporate System Resolution Program and Stabilization Fund.

NCUA recognizes regulations promulgated prior to the Great Recession do not adequately represent the policy objectives of programs created during the recession.[17] NCUA therefore proposes new regulations designed to provide "greater fairness, transparency, and predictability regarding NCUSIF equity distributions." To accomplish these goals, NCUA focuses on the fairest way to distribute the money that will be transferred to credit unions from the TCCUSF (via the SIF) as the Corporate System Resolution Program is closed.[18] Navy Federal supports returning excess funds to credit unions, but NCUA should take steps to ensure credit unions are repaid as much as possible by the AMEs that took part in the Corporate System Resolution Program and borrowed from the TCCUSF.

NCUA's current plan does not accomplish this goal. The plan, set out in the Office of Examination & Insurance's December 15, 2016 Corporate System Resolution Program Update,[19] results in corporate

[13] Stabilization Fund Audit at 1.
[14] Stabilization Fund Audit at 1-2; NCUA, Transaction Details (By Closing Date) (Oct. 14, 2016), available at https://www.ncua.gov/regulation-supervision/Pages/guaranteed-notes/transaction-details.aspx (visited July 27, 2017).
[15] Office of Examination & Insurance, NCUA, Corporate System Resolution Program Update at 26 (Dec. 15, 2016), available at https://www.ncua.gov/Resources/Documents/QA-Corporate-Resolution-Costs-and-Assessments.pdf (visited July 27, 2017) (hereinafter, "Corporate System Resolution Program Update").
[16] Corporate System Resolution Program Update at 28-29. These figures have changed in the July 20, 2017 update and will likely change over time.
[17] NPRM at 6, 22-23 (explaining that "§ 741.4 is ill-suited to address" Insurance Fund equity distributions related to closing the Stabilization Fund and the Corporate System Resolution Program).
[18] See NPRM at 21-27 (proposing to add Section 741.13 to the Code of Federal Regulations that will create a temporary provision "to govern any NCUSIF equity distributions resulting from the Corporate System Resolution Program").
[19] Office of Examination & Insurance, NCUA, Corporate System Resolution Program Update (Dec. 15, 2016), available at https://www.ncua.gov/Resources/Documents/QA-Corporate-Resolution-Costs-and-Assessments.pdf (visited July 27, 2017) (hereinafter, "Corporate System Resolution Program Update").

capital holders of the liquidated AMEs receiving payments before the Stabilization Fund has been fully reimbursed for loans made to the AMEs. In other words, corporate credit union equity holders would receive reimbursements before those credit unions who contributed to the fund are fully reimbursed. As a consequence, the low end projections provide that members of these failed FICUs will receive $900 million in payments while the Stabilization Fund suffers a $3.2 billion loss.[20] And, on the high end, members of the failed FICUs will receive $1.7 billion while the Stabilization Fund suffers a $2.5 billion loss.[21]

II. Making Distributions to Shareholders Of Failed AMEs Before Reimbursing The Stabilization Fund Is Inconsistent With The Purpose And Management Of The Stabilization Fund And The Corporate System Resolution Program.

The projected shortfall in reimbursements to the Stabilization Fund is the direct result of the NCUA's decision to treat each AME as an individual estate in liquidation rather than treating all AMEs as a collective estate. The plan explains: "The priorities are applied per estate, not in aggregate. There is no cross collateralization."[22] At no point does the plan explain why it has adopted this approach, and the plan was never the subject of a rulemaking proceeding.

This approach is inconsistent with both the purpose of the Stabilization Fund and the NCUA's management of Fund and AME resources. The purpose of the Stabilization Fund was not to provide greater insurance to the shareholders of individual failed corporate credit unions than they would be entitled to under the Insurance Fund. Instead, the purpose was to provide stability and certainty for the credit union system in a time of systemic financial turmoil by serving as a unique, temporary entity that would accept the losses of these credit unions, relieve solvent FICU's of massive one-time assessments to the Insurance Fund, and attempt to recover as much of the losses that it could.[23] By effectively prioritizing the payment of equity shareholders of certain of the failed corporate credit unions over the repayment of the Stabilization Fund and those who contributed to it, the plan departs from the appropriate focus of the program.

Applying the prioritization scheme of Part 709 "per estate" is at odds not just with the purpose of the program itself, but also the manner in which the NCUA managed the AMEs to mitigate the collective risk that the failed credit unions imposed on the system through their near simultaneous failure. Rather than treat each estate individually as would be the case in a standard liquidation of a failed FICU, the NCUA has appropriately treated the failing FICUs during the Great Recession as one estate. "As part of the Corporate System Resolution Program, the Board repackaged portfolios of asset-backed securities and corporate bonds (legacy assets) into NCUA Guaranteed Notes (NGNs) and funded the securitization of these assets through corporate assessments and borrowing against a line of credit at the U.S. Treasury."[24] This repackaging, unlike other FICU liquidations, bundled the assets of the failed FICUs into collective

[20] Corporate System Resolution Program Update at 28.
[21] Corporate System Resolution Program Update at 29.
[22] Corporate System Resolution Program Update at 26.
[23] Stabilization Fund Audit at 1-2.
[24] NPRM at 21-22.

securities. All but one of the securities transactions involved assets from more than one FICU, over half involved assets from all of the FICUs, and only two involved two or fewer FICUs.[25]

This collective management of AME assets means that liquidation of these FICU's AMEs ought to be managed differently from the liquidation of an individual failed credit union, especially one that is outside the context of the systemic failure that occurred here and the systemic solution adopted to address it. Just as assets were pooled in the management of the AMEs in order to achieve the goals of the Corporate System Resolution Program and Stabilization Fund, so too should assets be pooled in the liquidation of the AMEs to ensure that those who contributed to the Stabilization Fund are reimbursed to the greatest extent possible.

Any other result would effectively transfer funds from solvent FICUs that paid the special premiums necessary to sustain the AMEs and the Corporate System Resolution Program to the equity shareholders of certain failed corporate credit unions. This is true because, absent the solvent FICUs' contributions, the payments to the members of the failed FICUs would not have been possible. Relatedly, allowing members of the failed FICUs to recover funds would incentivize the excessive risk-taking behavior that resulted in FICUs' failure.

The NPRM itself properly recognizes that the standard regulations governing distributions from the Share Insurance Fund are ill-equipped to address how the Share Insurance Fund should be distributed in the context of the unique circumstances presented by the Great Recession and the Corporate System Resolution Program.[26] They likewise are ill-equipped to address the problem of whether assets that were preserved only through the Stabilization Fund and the underlying contributions of stable, solvent FICUs and managed on a collective basis should go to the individual estates before the Stabilization Fund is made whole.

III. The NCUA Should Promulgate A New Regulation Providing That AMEs That Were Created As Part Of The Corporate System Resolution Program, And Borrowed From The Stabilization Fund, Will Be Treated As One Estate.

The harms described above can be easily avoided by recognizing that 12 C.F.R. § 709.5, governing payout priorities for individual failed credit unions, does not appropriately account for the collective management of AMEs resulting from FICUs that failed during a financial crisis and the special issues presented by the Stabilization Fund. This is entirely consistent with the NPRM's acknowledgement that 12 C.F.R. § 741.4 "is ill-suited to address" Insurance Fund distributions associated with winding down the Program and Fund.[27]

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[25] NCUA, Transaction Details (By Closing Date) (Oct. 14, 2016), available at https://www.ncua.gov/regulation-supervision/Pages/guaranteed-notes/transaction-details.aspx (visited July 27, 2017).
[26] NPRM at 22-23 ("Because any NCUSIF equity distribution related to the Corporate System Resolution Program would go first towards repaying FICUs that paid corporate assessments, a FICU that has not paid a corporate assessment would not be entitled to receive an NCUSIF equity distribution related to the Corporate System Resolution Program unless all such corporate assessments are first repaid in full.").
[27] NPRM at 22.

Accommodating for the unique circumstances of the Corporate System Resolution Program and the Stabilization Fund in Section 709.5 requires promulgation of a regulation that specifies that AMEs created by, participated in, or benefitted by the Program or the Fund will be treated as a single estate for purposes of applying the payout prioritization set out in Section 709.5. This will ensure that the Stabilization Fund is fully repaid, to the extent it can be, before any members of failed FICUs receive money from the liquidations.[28]

NCUA's authority to use the specific mechanism proposed—treating the AMEs' estates as one estate rather than five separate estates to ensure the AMEs' obligations are repaid—follows from the broad incidental powers provided to the NCUA. These powers provide it with "such incidental powers as shall be necessary to carry out" the powers conferred on it as a liquidating agent and to "take any action authorized by this chapter, which the Board determines is in the best interests of . . . the Board."[29] Treating the AMEs as one estate is in the interest of the NCUA because, as explained above, it provides for the most fair dissolution of the Corporate System Resolution Program by preventing an outcome in which solvent FICUs are effectively subsidizing the risks taken by the FICUs that failed during the Great Recession, which would create incentives for FICUs to take such risks again on the basis that any losses they suffer would be mitigated through contributions by solvent FICUs through the NCUA. Additionally, treating the AMEs as a single estate is consistent with the co-mingling of the assets in the NGNs.

CONCLUSION

For the reasons stated above, Navy Federal recommends NCUA adopt a temporary regulation that accommodates for the unique circumstances of the Corporate System Resolution Program and the Stabilization Fund by treating the AMEs of the failed FICUs that participated in the Program, and borrowed money from the Fund, as one estate for purposes of the liquidation priorities set out in 12 C.F.R. § 709.5.

[28] See Corporate System Resolution Program Update at 26-27 (showing that the Stabilization Fund is repaid prior to members).
[29] 12 U.S.C. § 1787(b)(2)(J).