July 20, 2017

The Honorable Michael D. Crapo
Chairman
Senate Committee on Banking,
Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Senate Committee on Banking,
Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

This letter is to inform you of two NCUA Board actions approved unanimously today that relate to the final phase of resolving the five corporate credit unions that failed during the 2007–2009 recession. I want to make you aware of the considerations that went into the two proposals issued for public comment.

The Temporary Corporate Credit Union Stabilization Fund (the Stabilization Fund) was created in May 2009 to accrue the losses from five failed corporate credit unions and assess insured credit unions for such losses over time. But for the creation of the Stabilization Fund, these losses would have been borne by the National Credit Union Share Insurance Fund (the Share Insurance Fund), exhausting the Share Insurance Fund's retained earnings and significantly impairing credit unions' one-percent contributed capital deposit. The Stabilization Fund is used to account for the costs of the Corporate System Resolution Program[1] and provide short-term and long-term funding to resolve a portfolio of residential mortgage-backed securities, commercial mortgage-backed securities, other asset-backed securities, and corporate bonds (collectively, the Legacy Assets). Under the Corporate System Resolution Program, the NCUA created a re-securitization program where the NCUA issued a series of NCUA Guaranteed Notes (the NGNs) that were sold to investors to provide long-term funding for the Legacy Assets.

The Corporate System Resolution Program did not bail out corporate credit unions. Resolution of the failed corporate credit unions was funded through the Stabilization Fund from two primary sources: $4.8 billion in Stabilization Fund assessments paid by insured credit unions and borrowings on the NCUA's $6 billion line of credit with the U.S. Department of the Treasury. The Treasury borrowings were repaid fully in October 2016, primarily through legal recoveries, credit union assessments, NGN guarantee fees and distributions from the Share Insurance Fund.

The Stabilization Fund is currently scheduled for closure in 2021. However, the Federal Credit Union Act (the Act) gives the NCUA Board the authority to close the Stabilization Fund before the scheduled closure date.

[1] For more information on the Corporate System Resolution Program, please see the NCUA Corporate System Resolution Costs webpage.

At its meeting today, the NCUA Board proposed to close the Stabilization Fund in 2017. Upon closure, the Stabilization Fund's remaining assets and liabilities will be distributed to the Share Insurance Fund. As part of this proposal, the NCUA Board proposes to raise the Share Insurance Fund's normal operating level to account for the remaining obligations of the Corporate System Resolution Program. Even with the proposed increase to the normal operating level, the NCUA is projecting a return of excess equity to insured credit unions through a distribution from the Share Insurance Fund in 2018. The closing of the Stabilization Fund in 2017 allows the NCUA to return funds to credit unions that can be put to work in the system prior to the original closure date in 2021.

The proposal to close the Stabilization Fund in 2017 is prudent, based on a number of factors. Unlike in 2009, the current exposure presented to the Share Insurance Fund by the Legacy Assets and the NGNs are dramatically lower than the $13.3 billion in Share Insurance Fund assets (as of April 30, 2017). Due primarily to nearly $4 billion in net legal recoveries, the Stabilization Fund has a positive net position of approximately $1.9 billion as of May 2017. The NCUA Board believes that the remaining obligations of the Corporate System Resolution Program can now be prudently borne by the Share Insurance Fund without inordinate risk, provided additional equity is maintained in the Share Insurance Fund. Additionally, there remain no outstanding borrowings with the Treasury Department. The Stabilization Fund has, accordingly, served its purpose of retaining the resolution costs of the five failed corporate credit unions within the credit union system, at no cost to taxpayers.

With respect to the additional equity needed in the Share Insurance Fund to accomplish the Stabilization Fund's closure, the NCUA Board has proposed to increase the normal operating level to 1.39 percent from its current 1.30 percent level set in 2007, prior to the financial crisis. In accordance with the Act, the normal operating level is the point at which a distribution of surplus equity in the Share Insurance Fund is returned to insured credit unions. Based on current projections, this could result in an estimated distribution to insured credit unions of $600 million to $800 million in 2018. The proposed methodology for this distribution is described in a notice of proposed rulemaking, the second related action taken by the NCUA Board today.

The NCUA Board recognizes the importance of returning surplus funds to insured credit unions. At the same time, the NCUA must guard the Share Insurance Fund against reasonably foreseeable future adverse economic conditions and maintain a counter-cyclical posture to avoid charging credit unions a premium during the worst possible time if another economic downturn occurs. At 1.39 percent, the Share Insurance Fund is projected to be able to withstand a moderate recession, including exposure to remaining obligations of the Corporate System Resolution Program, without the equity ratio falling below 1.20 percent. Ensuring the Share Insurance Fund's equity ratio remains above 1.20 percent is consistent with the minimum equity level established by Congress.

The 1.39 percent normal operating level was determined by modeling the Share Insurance Fund's exposure to the impact of a moderate recession, as characterized by the Federal Reserve Board's Adverse economic scenario developed for its 2017 annual stress test supervisory protocol. For the Legacy Asset exposure, the NCUA engaged BlackRock to model the impact on the projected cash flows of the Legacy Assets by also incorporating the Federal Reserve Board's Adverse economic stress scenario. Specifically, the 1.39 percent normal operating level consists of (i) a 1.33 percent base-line normal operating level, plus (ii) a 0.04 percent reserve to reflect contingent liabilities of the NGN program, plus (iii) a 0.02 percent reserve to reflect the projected downward trend in the equity ratio through 2019, with the goal of avoiding a future premium assessment. We will continue to assess the normal operating level periodically and adjust as warranted.

Prudent administration of the Share Insurance Fund and the related protection it provides for member deposits are paramount and fundamental to maintaining a safe and sound national credit union system. The NCUA Board has a duty to responsibly manage the Share Insurance Fund for the benefit of insured credit union members, the credit union community, and the taxpayers. It is also important to maintain public confidence in federal share insurance. The proposed plan to close the Stabilization Fund in 2017, including increasing the normal operating level for the interim, will ensure the Share Insurance Fund has the appropriate level of resiliency to meet these objectives.

Stakeholder communications will take a variety of forms. In addition to holding a publicly noticed and broadcasted meeting today of the NCUA Board, agency experts will host an in-depth webinar for stakeholders. The NCUA has also added a page on the agency's website devoted to educating credit unions and the community at large on the intricacies of the proposals.

These proposals have the potential to create a viable path forward that will allow the credit union system to put the resolution of the failed corporate credit unions to rest. It is imperative that we accomplish this significant objective in a transparent and fully accountable manner that is as beneficial to credit unions and the agency, given legal, accounting, and economic constraints and realities.

In closing, the NCUA stands ready to meet with you, at your convenience, to answer any questions you may have.

Sincerely,

J. Mark McWatters
Chairman

cc: Senate Committee on Banking, Housing and Urban Affairs