

Opinion NCUA Offers Progress Report on Corporate Resolution Costs

By Larry Fazio

Published July 20 2015, 12:17pm EDT

NCUA is making excellent progress towards resolving the corporate credit union crisis. The agency's securitization strategy for the corporates' distressed securities — the legacy assets — is being managed to achieve the lowest possible resolution cost. Since 2012, Temporary Corporate Credit Union Stabilization Fund assessments have not been necessary. As of December 2014, the net remaining projected assessments are negative.

At the height of the crisis in 2009, the total unpaid principal balance for the distressed securities was \$52.7 billion, but their market value was less than \$22 billion. Thus, market losses from the five failed corporates would have exceeded \$30 billion, an amount far in excess of the Share Insurance Fund's then \$11 billion balance available to cover those losses. Consider the potential impact on the credit union system with losses of that size cascading through individual credit union balance sheets. The agency's securitization strategy prevented that scenario.

As of December 2014, the unpaid principal balance of the distressed securities was \$21.3 billion, and the market value was \$16.7 billion. The midpoint for total projected corporate system resolution costs has decreased to \$8.8 billion from the original 2010 estimate of \$15 billion.

NCUA's diligent pursuit of legal recoveries from Wall Street firms involved in the underwriting and sale of faulty securities sold to the corporates has amounted to more than \$1.75 billion to date. NCUA does not account for potential legal or other recoveries in corporate resolution cost projections until the recoveries become certain. Those recoveries have so far provided about one-third of the improvement in overall corporate resolution cost projections.

NCUA uses BlackRock Solutions to project the values of the distressed securities securing the NCUA Guaranteed Notes the agency issued as part of the corporate resolution. Along with proprietary modelling techniques, economic variables such as home prices, gross domestic product, unemployment, and interest rates are key assumptions in determining the on-going valuation of the distressed securities for financial reporting and projecting losses.

The Stabilization Fund currently owes the Treasury \$2.6 billion, down from over \$5 billion in 2012. These borrowed funds were used to manage the corporate resolution process and reduce the up-front cash needs that would have otherwise needed to be funded by credit unions through even larger corporate assessments. The outstanding Treasury balance and all senior claims of the Stabilization Fund and asset management estates must eventually be repaid, and the remaining distressed securities monetized, before any surplus could be refunded to credit unions. This is not likely to occur before 2021.

While the performance of the legacy assets has improved, note that this improvement would not have been sufficient to make any of the five failed corporates viable. The distressed securities held by the asset management estates of the failed

corporates have already incurred approximately \$8.9 billion in realized losses through the end of the fourth quarter of 2014. The level of realized losses attributable to each failed corporate makes clear that all five corporates were insolvent or critically undercapitalized. Even if it is possible that some of the five corporates' asset management estates ultimately perform well enough to result in fractional recoveries on depleted member capital, the projected net assets of each estate remain a fraction of pre-failure capital.

The assets of the failed corporates' asset management estates improved last year by a net \$850 million, and the Stabilization Fund net position improved by \$380 million. The \$850 million improvement in the value of the legacy assets relative to amounts owed to NGN investors and other creditors, including the Stabilization Fund, is incorporated in the failed corporates' asset management estates' net assets/liabilities, and shown in the notes to the Stabilization Fund's 2014 audited financial statements.

From an accounting perspective, it is important to note that the Stabilization Fund does not have claims on certain asset management estate assets, and there are necessary differences under accounting rules between the asset management estates and the Stabilization Fund. The two primary differences are:

1) An increase of \$200 million in projected asset management estate net assets beyond the amount needed to fully repay other senior creditors and the Stabilization Fund for a particular estate. This additional value is allocated to the benefit of the depleted member capital holders, consistent with claim pay-out priorities, and thus is not reflected in the core Stabilization Fund financial statements.

2) An increase of more than \$300 million in asset management estate assets allocated to repayment of the unpaid \$1 billion U.S. Central NCUA-issued capital note. This non-cash recovery cannot be reflected in the Stabilization Fund's core financial statements until received, per accounting standard FASB ASC 320-10-35.

These two differences, totaling more than \$500 million, account for the majority of the difference between the improvement in the asset management estates' net assets of \$850 million and the improvement in the Stabilization Fund financial statement net position of \$380 million. KPMG, the accounting firm that audits the Stabilization Fund, has given the Fund an unmodified, or clean, opinion for six years running.

NCUA continues to update information to provide transparency on both the [Corporate System Resolution Costs](#) and [NGN Program](#) sections of our website. All Stabilization Fund financial statements are posted by the [Office of the Inspector General](#) on the website as well. NCUA remains committed to informing stakeholders on the continued progress of the corporate system resolution program and will continue to publish updated information over the life of the Stabilization Fund.

Larry Fazio is the director of NCUA's Office of Examination and Insurance, Alexandria, Va.