

National Credit Union Share Insurance Fund

Financial Statements as of and for the Years Ended
December 31, 2017 and 2016, and
Independent Auditors' Report

NATIONAL CREDIT UNION SHARE INSURANCE FUND

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Overview

I. Mission and Organizational Structure

NCUSIF Mission

The National Credit Union Administration (NCUA) administers the National Credit Union Share Insurance Fund (NCUSIF or Fund).¹ Congress created the NCUSIF in 1970 to insure members' shares (deposits) in credit unions. The NCUSIF is backed by the full faith and credit of the United States. As of December 2017, the NCUSIF insures \$1.1 trillion in member shares in 5,573 credit unions.

The NCUSIF protects members' accounts in insured credit unions in the event of a credit union failure. The NCUSIF insures the balance of each members' accounts, dollar-for-dollar, up to at least the standard maximum share insurance amount of \$250,000, including principal and posted dividends through the date of a failure, subject to various rules on account types, rights, and capacities.

The NCUSIF also provides funding when the NCUA Board determines that some form of assistance to troubled credit unions is necessary, consistent with the Federal Credit Union Act (FCU Act). Examples of assistance include, but are not limited to, the following:

- a waiver of statutory reserve requirements (which can result in greater NCUSIF losses on failure);
- a guaranteed line of credit; and
- cash assistance, including subordinated notes or to arrange a merger or purchase and assumption.

When a credit union is no longer able to continue operating and assistance alternatives, including an assisted merger, are not practical, the credit union will be liquidated and the NCUSIF will pay members' shares up to at least the standard maximum insurance amount.

Organizational Structure

The NCUA's Executive Director is responsible for the agency's daily operation. The Director of the Office of Examination and Insurance (E&I) is responsible for the NCUA's supervision programs, which ensure the safety and soundness of federally insured credit unions. The E&I Director is responsible for managing the NCUSIF. Regional offices and the Office of National Examinations and Supervision are responsible for examination and supervision of federally insured credit unions. Other NCUA offices provide operational and administrative services to the NCUSIF.

The Asset Management and Assistance Center (AMAC) is responsible for conducting credit union liquidations. Upon liquidation, a credit union is closed and becomes an Asset Management

¹ The NCUSIF is one of four funds established in the U.S. Treasury and administered by the NCUA Board as of December 31, 2017. The four permanent funds include the NCUSIF, the Operating Fund, the Central Liquidity Facility (CLF) and the Community Development Revolving Loan Fund. All four funds report under separate financial statements.

Estate (AME), for which AMAC collects the obligations due to the liquidated credit union, monetizes assets and distributes amounts to claimants, including the NCUSIF, according to their respective regulatory payout priorities. AMEs include assets and liabilities from failed natural person credit unions (NPCU AMEs), as well as the corporate credit unions (Corporate AMEs).

Temporary Corporate Credit Union Stabilization Fund Closure

On September 28, 2017, the NCUA Board voted unanimously to close the Temporary Corporate Credit Union Stabilization Fund (TCCUSF) effective October 1, 2017, ahead of its sunset date of June 30, 2021. As required by statute (12 U.S.C. §1790e(h)), the TCCUSF's remaining funds, property, and other assets were distributed to the NCUSIF on October 1, 2017. Through the distribution, the NCUSIF assumed the activities and obligations of the TCCUSF, including the NCUA Guaranteed Notes (NGN) Program, and will report on such activities going forward.

II. Performance Goals, Objectives, and Results

The NCUA's mission, as outlined in the *NCUA Strategic Plan 2017 - 2021*, is to "provide through regulation and supervision, a safe and sound credit union system, which promotes confidence in the national system of cooperative credit." The plan outlines how the agency will continue to effectively supervise and insure a growing and evolving credit union system.

For 2017, there were 10 failures, compared to 14 failures in 2016. The cost of these failures, or the estimated cost of resolution at the time of liquidation, for the current year is \$24.4 million, compared to \$8.6 million for failures that occurred in 2016. Total assets in CAMEL² Code 4/5 credit unions slightly decreased to \$9.6 billion at the 2017 year-end, as compared to \$9.7 billion at the 2016 year-end.

In measuring the performance of the NCUSIF for 2017 and 2016, the following additional measures should be considered.

2017 and 2016 Performance Measures		
	December 31, 2017	December 31, 2016
Equity Ratio	1.46%	1.24%
Insurance and Guarantee Program Liabilities (Contingent Liability)	\$925.5 million	\$196.6 million
Net Position	\$15.7 billion	\$12.7 billion
Insured Shares	\$1.1 trillion	\$1.0 trillion
Number of Credit Union Involuntary Liquidations and Assisted Mergers	10	14
Assets in CAMEL 3, 4 and 5 rated Credit Unions	\$65.5 billion	\$98.2 billion

The equity ratio and contingent liability are significant financial performance measures in assessing the ongoing operations of the NCUSIF. The equity ratio serves as a measure of the overall capitalization of the NCUSIF.

Performance measures are designed to enable management and our stakeholders to assess programs and financial performance and to use this information to make improvements.

² CAMEL is the acronym for Capital, the quality of Assets, the capability of Management, the quality and level of Earnings, and the asset Liability management.

Performance measures have inherent limitations including the change over time in the correlation of cause and effect. A strong correlation between cause and effect in one period may not continue into the next. In addition, performance measures may not address systemic risks, which can have a significant effect on future results.

Equity Ratio and Normal Operating Level

The financial performance of the NCUSIF can be measured by comparing the equity ratio to the Normal Operating Level (NOL). The equity ratio is calculated as the ratio of the one-percent (1.00%) contributed capital deposit plus cumulative results of operations, excluding net cumulative unrealized gains and losses on investments, to the aggregate amount of insured shares in all federally insured credit unions. The NOL is the Board's target equity level for the NCUSIF. Pursuant to the Federal Credit Union Act, the NCUA Board sets the NOL between 1.20% and 1.50%. On September 28, 2017, the Board set the NOL at 1.39%, increasing it from 1.30%.

By statute, when the equity ratio falls below 1.20%, the NCUA Board must take action to restore the NCUSIF's equity ratio above 1.20%. When the NCUA Board projects that the equity ratio will, within six months, fall below 1.20%, the NCUA Board must establish and implement a restoration plan to rebuild the equity ratio, which may include a premium assessment to each insured credit union. The NCUSIF pays a distribution when the year-end equity ratio exceeds the NOL and the available assets ratio exceeds 1.00% at year-end.

As of December 31, 2017, the equity ratio was 1.46%, which is above the NOL. As a result, the NCUA Board will convene in 2018 to declare a distribution based on actual insured shares as of December 31, 2017. For 2016, the NCUSIF ended the year with an equity ratio of 1.24%, which resulted in no distribution. In 2017 and 2016, the NCUA Board did not assess a premium charge to insured credit unions. We expect that the NCUSIF will receive additional capitalization deposits of approximately \$110.5 million from insured credit unions in early 2018 when the NCUA invoices for its biannual contributed capital adjustment.

Insurance Losses (Contingent Liabilities)

Through its supervision process, NCUA employs the CAMEL rating system, which is based upon an evaluation of five critical elements of a credit union's operations: Capital Adequacy, Asset Quality, Management, Earnings, and Liquidity/Asset-Liability Management (CAMEL). CAMEL is designed to take into account and reflect all significant financial, operational, and management factors examiners assess in their evaluation of a credit union's performance and risk profile by applying a rating to the credit union ranging from "1" (strongest) to "5" (weakest). The CAMEL rating system is a tool to measure risk and allocate resources for supervisory purposes.

The NCUSIF's year-end contingent liability for insurance losses is derived by using an internal econometric model that applies estimated probability of failure and loss rates that take into account the historical loss history, CAMEL ratings, credit union level financial ratios, and other economic measures. In addition, specific analysis is performed on those insured credit unions where failure is probable and where additional information is available to make a reasonable estimate of losses. The NCUSIF ended 2017 with Insurance and Guarantee Program Liabilities of \$925.5 million to cover probable losses as compared with \$196.6 million for the previous year-end, an increase of \$728.9 million.

The NCUA identifies credit unions at risk of failure through the supervisory and examination process, and estimates losses based on economic trends and credit unions' financial condition and operations. The NCUA also evaluates overall credit union trends and monitors potential system-wide risk factors, such as increasing levels of consumer debt, bankruptcies, and delinquencies.

Due to uncertain economic risks and the possibility of variances from historical data, actual losses could differ materially from the contingent liabilities recorded by the NCUSIF. The NCUA's supervisory actions may result in the conservatorship of federally insured credit unions. As of December 31, 2017, four credit unions were operating in conservatorship. Estimated losses related to conserved credit unions are determined as part of the fund's reserve methodology and are contained within the Insurance and Guarantee Program Liabilities in the Balance Sheets. Actual losses could vary and may be materially different from the estimated losses recognized as of December 31, 2017.

The credit union industry remained stable overall during 2017 as reflected by the reduction of assets in CAMEL 3, 4 and 5 rated credit unions as compared to 2016. Assets in CAMEL 3, 4 and 5 rated credit unions decreased to \$65.5 billion at the end of 2017, versus \$98.2 billion at the end of 2016. The aggregate net worth ratio increased during the year, ending at 11.0%, versus 10.9% at December 31, 2016.

III. Financial Statement Analysis

The NCUSIF ended 2017 with an increase in Total Assets and its Total Net Position, primarily due to the transfer of \$2.6 billion in net assets from the TCCUSF in October 2017. Insurance and Guarantee Program Liabilities also increased from the prior year. Net Cost of Operations increased to \$438.3 million, primarily as a result of increases in the Reserve Expense within the Provision for Insurance Losses partially offset by \$480.0 million in interest income due to a recovery from the \$1.0 billion capital note previously held by the TCCUSF. These changes are explained in further detail below.

Summarized Financial Information (in thousands)		
	December 31, 2017	December 31, 2016
Total Assets	\$16,671,818	\$12,869,748
Investments, Net	16,106,500	12,724,719
Receivables from Asset Management Estates, Net	495,021	58,351
Insurance and Guarantee Program Liabilities	925,487	196,617
Contributed Capital	10,765,320	9,987,363
Net Position	15,736,687	12,666,793
Operating Expenses	199,016	209,260
Provision for Insurance Losses, Reserve Expense (Reduction)	747,777	44,432
Provision for Insurance Losses, AME Receivable Bad Debt Expense (Reduction)	(21,482)	(36,562)
Interest Revenue – Other	(480,000)	-
Total Net Cost of Operations	438,340	214,667
Cumulative Results of Operations	4,971,367	2,679,430
Interest Revenue – Investments	209,137	227,172
Transfers In from the TCCUSF	2,562,069	-

Balance Sheet Highlights

Total Assets increased by \$3.8 billion in 2017. The increase came primarily from the transfer-in of net assets from the TCCUSF of \$2.6 billion, which included \$1.9 billion in cash and \$0.7 billion in other net assets. The increase is also attributable to the net collection of capital deposits of \$778.0 million, and \$480.0 million in Interest Revenue due to the remaining recovery from the \$1.0 billion capital note previously held by the TCCUSF, partially offset by net unrealized losses on Investments of \$41.1 million.

Balances of Investments increased by \$3.4 billion during 2017, primarily driven by investing net additions to Contributed Capital of \$778.0 million, the transfer of \$1.9 billion in cash from the TCCUSF, and \$480.0 million recognized as interest revenue due to the remaining recovery from the \$1.0 billion capital note previously held by the TCCUSF. During 2017, U.S. Treasury yields have generally increased in Treasury securities within the NCUSIF portfolio, resulting in an overall decrease in the market value of U.S. Treasury securities.

Receivables from Asset Management Estates, Net increased \$436.7 million during 2017, due primarily to the transfer of \$671.8 million in net Corporate AME Receivables that the TCCUSF had collected, partially offset by \$237.5 million in net recoveries from AME activity. Receivables from Asset Management Estates, Net are funded by the collection of principal on outstanding loans, mortgages and other debt instruments. Also, Receivables from Asset Management Estates, Net were funded by various transactions that are explained in Note 7 to the financial statements.

Insurance and Guarantee Program Liabilities, referred to as contingent liabilities, were \$925.5 million and \$196.6 million as of December 31, 2017 and 2016, respectively. The overall increase in the Insurance and Guarantee Program Liabilities balance is due to the increase in the specific reserve of \$815.7 million, partially offset by a decrease in the general reserve of \$86.8 million. Specific reserves are identified for those credit unions where failure is probable and where additional information is available to make a reasonable estimate of losses associated with these credit unions. The general reserve reflects overall risk of loss due to potential credit union failures of federally insured credit unions taken as a whole.

Contributed Capital increased by \$778.0 million during 2017 due to the growth of insured shares in credit unions. Each insured credit union deposits one percent (1.00%) of its insured shares as Contributed Capital. In 2017, credit union insured shares grew by 5.7%.

Net Position increased \$3.1 billion during 2017. Increases include the transfer of net assets from the TCCUSF of \$2.6 billion, net additions of Contributed Capital of \$778.0 million, and interest revenue on Investments of \$209.1 million. Decreases include Net Cost of Operations of \$438.3 million and net unrealized losses on Investments of \$41.1 million.

Statements of Net Cost Highlights

Total Net Cost of Operations was \$438.3 million for 2017, as compared to \$214.7 million for 2016. The overall increase in Net Cost of Operations is attributable to an increase in the overall Provision for Insurance Losses of \$718.4 million, and partially offset by the receipt of \$480.0 million in interest income from the remaining recovery of the \$1.0 billion capital note previously held by the TCCUSF. Additionally, there was a \$10.2 million reduction in Operating Expenses attributable to a change to the allocation factor (Overhead Transfer Rate) for expenses from the NCUA Operating Fund that decreased from 73.1% to 67.7% for 2017. Within the Provision for

Insurance Loss for 2017, the Reserve Expense was \$747.8 million, reflecting the overall risk of losses due to potential credit union failures for the credit union industry, while the AME Receivable Bad Debt Expense was a \$21.5 million expense reduction, reflecting recoveries and increases in net realizable values of assets managed. The overall change in Provision for Insurance Losses of \$718.4 million is the result of an expense of \$726.3 million for 2017 compared to an expense reduction of \$7.9 million for 2016.

Statements of Changes in Net Position Highlights

Cumulative results of operations increased by \$2.3 billion in 2017. This increase was primarily driven by a transfer-in of net assets from the TCCUSF of \$2.6 billion and Net Cost of Operations of \$438.3 million, primarily offset by Interest Revenue of \$209.1 million. Interest Revenue was the primary source of funds to partially offset expenses and obligations.

With the closing of the TCCUSF effective October 1, 2017, funds, property, and other assets were distributed to the NCUSIF. Through this distribution, total Transfers In from the TCCUSF was \$2.6 billion, including \$1.9 billion in cash and \$0.7 billion in other net assets.

Statements of Budgetary Resources Highlights

Activity impacting budget totals of the overall federal government is recorded in the NCUSIF's Statements of Budgetary Resources. The NCUSIF's net outlays were negative, meaning that the NCUSIF had net cash inflows of \$1.5 billion and \$799.9 million for 2017 and 2016, respectively. This increase is primarily the result of the growth of credit union insured shares and the corresponding 1.00% contributed capital deposit adjustment received.

Fiduciary Activity Highlights

The financial results of the NPCU AMEs and Corporate AMEs with the NGN Trusts in the NGN Program are not presented in the results of the NCUSIF as described above, but are presented as fiduciary activities of the NCUSIF in accordance with the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standard (SFFAS) No. 31, *Accounting for Fiduciary Activities*, and are included in the notes to the NCUSIF financial statements.

NGN Program

The outstanding principal balance of the NGNs was \$5.4 billion as of December 31, 2017. This amount represents the maximum potential future guarantee payments that the NCUA could be required to make without consideration of future expected cash flows from underlying Legacy Assets and possible recoveries under the terms of the guarantees or from the Corporate AMEs. The losses from the guarantees of NGNs are expected to be significantly less than the above maximum potential exposure, and such losses are based on estimated guarantee payments, net of estimated guarantor reimbursements, if any, from the NGN Trusts and expected recoveries, if any, from the Corporate AMEs. The NCUA's estimate of the expected recovery from the Corporate AMEs reflects the NCUA's expectations and assumptions about the recovery value of the Corporate AMEs assets, which include economic residual interests in the NGN Trusts.

The NCUA's estimated guarantee payments, guarantor reimbursements and the recovery values, if any, of the Corporate AMEs economic residual interests in the NGN Trusts are derived using an external model that distributes estimated cash flows of the Legacy Assets transferred to the NGN Trusts in the priority of payments pursuant to the governing documents of each NGN Trust. The estimated cash flows incorporate the NCUA's assumptions about discount rates.

The estimated cash flows of the Legacy Assets transferred to the NGN Trusts are also derived from the external model that incorporates the NCUA's expectations and assumptions about the estimated cash flows from the collateral that comprises the Legacy Assets, and the priority of payments and estimated cash flows of the Legacy Assets pursuant to the governing documents for the respective Legacy Assets. The external model produces estimated cash flows of collateral underlying the Legacy Assets by incorporating the NCUA's expectations and assumptions about prepayments, defaults and loss severity of the collateral consisting of residential and commercial mortgage loans and other assets. Assumptions about prepayments, defaults, and loss severity are developed based on the characteristics and historical performance of the collateral, as well as assumptions about macroeconomic variables such as unemployment rates, housing prices, and interest rates.

As of December 31, 2017, the NCUA Board, as liquidating agent of the Corporate AMEs, held approximately \$1.8 billion in post-securitized assets. Generally, post-securitized assets are the Legacy Assets that are no longer secured by the NGNs.

Due to uncertain economic risks and the possibility of variances from historical data, actual losses could differ materially from contingent liabilities, if any, related to the NGN Program, that are recorded by the NCUSIF through December 31, 2017. The NCUSIF recorded no contingent liabilities on its Balance Sheet for NGNs as of December 31, 2017.

The table below represents the composition of Legacy Assets collateralizing the remaining nine NGNs with an aggregate unpaid principal balance of \$7.5 billion and recovery value of approximately \$6.3 billion as of December 31, 2017.

Composition of Legacy Assets Collateralizing the NGN Trusts

Asset Type and Credit Rating ¹	Based on Recovery Value		Based on Unpaid Principal Balance	
	December 31, 2017		December 31, 2017	
RMBS	AAA	1%		0%
	AA			1%
	A		88%	2%
	BBB	90%		3%
	Below Investment Grade			92%
	NA	2%		2%
CMBS	AAA			0%
	AA			0%
	A		1%	4%
	BBB	2%		1%
	Below Investment Grade			95%
NA	0%		0%	
ABS ²	AAA			31%
	AA			2%
	A		7%	0%
	BBB	4%		9%
	Below Investment Grade			49%
NA	1%		9%	
Agency	4%	100%	3%	100%
Corporate	AAA			0%
	AA			0%
	A			0%
	BBB	0%		1%
	Below Investment Grade			0%
	NA	100%		100%

Percentages may not total 100% due to rounding.

¹ The rating is based on the lowest published rating by S&P, Moody's, or Fitch.

² The collateral underlying the ABS included in the table above is primarily student loans.

Limitations of the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the NCUSIF. While the statements have been prepared from the books and records of the NCUSIF in accordance with U.S. generally accepted accounting principles (GAAP) for Federal entities and the formats prescribed by the Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources that are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Liquidity Risk and Capital Resources

For liquidity, the NCUSIF maintains cash in its Fund Balance with Treasury (FBWT) account as well as investments in U.S. Treasury securities. Investments in U.S. Treasury securities include overnight investments, which are available to meet urgent liquidity needs of the NCUSIF.

2017 and 2016 Fund Balance with Treasury and Investments		
	December 31, 2017	December 31, 2016
Fund Balance with Treasury	\$ 3.2 million	\$ 4.4 million
U.S. Treasury Securities		
Overnight	2,849.2 million	152.0 million
Available-for-Sale	13,257.3 million	12,572.8 million

During 2017, the FBWT account was primarily increased by maturing investments in U.S. Treasury securities and Interest Revenue collected. The FBWT account was decreased by purchases of U.S. Treasury securities and amounts expended for the purposes of the share insurance program.

The NCUSIF has multiple other sources of funding including:

- capitalization deposits contributed by insured credit unions, as provided by the *Federal Credit Union Act*, Public Law 73-467, as amended (FCU Act);
- cumulative results of operations retained by the NCUSIF;
- premium assessments on insured credit unions, as necessary;
- guarantee fees;
- interest income on recovery of \$1.0 billion capital note previously held by the TCCUSF;
- borrowings from the U.S. Treasury; and
- borrowings from the Central Liquidity Facility (CLF).

Investments in U.S. Treasuries increased when \$1.9 billion in cash was distributed from the TCCUSF to the NCUSIF, with the close of the TCCUSF, effective October 1, 2017.

The NCUSIF is a revolving fund in the U.S. Treasury and has access to sufficient funds to meet its obligations, including its Insurance and Guarantee Program Liabilities.

Contributed Capital

Each insured credit union must deposit and maintain in the NCUSIF 1.00% of its insured shares. For the years ended December 31, 2017 and 2016, the NCUSIF's contributed capital from insured credit unions increased by \$778.0 million and \$634.3 million, respectively. Total insured shares were reported at \$1.1 trillion and \$1.0 trillion as of December 31, 2017 and 2016, respectively. The NCUA has estimated the total insured shares, subject to certified reporting of insured share amounts. We expect that the NCUSIF will receive additional capitalization deposits of approximately \$110.5 million from insured credit unions in early 2018 when NCUA invoices for its biannual contributed capital adjustment.

Cumulative Results of Operations

The NCUSIF ended 2017 and 2016 with a total of \$5.0 billion and \$2.7 billion in cumulative results of operations, respectively. Interest Revenue from Investments and Transfers In are currently the primary source of funds for operations.

Assessments

The NCUA Board may assess premium charges to all insured credit unions, as provided by the FCU Act. During the years ended December 31, 2017 and 2016, the NCUA Board did not assess any premium charges to insured credit unions.

Borrowing Authority from the U.S. Treasury

The NCUSIF has \$6.0 billion in borrowing authority from the U.S. Treasury. As of December 31, 2017, the statutory amount of cash available to borrow based on current borrowing authority was \$6.0 billion.

Borrowing Authority from the CLF

The NCUSIF also has the ability to borrow from the CLF as provided in the FCU Act. At December 31, 2017 and 2016, the NCUSIF did not have any outstanding borrowing from the CLF. The CLF is authorized by statute to borrow, from any source, an amount not to exceed twelve times its subscribed capital stock and surplus. The CLF had statutory borrowing authority of \$6.6 billion as of December 31, 2017. The NCUA maintains a note purchase agreement with the Federal Financing Bank (FFB) on behalf of the CLF with a maximum principal amount of \$2.0 billion. Under the terms of its agreement, the CLF borrows from the FFB as needed. Under terms prescribed by the note purchase agreement, the CLF executes promissory notes in amounts as necessary and renews them annually. Advances under the current promissory note can be made no later than March 31, 2018.

IV. Systems, Controls, and Legal Compliance

The NCUSIF was created by Title II of the FCU Act, 12 U.S.C. §1781 *et seq.*, as amended. In January 2011, the *National Credit Union Authority Clarification Act*, Public Law 111-382, amended the definitions of “equity ratio” and “net worth” in the FCU Act. The NCUA, including the NCUSIF, is exempt from requirements under the *Federal Credit Reform Act of 1990* (2 U.S.C. § 661 *et seq.*).

Internal controls should be designed to provide reasonable assurance regarding prevention or prompt detection of unauthorized acquisition, use, or disposition of assets. The *Federal Managers’ Financial Integrity Act*, Public Law 97–255 (FMFIA), requires agencies to establish management controls over their programs and financial systems. Accordingly, NCUA management is responsible for establishing and maintaining effective internal controls and financial management systems that meet the objectives of FMFIA, which include safeguarding assets and compliance with applicable laws and regulations. NCUA management monitors and assesses its relevant internal controls and reports on its assessment. This allows NCUA management to provide reasonable assurance that internal controls are operating effectively. The NCUA is in compliance with FMFIA as well as all applicable laws such as the *Prompt Payment Act*, Public Law 97-177, and the *Debt Collection Improvement Act*, Public Law 104–134.

The *Improper Payments Information Act of 2002*, Public Law 107–300 (IPIA), as amended by the *Improper Payments Elimination and Recovery Act of 2010*, Public Law 111-204 (IPERA), and the *Improper Payments Elimination and Recovery Improvement Act of 2012*, Public Law 112-248 (IPERIA), requires federal agencies to review all programs and activities they administer and to identify those that may be susceptible to significant improper payments. We have determined that the NCUSIF’s programs are not susceptible to a high risk of significant improper payments.

As required by the *Federal Information Security Management Act*, Public Law 107-347, as amended (FISMA), the NCUA develops, documents, and implements an agency-wide program to provide information privacy and security (management, operational, and technical security controls) for the information and information systems that support the operations of the agency, including those provided or managed by another agency, contractor, or other source.



KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Independent Auditors' Report

Inspector General, National Credit Union Administration and
the National Credit Union Administration Board:

Report on the Financial Statements

We have audited the accompanying financial statements of the National Credit Union Share Insurance Fund (NCUSIF), which comprise the balance sheets as of December 31, 2017 and 2016, and the related statements of net cost, changes in net position, and statements of budgetary resources for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 17-03, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 17-03 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion on the Financial Statements

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the National Credit Union Share Insurance Fund as of December 31, 2017 and 2016, and its net costs, changes in net position, and budgetary resources for the years then ended in accordance with U.S. generally accepted accounting principles.



Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the information in the Overview and Required Supplementary Information sections be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements as of and for the year ended December 31, 2017, we considered the NCUSIF's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the NCUSIF's internal control. Accordingly, we do not express an opinion on the effectiveness of the NCUSIF's internal control. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the NCUSIF's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 17-03.



Purpose of the Other Reporting Required by *Government Auditing Standards*

The purpose of the communication described in the Other Reporting Required by *Government Auditing Standards* section is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the NCUSIF's internal control or compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

February 14, 2018

NATIONAL CREDIT UNION SHARE INSURANCE FUND

BALANCE SHEETS

As of December 31, 2017 and 2016

(Dollars in thousands)

	<u>2017</u>	<u>2016</u>
ASSETS		
INTRAGOVERNMENTAL		
Fund Balance with Treasury (Note 2)	\$ 3,162	\$ 4,410
Investments, Net - U.S. Treasury Securities (Note 3)	16,106,500	12,724,719
Accrued Interest Receivable (Note 3)	54,635	71,525
Note Receivable - Note due from the National Credit Union Administration Operating Fund (Note 5)	<u>7,710</u>	<u>9,051</u>
Total Intragovernmental Assets	<u>16,172,007</u>	<u>12,809,705</u>
PUBLIC		
Accounts Receivable - Due from Insured Credit Unions, Net (Note 4)	1,941	-
Accounts Receivable - Guarantee Fee on National Credit Union Administration Guaranteed Notes, Net (Note 4)	1,275	-
Accounts Receivable - Other	2	-
General Property, Plant and Equipment, Net (Note 6)	562	1,192
Other - Receivables from Asset Management Estates (AMEs), Net (Note 7)	495,021	58,351
Other Assets	<u>1,010</u>	<u>500</u>
Total Public Assets	<u>499,811</u>	<u>60,043</u>
TOTAL ASSETS	<u>\$ 16,671,818</u>	<u>\$ 12,869,748</u>
LIABILITIES		
INTRAGOVERNMENTAL		
Accounts Payable - Due to the National Credit Union Administration Operating Fund (Note 10)	<u>\$ 5,153</u>	<u>\$ 4,059</u>
Total Intragovernmental Liabilities	5,153	4,059
PUBLIC		
Accounts Payable	4,491	2,118
Other - Insurance and Guarantee Program Liabilities (Note 8)	925,487	196,617
Other Liabilities	<u>-</u>	<u>161</u>
Total Public Liabilities	<u>929,978</u>	<u>198,896</u>
TOTAL LIABILITIES	<u>935,131</u>	<u>202,955</u>
Commitments and Contingencies (Note 8)		
NET POSITION		
Contributed Capital (Note 13)	10,765,320	9,987,363
Cumulative Result of Operations	<u>4,971,367</u>	<u>2,679,430</u>
Total Net Position	<u>15,736,687</u>	<u>12,666,793</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 16,671,818</u>	<u>\$ 12,869,748</u>

The accompanying notes are an integral part of these financial statements.

NATIONAL CREDIT UNION SHARE INSURANCE FUND

STATEMENTS OF NET COST

For the Years Ended December 31, 2017 and 2016

(Dollars in thousands)

	<u>2017</u>	<u>2016</u>
GROSS COSTS		
Operating Expenses	\$ 199,016	\$ 209,260
Provision for Insurance Losses		
Reserve Expense (Reduction) (Note 8)	747,777	44,432
AME Receivable Bad Debt Expense (Reduction) (Note 7)	<u>(21,482)</u>	<u>(36,562)</u>
Total Gross Costs	<u>925,311</u>	<u>217,130</u>
 LESS EARNED REVENUES		
Interest Revenue on Note Receivable from the National Credit Union Administration Operating Fund (Note 5)	(128)	(179)
Guarantee Fee Revenue - National Credit Union Administration Guaranteed Notes	(5,077)	-
Insurance and Guarantee Premium Revenue	(1,765)	-
Interest Revenue on Notes (Note 5)	-	(2,070)
Interest Revenue - Other (Note 1)	(480,000)	-
Other Revenue	<u>(1)</u>	<u>(214)</u>
Total Earned Revenues	<u>(486,971)</u>	<u>(2,463)</u>
 NET COST	 <u>\$ 438,340</u>	 <u>\$ 214,667</u>

The accompanying notes are an integral part of these financial statements.

NATIONAL CREDIT UNION SHARE INSURANCE FUND

STATEMENTS OF CHANGES IN NET POSITION
For the Years Ended December 31, 2017 and 2016
(Dollars in thousands)

	<u>2017</u>	<u>2016</u>
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	\$ 2,679,430	\$ 2,803,048
BUDGETARY FINANCING SOURCES		
Non-Exchange Revenue		
Interest Revenue - Investments	209,137	227,172
Transfers-In Without Reimbursement		
Nonexpenditure Financing Sources - Transfers-In	1,888,075	-
Other		
Gains On Disposition of Assets	132	-
OTHER FINANCING SOURCES		
Non-Exchange Revenue		
Net Unrealized Gain/(Loss) - Investments (Note 3)	(41,061)	(136,123)
Transfers-In Without Reimbursement		
Financing Sources Transferred In Without Reimbursement	673,994	-
Total Financing Sources	2,730,277	91,049
Net Cost of Continuing Operations	(438,340)	(214,667)
Net Change	2,291,937	(123,618)
CUMULATIVE RESULTS OF OPERATIONS	<u>4,971,367</u>	<u>2,679,430</u>
CONTRIBUTED CAPITAL (Note 13)		
Beginning Balances	9,987,363	9,353,113
Change in Contributed Capital	777,957	634,250
CONTRIBUTED CAPITAL	<u>10,765,320</u>	<u>9,987,363</u>
NET POSITION	<u>\$ 15,736,687</u>	<u>\$ 12,666,793</u>

The accompanying notes are an integral part of these financial statements.

NATIONAL CREDIT UNION SHARE INSURANCE FUND

STATEMENTS OF BUDGETARY RESOURCES

For the Years Ended December 31, 2017 and 2016

(Dollars in thousands)

	<u>2017</u>	<u>2016</u>
BUDGETARY RESOURCES (Notes 11, 12 and 15)		
Unobligated balance, brought forward, January 1	\$ 12,723,150	\$ 11,910,709
Other changes in unobligated balance	1,887,072	-
Borrowing authority (mandatory)	-	-
Spending authority from offsetting collections (mandatory)	<u>2,249,175</u>	<u>1,086,690</u>
TOTAL BUDGETARY RESOURCES	<u>\$ 16,859,397</u>	<u>\$ 12,997,399</u>
STATUS OF BUDGETARY RESOURCES		
New obligations and upward adjustments (total)	\$ 731,503	\$ 274,249
Unobligated balance, end of year:		
Exempt from apportionment	<u>16,127,894</u>	<u>12,723,150</u>
Total unobligated balance, end of year	<u>16,127,894</u>	<u>12,723,150</u>
TOTAL STATUS OF BUDGETARY RESOURCES	<u>\$ 16,859,397</u>	<u>\$ 12,997,399</u>
CHANGE IN OBLIGATED BALANCE		
Unpaid Obligations:		
Unpaid obligations, brought forward, January 1	\$ 9,261	\$ 10,266
New obligations and upward adjustments	731,503	274,249
Outlays (gross)	(731,741)	(275,254)
Actual transfers, unpaid obligations	<u>1,386</u>	<u>-</u>
Unpaid obligations, end of year	<u>\$ 10,409</u>	<u>\$ 9,261</u>
Uncollected payments:		
Uncollected customer payments from federal sources, brought forward, January 1	\$ (71,525)	\$ (59,973)
Change in uncollected customer payments from Federal sources	<u>16,890</u>	<u>(11,552)</u>
Uncollected customer payments from Federal sources, end of year	<u>\$ (54,635)</u>	<u>\$ (71,525)</u>
Obligated balance, start of year (net)	<u>\$ (62,264)</u>	<u>\$ (49,707)</u>
Obligated balance, end of year (net)	<u>\$ (44,226)</u>	<u>\$ (62,264)</u>
BUDGET AUTHORITY AND OUTLAYS, NET		
Budget authority, gross (mandatory)	\$ 2,249,175	\$ 1,086,690
Actual offsetting collections (mandatory)	(2,266,065)	(1,075,138)
Change in uncollected customer payments from Federal sources (mandatory)	<u>16,890</u>	<u>(11,552)</u>
BUDGET AUTHORITY, NET (MANDATORY)	<u>\$ -</u>	<u>\$ -</u>
Outlays, gross (mandatory)	\$ 731,741	\$ 275,254
Actual offsetting collections (mandatory)	<u>(2,266,065)</u>	<u>(1,075,138)</u>
Outlays, net (discretionary and mandatory)	<u>(1,534,324)</u>	<u>(799,884)</u>
AGENCY OUTLAYS, NET (MANDATORY)	<u>\$ (1,534,324)</u>	<u>\$ (799,884)</u>

The accompanying notes are an integral part of these financial statements.

NATIONAL CREDIT UNION SHARE INSURANCE FUND

NOTES TO FINANCIAL STATEMENTS

For the Years Ended December 31, 2017 and 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The National Credit Union Share Insurance Fund (NCUSIF) was created by Title II of the *Federal Credit Union Act*, Public Law 73-467, as amended (FCU Act), 12 U.S.C. § 1781 *et seq.* The NCUSIF was established as a revolving fund in the Treasury of the United States (U.S. Treasury), under management of the National Credit Union Administration (NCUA) Board (NCUA Board) for the purpose of insuring member share deposits in all Federal Credit Unions (FCUs) and in qualifying state-chartered credit unions requesting insurance.

The NCUA exercises direct supervisory authority over FCUs and coordinates supervisory involvement with the state chartering authorities for state-chartered credit unions insured by the NCUSIF. Federally insured (insured) credit unions are required to report certain financial and statistical information to the NCUA on a quarterly basis and are subject to periodic examination by the NCUA. Information derived through the supervision and examination process provides the NCUA with the ability to identify insured credit unions experiencing financial difficulties that may require assistance from the NCUSIF.

Assistance from the NCUSIF, pursuant to the FCU Act, may be in the form of a waiver of statutory reserve requirements, liquidity assistance in the form of a guaranteed line of credit, cash assistance in the form of a subordinated note, or other such form. In some cases, a merger partner for the credit union may be sought. Mergers between financially troubled credit unions and stronger credit unions may also require NCUSIF assistance. Merger assistance may be in the form of cash assistance, purchase of certain assets by the NCUSIF, and/or guarantees of the values of certain assets (e.g., primarily loans). When a credit union is no longer able to continue operating and the merger and assistance alternatives are not practical, the NCUSIF or the appropriate state supervisory authority may liquidate the credit union. In the event of a credit union liquidation, the NCUSIF pays members' shares up to the maximum insured amount and monetizes the credit union's assets.

Temporary Corporate Credit Union Stabilization Fund Closure

Pursuant to the FCU Act, § 217(h), 12 U.S.C. §1790e(h), the NCUA Board was authorized to close the Temporary Corporate Credit Union Stabilization Fund (TCCUSF) at its discretion. At closure, the NCUA Board was required to distribute the funds, property, and other assets of the TCCUSF to the NCUSIF. On September 28, 2017, the NCUA Board voted unanimously to close the TCCUSF effective October 1, 2017. As required by statute, the TCCUSF's remaining funds, property, and other assets were distributed to the NCUSIF. Through the distribution, the NCUSIF assumed the activities and obligations of the TCCUSF, including the NCUA Guaranteed Notes (NGN) Program, and will report on such going forward.

Fiduciary Responsibilities

Fiduciary activities are the collection or receipt, management, protection, accounting, investment, or disposition by the federal government of cash or other assets, in which non-federal individuals or entities have an ownership interest that the federal government must uphold.

The NCUA's Asset Management and Assistance Center (AMAC) conducts liquidations and performs management and recovery of assets for failed credit unions. Assets and liabilities of liquidated credit unions reside in Asset Management Estates (AMEs). AMEs include assets and liabilities from failed natural person credit unions (NPCU AMEs), as well as the corporate credit union (CCU) AMEs (Corporate AMEs). These assets and liabilities are held in part, for the primary benefit of non-federal parties and therefore are considered fiduciary in accordance with Federal Accounting Standards Advisory Board (FASAB) Statement of Federal Financial Accounting Standards (SFFAS) No. 31, *Accounting for Fiduciary Activities*. Fiduciary assets are not assets of the federal government and therefore are not recognized on the Balance Sheet. Additionally, the NCUA entity assets are non-fiduciary.

On September 24, 2010, the NCUA Board announced the Corporate System Resolution Program (CSRP). The CSRP was a multi-stage plan for stabilizing the corporate credit union system, providing 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 referred to as the Legacy Assets) held by the failed CCUs, and establishing a new regulatory framework for CCUs. Under the CSRP, the NCUA created a re-securitization program (the NGN Program) to provide long-term funding for the Legacy Assets through the issuance of the NGNs by trusts established for this purpose (NGN Trusts). The NGN Trusts are guaranteed by the NCUA, and backed by the full faith and credit of the United States. Principal liability for these NGN Trust guarantees was transferred from the former TCCUSF to the NCUSIF on October 1, 2017.

Sources of Funding

Deposits insured by the NCUSIF are backed by the full faith and credit of the United States. The NCUSIF has multiple sources of funding. Each insured credit union is required to deposit and maintain in the NCUSIF 1.00% of its insured shares. The NCUA Board may also assess premiums to all insured credit unions, as provided by the FCU Act.

In addition, the NCUSIF may receive investment interest income, guarantee fees, recoveries from the AMEs including proceeds recovered from legal claims and asset sales, and has authority to borrow from the U.S. Treasury and the ability to borrow from the NCUA's Central Liquidity Facility (CLF).

Basis of Presentation

The NCUSIF's financial statements have been prepared from its accounting records in accordance with standards promulgated by FASAB. FASAB is designated by the American Institute of Certified Public Accountants as the source of generally accepted accounting principles (GAAP) for federal reporting entities. The format of the financial statements and footnotes is in accordance with the form and content guidance provided in Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*, revised August 15, 2017.

Consistent with SFFAS No. 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, the NCUA considers and where appropriate, applies Financial Accounting Standards Board (FASB) guidance for those instances where no applicable FASAB guidance is available. Any such significant instances are identified herein.

Basis of Accounting

In its accounting structure, the NCUSIF records both proprietary and budgetary accounting transactions. Following the accrual method of accounting, revenues are recognized when earned and expenses are recognized when incurred, without regard to the actual collection or payment of cash.

Federal budgetary accounting recognizes the obligation of appropriations, borrowing authorities, and other fund resources upon the establishment of a properly documented legal liability, which may be different from the recording of an accrual-based transaction. The recognition of budgetary accounting transactions is essential for compliance with legal controls over the use of federal funds and compliance with budgetary laws.

The NCUA, including the NCUSIF, is exempt from requirements under the *Federal Credit Reform Act of 1990* (2 U.S.C. § 661 et seq.).

The Statement of Net Cost, the Statement of Changes in Net Position and the Statement of Budgetary Resources cover the twelve-month period ending December 31, 2017. Due to the NCUSIF's assumption of receivables and obligations of the TCCUSF, effective October 1, 2017, these statements also include the last three months of the year for receivables and liabilities that were formerly administered by the TCCUSF. Accordingly, comparability differences exist between the two periods presented.

Use of Estimates

The preparation of financial statements in conformity with GAAP for the federal government requires management to make estimates and assumptions that affect the following:

- reported amounts of assets and liabilities;
- disclosure of contingent assets and liabilities at the date of the financial statements; and
- the amounts of revenues and expenses reported during that period.

Actual results could differ from estimates. Significant items subject to those estimates and assumptions include (i) reserves for probable losses and contingencies related to Insurance and Guarantee Program Liabilities; (ii) the amount and timing of recoveries, if any, related to any claims paid and settlement of the guarantee liabilities; (iii) allowance amounts established for loan losses related to cash assistance provided to insured credit unions; and (iv) allowance amounts for losses on the receivables from AMEs for claims paid on their behalf.

Fund Balance with Treasury

Fund Balance with Treasury (FBWT) is the aggregate amount of the NCUSIF's accounts with the federal government's central accounts, from which the NCUSIF is authorized to make expenditures and pay liabilities. The entire FBWT is a revolving fund type.

Investments

Investment securities primarily consist of marketable U.S. Treasury securities of varying maturities (debt securities). The NCUSIF also holds non-marketable U.S. Treasury overnight securities purchased and reported at par value, which are classified as held-to-maturity. All marketable securities are carried as available-for-sale, in accordance with FASB Accounting Standards Codification (ASC) 320, *Investments – Debt and Equity Securities*.

Interest earned and unrealized holding gains and losses on U.S. Treasury securities are excluded from net costs and reported as components of non-exchange revenue. Realized gains and losses from the sale of available-for-sale securities are determined on a specific identification basis.

All U.S. Treasury securities that are in an unrealized loss position are reviewed for other-than-temporary impairment (OTTI). The NCUSIF evaluates its U.S. Treasury securities on a monthly basis. An investment security is deemed impaired if the fair value of the investment is less than its amortized cost. Amortized cost includes adjustments (if any) made to the cost basis of an investment for accretion, amortization, and previous OTTI. To determine whether impairment is an OTTI, the NCUA takes into consideration whether it has the intent to sell the security. The NCUA also considers available evidence to assess whether it is more likely than not that it will be required to sell the debt security before the recovery of its amortized cost basis. If the NCUA intends to sell, or more likely than not will be required to sell the security before recovery of its amortized cost basis, an OTTI shall be considered to have occurred.

Premiums and discounts are amortized or accreted over the life of the related available-for-sale security as an adjustment to yield using the effective interest method.

Accounts Receivable

Accounts receivable represents the NCUSIF's claims for payment from other entities. Gross receivables are reduced to net realizable value by an allowance for doubtful accounts as further discussed below. Public accounts receivable represent accounts receivable between the NCUSIF and a non-federal entity and are categorized as follows:

Capitalization Deposits from Insured Credit Unions

Each insured credit union pays to and maintains with the NCUSIF a capitalization deposit amount equal to 1.00% of its insured shares. Receivables and associated non-exchange revenue are recognized upon invoicing.

Premium Assessments from Insured Credit Unions

The NCUA Board has the statutory authority under Section 202 of the FCU Act to assess a premium charge to insured credit unions. The NCUA Board may assess each insured credit union a premium charge in an amount stated as a percentage of insured shares only if the equity ratio is less than 1.30% and the premium charge does not exceed the amount necessary to restore the equity ratio to 1.30%. When the NCUA Board projects that the equity ratio will, within six months, fall below 1.20%, the NCUA Board must establish and implement a restoration plan within 90 days, which meets the statutory requirements and any further conditions that the NCUA Board determines appropriate. In order to meet statutory requirements, the plan must provide that the equity ratio will meet or exceed the minimum amount specified of 1.20% before the end of the eight-year period beginning upon the implementation of the plan (or such longer period as the NCUA Board may determine to be necessary due to extraordinary circumstances).

The NCUA Board did not assess premiums for 2017 and 2016.

Guarantee Fee on NCUA Guaranteed Notes

Guarantee Fee accounts receivable represents outstanding balances of guarantee fees associated with the NGNs as described herein.

Allowance for Doubtful Accounts

An allowance for doubtful accounts is the NCUA's best estimate of the amount of losses in an existing NCUSIF receivable. Based on an assessment of collectability, the NCUSIF calculates an allowance on an individual account basis for public accounts receivable. An account may be impaired or written off if it is probable that the NCUSIF will not collect all amounts contractually due. No allowance is calculated for intragovernmental accounts receivable, as these are deemed to be fully collectible.

Accrued Interest Receivable

The NCUSIF recognizes accrued interest receivable for amounts of interest contractually earned but not yet received.

Public – Notes Receivable, Net

Notes Receivable, Net represent loans to insured credit unions as authorized by the NCUA Board, including assistance under Section 208 of the FCU Act. Any related allowance for loss represents the difference between the funds disbursed and the expected repayment from the insured credit unions.

General Property, Plant and Equipment, Net

General Property, Plant and Equipment, Net consists of internal-use software and assets under capital lease, and is recognized and measured in accordance with SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, as amended by SFFAS Nos. 10, 23, 44 and 50.

Incurred costs for internal use software during the software development phase are capitalized in accordance with SFFAS No. 10, *Accounting for Internal Use Software*. General Property,

Plant and Equipment is subject to depreciation and carried at net cost once placed into service. Depreciation and amortization are recognized over the useful life of the asset.

Other - Receivables from Asset Management Estates, Net

Receivables from AMEs, Net include claims to recover payments made by the NCUSIF and claims to recover payments that were formerly administered by the TCCUSF to satisfy obligations to insured shareholders and other guaranteed parties and for administrative expenses paid on behalf of AMEs. A related allowance for loss represents the difference between the funds disbursed and obligations incurred and the expected repayment, when recognized, from the AMEs pursuant to the liquidation payment priorities set forth in 12 C.F.R. § 709.5(b). Assets held by the AMEs are the main source of repayment of the NCUSIF's receivables from the AMEs. The recoveries from these AME assets are paid to the NCUSIF as AME assets are monetized and, to the extent a receivable is due to the NCUSIF from the AME.

The allowance for loss on receivables from AMEs is based on expected asset recovery rates, and come from several sources including:

- actual or pending AME asset disposition data;
- asset valuation data based upon the performance, quality, and type of the assets in the portfolio;
- estimated liquidation costs based on information from similar recently failed credit unions; and
- estimated AME specific administrative expenses based upon complexity and expected duration of the AME.

Expected asset recovery rates are evaluated during the year, but remain subject to uncertainties because of potential changes in economic and market conditions.

Capital Leases

In accordance with SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, and SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, the NCUSIF records a depreciable asset and liability for all capital leases at the present value of the rental and other minimum lease payments during the lease term.

Insurance and Guarantee Program Liabilities

In accordance with SFFAS No. 5, all federal insurance and guarantee programs, except social insurance and loan guarantee programs, should recognize a liability for:

- unpaid claims incurred, resulting from insured events that have occurred as of the reporting date;
- a contingent liability when an existing condition, situation, or set of circumstances involving uncertainty as to possible loss exists, and the uncertainty will ultimately be resolved when one or more probable future events occur or fail to occur; and
- a future outflow or other sacrifice of resources that is probable.

The NCUSIF records a contingent liability for probable losses relating to insured credit unions and the NGNs. Through its supervision process, the NCUA employs the CAMEL rating system, which is based upon an evaluation of five critical elements of a credit union's operations: Capital Adequacy, Asset Quality, Management, Earnings, and Liquidity/Asset-

Liability Management (CAMEL). CAMEL is designed to take into account and reflect all significant financial, operational, and management factors examiners assess in their evaluation of a credit union's performance and risk profile by applying a rating to the credit union ranging from "1" (strongest) to "5" (weakest). The CAMEL rating system is a tool to measure risk and allocate resources for supervisory purposes. The year-end contingent liability is derived by using an internal econometric model that applies estimated probability of failure and loss rates that take into account the historical loss history, CAMEL ratings, credit union level financial ratios, and other economic measures. Management routinely reviews the internal econometric model and refines the parameters as more information becomes available which allows for improved estimates. In addition, credit union specific analysis is performed on those credit unions where failure is probable and where additional information is available to make a reasonable estimate of losses. In such cases, specific reserves are established.

Liabilities for loss contingencies also arise from claims, assessments, litigation, fines, penalties, and other sources. These loss contingencies are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated. Legal costs incurred in connection with loss contingencies are expensed as incurred for any contingencies.

Net Position and Contributed Capital

Each insured credit union pays to and maintains with the NCUSIF a capitalization deposit in the amount equal to 1.00% of its insured shares. The NCUSIF reports the capitalization deposits from insured credit unions as contributed capital. This amount is included in the NCUSIF's Balance Sheets and Statements of Changes in Net Position.

Revenue Recognition

Exchange Revenue

Exchange revenues arise and are recognized when a federal government entity provides goods and services to the public or to another federal government entity for a price. Exchange revenue primarily consists of premium assessments, guarantee fee income, and interest revenue the purpose of which is to recover the losses of the credit union system.

Premium Assessments from Insured Credit Unions

The NCUA Board may assess each insured credit union a premium charge for insurance in an amount stated as a percentage of insured shares.

Guarantee Fees on NCUA Guaranteed Notes

For a fee, the NCUA guarantees the timely payment of principal and interest on the NGNs.

Interest Revenue – Other

On January 28, 2009, the NCUA Board approved the issuance of a \$1.0 billion capital note to U.S. Central Federal Credit Union (USCFCU). The capital note was classified as a debt security held-to-maturity and issued by the NCUSIF, and was subsequently transferred to the TCCUSF on June 18, 2009. Due to the NCUA's understanding of USCFCU's financial position as of December 31, 2009, which included independent valuation analyses, the NCUA concluded that an OTTI had occurred with the capital note, and, accordingly, recorded an impairment charge, or bad debt expense, for the entire value of the capital note.

In accordance with FASB ASC 310-30-35-3, due to the uncertainty of the amount and timing of the expected cash flows from USCFCU AME, recoveries shall be recognized when cash is received under the cost recovery method. As of December 31, 2017, \$480.0 million has been recognized as interest revenue in the NCUSIF due to the remaining recovery of the \$1.0 billion capital note from the AME of USCFCU. Coupled with the previous partial recovery of \$520.0 million recognized in September 2017 in the TCCUSF, the principal balance of the capital note has been fully recovered as of December 31, 2017.

Non-Exchange Revenue

Non-exchange revenues are inflows of resources that the federal government demands or receives by donation. Such revenues are recognized when a specifically identifiable, legally enforceable claim to resources arises, to the extent that collection is probable (more likely than not) and the amount is reasonably estimable. The NCUSIF recognizes non-exchange revenue as described below.

Each insured credit union pays to and maintains with the NCUSIF a capitalization deposit amount equal to 1.00% of its insured shares. This amount is recognized as non-exchange revenue when invoiced. In accordance with SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, interest revenue on investments in U.S. Treasury securities is recognized as non-exchange revenue because the main source of funds for investments comes from capital deposits. Additionally, the related unrealized holding gains and losses on investments in U.S. Treasury securities are excluded from net costs and reported as a component of non-exchange revenue.

Tax-Exempt Status

The NCUA, as a government entity, is not subject to federal, state, or local income taxes and accordingly, no provision for income taxes is recorded for the NCUSIF.

Reclassification

Certain prior year amounts have been reclassified to conform to the current year presentation.

2. FUND BALANCE WITH TREASURY

FBWT balances and status at December 31, 2017 and 2016, consisted of the following (in thousands):

	<u>2017</u>	<u>2016</u>
Total Fund Balance with Treasury: Revolving Funds	\$ <u>3,162</u>	\$ <u>4,410</u>
Status of Fund Balance with Treasury:		
Unobligated Balance - Available	\$ 16,127,894	\$ 12,723,150
Obligated Balances Not Yet Disbursed	10,409	9,261
Non-Budgetary Investment Accounts	(16,080,506)	(12,656,476)
Non-FBWT Budgetary Accounts	<u>(54,635)</u>	<u>(71,525)</u>
Total	<u>\$ 3,162</u>	<u>\$ 4,410</u>

As a revolving fund, the FBWT account is used for continuing business-like activities. The NCUSIF collects premiums, capitalization deposits, guarantee fees and AME recoveries, which in turn may be invested in U.S. Treasury securities. The proceeds are primarily held to cover insurance losses and guarantee payments, and are also used for merger assistance, liquidations, and other administrative expenses, without requirement for annual appropriations. The FBWT account contains monies available for future obligations as well as monies obligated for current activities. Non-Budgetary Investment Accounts, which consist of U.S. Treasury investments, reduce the status of fund balance. Non-FBWT Budgetary Accounts may consist of budgetary receivables, borrowing authority, and non-expenditure transfers. Funds not needed for immediate liquidity are invested in overnight U.S. Treasury securities.

On October 1, 2017, \$1.9 billion was distributed in cash from the TCCUSF to the NCUSIF through the closing of the TCCUSF.

As of December 31, 2017 and 2016, there were no unreconciled differences between U.S. Treasury records and balances reported on the NCUSIF's general ledger.

3. INVESTMENTS

The FCU Act, Section 203(c), 12 U.S.C. § 1783(c), as amended, provides guidance regarding U.S. Treasury security investments. All investments at the NCUSIF pertain to marketable (available-for-sale) U.S. Treasury securities of varying maturities and non-marketable (held-to-maturity) U.S. Treasury daily overnight securities. Premiums or discounts on available-for-sale securities are amortized using the effective interest method.

As of December 31, 2017 and 2016, the carrying amount, gross unrealized holding gains, gross unrealized holding losses, and fair value of U.S. Treasury securities were as follows (in thousands):

	<u>Cost</u>	<u>Amortized (Premium) Discount</u>	<u>Interest Receivable</u>	<u>Investments, Net (Par)</u>	<u>Net Unrealized Gain (Loss)</u>	<u>Carrying/ Fair Value</u>
As of December 31, 2017:						
U.S. Treasury Securities						
Available-for-Sale	\$ 13,449,547	\$ (75,758)	\$ 54,635	\$ 13,300,000	\$ (116,450)	\$ 13,257,339
Held to Maturity	<u>2,849,161</u>	<u>-</u>	<u>-</u>	<u>2,849,161</u>	<u>-</u>	<u>2,849,161</u>
Total	<u>\$ 16,298,708</u>	<u>\$ (75,758)</u>	<u>\$ 54,635</u>	<u>\$ 16,149,161</u>	<u>\$ (116,450)</u>	<u>\$ 16,106,500</u>
As of December 31, 2016:						
U.S. Treasury Securities						
Available-for-Sale	\$ 12,789,828	\$ (141,673)	\$ 71,525	\$ 12,600,000	\$ (75,389)	\$ 12,572,766
Held to Maturity	<u>151,953</u>	<u>-</u>	<u>-</u>	<u>151,953</u>	<u>-</u>	<u>151,953</u>
Total	<u>\$ 12,941,781</u>	<u>\$ (141,673)</u>	<u>\$ 71,525</u>	<u>\$ 12,751,953</u>	<u>\$ (75,389)</u>	<u>\$ 12,724,719</u>

Maturities of U.S. Treasury securities as of December 31, 2017 and 2016 were as follows (in thousands):

	<u>2017 Fair Value</u>	<u>2016 Fair Value</u>
Held to Maturity (Overnights)	\$ 2,849,161	\$ 151,953
Available-for-Sale:		
Due in one year or less	2,341,183	1,407,547
Due after one year through five years	7,675,250	4,991,625
Due after five years through ten years	<u>3,240,906</u>	<u>6,173,594</u>
	<u>\$ 16,106,500</u>	<u>\$ 12,724,719</u>

For the years ended December 31, 2017 and 2016, there were realized gains from sales of Treasury securities of \$131.6 thousand and \$0, respectively.

The following table includes gross unrealized losses on investment securities, for which an OTTI has not been recognized, in addition to the fair values of those securities, aggregated by investment classification and length of time the investments have been in a loss position, at December 31, 2017 and 2016 (in thousands):

	Losses		Losses		Total	
	Less than 12 months		12 months or more			
	Unrealized Losses	Fair Value	Unrealized losses	Fair value	Unrealized losses	Fair value
As of December 31, 2017:						
Available-for-Sale:						
U.S. Treasury Securities	\$ (52,278)	\$ 9,542,745	\$ (64,769)	\$ 3,023,844	\$ (117,047)	\$ 12,566,589
As of December 31, 2016:						
Available-for-Sale:						
U.S. Treasury Securities	\$ (168,270)	\$ 7,633,360	\$ -	\$ -	\$ (168,270)	\$ 7,633,360

4. ACCOUNTS RECEIVABLE

Public – Accounts Receivable

Accounts Receivable Due from Insured Credit Unions

As of December 31, 2017 and 2016, accounts receivable due from insured credit unions were \$1.9 million and \$0, respectively.

NGN Guarantee Fee Receivable

For a fee, the NCUA guarantees the timely payment of principal and interest on the NGNs. Guarantee fees on each NGN Trust are 35 basis points per year, payable monthly, on the outstanding balance of the NGNs. As of December 31, 2017, the NGN guarantee fee receivable was \$1.3 million. There was no corresponding balance as of December 31, 2016, as the receivable was not transferred to the NCUSIF from the TCCUSF until October 1, 2017.

As none of these amounts were deemed uncollectible, the allowance for doubtful accounts on public accounts receivable as of December 31, 2017 and 2016 was \$0.

5. NOTES RECEIVABLE

Intragovernmental – Notes Receivable

Note Due from the NCUA Operating Fund

In 1992, the NCUSIF lent \$42.0 million to the NCUA Operating Fund, pursuant to a 30-year note secured by the NCUA premises in Alexandria, Virginia. Interest income recognized was approximately \$127.6 thousand and \$179.0 thousand for the years ended December 31, 2017 and 2016, respectively. The note receivable balance as of December 31, 2017 and 2016 was approximately \$7.7 million and \$9.1 million, respectively.

The variable rate on the note is equal to the NCUSIF's prior-month yield on investments. The average interest rate for the years ended December 31, 2017 and 2016 was 1.51% and 1.84%,

respectively. The interest rate as of December 31, 2017 and 2016 was 1.59% and 1.83%, respectively.

As of December 31, 2017, the above note requires principal repayments as follows (in thousands):

<u>Years Ending December 31</u>	<u>Secured Term Note</u>
2018	\$ 1,341
2019	1,341
2020	1,341
2021	1,341
2022	1,341
Thereafter	<u>1,005</u>
Total	<u>\$ 7,710</u>

Public – Notes Receivable

As of December 31, 2017 and 2016, the NCUSIF did not have any outstanding capital notes due from insured credit unions.

6. GENERAL PROPERTY, PLANT AND EQUIPMENT, NET

The components of General Property, Plant and Equipment as of December 31, 2017 and 2016 were as follows (in thousands):

	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>
As of December 31, 2017:			
Assets under Capital Lease	\$ 471	\$ (435)	\$ 36
Internal-Use Software	<u>2,017</u>	<u>(1,491)</u>	<u>526</u>
Total General Property, Plant and Equipment	<u>\$ 2,488</u>	<u>\$ (1,926)</u>	<u>\$ 562</u>
As of December 31, 2016:			
Assets under Capital Lease	\$ 471	\$ (290)	\$ 181
Internal-Use Software	<u>2,017</u>	<u>(1,006)</u>	<u>1,011</u>
Total General Property, Plant and Equipment	<u>\$ 2,488</u>	<u>\$ (1,296)</u>	<u>\$ 1,192</u>

Assets under capital lease are depreciable over 39 months, which corresponds with the life of the underlying capital lease. Internal use software has a useful life of three years per the NCUA capitalization policy.

As of December 31, 2017 and 2016, the NCUSIF had no internal labor costs attributable to internal use software during its software development stage. The NCUSIF reimburses the Operating Fund for these internal labor costs since these costs are incurred by the Operating Fund.

7. OTHER – RECEIVABLES FROM ASSET MANAGEMENT ESTATES

AMEs include assets and liabilities from failed natural person credit unions (NPCU AMEs), as well as the corporate credit union AMEs (Corporate AMEs). As of December 31, 2017 and 2016, the gross receivable from AMEs was \$4.0 billion and \$926.2 million, and the related allowance for loss was \$3.5 billion and \$867.8 million, for a net receivable from AMEs of \$495.0 million and \$58.4 million, respectively.

	2017			2016
	<u>NPCU AMEs</u>	<u>Corporate AMEs</u>	<u>Total</u>	<u>NPCU AMEs only</u>
Gross Receivable from AME	\$ 796,436	\$ 3,165,931	\$ 3,962,367	\$ 926,171
Allowance for Loss, beginning balance	867,820	-	867,820	922,184
Transfer-In of Allowance for Loss from TCCUSF, effective 10/1/2017	-	2,681,036	2,681,036	-
AME Receivable Bad Debt Expense (Reduction)	(20,295)	(1,187)	(21,482)	(36,562)
Increase in Allowance	18,376	-	18,376	10,708
Write-off of Cancelled Charters	(78,997)	-	(78,997)	(27,939)
Other	593	-	593	(571)
Allowance for Loss, ending balance	<u>787,497</u>	<u>2,679,849</u>	<u>3,467,346</u>	<u>867,820</u>
Receivable from AME, Net	<u>\$ 8,939</u>	<u>\$ 486,082</u>	<u>\$ 495,021</u>	<u>\$ 58,351</u>

AME Receivable Bad Debt Reduction for the NPCU AMEs represents overall increases in expected asset recovery rates and related repayments. The Increase in Allowance primarily represents the net loss on payments made during liquidation. The amounts for Write-off of Cancelled Charters total the final loss or recovery recognized upon closing AMEs.

AME Receivable Bad Debt Reduction for the Corporate AMEs takes into account the NCUA's assessment of expected recovery from the Corporate AMEs that reflects the NCUA's expectations and assumptions about the recovery value of the Corporate AMEs' assets, as further discussed under fiduciary activities in Note 14.

8. OTHER LIABILITIES – INSURANCE AND GUARANTEE PROGRAM LIABILITIES

Insured Credit Unions

The NCUA identifies insured credit unions experiencing financial difficulty through the NCUA's supervisory and examination process. On both a general and specific case basis, management determines the estimated losses from these credit unions. The NCUA also evaluates overall economic trends and monitors potential system-wide risk factors, such as increasing levels of consumer debt, bankruptcies, and delinquencies. The NCUA uses the CAMEL rating system to evaluate an insured credit union's financial condition and operations. The CAMEL rating system is a tool to measure risk and allocate resources for supervisory purposes. The general reserve is derived using an internal econometric model that applies estimated probability of failure and loss rates and takes into account the historical loss history, CAMEL ratings, credit union level financial ratios, and other economic measures. In addition,

specific reserves are identified for those credit unions where failure is probable and where additional information is available to make a reasonable estimate of losses. The anticipated losses for specific reserves are net of estimated recoveries from the disposition of the assets of failed credit unions. The total general and specific reserves for losses resulting from insured credit union failures were \$925.5 million and \$196.6 million as of December 31, 2017 and 2016, respectively.

In exercising its supervisory function, the NCUSIF will occasionally extend guarantees of assets (primarily loans) to third-party purchasers or existing insured credit unions in order to facilitate mergers. The NCUSIF would be obligated upon borrower nonperformance. There were no guarantees outstanding during 2017 or as of December 31, 2017. There were no guarantees outstanding during 2016 or as of December 31, 2016.

In addition, the NCUSIF may grant a guaranteed line-of-credit to a third-party lender, such as a corporate credit union or bank, if a particular insured credit union were to have a current or immediate liquidity concern and the third-party lender refuses to extend credit without a guarantee. The NCUSIF would thereby be obligated if the insured credit union failed to perform. Total line-of-credit guarantees of credit unions as of December 31, 2017 and 2016 were approximately \$410.0 million and \$1.7 million, respectively. The insured credit unions borrowed \$206.0 million and \$0 from the third-party lender under these lines-of-credit guarantees as of December 31, 2017 and 2016. As of December 31, 2017 and 2016, the NCUSIF reserved \$9.0 million and \$40.0 thousand, respectively, for these guaranteed lines-of-credit.

On rare occasions, the NCUSIF may provide indemnifications as part of merger assistance or purchase and assumption agreements with acquiring credit unions. Such indemnifications make the NCUSIF contingently liable based on the outcome of any legal actions. There were no such indemnification contingencies as of December 31, 2017 and 2016, respectively.

The activity in the Insurance and Guarantee Program Liabilities from insured credit unions and AMEs was as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Beginning balance	\$ 196,617	\$ 164,857
Reserve Expense (Reduction)	747,777	44,432
Insurance losses claims paid	(33,758)	(27,882)
Net Estimated Recovery/Claim on AMEs	<u>14,851</u>	<u>15,210</u>
Ending balance	<u>\$ 925,487</u>	<u>\$ 196,617</u>

The Insurance and Guarantee Program Liabilities at December 31, 2017 and December 31, 2016 were comprised of the following:

- Specific reserves were \$818.6 million and \$2.9 million, respectively. Specific reserves are identified for those credit unions where failure is probable and where additional information is available to make a reasonable estimate of losses. During the year, specific reserves increased based on information acquired through NCUA's supervisory actions. This information provided additional clarity concerning the probability and amount of estimated insurance losses for certain troubled credit unions. Actual losses

could vary and may be materially different from the estimated losses recognized as of December 31, 2017.

- General reserves were \$106.9 million and \$193.7 million, respectively.

In addition to these recognized contingent liabilities, adverse performance in the financial services industry could result in additional losses to the NCUSIF. The ultimate losses for insured credit unions will largely depend upon future economic and market conditions and, accordingly, could differ significantly from these estimates.

NCUA Guaranteed Notes

The TCCUSF was principally responsible for the guarantees related to the NGNs. Effective October 1, 2017, these guarantee obligations were transferred to the NCUSIF. The NCUA's guarantees on the NGNs are a direct result of the NCUA's implementation of the CSRP. Pursuant to the FCU Act, the NCUA is authorized to assess insured credit unions for the recovery of any losses from this initiative. The NCUA uses both internal and external models to estimate contingent liabilities associated with the NGN Program, as discussed herein. The NCUSIF recorded no contingent liabilities on its Balance Sheet for NGNs as of December 31, 2017.

Beginning in October 2010, the NCUA Board, as liquidating agent of the AMEs, transferred Legacy Assets to NGN Trusts and re-securitized them through the issuance of a series of floating and fixed-rate NGNs. The NGNs have final maturities ranging from 2016 to 2021. As of December 31, 2017, the outstanding principal balance of the NGNs was \$5.4 billion. This amount represents the maximum potential, but not the expected, future guarantee payments that the NCUA could be required to make.

The NCUA, now through the NCUSIF, is liable to make guarantee payments through the NGN Trusts to the NGN holders under certain conditions outlined in the respective indentures and related agreements with respect to timely payment of interest and ultimate principal on the NGNs. In addition to the ultimate payment of principal and interest, the guarantee requires parity payments when the unpaid principal balance of all Legacy Assets underlying a particular NGN Trust, after realized and implied losses, if applicable, is less than the remaining unpaid principal balance of the related NGNs after distribution of all cash collected on the Legacy Assets for any given payment date.

As of December 31, 2017, there were no probable losses for the guarantee of NGNs associated with the re-securitization transactions. Although the gross estimated guarantee payments were approximately \$2.7 billion, these payments are estimated to be offset by:

- i) contractual guarantee reimbursements and interest based on NGN governing documents from the Legacy Assets of the NGN Trusts of approximately \$2.6 billion as of December 31, 2017; and
- ii) receivables from the Corporate AMEs based on the value of their economic residual interests in NGN Trusts of up to approximately \$1.3 billion as of December 31, 2017, respectively.

Recoveries in the form of potential guarantor reimbursements by the NGN Trusts to the NCUA are subordinate to payments on the NGNs in accordance with the respective indentures. As

such, reimbursements of guarantee payments to the NCUA will not occur until the applicable NGNs have been repaid in full; after the NGNs are repaid in full, any cash flows received on the Legacy Assets underlying the NGN Trusts are directed toward reimbursements until the NCUA is reimbursed in full. The NCUA earns interest on any guarantee payments not yet reimbursed by the NGN Trusts at a rate equal to the interest rate on the associated NGNs.

Guarantee fees are senior in the NGN Trust payment waterfall in accordance with the respective indentures. It is expected that the NCUA will receive a guarantee fee payment from the NGN Trusts on each NGN payment date. The guarantee fee amount due to the NCUA, at each monthly payment date, is equal to 35 basis points per year on the outstanding NGN balance prior to the distribution of principal on the payment date.

The NCUA's estimated guarantee payments, guarantor reimbursements, and the recovery value of the Corporate AMEs' economic residual interests in the NGN Trusts are derived using an external model that distributes estimated cash flows of the Legacy Assets transferred to the NGN Trusts in the priority of payments pursuant to the indenture of each NGN Trust. The estimated cash flows incorporate the NCUA's assumptions about discount rates.

The estimated cash flows of the Legacy Assets transferred to the NGN Trusts are also derived from the external model that incorporates the NCUA's expectations and assumptions about the estimated cash flows from the collateral that supports the Legacy Assets, and the priority of payments and estimated cash flows of the Legacy Assets pursuant to the governing documents for the respective Legacy Assets.

The external model produces estimated cash flows of collateral underlying the Legacy Assets by incorporating the NCUA's expectations and assumptions about prepayments, defaults and loss severity of the collateral consisting of residential and commercial mortgage loans and other assets. Assumptions about prepayments, defaults and loss severity are developed based on the characteristics and historical performance of the collateral, as well as assumptions about macroeconomic variables such as unemployment rates, housing prices and interest rates.

9. OTHER LIABILITIES

The NCUSIF leases laptops for state credit union examiners under a capital lease agreement that will run through early 2018. The capital lease liability as of December 31, 2017 and 2016 was \$0 and \$160.6 thousand, respectively. The future minimum lease payments to be paid over the remaining life as of December 31, 2017, is \$0.

10. INTRAGOVERNMENTAL COSTS AND EXCHANGE REVENUE

Program costs and revenues are separated between Intragovernmental and Public to facilitate government-wide financial reporting. Intragovernmental revenue and costs arise from transactions with other federal entities. Public revenue and costs arise from transactions with domestic and foreign persons and organizations outside of the federal government. Intragovernmental costs and exchange revenue as of December 31, 2017 and 2016 were as follows (in thousands):

Intragovernmental Costs and Exchange Revenue	2017	2016
Intragovernmental Costs	\$ 189,217	\$ 203,026
Public Costs/(Cost Reduction)	736,094	14,104
Total	<u>925,311</u>	<u>217,130</u>
Intragovernmental Exchange Revenue	(128)	(179)
Public Exchange Revenue	(486,843)	(2,284)
Total	<u>(486,971)</u>	<u>(2,463)</u>
Net Cost	<u>\$ 438,340</u>	<u>\$ 214,667</u>

Certain administrative services are provided to the NCUSIF by the NCUA Operating Fund. The NCUSIF is charged by the NCUA Operating Fund for these services based upon an annual allocation factor derived from a study of actual usage. In 2017 and 2016, the allocation to the NCUSIF was 67.7% and 73.1% of the NCUA Operating Fund expenses, respectively. The cost of the services allocated to the NCUSIF, which totaled approximately \$189.2 million and \$203.0 million for the years ended December 31, 2017 and 2016, respectively, is reflected as an expense in the Statements of Net Cost and above in Intragovernmental Costs. These transactions are settled monthly. As of December 31, 2017 and 2016, amounts due to the NCUA Operating Fund for allocated administrative expenses were \$5.2 million and \$4.1 million, respectively. The following table provides a breakdown of the administrative services provided to the NCUSIF by the NCUA Operating Fund (in thousands):

Administrative Services Reimbursed to the NCUA Operating Fund	2017	2016
Employee Salaries	\$ 100,606	\$ 109,225
Employee Benefits	40,553	42,174
Employee Travel	15,617	19,252
Contracted Services	19,019	18,479
Administrative Costs	5,443	6,122
Depreciation and Amortization	3,655	3,591
Rent, Communications, and Utilities	<u>4,324</u>	<u>4,183</u>
Total Services Provided by the NCUA Operating Fund	<u>\$ 189,217</u>	<u>\$ 203,026</u>

11. AVAILABLE BORROWING AUTHORITY, END OF PERIOD

The NCUSIF has \$6.0 billion in borrowing authority from the U.S. Treasury. Available borrowing authority, as of December 31, 2017 and 2016, was \$6.0 billion and \$6.0 billion, respectively.

Under the FCU Act, the NCUSIF also has the ability to borrow from the CLF. The NCUSIF is authorized to borrow from the CLF up to the amount of the CLF's unused borrowing authority. As of December 31, 2017 and 2016, the CLF had statutory borrowing authority of \$6.6 billion

and \$6.1 billion, respectively. As of December 31, 2017 and 2016, the CLF had a note purchase agreement with the Federal Financing Bank with a maximum principal of \$2.0 billion and \$2.0 billion, respectively, all of which was unused. Advances made under the current promissory note can be made no later than March 31, 2018.

At December 31, 2017 and 2016, the NCUSIF had \$8.0 billion and \$8.0 billion, respectively, in total available borrowing capacity.

12. DISCLOSURES RELATED TO THE STATEMENTS OF BUDGETARY RESOURCES

The Statements of Budgetary Resources discloses total budgetary resources available to the NCUSIF, and the status of resources as of December 31, 2017 and 2016. Activity impacting budget totals of the overall federal government budget is recorded in the NCUSIF's Statements of Budgetary Resources budgetary accounts. As of December 31, 2017 and 2016, the NCUSIF's resources in budgetary accounts were \$16.9 billion and \$13.0 billion, respectively, and undelivered orders were \$863.8 thousand and \$2.9 million, respectively. All liabilities are covered by budgetary resources, excluding the Insurance and Guarantee Program Liabilities because they are contingent liabilities and do not require budgetary resources until the liabilities are no longer contingent. All obligations incurred by the NCUSIF are reimbursable. The NCUSIF is exempt from OMB apportionment control.

Budgetary resources listed on the NCUSIF's financial statements and the budgetary resources found in the budget of the federal government differ because the NCUSIF's statements are prepared as of December 31, on a calendar year, rather than as of September 30, the federal government's fiscal year end.

13. CONTRIBUTED CAPITAL

The *Credit Union Membership Access Act of 1998*, Public Law 105–219 (CUMAA), mandated changes to the NCUSIF's capitalization provisions, effective January 1, 2000. Under Section 202(c) of the FCU Act, 12 U.S.C. § 1782(c), each insured credit union must pay to and maintain with the NCUSIF a deposit in an amount equaling 1.00% of the credit union's insured shares. The CUMAA added provisions mandating that the amount of each insured credit union's deposit is adjusted as follows, in accordance with procedures determined by the NCUA Board, to reflect changes in the credit union's insured shares: (i) annually, in the case of an insured credit union with total assets of less than \$50.0 million; and (ii) semi-annually, in the case of an insured credit union with total assets of \$50.0 million or more. The annual and semi-annual adjustments are based on insured member share deposits outstanding as of December 31 of the preceding year and June 30 of the current year, respectively. The 1.00% contribution is returned to the insured credit union in the event that its insurance coverage is terminated, or is obtained from another source, or the operations of the NCUSIF are transferred from the NCUA Board. As of December 31, 2017 and 2016, contributed capital owed to the NCUSIF totaled \$1.9 million and \$0, respectively. As of December 31, 2017 and 2016, contributed capital due to insured credit unions was \$0 and \$1.9 million, respectively.

Beginning in 2000, the CUMAA mandated that distributions to insured credit unions be determined from specific ratios, which are based in part upon year-end data. Accordingly, distributions associated with insured shares at year-end are declared and paid in the subsequent year. The NCUSIF equity ratio is calculated as the ratio of contributed capital plus cumulative

results of operations, excluding net cumulative unrealized gains and losses on investments, to the aggregate amount of the insured shares in all insured credit unions. On September 28, 2017, the Board set the NOL at 1.39%, increasing it from 1.30%.

Pursuant to the FCU Act, the NCUSIF-calculated equity ratio is 1.46% as of December 31, 2017. This equity ratio is based on insured shares of \$1.1 trillion as of December 31, 2017, and is above the normal operating level of 1.39%. The NCUA Board will convene in 2018 to declare a distribution based on actual insured shares as of December 31, 2017.

As of December 31, 2016, the NCUSIF equity ratio of 1.24% was below the normal operating level of 1.30%; therefore, the NCUSIF did not estimate or record a distribution in 2017. Total contributed capital as of December 31, 2017 and 2016 was \$10.8 billion and \$10.0 billion, respectively. Total insured shares as of December 31, 2016, was \$1.0 trillion.

The NCUSIF's available assets ratio as of December 31, 2017 and 2016 was 1.40% and 1.22%, based on total insured shares as of December 31, 2017 and 2016 of \$1.1 trillion and \$1.0 trillion, respectively. The NCUSIF available assets ratio, as defined by the FCU Act, is calculated as the ratio of (A) the amount determined by subtracting (i) direct liabilities of the NCUSIF and contingent liabilities for which no provision for losses has been made, from (ii) the sum of cash and the market value of unencumbered investments authorized under Section 203(c) of the FCU Act, to (B) the aggregate amount of the insured shares in all insured credit unions.

14. FIDUCIARY ACTIVITIES

Fiduciary activities are the collection or receipt, management, protection, accounting, investment, and disposition by an AME of cash and other assets, in which non-federal individuals or entities have an ownership interest. Fiduciary assets are not assets of the federal government. Fiduciary activities are not recognized on the basic financial statements, but are reported on schedules in the notes to the financial statements in accordance with SFFAS No. 31, *Accounting for Fiduciary Activities*. The NCUA Board, as liquidating agent of the AMEs, disburses obligations owed by and collects money due to the liquidating credit unions through AMAC.

Fiduciary assets are recorded at values that are estimated to be recovered based on market information and external valuations, such as appraisals, as well as internal and external models incorporating the NCUA's current assumptions regarding numerous factors, including prepayments, defaults, loss severity and discount rates. Legacy Assets may benefit from litigation and other efforts by various trustees, insurers, investors, and investor consortiums, including the NCUA Board as liquidating agent, to recover losses that the Legacy Assets have suffered. Any benefits from these recovery efforts will be recognized by an AME when receipt is certain. Fiduciary liabilities related to borrowings and claims are recorded at their contractual or settlement amounts as agreed by the liquidating agents and the creditors. Contingent liabilities related to legal actions are recorded if probable and measurable. Accrued liquidation costs reflect the NCUA's estimates and assumptions regarding the timing and associated costs to dispose of the AME assets. The future estimate of liquidation costs, as well as the actual amounts, could differ materially from current estimates and assumptions.

Unless expressly guaranteed by the NCUA and backed by the full faith and credit of the United States, the AMEs' unsecured creditors, including the NCUSIF, could only expect to be paid if recoveries from the assets of the AMEs are sufficient to be distributed to the unsecured creditors in order of priority as set forth in 12 CFR §709.5(b).

(a) Natural Person Credit Unions AMEs

Following is the Schedule of Fiduciary Activity as of December 31, 2017 and 2016 (in thousands):

<u>Schedule of Fiduciary Activity</u>	<u>2017</u>	<u>2016</u>
Fiduciary Net Liabilities, beginning of year	\$ (871,271)	\$ (929,060)
Net Realized Losses upon Liquidation	(23,774)	(6,346)
Revenues		
Interest on Loans	2,481	6,411
Other Fiduciary Revenues	451	424
Expenses		
Professional & Outside Services Expenses	(4,319)	(4,650)
Compensation and Benefits	(871)	(1,409)
Other Expenses	(667)	(1,295)
Net Change in Recovery Value of Assets and Liabilities		
Net Gain/(Loss) on Loans	16,803	32,891
Net Gain/(Loss) on Real Estate Owned	(1,090)	(1,349)
Other, Net Gain/(Loss)	7,857	5,173
(Increase)/Decrease in Fiduciary Net Liabilities	<u>(3,129)</u>	<u>29,850</u>
Write off of Fiduciary Liabilities for Cancelled Charters	78,997	27,939
Fiduciary Net Liabilities, end of year	<u>\$ (795,403)</u>	<u>\$ (871,271)</u>

Comparing 2017 activity in the schedule of fiduciary activity with 2016, the NPCU AMEs' fiduciary net liabilities improved by \$75.9 million overall, including an increase in fiduciary net liabilities of \$3.1 million and cancelled charter write-offs of \$79.0 million. For 2017, the primary drivers were an improvement (decrease) in net realized losses upon liquidation, improvement in the recovery value of assets and liabilities, and cancelled charters. The net realized losses upon liquidation increased by \$17.5 million due, in part, to an increase in the average cost of failure per credit union for liquidations during 2017. The net change in recovery value of assets and liabilities line items increased by \$33.0 million due to rising net realizable values of assets managed. Charter cancellation write-offs increased by \$51.1 million, corresponding with more credit union charter cancellations in 2017 than the previous year.

Revenues consist of cash collected during the liquidation of assets held within the AME. Gains and losses include the revaluation of assets based upon expected asset recovery rates, as well as the disposition of assets and adjustments to liabilities, which contribute to the change in fiduciary net assets/liabilities. Following is the Schedule of Fiduciary Net Assets/Liabilities as of December 31, 2017 and 2016 (in thousands):

<u>Schedule of Fiduciary Net Assets/Liabilities</u>	<u>2017</u>	<u>2016</u>
Fiduciary Assets		
Loans	\$ 9,042	\$ 61,392
Real Estate Owned	8,798	10,231
Other Fiduciary Assets	3,565	4,061
Total Fiduciary Assets	<u>21,405</u>	<u>75,684</u>
Fiduciary Liabilities		
Insured Shares	1,535	1,373
Accrued Liquidation Expenses	14,441	15,220
Unsecured Claims	1,277	409
Uninsured Shares	3,119	3,782
Due to NCUSIF (Note 7)	796,436	926,171
Total Fiduciary Liabilities	<u>816,808</u>	<u>946,955</u>
Total Fiduciary Net Assets/(Liabilities)	<u>\$ (795,403)</u>	<u>\$ (871,271)</u>

(b) Corporate AMEs (Legacy TCCUSF AMEs)

Following are the Schedules of Fiduciary Activity for the three months ended December 31, 2017 (in thousands):

<u>Schedule of Fiduciary Activity</u>	<u>For the Three Months Ended December 31, 2017</u>			
	AMEs	NGN Trusts	Eliminations	Total
Fiduciary Net Liabilities, October 1, 2017	<u>\$ 682,257</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 682,257</u>
Revenues				
Interest on Loans	(2,361)	-	-	(2,361)
Income from AMEs on Re-Securitized Assets	-	(140,461)	140,461	-
Income from Investment Securities	(190,409)	-	-	(190,409)
Settlements and Legal Claims	(858,080)	-	-	(858,080)
Other Fiduciary Revenues	(5,591)	-	-	(5,591)
Expenses				
Professional and Outside Services Expenses	215,600	-	-	215,600
Interest Expense on Borrowings and NGNs	-	116,990	-	116,990
Payments to NGN Trusts	140,461	-	(140,461)	-
Guarantee Fees	-	23,471	-	23,471
Other Expenses	634	-	-	634
Net Change in Recovery Value of Assets and Liabilities	627,365	-	-	627,365
Charter Cancellation	20,444	-	-	20,444
Decrease in Fiduciary Net Liabilities	<u>(51,937)</u>	<u>-</u>	<u>-</u>	<u>(51,937)</u>
Fiduciary Net Liabilities, December 31, 2017	<u>\$ 630,320</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 630,320</u>

For the three months ended December 31, 2017, the Corporate AMEs' Fiduciary Net Liabilities decreased by \$51.9 million. This decrease represents a benefit to the AME claimants, of which a portion was recognized by the NCUSIF through the reduction of the AME Receivable Bad Debt Expense, as discussed in Note 7. The main driver of this decrease was \$858.1 million in revenues from Settlements and Legal Claims. The Net Change in Recovery Value of Assets and Liabilities line includes the realized and unrealized gains and losses on the Legacy Assets, loans, real estate, investments and other assets and liabilities. For the three months ended December 31, 2017, this line was \$627.4 million, which reflects a net loss that is the combination of the \$480.0 million, paid on the \$1.0 billion capital note by the AME of USCFCU and improving values of the anticipated future cash flows of the Legacy Assets in the NGN Program.

The Schedule of Fiduciary Activity includes revenues earned on investments, including Legacy Assets, loans, real estate and other investments, and expenses incurred in orderly liquidation of the AMEs, including interest expense on borrowings and the NGNs.

Following are the Schedules of Fiduciary Net Assets/Liabilities as of December 31, 2017 (in thousands):

Schedule of Fiduciary Net Assets/Liabilities	As of December 31, 2017			
	AMEs	NGN Trusts	Eliminations	Total
Fiduciary Assets				
Cash and Cash Equivalents	\$ 168,535	\$ 125,541	\$ -	\$ 294,076
Legacy Assets	1,074,365	-	-	1,074,365
Legacy Assets/Investments Collateralizing the NGNs	6,281,218	314,069	-	6,595,287
Loans	54,955	-	-	54,955
Receivable from AMEs	-	5,009,469	(5,009,469)	-
Other Fiduciary Assets	178	-	-	178
Total Fiduciary Assets	<u>7,579,251</u>	<u>5,449,079</u>	<u>(5,009,469)</u>	<u>8,018,861</u>
Fiduciary Liabilities				
Accrued Expenses	(34,065)	(8,669)	-	(42,734)
NGNs	-	(5,440,410)	-	(5,440,410)
Due to NGN Trusts	(5,009,469)	-	5,009,469	-
Unsecured Claims and Payables	(106)	-	-	(106)
Due to NCUSIF (Note 7)	(3,165,931)	-	-	(3,165,931)
Total Fiduciary Liabilities	<u>(8,209,571)</u>	<u>(5,449,079)</u>	<u>5,009,469</u>	<u>(8,649,181)</u>
Total Fiduciary Net Assets/(Liabilities)	<u>\$ (630,320)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (630,320)</u>

The Schedule of Fiduciary Net Assets reflects the expected recovery value of the Corporate AMEs' assets, including the Legacy Assets collateralizing the NGNs issued through the NGN Trusts, and the settlement value of valid claims against the Corporate AMEs outstanding at December 31, 2017. Certain claims against the Corporate AMEs and the NGNs are guaranteed by the NCUA as previously discussed herein.

Cash flows from the Legacy Assets securing the NGN 2011-R4 1A Trust paid off the outstanding NGN principal balances on October 5, 2017, resulting in the maturity of this trust

prior to its scheduled maturity date. Additionally, on November 6, 2017, NGN 2010-R2 1A matured on its legal maturity date.

As of December 31, 2017 and December 31, 2016, the NCUA held \$167.0 million and \$0, respectively, in fiduciary cash on behalf of the Corporate AMEs.

15. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

The Reconciliation of Net Cost of Operations to Budget explains the difference between the budgetary net obligations and the proprietary net cost of operations. The Reconciliation of Net Cost of Operations to Budget consisted of the following (in thousands):

Budgetary Resources Obligated		
New Obligations and Upward Adjustments (Total)	\$ 731,503	\$ 274,249
Less: Spending Authority from Offsetting Collections and		
Change in Receivables from Federal Sources	<u>(2,249,175)</u>	<u>(1,086,690)</u>
Net Obligations	(1,517,672)	(812,441)
Other Resources:		
Net Unrealized (Gain)/Loss	<u>41,061</u>	<u>136,123</u>
Total Resources Provided to Finance Activities	<u>(1,476,611)</u>	<u>(676,318)</u>
Resources Provided to Fund Items Not Part of the Net Cost of Operations:		
Change in Budgetary Resources Obligated for Goods and		
Services Not Yet Received	3,502	(790)
Costs Capitalized on the Balance Sheet	1,095,211	822,486
Other Resources or Adjustments to Net Obligated Resources		
that do not Affect Net Cost of Operations	<u>89,179</u>	<u>60,483</u>
Total Resources Provided to Fund Items Not Part of the		
 Net Cost of Operations	<u>1,187,892</u>	<u>882,179</u>
Resources Generated to Finance the Net Cost of Operations	<u>(288,719)</u>	<u>205,861</u>
Components of Net Cost of Operations that will not		
Require or Generate Resources in the Current Period:		
Provision for Insurance Losses		
Reserve Expense (Reduction)	747,777	44,432
AME Receivable Bad Debt Expense (Reduction)	(21,482)	(36,562)
Increase in Exchange Revenue	-	253
Change in Accrued Leave	2	-
Depreciation Expense	630	590
Other Expenses	<u>132</u>	<u>93</u>
Total Components of Net Cost of Operations That Do Not		
 Require or Generate Resources During the Reporting Period	<u>727,059</u>	<u>8,806</u>
Net Cost of Operations	<u>\$ 438,340</u>	<u>\$ 214,667</u>

Other Resources or Adjustments to Net Obligated Resources that do not affect Net Cost of Operations consists largely of unrealized losses on investments net of investment revenue and increases to the receivable from AME Allowance due to transfers, net of AME receivable bad debt expense.

16. SUBSEQUENT EVENTS

Subsequent events have been evaluated through February 14, 2018, which is the date the financial statements were available to be issued. Management determined that there were no significant items to be disclosed as of December 31, 2017.

REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)

Risk Assumed Information

Insurance and Guarantee Program Liabilities

Insured Credit Unions

As of December 31, 2017 and 2016, the aggregate outstanding insured shares of the insured credit unions were \$1.1 trillion and \$1.0 trillion, respectively. The NCUSIF insures member savings in federally insured credit unions, which account for about 98 percent of all credit unions in the United States. Deposits at all federal credit unions and the vast majority of state-chartered credit unions are covered by NCUSIF protection.

As discussed previously herein, the NCUA identifies credit unions at risk of failure through the supervisory and examination process, and estimates losses based upon economic trends and credit unions' financial condition and operations. The NCUA also evaluates overall economic trends and monitors potential credit union system-wide risk factors, such as increasing levels of consumer debt, bankruptcies, and delinquencies. The NCUA uses the CAMEL rating system to evaluate a credit union's financial condition and operations. The CAMEL rating system is a tool to measure risk and allocate resources for supervisory purposes. The aggregate amount of reserves recognized for credit union failures was \$925.5 million and \$196.6 million as of December 31, 2017 and 2016, respectively. At December 31, 2017 and 2016, the general reserves were \$106.9 million and \$193.7 million, respectively. At December 31, 2017 and 2016, the specific reserves were \$818.6 million and \$2.9 million, respectively.

The NCUSIF's contingent liability increased by \$728.9 million from 2016 to 2017, reflecting the overall risk of losses due to potential credit union failures for insured credit unions, and increased by \$31.7 million from 2015 to 2016. Nevertheless, the overall credit union industry generally remained stable during 2017 as reflected by the reduction in the assets in CAMEL 3, 4 and 5 rated credit unions as compared to 2016. Assets in CAMEL 3, 4 and 5 rated credit unions decreased 33.3% to \$65.5 billion at the end of 2017, versus \$98.2 billion at the end of 2016. The aggregate net worth ratio increased during the year, ending at 11.0%, versus 10.9% at December 31, 2016. The ratio has shown overall improvement since 2011.

NCUA Guaranteed Notes

As discussed previously herein, the purpose of the former TCCUSF was to accrue the losses of the CCU system and recover such losses over time. After assuming the balances of the former TCCUSF, the NCUSIF recognized no net contingent liability for expected losses from the

failed CCUs pursuant to SFFAS No. 5 at December 31, 2017 and the NCUA estimated no insurance losses from the NGNs. At December 31, 2017, the NCUSIF had accrued for losses of the CCU system of approximately \$2.7 billion, consisting of allowance for loss against receivables from the Corporate AMEs.

As of December 31, 2017, the NCUSIF had gross receivables from the AMEs of \$4.0 billion against which an allowance for losses of approximately \$3.5 billion was established, for a net receivable from AMEs of \$495.0 million.

Fees and Premiums

Insured Credit Unions

During 2017 and 2016, the NCUA Board did not assess premiums to insured credit unions.

NCUA Guaranteed Notes

Under the NGN Program, the NCUSIF is entitled to guarantee fees on a monthly basis for providing associated guarantees as previously discussed in Notes 4 and 8. As of December 31, 2017, the estimated value of NCUSIF guarantee fees for the remaining term of the NGNs, which will lessen the expected losses recognized by NCUSIF, was \$42.3 million.

Sensitivity, Risks and Uncertainties of the Assumptions

Insured Credit Unions

During 2013, the NCUA implemented the use of an econometric reserve model to improve the precision of the loss forecast. As discussed previously herein, the NCUA estimates the anticipated losses resulting from insured credit union failures by evaluating probable failures and using an internal econometric model that applies estimated probability of failure and loss rates that take into account the historical loss history, CAMEL ratings, credit union level financial ratios, and other economic measures. The effectiveness of the reserving methodology is evaluated by applying analytical techniques to review variances between projected losses and actual losses. Actual losses will largely depend on future economic and market conditions and could differ materially from the anticipated losses recorded by the NCUSIF as of December 31, 2017.

The inclusion of variables in the estimation model is a highly subjective process that involves significant judgment and will change over time. Future values are difficult to estimate, especially over longer timeframes. Key assumptions in the modeling include probability of failure and loss rates. The probability of failure is developed based on actual failures and historical migration trends in the CAMEL ratings, and incorporates macroeconomic data such as the consumer price index and geographic housing prices, as well as individual credit union factors such as delinquencies and charge-offs. Prior to 2017, the loss rate was based on historical loss experience from actual failures. In 2017, the NCUA changed the loss rate used in the estimation model from historical loss experience to using regression analysis to calculate a loss experience rate for each credit union. The variables included in the estimation model are periodically evaluated by the NCUA to determine the reasonableness of the model output.

The internal model provides a range of losses. Per current policy, the minimum in the range of losses is the 75 percent confidence level forecast and the upper bound is the 90 percent

confidence level forecast. Additionally, management's judgment is used to select the best estimate within the range of projected losses to record probable contingent liabilities in compliance with SFFAS No. 5. When no estimate is better, the agency will use the low end of the range, in accordance with applicable accounting standards, which was \$106.9 million in anticipated losses recognized on the NCUSIF's balance sheet at December 31, 2017. In selecting the best estimate within the range of the forecasts, management considers overall credit union economic trends and system-wide risk factors, such as increasing levels of consumer debt, bankruptcies and delinquencies.

NCUA Guaranteed Notes

As discussed in Note 8, the NCUA estimated the expected losses from the initiatives created to stabilize the CCU system using various methodologies, including internal and external models that incorporate the NCUA's expectations and assumptions about the anticipated recovery value, if any, of the Corporate AMEs' assets and the Legacy Assets collateralizing the NGNs.

The development of assumptions for key input variables of the estimation models and external valuations is a highly subjective process that involves significant judgment. Future values are difficult to estimate, especially over longer timeframes. Key assumptions in the modeling included borrower status, prepayments, default, loss severity, discount rates, forward interest rate curves, house price appreciation forecasts, legal and regulatory changes, property locations, and unemployment expectations. Assumptions also varied by asset type and vintage. The assumptions developed for the estimation models are regularly evaluated by the NCUA to determine the reasonableness of those assumptions over time.

Also discussed in Note 8, the NCUA's estimated guarantee payments, guarantor reimbursements, and the recovery values, if any, of the Corporate AMEs' economic residual interests in the NGN Trusts are derived using an external model that distributes estimated cash flows of the Legacy Asset transferred to the NGN Trusts in the priority of payments pursuant to the governing documents of each NGN Trust. The estimated cash flows incorporated the NCUA's assumptions about discount rates.

The estimated cash flows of the Legacy Assets transferred to the NGN Trusts were also derived from the external model that incorporates the NCUA's expectations and assumptions about the estimated cash flows from the collateral underlying the Legacy Assets and the priority of payments and estimated cash flows of the Legacy Assets pursuant to the governing documents for the respective Legacy Assets.

The external model produced estimated cash flows of collateral underlying the Legacy Assets by incorporating the NCUA's expectations and assumptions about prepayments, defaults and loss severity of the collateral consisting of residential and commercial mortgages and other assets. Assumptions about prepayments, defaults and loss severity were developed based on the characteristics and historical performance of the collateral, as well as assumptions about macroeconomic variables such as unemployment rate and housing prices, among other factors.

While certain parts of the credit market have seen improvements, the performance of asset- and mortgage-backed securities, such as the Legacy Assets, remains uncertain. The longer-term outlook for borrower and loan performance is uncertain. Uncertainty around housing prices, interest and unemployment rates, legal and regulatory actions, and the relationship of these

factors to prepayment, loss severity, default and delinquency rates will likely change over time. Legacy Asset performance continues to be challenging to predict, and the external model used to derive the expected losses from the guarantee of the NGNs is sensitive to assumptions made about Legacy Asset performance. For example, changing the assumptions for reasonably possible variations in certain macroeconomic factors such as a decline in housing prices from its most recent peak in the external model would have resulted in no expected losses, net of estimated guarantor reimbursements and the economic residual interests in the NGN Trusts (but exclusive of the estimated guarantee fees for the remaining term of the NGNs) associated with the re-securitization transactions, under any scenario as of December 31, 2017. However, such changes in the assumptions would have resulted in an amount for the Receivables from the Corporate AMEs, Net that differed from the recognized amount on the NCUSIF's Balance Sheet as of December 31, 2017.

Consistent with accounting standards, the assumptions and method used to estimate the anticipated losses will require continued calibration and refinement as circumstances change.