

# **NCUA Corporate Stabilization Program: Challenges & Questions**

**February 4, 2009**

# Today's Presenters

**Dan Mica, President & CEO, CUNA, Inc.**

**Larry Fazio, Deputy Executive Director, NCUA**

**Owen Cole, Director, OCMP, NCUA**

**Bill Hampel, SVP-Research/Chief Economist, CUNA, Inc.**

**Scott Waite, Chairman, CUNA Accounting Taskforce**

**Terry West, CUNA's Corporate Credit Union Taskforce**

**Eric Richard, CUNA General Counsel & EVP**

**Mary Dunn, SVP & Deputy General Counsel, CUNA, Inc.**

**Deputy Executive Director Larry Fazio**  
**Director, OCMP Owen Cole**  
**NCUA**

# History of CCU investments

- ❖ Overall balance sheet management
- ❖ By regulation, highly rated securities
- ❖ Readily sold or used to collateralize borrowing

# What changed?

- ❖ **Market conditions since mid-2007**
- ❖ **Sub-prime mortgage spread to Alt-A loans and option ARMS**
- ❖ **Stress in the entire market**

# First Steps

- ❖ **Supervisory actions for affected CCUs**
- ❖ **Restricted types and terms of investments**
- ❖ **Required stress test modeling**

# Initial Programs in 2008

- ❖ Temporary CCU Liquidity Guarantee Program
- ❖ Authorized CLF's full statutory borrowing authority
- ❖ CU SIP and CU HARP
- ❖ Approved US Central's conversion of MC to PIC

# January 2009

- ❖ Severe strain on liquidity
- ❖ \$64 billion in mortgage/asset backed securities – no market
- ❖ \$18 billion in unrealized losses
- ❖ OTTI charges turn unrealized losses into realized expenses

# **NCUA Board Actions 1/28/2009**

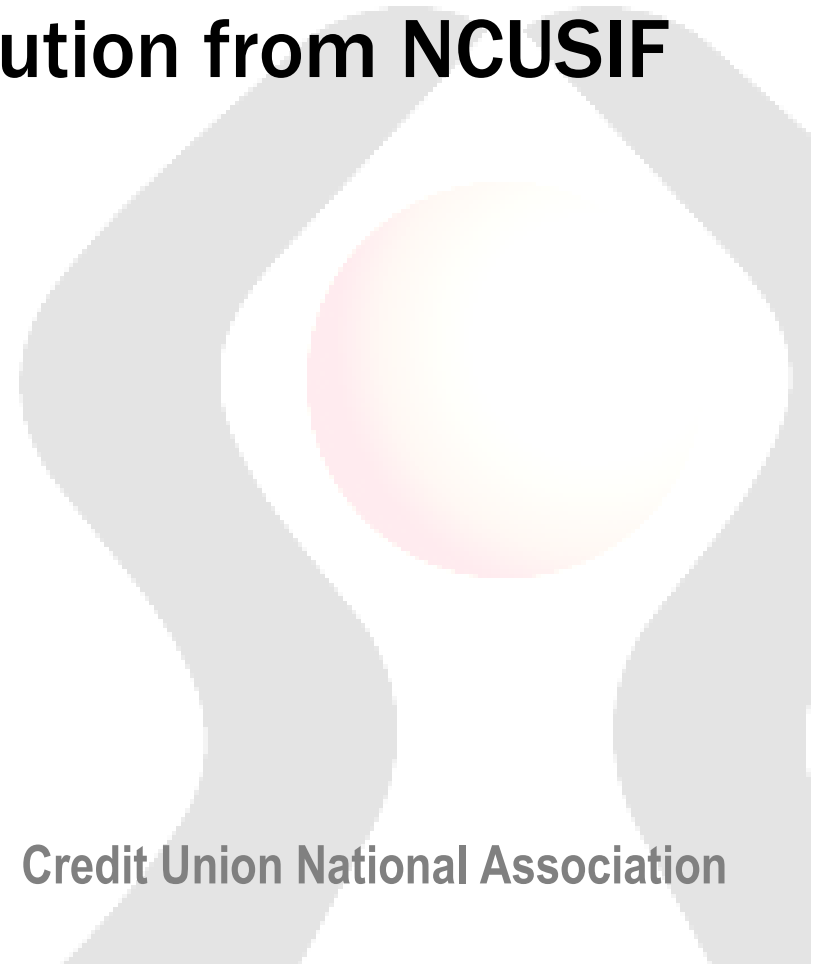
- **Temporary Guarantee of Excess Shares**
- **Capital Infusion into U.S. Central FCU**
- **Advance Notice of Proposed Rulemaking 12 CFR Part 704**

# Temporary Share Guarantee Program

- ❖ All shares except Membership Capital and Paid in Capital
- ❖ Corporate Credit Unions must opt in by February 28, 2009
- ❖ Maintain and increase natural person CU deposits in corporate CUs

# Capital Infusion

❖ **\$1.0 Billion Cash contribution from NCUSIF  
to U.S. Central FCU**



# Cost to NCUSIF and Credit Unions

## NCUSIF

- ❖ \$1.0 billion immediate cost
- ❖ \$3.7 billion loss reserve on guarantee

## Natural Person Credit Unions

- ❖ Approximate 51% impairment of NCUSIF deposit
- ❖ Premium declared, billed later in 2009

# Impact on Natural Person Credit Unions

- ❖ **Liability to NCUSIF passed on proportionally**
- ❖ **Lowest cost alternative to entire credit union industry**
- ❖ **Excess shares will have temporary guarantee**

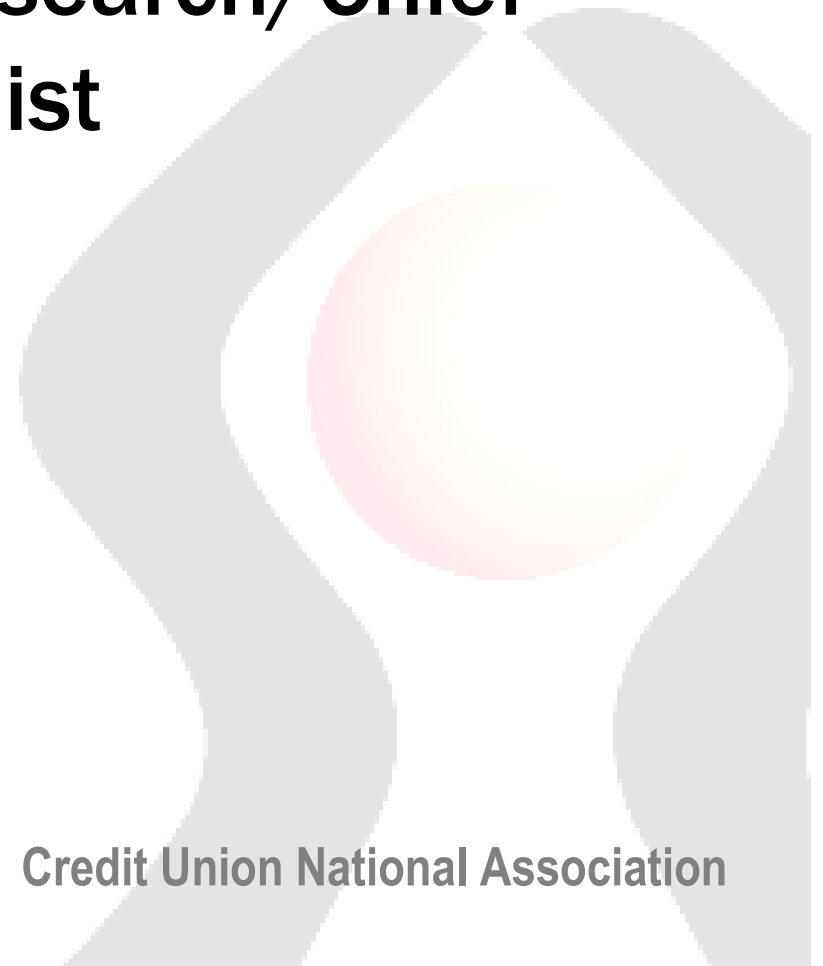
# Advance Notice of Proposed Rulemaking

- ❖ Determine effective reforms to enhance the corporate structure
- ❖ Solicit input from stakeholders within the credit union industry
- ❖ Follow-up with public forums

# Next Steps

- ❖ **Accounting Bulletin 09-1**
- ❖ **Independent credit analysis of CCU investments**

# **Bill Hampel, SVP-Research/Chief Economist**



# The Cost to Credit Unions

## ❖ Assumptions:

- \$3.7 billion initial estimate of the cost of the deposit guarantee.
- No credit union asset growth

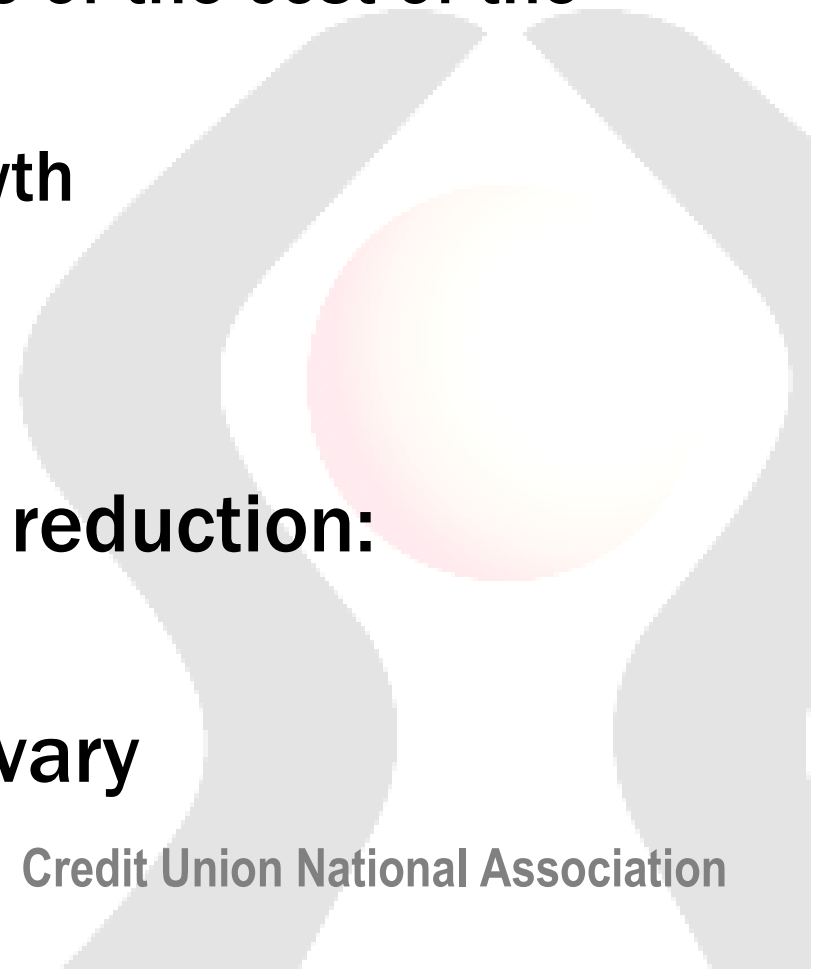
## ❖ Average ROA reduction

- 62 basis points

## ❖ Average Net Worth Ratio reduction:

- 56 basis points

## ❖ Individual CU results will vary



# CUNA Estimate of Aggregate Effects of NCUA's Initial Corporate Stabilization Proposal

(As outlined in NCUA Letter to Credit Unions 09-CU-02)

The analysis below is CUNA's estimate of the aggregate effects of NCUA's initial Corporate Stabilization Proposal. NCUA's Stabilization plan consists of an infusion of \$1.00 billion into U.S. Central and an initial estimate of \$3.70 billion to guarantee corporate deposits. CUNA, state credit union leagues and others are working with the NCUA to explore alternative funding mechanisms that would ease the financial burdens of the initial plan. If those efforts are successful, the costs outlined below would be reduced.

## Credit union totals 12/08:

Estimated total assets in insured CUs  
Insured shares  
Net worth

|                                       | <u>Billions of Dollars</u> | <u>Percent of Assets</u> |
|---------------------------------------|----------------------------|--------------------------|
| Estimated total assets in insured CUs | \$785.00                   |                          |
| Insured shares                        | \$604.20                   | 77.0%                    |
| Net worth                             | \$84.29                    | 10.74%                   |

## NCUSIF:

Beginning NCUSIF fund balance  
US Central infusion  
Preliminary estimate of corporate share guarantee  
Fund balance after infusion/guarantee

|   | <u>Billions of Dollars</u> | <u>Percent of insured shares</u> |
|---|----------------------------|----------------------------------|
| Beginning NCUSIF fund balance                     | \$7.67                     | 1.27%                            |
| US Central infusion                               | -\$1.00                    | -0.17%                           |
| Preliminary estimate of corporate share guarantee | -\$3.70                    | -0.61%                           |
| Fund balance after infusion/guarantee             | \$2.97                     | 0.49%                            |

Note: The \$3.7 billion corporate share guarantee is an estimate of the total costs associated with a corporate deposit guarantee - it may understate or overstate the true cost of that guarantee. NCUA has engaged PIMCO to analyze corporate investments - the results of that analysis will be used to more accurately determine the total costs. The final cost estimate also will depend on the stability of corporate funding. The more stable and long-term the funding, the lower the final costs will be.

## Aggregate ROA Effect at CUs:

Fund balance after infusion and guarantee  
1% Deposit replenishment  
After replenishment  
Premium to bring fund to 1.30%  
Total

|   | <u>Billions of Dollars</u> | <u>Percent of CU Assets</u> | <u>Percent of insured shares</u> |
|---|----------------------------|-----------------------------|----------------------------------|
| Fund balance after infusion and guarantee | \$2.97                     |                             | 0.49%                            |
| 1% Deposit replenishment                  | \$3.07                     | 0.39%                       | 0.51%                            |
| After replenishment                       | \$6.04                     |                             | 1.00%                            |
| Premium to bring fund to 1.30%            | \$1.81                     | 0.23%                       | 0.30%                            |
| Total                                     | \$7.85                     |                             | 1.30%                            |

NCUSIF undivided earnings are exhausted. Credit unions write down their NCUSIF deposit from 1.00% to 0.49% and replenish an amount equal to:

$$1.00\% - 0.49\% = 0.51\%$$

Total cost (1% deposit replenishment + premium)

\$4.88      0.62%      0.81%

## Aggregate Net Worth Effect at CUs:

Ending assets (beginning assets - total cost)  
Ending net worth (beginning NW - total cost)  
Ending net worth as a % of ending assets  
Change in net worth ratio

\$780.12  
\$79.41  
10.18%  
-0.56%

These are the "average" effects cited in the NCUA letter. Most credit unions can't use these numbers to estimate impact since their insured-share-to-assets ratio will differ from the movement average. Instead, CUs need to apply the 81bp of insured shares figure.

Source: CUNA E&S.

# Estimating the Effect of NCUA's Initial Corporate Stabilization Proposal on Your CU

(Based on information in NCUA's Letter to Credit Unions 09-CU-02)

The analysis below allows you to estimate the effects of NCUA's initial Corporate Stabilization Proposal on your credit union's ROA and net worth. NCUA's Stabilization plan consists of an infusion of \$1.00 billion into U.S. Central and an initial estimate of \$3.70 billion to guarantee corporate deposits. CUNA, state credit union leagues and others are working with the NCUA to explore alternative funding mechanisms that would ease the financial burdens of the initial plan. If those efforts are successful, the 0.81% assessment rate outlined below would be reduced.

## Your Credit Union's Totals

|                             |          | Percent of Assets |
|-----------------------------|----------|-------------------|
| Beginning assets (input)    | \$100.00 |                   |
| Insured shares (input)      | \$90.00  | 90.0%             |
| Beginning Net worth (input) | \$9.00   | 9.00%             |
| Budgeted net income (input) | \$0.50   | 0.50%             |

Note: The 0.81% assessment rate reflects an initial estimated cost of \$3.7 billion for the corporate deposit guarantee. This may understate or overstate the true cost of that guarantee. NCUA has engaged PIMCO to analyze corporate investments - the results of that analysis will be used to more accurately determine the total costs. The final cost estimate also will depend on the stability of corporate funding. The more stable and long-term the funding, the lower the final costs will be.

## Assessment cost:

|                         |         |       |
|-------------------------|---------|-------|
| Assessment rate         | 0.81%   |       |
| x Insured shares        | \$90.00 |       |
| = Total assessment cost | \$0.73  | 0.73% |

## Effect on your credit union's assets:

|                  |          |
|------------------|----------|
| Beginning assets | \$100.00 |
| Ending assets    | \$99.27  |
| Change in assets | -\$0.73  |

## Effect on your credit union's ROA:

|   |         |        |
|---|---------|--------|
| Budgeted net income                           | \$0.50  | 0.50%  |
| Change in budgeted net income (total cost)    | -\$0.73 | -0.73% |
| Net income after infusion & deposit guarantee | -\$0.23 | -0.23% |

## Effect on your credit union's net worth ratio:

|  |         |        |
|--|---------|--------|
| Beginning net worth (& as a % of beginning assets) | \$9.00  | 9.00%  |
| Ending net worth (& as a % of ending assets)       | \$8.27  | 8.33%  |
| Change in net worth ratio                          | -\$0.73 | -0.67% |

The average effects cited in NCUA letter 09-CU-02 were (1) a 0.62% drop in ROA and (2) a 0.56% decline in net worth ratio. This calculation was based on movement aggregates & your credit union will have identical results only if its insured-share-to-assets ratio is equal to the 77% movement average.

If your credit union's insured-share-to-asset ratio is greater than the movement average 77% then your declines in ROA and net worth will exceed the movement averages cited in the NCUA letter. Conversely, if your insured-share-to-asset ratio is less than 77%, then your declines in ROA and net worth will be lower than the movement averages discussed in the NCUA letter.

# Return on Assets

Based on First Three Quarters of 2008

|             | <u>Number of CUs</u> |       |        | <u>Total Assets, \$ billion</u> |         |          |
|-------------|----------------------|-------|--------|---------------------------------|---------|----------|
|             | Before               | After | Change | Before                          | After   | Change   |
| Negative    | 1,709                | 5,019 | 3,310  | \$122.3                         | \$394.8 | \$272.6  |
| 0 - 50 bp   | 2,551                | 1,844 | -707   | \$209.3                         | \$306.2 | \$96.9   |
| 50 - 100 bp | 2,240                | 731   | -1,509 | \$313.4                         | \$86.2  | -\$227.2 |
| Over 100 bp | 1,567                | 473   | -1,094 | \$169.1                         | \$26.7  | -\$142.4 |

# Net Worth Ratio

Based on September 2008 Ratios

|         | <u>Number of CUs</u> |              |               | <u>Total Assets, \$ billion</u> |              |               |
|---------|----------------------|--------------|---------------|---------------------------------|--------------|---------------|
|         | <u>Before</u>        | <u>After</u> | <u>Change</u> | <u>Before</u>                   | <u>After</u> | <u>Change</u> |
| LT 6%   | 75                   | 112          | 37            | \$1.9                           | \$8.9        | \$7.0         |
| 6 to 7% | 68                   | 167          | 99            | \$8.8                           | \$45.4       | \$36.6        |
| 7 to 9% | 748                  | 995          | 247           | \$163.4                         | \$191.4      | \$28.1        |
| Over 9% | 7,176                | 6,793        | -383          | \$639.9                         | \$568.3      | -\$71.6       |

Credit Union National Association

# The Deposit Guarantee Cost

- ❖ **Initial estimate: \$3.7 billion**
- ❖ **79% of the cost of the stabilization**
- ❖ **Final provision expense depends on:**
  - **PIMCO analysis of the bonds**
    - **Economic value if held to maturity**
  - **Probability of sale before maturity**
    - **Realized losses reduced if held to maturity**
  - **Vital impact of stability of corporate funding**

**Scott Waite**  
**Chairman – CUNA Accounting**  
**Task Force**

Credit Union National Association

# Accounting Treatment

- ❖ **NCUSIF Capitalization Deposit is accounted for as an asset on the CU's financial statement as long as such amounts are fully refundable**
- ❖ **In years in which the insurance premiums are not waived by the NCUA, the premiums shall be expensed in the period to which they relate. To the extent that the NCUA assesses premiums to cover prior operating losses of the insurance fund or to increase the fund balance to normal operating levels, credit unions shall expense those premiums when assessed**

# Accounting Treatment

- ❖ The refundability of the NCUSIF deposit shall be reviewed for impairment
- ❖ When the refundability of a deposit is evaluated, the financial condition of the credit union and of the NCUSIF shall be considered

# Accounting Treatment

- ❖ To the extent that the NCUSIF deposit is not refundable, it shall be charged to expense in the period in which the deposit is made or the asset becomes impaired

# Sample \$100 Million Credit Union

|   |                |                    |
|---|----------------|--------------------|
| NCUA share insurance fund 12/31/08                  | 775,000        |                    |
| Write down %  | 51%            |                    |
| Write down amount                                   | <b>395,250</b> | 2009 Avg. Assets   |
| Write down amount as a % of budgeted average assets | 0.40%          | 100,000,000        |
| Insured shares at 12/31/08, 6/30/09 (\$100k level)  | 75,000,000     |                    |
| Premium charge                                      | 0.30%          |                    |
| Premium amount                                      | <b>225,000</b> |                    |
| Write down amount as a % of budgeted average assets | 0.23%          |                    |
| Write down amount                                   | <b>395,250</b> |                    |
| Premium charge                                      | <b>225,000</b> |                    |
| Total P&L impact                                    | <b>620,250</b> |                    |
| Budgeted ROA  | 0.75%          |                    |
| ROA after write down/premium charge                 | 0.13%          |                    |
| Impact on ROA of write-down/premium charge          | 0.62%          |                    |
| Net worth before write down/premium charge          | 10.00%         | 2009 Ending Assets |
| Net worth after write down/premium charge           | 9.44%          | 110,000,000        |
| Impact on net worth of write-down/premium charge    | 0.56%          |                    |

Impairment Amount

Premium Amount

# Accounting Issues

- ❖ **Credit Unions required to follow U.S. GAAP should consult with their own Accounting / Auditing firm for proper accounting treatment**
- ❖ **NCUA Accounting Bulletin expected to be issued soon**

# Accounting Issues

- ❖ Record an impairment charge for 51% of your NCUSIF insurance deposit
- ❖ Determine if to recognize in 2008 or 2009
- ❖ Discuss Subsequent Event disclosure requirements for 2008 financial statements
- ❖ Recapitalize insurance deposit when requested

# Accounting Issues

- ❖ Determine suitability of accruing for Premium expense payment until paid
- ❖ Consider whether a Contingent Liability for the Premium now exists and whether recognition is needed
- ❖ Discuss recognition treatment of future adjustments made by the NCUA

# Accounting Issues

- ❖ **Credit Unions required to follow U.S. GAAP should consult with their own Accounting / Auditing firm for proper accounting treatment**
- ❖ **NCUA Accounting Bulletin expected to be issued soon**

**Terry West  
CUNA's  
Corporate Credit Union  
Task Force**

# Task Force Members

- ❖ **Terry West, CEO of Vystar CU, FL, Chairman;**
- ❖ **Bob Allen, CEO of Teachers FCU, Farmingville, NY;**
- ❖ **Dale Dalbey, CEO of Mutual Savings CU, AL;**
- ❖ **Tom Gaines, CEO of the TN CU League;**
- ❖ **Frank Michael, CEO of Allied CU, Stockton, CA;**
- ❖ **Dave Rhamy, CEO of Silver State Schools CU, NV;**
- ❖ **Jane Watkins, CEO of Virginia CU, Inc., VA**

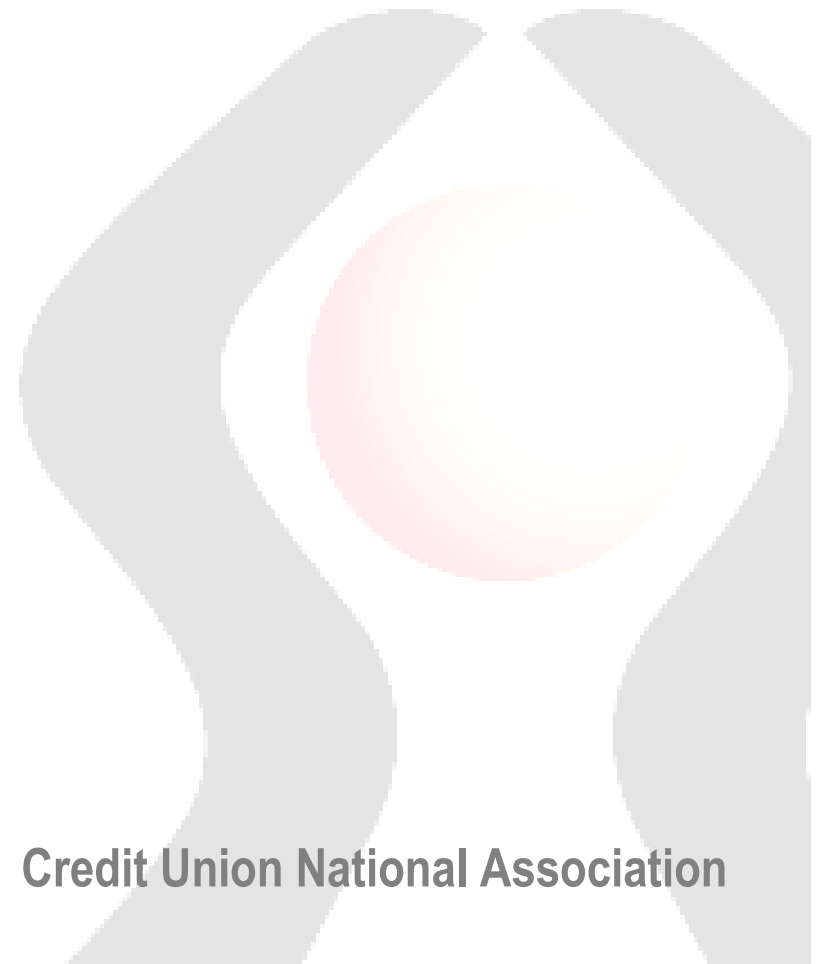
## **Ex officio:**

- ❖ **Tom Dorety, CUNA Chairman and CEO**
- ❖ **Kris Mecham, CUNA's GAC Chairman and CEO**

# CUNA's Corporate Credit Union Task Force

## ❖ Role:

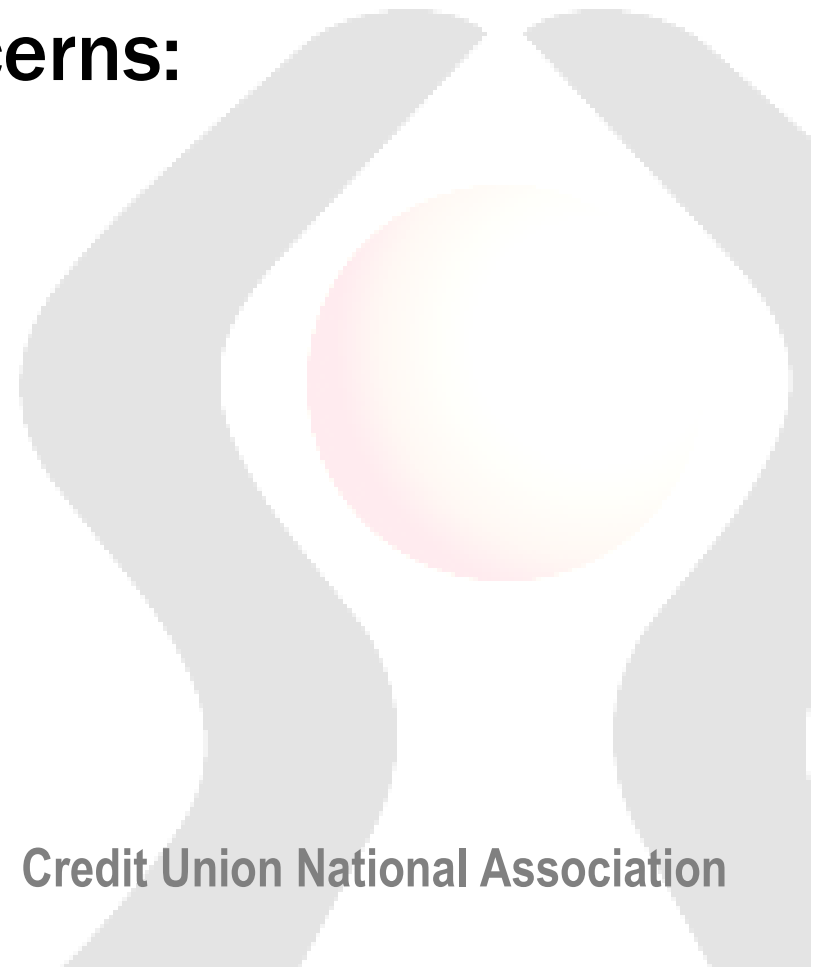
- Hear from stakeholders:
  - Natural person CUs
  - Corporates
  - NCUA



# CUNA's Corporate Credit Union Task Force

## ❖ Consider issues and concerns:

- Liquidity
- Capital
- Structure



# Advocacy to NCUA

## ❖ Role cont'd:

- Review NCUA's actions announced last week
- Develop CUNA's comment letter to the ANPR
- Review CUNA's policy on the corporates

# Advocacy to NCUA

## ❖ Reaction of Task Force to NCUA's Steps:

- Action for the corporates was needed
- The impact on credit unions is too harsh
- Alternatives must be found

# CUNA's Corporate Credit Union Task Force

## ❖ Time Frame:

- Meet again shortly
- Develop CUNA's letter before the GAC
- Report to the CUNA GAC and the Board at the Governmental Affairs Conference

# **CUNA'S ACTIONS TO PROTECT CREDIT UNIONS' INTERESTS**

**Eric Richard, CUNA General Counsel &  
Executive Vice President**

# ADVOCACY TO NCUA

❖ **CUNA OPPOSES NCUA'S PLAN  
TO ASSESS CUS TO FUND THE  
CORPORATE CU ASSISTANCE**

# ADVOCACY TO NCUA

- ❖ **CUNA's objective in dealing with NCUA**
  - **Minimize the costs to natural person credit unions while supporting corporate credit unions**

# ADVOCACY TO NCUA

- ❖ **CUNA reviewed NCUA's plans with CUNA's Corporate CU Task Force last week**
- ❖ **CUNA identified concerns regarding the funding of the assistance for the corporates**
- ❖ **CUNA's Corporate Credit Union Task Force met with Gigi Hyland, Senior NCUA staff to raise questions and objections**

# ADVOCACY TO NCUA

- ❖ **Dan Mica discussed opposition and concerns with Chairman Fryzel**
- ❖ **CUNA staff met and discussed concerns with agency senior staff over the weekend and every day this week**

# ADVOCACY TO NCUA

- ❖ **Guided by the CUNA Corporate CU Task Force and countless emails from leagues and credit unions....**
- ❖ **CUNA has worked to develop funding alternatives, which we will now address.**

# **Alternatives to Lessen Credit Unions' Costs**

**Mary Dunn, CUNA Senior Vice President  
& Deputy General Counsel**

# Alternatives That Should be Considered by NCUA

## ❖ Within the system

- Capital from CUs
- Greater Use of the CLF
- Corporate CU Assets
- Expand SIP
- Corporates Provide Capital
- Accounting Issues
- TARP



# Alternatives

- ❖ **Capital from Credit Unions**
  - **Paid-In or Membership Capital**
  - **Subordinated Notes**

# Alternatives

- ❖ **Greater Use of Central Liquidity Funds**
- ❖ **Allow Natural Person Credit Unions to Purchase Corporate CU Assets**

# Alternatives

- ❖ **Expand the CU System Investment Program (SIP)**
- ❖ **Corporates provide capital to the NCUSIF**

# Alternatives

- ❖ **Accounting Treatment/Issues**
- ❖ **Use TARP Funds as a Back-Up**