

NCUA'S PROPOSED PLAN FOR VOLUNTARY PREPAYMENT OF CORPORATE CREDIT UNION STABILIZATION FUND ASSESSMENTS

NCUA has proposed a plan under which credit unions could prepay some of the assessments they owe to the Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund). The agency is seeking comments through June 20, 2011 on the proposal.

Credit unions are strongly encouraged to review the plan. The background information and set of questions and answers below is designed to further credit unions' understanding of NCUA's proposal. This information is also provided to assist credit unions as they review the details of the program and consider whether or not to participate in it.

Background

At the NCUA Board meeting May 19, agency staff reported that this year's Stabilization Fund assessment could be around 25 basis points (bp) of insured shares, and possibly around 13 bp for next year. This is NOT due to any anticipated increases in expected losses on the assets held in the Stabilization Fund. Rather, it is because the total of around \$8.5 billion of obligations of the Stabilization Fund exceeds the \$6 billion line of credit from Treasury that is being used to spread the Stabilization Fund costs over as many as eleven years. In addition, the agency has indicated a need to keep \$0.5 billion of the Treasury line unused, in reserve in the event of unforeseen funding needs. Therefore, unless loss estimates change in the future (and they could change in either direction), in the absence of any assessment prepayment, credit union assessments will have to be around \$3 billion over the next two years (an average of \$1.5 billion a year), and \$5.5 billion over the following 9 years (an average of about \$660 million a year; NCUA is in the process of getting an updated loss estimate).

CUNA has been aware of the liquidity issues facing the Stabilization Fund that require "frontloading" of some of the assessments through 2012. Because of this, and because it is a liquidity rather than a loss issue, CUNA and credit unions have been urging NCUA Board members and staff to adjust for the larger early-year assessments by allowing a prepayment of future assessments. This would not only provide the additional cash the Stabilization Fund needs over the next two years, but also allow the expensing of the assessments on a more even basis over a longer period.

Questions and Answers Regarding the Proposed Prepaid Assessment Program

- **Is the program mandatory?**

No. Whether a credit union participates in the program would be its decision. NCUA does not believe that the Federal Credit Union Act allows it to charge a mandatory prepaid assessment to all credit unions. However, the plan it developed would allow eligible credit unions to prepay some of their Stabilization Fund assessments on a voluntary basis.

- **Would the program reduce credit unions' Corporate Stabilization Fund assessments?**

Yes and no. The program would affect the amount of each year's assessment through time, but not the total amount of assessments. It would reduce the size of assessments in the next two years, but as a result, assessments would be higher in years three and later than they would be without the program. Based on current loss estimates, the total amount credit unions will be assessed over the life of the Stabilization Fund is around \$8.5 billion. Without the voluntary prepay program, \$3 billion of that would need to be assessed over the first two years, with the remaining \$5.5 billion assessed over the remaining life of the Fund.

- **How much would assessments in 2011 and 2012 be reduced by this program?**

That depends on the level of credit union participation in the program. NCUA estimates that if there is maximum participation in the program by credit unions, about \$2.8 billion would be raised. The agency said that the funds would be used to reduce assessments and to reduce the amount of funds borrowed from the U.S. Treasury by the Stabilization Fund. CUNA estimates that with sufficient participation, the 2011 and 2012 assessments could each be around 11 bp instead of 25 bp and 13 bp respectively.

- **Would assessments after 2012 be affected?**

Yes. Without the program, after the estimated assessments of 25 bp in 2011 and 13 bp in 2012, the 2013 assessments could fall to around 8 bp if NCUA uses the full eleven years of the Fund to collect assessments. With the program, assuming substantial participation by credit unions, the 2013 assessment would likely remain at around 10 bp. In both cases, assessment rates would likely fall in the following years as the assessment base, insured shares, grows. Simply put, in exchange for a combined 18 basis point reduction in assessments in 2011 and 2012, future assessments would be about 2 bp a year higher.

- **Will each credit union's assessment reduction be tied to the amount it decides to prepay?**

No, the total amount of prepayments the Agency receives from participating credit unions will determine the amount of assessment reduction for all credit unions in 2011 and 2012.

- **In that case, if only a few credit unions agree to participate, would that not be a bad deal for them?**

There is a potential "free-rider" issue. To address that, NCUA has said that in order to ensure sufficient involvement from credit unions, participating credit unions would need to commit to providing in the aggregate at least \$300 million in prepayments. That would be enough to reduce assessments by 2 bp each in 2011 and 2012. If commitments by credit unions are for less than \$300 million, the program will not be implemented. In that case, credit unions that had previously committed to prepay a portion of future assessments would NOT have to make those prepayments.

- **How much participation is necessary for this to really make a difference in 2011 and 2012?**

Most of the benefit of assessment smoothing would occur if prepay commitments total at least \$1 billion. For example, at \$1.2 billion, the total reduction in 2011 and 2012 assessments could be around 16 bp. That could lower the 2011 and 2012 assessments each to around 11 bp.

- **Are there specific requirements as to the amount that a credit union may advance to the Stabilization Fund?**

Yes. Credit unions that want to participate would have to advance at least \$10,000, which is the minimum advance amount allowed. The maximum that could be advanced from any credit union would be 36 bp of its insured shares as of March 31, 2011, which approximates projected Stabilization Fund assessments spread out evenly over three years. Any amount between the minimum and maximum could be advanced by a credit union. NCUA says it set these limits to accommodate transaction and administrative costs and also to avoid an individual credit union assuming too large a burden.

- **Are all federally insured credit unions eligible to participate?**

Yes, from a legal standpoint. However, all participating credit unions would have to be able to advance at least \$10,000 to the Stabilization Fund. NCUA said that practically, credit unions with assets more than \$2.8 million are able to participate. This would be about 6,023 credit unions.

- **Would there be interest payments to credit unions on the prepaid assessments?**

No. Credit unions would essentially be providing an interest free loan to the Stabilization Fund. Early on, there would not be substantial opportunity costs associated with the prepayments, but that could change if interest rates rise.

- **If a credit union prepays some future assessments in 2011, when would that prepayment actually be used to cover future assessments?**

The agency's proposal is that any prepayments made in 2011 would be used for assessments beginning in 2013. A participating credit union would make the prepayment in addition to the reduced assessment in 2011, would pay another reduced assessment in 2012, then could begin expensing assessments against the prepaid asset in 2013.

- **Has NCUA indicated how credit unions would account for the prepaid assessments?**

Yes, but interested credit unions are strongly encouraged to consult their accountants. Under the proposal, the prepayments would be prepaid assets from which actual assessments for 2013 and later would be paid. They would be treated by participating credit unions as an asset purchase instead of an expense until they are used by the Stabilization Fund to cover assessments. Participating credit unions would record their assessment expense annually as they are assessed by the NCUA Board.

- **Is there a process for how credit unions should let NCUA know they want to participate?**

Yes. If the program is approved by the NCUA Board, based on sufficient interest from credit unions, a letter from the agency will be sent to credit unions to solicit actual commitments. The letter will include program agreement forms that would be returned to NCUA. If the \$300 million minimum required volume is met, NCUA would process a direct debit from the credit union's account through Pay.Gov. The process would take about 47 days or so from the time of NCUA Board approval.

- **Should credit unions let NCUA know their reactions to the proposal?**

Yes. NCUA is seeking comments through June 20, 2011 on the following:

- Will the program work;
- Account treatment considerations;
- Whether there is sufficient interest in the program and
- Any suggestions or concerns about the program.

Comments may be emailed to regcomments@ncua.gov and should be identified as [Your name] – Comments on Potential Voluntary Prepaid Assessments Program in the subject line. You can also mail them to Mary Rupp, Secretary of the Board, NCUA, 1775

Duke Street, Alexandria, VA 22314-3428. Please also send a copy of your comments to mdunn@cuna.com.

Issues and Considerations

In reviewing the agency's prepaid assessment program, there are many issues credit union boards and management should consider. These issues include:

- Does the credit union want to participate in the program?
- Does the credit union have sufficient liquidity to commit to the prepaid assessment?
- Does the credit union believe that smoothing assessments over time is desirable?
- Will the loss of interest income on the prepaid assessments be justified? (NCUA says it can't pay interest in order for the program to meet accounting and legal hurdles.)
- Is the \$10,000 minimum to participate in the program appropriate? Should small credit unions have an option of paying a lower minimum to participate?
- Do the credit union's accountants have any issues regarding the accounting treatment of the prepayment?

Conclusion

The proposal announced by NCUA this week is creative and indicates willingness by the agency to pursue measures that will help lessen the impact of the Stabilization Fund assessments on credit unions. Each eligible credit union's officials should become informed about the proposal, assess the usefulness of the program to the credit union and the credit union system, and provide comments to NCUA by June 20 on whether your credit union will participate. Please share your thoughts on this with your league and CUNA. Comments and questions to CUNA can be directed to Bill Hampel at bhampel@cuna.com or Mary Dunn at mdunn@cuna.com.

Again, credit unions are also encouraged to participate in NCUA's webinar. May 26 at 4 PM ET. Here is the link <http://1.usa.gov/mlrZ8N> to information about the webinar, including how to register.