CONSIDERING THE CORPORATE STABILIZATION PREPAY PLAN

NCUA's final voluntary prepayment plan for corporate stabilization assessments was adopted June 29th at a special agency Board meeting.

Details about the program are available at:
http://www.ncua.gov/news/VoluntaryPrePaymentAssessmentProgram.aspx

ESSENTIAL FEATURES OF THE PROGRAM

- Participation by credit unions is voluntary. Participating credit unions may prepay a portion of their future corporate stabilization assessments. Amounts that are prepaid this year will be used to meet assessment obligations starting in 2013.
- For each credit union, the minimum amount to participate is a prepayment $1,000 or 5 bp of March 31, 2011 insured shares, whichever is greater.
- For each credit union, the maximum amount of prepayment is 48 bp of March 31, 2011 insured shares.
- Between now and July 29, credit unions wishing to participate will inform NCUA of the amount of their intended participation.
- The program will only run if total prepayment commitments amount to at least $500 million, and only $500 million of total prepayments will be collected from credit unions. If total commitments are less than $500 million, the program will be cancelled. If total commitments are more than $500 million, prepayments will be collected on a pro-rata basis. For example, if total commitments amount to $1 billion, each credit union will have one half of its commitment collected.

IMPACT OF THE PLAN

- Without the prepayment plan, this year's assessment will likely be about 25 bp of insured shares. Next year's will be around 13 bp. After that, assessment rates would gradually fall from that level as insured shares grow.
- With the prepayment, this year's assessment will be reduced by about 6.5 bp to about 18.5 bp. Next year's assessment would still be around 13 bp. There would be slightly higher assessments in 2013 and the following few years, compared to the situation if there had been no prepayments, to make up for the fact that the 2011 assessment was reduced.
- The prepayment plan itself will not change the total dollar amount of assessments credit unions must pay over the next decade. The current estimate for that total is around $8.5 billion, but the final amount depends on the future losses on the corporate legacy assets which have not yet occurred. Those losses will depend on the pace of the recoveries (or contractions) in the general economy and housing markets.

CUNA had urged that the size of the program be set at $1 billion rather than $500 million. That would have lowered this year's assessment by about 13 bp to around 12 bp.

EVALUATING THE PREPAYMENT PLAN

The whole purpose of the Temporary Corporate Credit Union Stabilization Fund (TCCUSF) is to allow NCUA to spread the losses on the legacy assets over several years--as many as eleven. This protects credit unions from having to expense the full remaining expected losses at one time. Expensing all the expected losses this year would subtract almost 1% of assets from this year's net income and net worth ratios. That would push most credit unions into substantially negative earnings and place severe capital restraints on many others, and even cause some to fail. In addition, the $8.5 billion figure is just an estimate of future losses. The final cost will be something more or less than that. Expensing an estimate today would undoubtedly require either a refund or additional expense several years down the road as the final disposition of the legacy assets is learned.

Spreading the expected total of $8.5 billion evenly over the full eleven years of the program would require an initial assessment of around 10 bp of insured shares, falling gradually in later years as insured shares grow. However, because of additional liquidity needs in the next two years, NCUA has announced that, without a prepayment plan, the assessments for 2011 and 2012 would have to be 25 bp and 13 bp respectively. That would raise $3 billion of the total of $8.5 billion in just the first two years.

Because those assessment rates would front-load much of the cost of corporate stabilization, contrary to the purpose of the TCCUSF, many credit unions, leagues and CUNA requested NCUA adopt a prepayment plan similar to one used by FDIC last year to meet some of the initial liquidity needs of the Fund. This would involve collecting the cash needed in the first two years, but only requiring credit unions to expense a portion of that cash as current assessments, with the remainder instead treated as an asset purchase (prepaid expense) to be used to meet assessment obligations in 2013 and later.

We had originally expected a prepayment program sufficient to lower this year's assessment to somewhere between 10 bp and 15 bp. That would have been consistent with long-term smoothing of assessments over the entire life of the TCCUSF. However, any cash accepted as prepayments in 2011 would be counted against assessments in 2013 and 2014, reducing cash flow to the Fund in those years.

NCUA believes there could be additional liquidity needs in 2013 and 2014, and therefore it feels the program should be limited to $500 million, preserving expected cash flows from assessments in 2013 and 2014. However, this limit lowers this year's assessment by only 6.5 bp to 18.5 bp. CUNA is not convinced that potential future liquidity needs warrant limiting the program to $500 million. If liquidity pressures were to arise in 2013 and 2014, the Fund could either levy higher assessments then, or repeat an assessment prepayment to raise additional cash in 2013 against future assessments.

Nevertheless, NCUA has decided to keep a substantial amount of powder dry, so it appears the program will be limited to $500 million, and a 6.5 bp assessment reduction. This leaves the decision to each credit union as to whether or not to participate, and if so, at what level.

DECIDING ON PARTICIPATION

An unusual feature of the program is that for any individual credit union, the possibility of the 6.5 bp assessment reduction does not really depend on that credit union's voluntary prepayment of some of its future assessments. Instead it depends on the decisions of all other credit unions—whether collectively they commit to sufficient prepayments to amount to the $500 million cutoff. Therefore, each credit union is faced with an unusual choice: whether or not we participate won't directly impact any benefit we might receive.

In addition, for many credit unions a 6.5 bp reduction in this year's assessment would be of little value. However, for some credit unions just beginning to recover from the Great Recession, any boost, no matter how modest, to this year's ROA and net worth ratio would be welcomed.

Therefore, this is a situation where traditional dollars-and-cents cost/benefit approaches are difficult to apply. However, there are a few aspects of the program that might help in the decision.

Deciding on whether to participate depends on what one expects other credit unions to do, and on the likelihood that the 2013 assessment will be something close to 13 bp or 14 bp of insured shares. Here are a few scenarios.

- If all credit unions volunteer to participate, at just a 6.5 bp rate, the program would go forward and each credit union would send the same amount of cash to the Agency as if the assessment had been the full 25 bp. However, only 18.5 bp of that cash would be expensed as an assessment. Then, in 2013, all credit unions would send a little more than half of that year's assessment in cash; the remainder would be covered by this year's prepayment. This is basically how a mandatory prepayment would have worked.
- If instead only half of credit unions participate, evenly distributed across asset sizes, and if all those credit unions committed to 13 bp each, the program would go forward, and all credit unions would expense an 18.5 bp assessment this year. Participating credit unions would send 31.5 bp in cash this year (18.5 + 13) and would have to send very little cash to meet their 2013 assessments; non-participating credit unions would fully fund 2013 assessments with cash.
- If only a quarter of credit unions participate, evenly distributed across asset sizes, those credit unions would need to each (or on average) commit to 26 bp to generate the $500 million to make the program. In that event, all credit unions would expense an 18.5 bp assessment this year, and participating credit unions would send 44.5 bp in cash this year (18.5 = 26) and would have all of their 2013 and most of their 2014 assessments funded by the prepaid amounts in those two years.

The fact that 2013's assessment is likely to be around 13 bp to 14 bp of insured shares as of 2013 means that any prepayment amount of up to 15 bp of March 2011 insured shares will only be on the books as a prepaid expense for two years, until it is used for the 2013 assessment. (Assuming modest growth of insured shares, 15 bp of 2011 shares would be equivalent to 13 bp or 14 bp of 2013 shares). Prepayment commitments of more than 15 bp might be on the books for longer, depending on the

commitments of other credit unions. (If half of credit unions commit 26 bp, which would amount to $1 billion, only half of each credit union's commitment would be collected).

Considering costs and benefits, the cost to a participating credit union is the opportunity cost of lost interest on the prepaid amount. For the next year, given the outlook for short-term interest rates, that cost is likely to be very low for any credit union with excess liquidity. After that is anyone's guess. The benefit to a participating credit union is knowing the credit union has provided some relief and support to some other credit unions in difficult straights.

Given the size of the program, both the costs and benefits are fairly low, but not inconsequential. At a participation level of up to 15 bp, the cost would be capped at two years of lost interest on a very small slice of a credit union's assets.

It's now up to each credit union to decide.

Bill Hampel, Chief Economist
Credit Union National Association, July 8, 2011