Regulatory Alert

National Credit Union Administration: Insurance Requirements; Share Insurance Fund Equity Distributions

17-EA-22

NAFCU would like to highlight the following:

- The National Credit Union Administration (NCUA) is proposing to amend the method for determining a FICU's proportionate share of a NCUSIF equity distribution by using either: (1) the average of the four quarter-end insured share balances reported on the FICUs Call Reports during the calendar year applicable to a NCUSIF equity distribution; or (2) insured share balances reported on the FICU's December 31 Call Report during the calendar year.
- The proposal will prohibit SIF distributions to FICUs that terminate NCUSIF coverage.
- The proposal creates a provision in Part 741 related to distribution of the Corporate System Resolution Program.
- NCUA is considering making any NCUSIF equity distributions related to the Corporate System Resolution Program in the form of a series of NCUSIF equity distributions repaying any corporate assessments against FICUs on either a first-in, first-out (FIFO) or a last-in, first-out (LIFO) basis.

Comments due to NAFCU: August 22, 2017
Comments due to NCUA: September 5, 2017

Comment Now!

Charter number of credit union:

Your name:

NAFCU requests your assistance in answering the following questions regarding the proposed rule. Please refer to the summary for background information. NAFCU appreciates any feedback you can provide. Contact Andrew Morris, Regulatory Affairs Counsel, if you have any questions at (703) 842-2266, or amorris@nafcu.org.

1. In the event that NCUA closes the Stabilization Fund, how should NCUA calculate a FICU's proportionate share of a NCUSIF equity distribution? Do you have a preference for either method that NCUA has proposed?

2. Do you agree with NCUA's proposal to prohibit equity distributions to FICUs that terminate NCUSIF coverage? Would you suggest an alternative approach?

3. With respect to future NCUSIF equity distributions related to the Corporate System Resolution Program, do you have a preference for repaying assessments against FICUs on a first-in, first-out (FIFO) basis, or a last-in, first-out (LIFO) basis?

4. Should a FICU's liquidation estate should receive a NCUSIF equity distribution related to the Corporate System Resolution Program?

5. Would you recommend any particular method(s) for repaying assessments to liquidation estates that have remained open for several years or that have recently closed?

6. Do you believe that NCUA should consider additional amendments or rules to improve the current process for assessing and collecting federal share insurance premiums?

BACKGROUND

The Federal Credit Union Act (FCU Act) requires NCUA to make a proportionate distribution from the National Credit Union Share Insurance Fund (NCUSIF) to federally-insured credit unions (FICUs) for each year where, at the end of the year, the following circumstances are present:

(1) the NCUSIF has no outstanding loans from the United States Treasury and any outstanding interest on those loans has been repaid;

(2) the NCUSIF's equity ratio exceeds the normal operating level set by the Board; and

(3) the NCUSIF's available assets ratio exceeds 1 percent.

Where those circumstances are present, the FCU Act requires the Board to make the maximum possible distribution that does not reduce the NCUSIF's equity ratio below its normal operating level or reduce the NCUSIF's available assets ratio below 1 percent.

As NCUA considers closing the Temporary Corporate Credit Union Stabilization Fund (TCCUSF), which was created to address problems in the corporate credit union system arising from the Great Recession, and transferring all of its remaining assets to the NCUSIF, it has begun to reexamine the rules applicable to a NCUSIF equity distribution. These rules are contained in Part 741.4 of NCUA's regulations. The proposed rule seeks to amend § 741.4 to provide a transparent and predictable methodology for NCUSIF equity distributions.

SUMMARY

The proposal seeks to amend the calculation of a FICU's proportionate share of a NCUSIF equity distribution by using either: (1) the average of the four quarter-end insured share balances reported on the FICU's Call Reports during the calendar year applicable to a NCUSIF equity distribution; or (2) insured share balances reported on the FICU's December 31 Call Report during the calendar year. Of the two methods, the Board believes the four quarter average has more advantages, but is requesting comment on both.

The proposal will also prohibit SIF distributions to FICUs that terminate NCUSIF coverage.

Finally, NCUA proposed to create a temporary provision in Part 741 related to distribution of the Corporate System Resolution Program, which was a response to increased administrative costs resulting from the conservatorship and liquidation of corporate credit unions.

The Board is considering making any NCUSIF equity distributions related to the Corporate System Resolution Program in the form of a series of NCUSIF equity distributions repaying any corporate assessments against FICUs on either a first-in, first-out (FIFO) or a last-in, first-out (LIFO) basis.

SECTION-BY-SECTION ANALYSIS

Section 741.4(e) Distribution of NCUSIF Equity

NCUA seeks to amend § 741.4(e) to provide a clear description of how a FICU's proportionate share is based on the FICU's daily NCUSIF capitalization balance. In addition, the amendments seek to correct certain flaws in current § 741.4(e) that may give advantages to FICUs with assets over $50 million.

NCUA's current method for determining a FICU's proportionate share of a NCUSIF equity distribution involves dividing the total dollar amount of the NCUSIF equity distribution by the total dollar amount of the NCUSIF capitalization deposits. The quotient represents the dividend rate when expressed as a percentage. NCUA then divides the dividend rate by 365 to arrive at a daily distribution rate, which is then applied to a FICU's daily NCUSIF capitalization deposit balance to determine that FICU's proportional share.

NCUA adjusts a smaller FICU's (less than $50 million in assets) NCUSIF capitalization deposit annually in April using insured shares reported on the December 31 Call Report. Consequently, for the first 3 months of the calendar year, a FICU's capitalization deposit balance is based on Call Report Data that is almost two years old. For the remainder of remainder of the calendar year (after April), the capitalization deposit balance is based on the previous year's Call Report data. The informational delay resulting from this method means that insured share growth during the previous calendar year may be unaccounted for until NCUA adjusts the NCUSIF capitalization deposit.

NCUA adjusts a larger FICU's ($50 million or greater in assets) capitalization deposit semiannually in April using insured shares reported on the December 31 Call Report and in October using insured shares reported on the June 30 Call Report. As a result, for the last 3 months of the calendar year applicable to the NCUSIF equity distribution, the FICU's capitalization deposit balance is based on current Call Report data. The use of more up-to-date data may give a larger FICU an unfair advantage insofar as this method will be more responsive to insured share growth during the calendar year.

To remedy this difference, NCUA proposes to adopt a new method for calculating a FICU's proportionate share of a NCUSIF equity distribution. The proposal indicates that NCUA is considering one of two methods.

Method 1 / Four Quarter Average of Insured Shares:

The equity distribution reflects an average of the four quarter-end insured share balances reported on the FICU's Call Reports during the calendar year applicable to a NCUSIF equity distribution.

Expressed as a mathematical formula, the proportionate distribution $_i$ =

$$\left(\frac{NCUSIF\ equity\ distribution}{Aggregate\ avg.\ amount\ of\ insured\ shares}\right) * Avg.\ amount\ of\ insured\ shares_i$$

$$Aggregate\ average\ amount\ of\ insured\ shares = \sum_{i=1}^{N} (Avg.\ amount\ of\ insured\ shares_i)$$

$$Avg.\ amount\ of\ insured\ shares_i = \sum_{q=1}^{4} \left(\frac{insured\ shares_{q,i}}{4}\right)$$

Where:

i = the *i*th federally insured credit union in the series
N = the total number of all federally insured credit unions as of December 31 of the calendar year for which the NCUSIF equity distribution is declared.
n = the *n*th federally insured credit union in the series.
q= the *q*th quarterly Call Report in the series.

The primary advantage of Method 1 is that it adjusts for seasonal fluctuations in insured share levels and removes any incentive to inflate year-end insured share levels. On the other hand, to ensure accuracy, NCUA would need to separately track FICUs that merge during the calendar year to combine their insured shares. NCUA requests comment on whether the calculation should include a longer look-back period, such as 18 to 24 months, which could better capture the proportionate size of each FICU.

Method 2 / Year-end Insured Share Balance:

The equity distribution reflects insured share balances reported on the FICU's December 31 Call Report during the calendar year applicable to a NCUSIF equity distribution. NCUA would determine a FICU's proportionate share by dividing the dollar amount of a NCUSIF equity distribution by the aggregate amount of insured shares in all FICUs as reported on the December 31 Call Report for the year applicable to the distribution. That proportionate share would then be multiplied by the amount of insured shares reported in the FICU's December 31 Call Report for the year applicable to the distribution to determine each FICU's proportionate share.

Method 2 does not account for seasonal fluctuations in share levels. Accordingly, where a FICU loses insured shares in the fourth quarter, it will receive a smaller NCUSIF equity distribution despite maintaining a higher amount of insured shares over the calendar year. As a result, FICUs may have an incentive to increase insured shares at the fourth quarter to receive a larger equity distribution. On the other hand, Method 2 would present fewer administrative challenges for NCUA. For example, NCUA would not need to adjust for FICU mergers because merger activity for the calendar year would be captured in the December 31 Call Report.

NCUA's proposal indicates that the Board prefers Method 1, but invites comment on either approach.

Section 741.4(j) Conversion from, or Termination of, Federal Share Insurance

The proposal amends § 741.4(j)(1)(ii) to prohibit NCUSIF equity distributions to FICUs that terminate federal share insurance coverage during the calendar year. Under the current rule, FICUs are entitled to receive a NCUSIF equity distribution if they terminate share insurance coverage. The distribution is based on the FICUs' insured shares as of the last day of the most recently ended reporting period reduced by the number of months remaining in the calendar year after termination of coverage.

NCUA's proposal indicates that the Board feels that prohibiting equity distributions to FICUs that terminate federal share insurance coverage is a more "fair and reasonable approach" than the current rule. However, NCUA recognizes that there may be other approaches and requests comment on this aspect of the proposed rule.

Section 741.13 NCUSIF Equity Distributions Related to the Corporate System Resolution Program

The proposal adopts a special provision governing NCUSIF equity distributions resulting from the Corporate System Resolution Program. Any NCUSIF equity distributions declared from 2017 through 2021 would fall within the scope of this provision.

Closing the TCCUSF and winding down the Corporate System Resolution Program will require NCUA to transfer all remaining funds, property and other assets to the NCUSIF, which could trigger an equity distribution. Accordingly, the proposal will adopt rules to govern the ordering of the distribution. Specifically, the proposal will order any NCUSIF equity distributions related to the Corporate System Resolution Program as a series of equity distributions repaying any corporate assessments against FICUs on either a first-in, first-out (FIFO) or a last-in, first-out (LIFO) basis where each FICU receives a pro rata distribution based on the amount of funds available for the relevant assessment period.

First-in, First-out Basis

Under a FIFO approach, NCUA would make a NCUSIF equity distribution to each FICU up to the total dollar amount of corporate assessments paid by that FICU during the relevant assessment period beginning with the first assessment period in 2009.

Last-in, First-out Basis
Under a LIFO approach, NCUA would make a NCUSIF equity distribution to each FICU up to the total dollar amount of premiums paid by that FICU during the relevant assessment period beginning with the last assessment period.
NCUA requests comment on whether the FCU Act permits the FIFO and LIFO methods.

For either basis, any payments paid to a FICU that has merged into another FICU would be paid to the continuing FICU. Any payments owed to a liquidated FICU with an open liquidation estate or a closed liquidation estate still within its applicable look-back period would be made to the liquidation estate and distributed ratably to the FICU's creditors in accordance with part 709 of NCUA's rules.

NCUA requests comment on whether a FICU's liquidation estate should receive a NCUSIF equity distribution related to the Corporate System Resolution Program. NCUA would prefer to make equity distributions to liquidation estates that remain open or were recently closed and are still within the relevant look-back period; however, NCUA also recognizes that the treatment of estates which have remained open for several years may be problematic.

FICUs that paid corporate assessments would receive first priority in any NCUSIF equity distribution related to the Corporate System Resolution Program. FICUs that have not paid corporate assessments would not be entitled to the equity distribution unless all such corporate assessments are repaid in full. In addition, a FICU that terminates federal share insurance before the payment date of the equity distribution related to the Corporate System Resolution Program would not be entitled to a distribution.

Section 741.4(b) Definitions

The proposal makes a technical correction to the definition of the “available assets ratio” by updating the relevant mathematical formula to reflect the actual text of the regulation. The proposed correction would be purely technical and would not create any substantive legal change.

Section 741.4(i) Conversion to Federal Share Insurance

Section 741.4(i)(1)(v) describes the procedures governing a NCUSIF equity distribution to a financial institution that converts to federal share insurance coverage during the calendar year. Section 741.4(i)(2)(iii) determines how a NCUSIF equity distribution is made to a FICU that merges with a financial institution that is not federally insured by NCUA where the FICU is the surviving entity.

The proposal will amend §§ 741.4(i)(1)(v) and 741.4(i) (2)(iii) depending on the method chosen in § 741.4(e) (see above) for calculating a FICU’s proportionate share of a NCUSIF equity distribution.

Method 1 / Four Quarter Average of Insured Shares

If the proportionate equity distribution is determined by Method 1, NCUA will change §§ 741.4(i)(1)(v) and 741.4(i) (2)(iii) by removing the calculation methods set out in those paragraphs and replacing them with cross-references to amended § 741.4(e).

Amended § 741.4(e) would state that a financial institution converting to federal share insurance during the calendar year applicable to a NCUSIF equity distribution would be treated as not having any insured shares for the quarterly periods that it is not federally insured by NCUA. The Board would apply the same approach to mergers where the merging institution is not federally insured by NCUA.

Method 2 / Year-end Insured Share Balance

If Method 2 is used to determine a FICU's proportionate share of a NCUSIF equity distribution, NCUA will not amend §§ 741.4(i)(1)(v) or 741.4(i) (2)(iii) because the year-end share balance calculation will reflect the FICU's share of the distribution for the proportion of the year it was federally insured by NCUA.

<u>Appendix A to Part 741 - Examples of Partial-Year NCUSIF Assessment and Distribution Calculations under § 741.4</u>

The proposal would remove Appendix A to part 741 and replace it with examples and frequently asked questions published on NCUA's public website. These examples would clarify how to perform partial-year assessment and distribution calculations.

NAFCU's Regulatory Committee 2017

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NAFCU’S 2017 REGULATORY ALERTS

Number	Topic	Date Issued
17-EA-01	Treasury: Participation in the Automated Clearing House	1/3/2017
17-EA-02	CDFI Fund: RFI Regarding Policies and Procedures	1/18/2017
17-EA-03	NCUA: Alternative Capital ANPR	2/8/2017
17-EA-04	CFPB: Alternative Data	3/22/2017
17-EA-05	CFPB: Remittance Rule Assessment	4/5/2017
17-EA-06	CFPB: Amendments to HMDA Final Rule	5/2/2017
17-EA-07	CFPB: CARD Act Review	5/9/2017
17-EA-08	CFPB: Small Business Lending Information Collection RFI	5/17/2017
17-EA-09	NCUA: 2017 Regulation Review	5/19/2017
17-EA-10	NCUA: Exam Appeals	6/6/2017
17-EA-11	NCUA: Supervisory Review Committee	6/6/2017
17-EA-12	NCUA: Mergers	6/7/2017
17-EA-13	CFPB: Improving Language Access	6/9/2017
17-EA-14	CFPB: Mortgage Servicing Rules Assessment	6/9/2017
17-EA-15	Federal Reserve: Regulation CC – Forged or Altered Checks	6/28/2017
17-EA-16	CFPB: Amendments to Rules Concerning Prepaid Accounts	6/29/2017
17-EA-17	CFPB: ATR/QM Rule Assessment	6/30/2017
17-EA-18	NCUA: OTR Methodology	7/10/2017
17-EA-19	DOL: Fiduciary Rule and Prohibited Transaction Exemptions	7/10/2017
17-EA-20	NCUA: Corporate Credit Unions	7/14/2017
17-EA-21	NCUA: Merger of Stabilization Fund and SIF	7/28/2017
17-EA-22	NCUA: Share Insurance Fund Equity Distributions	7/28/2017

NAFCU’S 2017 FINAL REGULATIONS

Number	Topic	Date Issued
17-EF-01	FHFA: Acquired Member Assets	1/12/2017
17-EF-02	FHFA: Duty to Serve Underserved Markets	1/18/2017
17-EF-03	FFIEC: CC Rating System	2/3/2017
17-EF-04	Federal Reserve: Availability of Funds and Collection of Checks	6/28/2017
17-EF-05	NCUA: Safe Harbor	7/13/2017