NCUA Corporate Credit Union Stabilization Fund Frequently Asked Questions
(Updated August 2017)

1. Why is NAFCU asking NCUA to rebate monies to credit unions now?

NAFCU has consistently urged NCUA to pursue any and all options available to refund monies to credit unions to offset their costs for the corporate stabilization effort as soon as possible. The NAFCU Board strongly believes that NCUA should be constantly and fluidly examining how it is managing the Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund) and credit union money.

Credit unions have paid $4.8 billion in stabilization assessments and $5.6 billion in depleted capital into the Stabilization Fund to cover resolution costs for the failure of five corporate credit unions during the Great Recession. NCUA projects there will likely be no need for future assessments.

As of May 3, 2017, NCUA had recovered $5.1 billion in claims related to the sale of faulty residential mortgage backed securities (MBS) that contributed to the corporate failures. The agency's recovery efforts from the corporate crisis continue with ongoing litigation. More information about NCUA's legal efforts is available on NCUA's legal recoveries webpage. In October 2016, the agency also fully repaid to the U.S. Department of the Treasury the $1 billion outstanding balance on the agency's borrowing line.

In light of the continued improvement of the U.S. economy and the overall condition of the Stabilization Fund, including the payment to Treasury, NAFCU is advocating that NCUA undertake a review of whether or not any monies are available for a prompt rebate of funds to insured credit unions.

2. What is the NCUA Corporate Credit Union Stabilization Fund?

On May 20, 2009, President Obama signed into law the Helping Families Save Their Homes Act of 2009. The legislation amended the Federal Credit Union Act (FCU Act) to provide NCUA with authorities to mitigate costs associated with stabilizing the corporate credit union system, so those costs would not have to be borne by the National Credit Union Share Insurance Fund (NCUSIF). Acting under its new authority granted by Congress, in June 2009, the NCUA Board implemented the Stabilization Fund to cover the costs of the Corporate System Resolution Program, approved in September 2010 as a comprehensive strategy to address the failure of five corporate credit unions due to investment losses. Initially, the Stabilization Fund was set to expire after seven years. However, NCUA and the Department of the Treasury agreed in September 2010 to extend the life of the Stabilization Fund until June 30, 2021.

3. Why are federally insured credit unions obligated to cover the corporates' losses and the costs of the Corporate System Resolution Program?

Under Section 202 of the FCU Act, any NCUSIF premiums or assessments must be shared proportionally by all federally insured credit unions based on the credit union's insured shares. The Corporate System Resolution Program was established as a means to cover corporate resolution costs within the credit union system.

4. What was the purpose of the Stabilization Fund?

The primary purpose of the Stabilization Fund was to mitigate assessment burdens by spreading over multiple years the costs to insured credit unions for the corporate credit union stabilization effort. By isolating corporate stabilization costs in the Stabilization Fund, separately from the NCUSIF, insured credit unions were relieved from bearing a significant onetime assessment burden for stabilizing the corporate system. The Stabilization Fund allowed the NCUA Board to improve the NCUSIF's equity ratio in order to be well positioned to cover future insurance losses.

5. What are NCUA Guaranteed Notes?

As a key part of the Corporate System Resolution Program, NCUA developed the NCUA Guaranteed Note (NGN) Program to address a large group of distressed investment securities (referred to as the Legacy Assets) from the failed corporate credit unions. To protect credit unions from realizing the full market loss of the Legacy Assets at liquidation, NCUA adopted a strategy to re-securitize those investments by transferring the Legacy Assets to NGN trusts and then issuing NGNs, in a series of thirteen securitization transactions, each collateralized by Legacy Assets. The NGNs have an NCUA guaranty for timely payment of interest and principal at maturity. The guaranty is backed by the full faith and credit of the United States and primarily funded by the Stabilization Fund.

6. Will credit unions be required to pay future annual assessments to the Stabilization Fund?

Under the FCU Act, the NCUA Board has the authority to determine annual assessments until the Stabilization Fund expires in June 2021. Whether credit unions will be subject to future assessments is based on a number of factors, including the current year's cash needs relative to the Stabilization Fund, as well as performance and projected losses and cash flows on the Legacy Assets. As of the July 2017, NCUA projects there will likely be no need for future assessments. In fact, the projected net assessments range of negative $4.9 billion to negative $3.5 billion indicates the possibility of a refund at the end of the Stabilization Fund in 2021. Further, in October 2016, NCUA fully repaid the $1 billion outstanding balance on the agency's borrowing line with the U.S. Treasury. With this final payment, the Stabilization Fund's outstanding borrowings are fully paid off, which might further indicate that future rebates or recoveries to insured credit unions may be possible.

7. Given the improving condition of the Stabilization Fund, will credit unions see a rebate soon?

NCUA has previously maintained that 2021 is the earliest credit unions may expect any potential rebate. There are two potential rebates or recoveries that could become available to credit unions. First, investors with claims for depleted capital of the failed corporate credit unions could see capital recoveries from the corporate credit union asset management estates, but only after all senior claims against the liquidation estates are fully paid or funded. Section 709.5(e) of NCUA's regulations provides that "[a]ll unsecured claims of any category or class or priority . . . shall be paid in full, or provisions made for such payment, before any claims of less priority are paid." Any Stabilization Fund claims, including guaranty payments, are senior to a capital holder claim. Thus, while NCUA's current projections might indicate the availability of funds for recoveries by former corporate credit union capital holders, NCUA must first satisfy any outstanding senior obligations of the Stabilization Fund and corporate credit union asset management estates. If the corporate credit union asset management estates have assets that are collateralizing NGNs and covered by a contingent Stabilization Fund guaranty, capital recoveries cannot occur until provisions are made for payment of those contingent obligations. As such, it is unclear whether NCUA will make any recoveries available to capital holders until 2021, after all senior claims are fully satisfied.

Second, a rebate could become available for insured credit unions that paid assessments to the Stabilization Fund. The FCU Act provides that any funds and assets remaining in the Stabilization Fund will be distributed to the NCUSIF when the Stabilization Fund closes. The NCUA Board, "at [its] discretion," may close the Stabilization Fund earlier than June 30, 2021, but there is no provision to reopen it, and NCUA has indicated that closing the Stabilization Fund could foreclose a contingency funding source that could be necessary for disposition of the NGNs. The agency's rationale is that if the Stabilization Fund closes prematurely, NCUA may be required to use the NCUSIF to satisfy future agency contingent funding needs, including obligations of the NGNs, which would negatively affect the NCUSIF equity ratio. For this reason, NCUA has argued that it may not be prudent to close the Stabilization Fund prior to 2021. In addition, NCUA has indicated that possible assessment rebates are based on projections that can change over time and projected values of the Stabilization Fund and the corporate credit union asset management estates may not be realized until 2021. The agency has also cautioned that future changes in the economy or the performance of the Legacy Assets securing the NGNs could change their value. Thus, the agency has taken the position that, once the Stabilization Fund is closed and remaining assets are distributed to the NCUSIF, an assessment rebate to insured credit unions could occur if the NCUSIF's equity ratio exceeds the normal operating level (between 1.2 and 1.5 percent), and the available assets ratio exceeds 1.0 percent at the end of a calendar year. Under ordinary circumstances, any assessment rebate would be distributed pro-rata to all insured credit unions. However, in July 2017 NCUA issued a proposal whereby any NCUSIF distributions to credit unions through 2021 would be made according to their share of corporate stabilization assessments paid, in the event that the Stabilization Fund is closed prior to that date. As of the fourth quarter of 2016, NCUA indicated the projection for the total amount of a potential future rebate to all insured credit unions was an estimated $3.5 billion to $4.9 billion.

However, NAFCU believes NCUA has the legal authority to provide assessment rebates to credit unions without merging the Stabilization Fund into the NCUSIF. Although NCUA has asserted that the FCU Act does not provide for a mechanism for assessment rebates directly from the Stabilization Fund, NAFCU believes that NCUA should reexamine its authority in that regard.

The FCU Act provides that NCUA may make expenditures directly from the Stabilization Fund if they are "*connected to* the conservatorship, liquidation, or threatened conservatorship or liquidation, of a corporate credit union." NAFCU believes this provision could be reasonably interpreted to present the requisite legal authority for NCUA to direct funds from the Stabilization Fund to the NCUSIF, without closing the fund prior to 2021, as such action would arise from the conservatorship of a corporate credit union.

NAFCU strongly believes that Congress did not intend to restrict or hinder the reasonable refund of monies to credit unions, especially when funds are no longer needed to secure senior creditor obligations. Congress' goal in amending the FCU Act was to stabilize the corporate credit union market without depleting the NCUSIF. Refunding assessments in a manner that does not impair the financial condition of the Stabilization Fund or the NCUSIF and would not run counter to those purposes. Indeed, NCUA would be entitled to judicial deference in adopting this reasonable approach.

8. Is it possible that credit unions could receive a rebate prior to 2021?

Thus far, NCUA has indicated that although future assessments will likely not be necessary and Treasury borrowings are now fully repaid no funds are immediately available to provide refunds to federally insured credit unions. NAFCU, however, strongly supports the issuance of rebates prior to 2021 and is strongly advocating for the agency to thoroughly examine and consider all options for a refund to credit unions well before 2021.

It appears the NGN Program is currently over-collateralized, which affords NCUA the opportunity to explore additional options for an expeditious rebate to credit unions. In addition, two NGNs matured at the end of 2016, freeing up 133 securities with a total market value of $1.1 billion. In addition to the securities that became available in 2015 and 2016, NCUA actively manages about 225 securities with a total market value of approximately $1.7 billion as of year-end 2016. While there could be legal obligations relative to these securities, NAFCU is urging NCUA to consider if any modifications to these obligations could be made. NAFCU will continue to urge the agency to develop a concrete plan to dissolve the Stabilization Fund, and to be fully transparent in its management of the fund.

9. At its July 2017 open meeting, the NCUA Board proposed to close the Stabilization Fund and raise the normal operating level for the NCUSIF from 1.3 percent to 1.39 percent. Would this result in an assessment rebate for credit unions?

NCUA's July 2017 proposal indicated that, based on agency staff's most recent estimates, closing the Stabilization Fund prior to the end of the year would increase the NCUSIF equity ratio by 22 to 24 basis points. By statute the NCUSIF distributes to federally-insured credit unions the amount of surplus equity in the fund over the normal operating level at year end. Based on the projected year-end equity ratio and the current normal operating level of 1.3 percent, closing the Stabilization Fund this year would result in a rebate to credit unions of roughly 15 to 17 basis points of insured shares. However, if, as proposed, NCUA raises the normal operating level by 9 basis points, that rebate would be reduced to just 6 to 8 basis points. That equates to roughly $900 million that would otherwise be returned to credit unions, but would instead be retained as equity in the NCUSIF.

NCUA's rationale for increasing the normal operating level is twofold. NCUA believes that the various stresses that have resulted in a drop in the NCUSIF equity ratio are likely to continue, and based on NCUA's projections, the agency believes a larger equity cushion is necessary. In addition, closing the Stabilization Fund would mean that any future declines in the estimated cash flows from the legacy assets of the failed corporate credit unions could adversely affect the equity ratio. NCUA believes the NCUSIF should retain an additional layer of equity to protect the fund from this possibility.

With respect to potential capital recoveries, staff indicated that there are four corporate credit union asset management estates currently projected to have potential recoveries for credit union capital investors. However, currently, all five corporate credit union asset management estates have outstanding senior-creditor obligations, including to the Stabilization Fund for the NGN guaranty, until 2021. Until senior-creditor obligations for each estate is repaid or fully funded, including for contingencies, NCUA does not anticipate any distributions to the subordinate depleted capital claimants.

10. What are the potential risks to insured credit unions of closing the Stabilization Fund prior to 2021?

NCUA has clearly indicated that possible assessment rebates to insured credit unions are based on projections that can change over time and projected values of the Stabilization Fund may not be fully realized until 2021. The agency has also cautioned that future changes in the economy or the performance of the Legacy Assets securing the NGNs could change their value. Closing the Stabilization Fund early could foreclose a key contingency funding source for NCUA. Without it, NCUA is concerned that future agency contingent funding needs, including obligations of the NGNs, would have to be satisfied by the NCUSIF. Using the NCUSIF as contingency funding for disposition of the NGNs would have a negative impact on the equity ratio. In the July 2017 briefing, staff suggested that an increased potential volatility for the NCUSIF equity ratio is a considerable disadvantage to closing the Stabilization Fund prior to 2021.

The potential risk to insured credit unions is that, to hedge against these risks to the NCUSIF, NCUA will adopt a strategy to wind-down the Stabilization Fund that is not ultimately in the best interest of credit unions. In addition to the possibility that NCUA may substantially raise the normal operating level, if the Legacy Assets continue to outperform agency estimates, NCUA may have little incentive to improve its management of the NCUSIF and may not optimize the return of funds to credit unions after closure of the Stabilization Fund. Neither scenario would ultimately benefit credit unions.

11. What are the potential ramifications of NCUA raising the NCUSIF's normal operating level?

Any assessment rebate to insured credit unions, via a distribution from the NCUSIF , hinges on an assumption that the distribution of the Stabilization Fund's residual assets to the NCUSIF will increase the NCUSIF equity ratio above its normal operating level. While the normal operating level has been set at 1.3 percent since 1999, the FCU Act authorizes the NCUA Board to specify a normal operating level for the NCUSIF of anywhere between 1.2 percent and 1.5 percent. In other words, the NCUA Board has the statutory authority to raise the normal operating level to as high as 1.5 percent.

In its [2013 White Paper on NCUSIF Improvements](), NCUA suggested that the current statutory equity ratio, requiring the NCUSIF to fall within 1.2 to 1.5 percent, is too restrictive and concluded that "an NCUSIF operating level in the range of 2 percent would be appropriate." The agency also recommended that Congress should remove the statutory cap from the NCUSIF equity ratio and authorize the NCUA Board to assess NCUSIF premiums at its sole discretion. NAFCU is concerned that any increase in the normal operating level could become permanent. Far from being merely a temporary change that would expire with the NGN program obligations in 2021, NCUA could capitalize on this opportunity to raise the normal operating fund indefinitely. This scenario would be legally permissible; the FCU Act permits the NCUA Board to raise the normal operating level up to a maximum of 1.5 percent. There is no provision in NCUA's July 2017 proposal to unwind the increase to the normal operating level, and the NCUA Board would have no legal obligation to reset the normal operating level back down to 1.3 percent after the disposition of the NGN Program in 2021, or even to reset it back down at all. The NCUA Board has clear authority under the FCU Act to set the normal operating level up to the statutory maximum of 1.5 percent—and it may be held at that maximum level indefinitely. Indeed, NCUA has clearly indicated a desire to obtain additional authority from Congress to raise the normal operating level to as high as 2 percent. Ultimately, this would likely mean fewer and smaller NCUSIF dividends for credit unions in the future, and it would tie up funds that could otherwise be used to benefit credit union members.

In light of these potential risks, NAFCU recommends that the agency consider whether it has the legal authority to provide for the distribution of rebates to insured credit unions directly from the Stabilization Fund . Although NCUA has asserted that the FCU Act does not provide for a mechanism for rebates directly from the Stabilization Fund, NAFCU believes that NCUA should reexamine the issue.

The FCU Act could be interpreted to present the requisite legal authority for NCUA to make direct payments to insured credit unions out of the Stabilization Fund. Pursuant to the FCU Act, NCUA is permitted to make expenditures from the Stabilization Fund so long as they are "*connected to* the conservatorship, liquidation, or threatened conservatorship or liquidation, of a corporate credit union." NAFCU believes that NCUA could reasonably find legal authority to disburse funds directly from the Stabilization Fund as such action would arise from, and thus provide the nexus to, the conservatorship of a corporate credit union.

12. If the NCUSIF normal operating level remains at 1.3 percent, are there any other potential downsides to closing the Stabilization Fund prior to 2021?

If NCUA keeps the NCUSIF normal operating level at 1.3 percent, closure of the Stabilization Fund would likely cause the equity fund to exceed 1.3 percent, triggering a distribution to insured credit unions *and* avoiding a NCUSIF premium charge in 2017. At face value, this could certainly be a winning scenario for credit unions. However, one potential downside to this strategy is that NCUA may have little incentive to improve its management of the NCUSIF, to the ultimate detriment of credit unions.

NAFCU has consistently pushed NCUA to work diligently to maintain a healthy equity ratio through prudent management of the NCUSIF. The improving condition of the Stabilization Fund and the potential for its closure to bolster the equity ratio must not lull NCUA into complacency in its management of the NCUSIF.

The Stabilization Fund's merger into the NCUSIF would likely mean an *earlier* assessment rebate to insured credit unions, but credit unions could ultimately see a *less optimal total return* of monies if the agency is not held to a high degree of accountability for its management of the NCUSIF through 2021 and beyond. This is because, once the Stabilization Fund is closed and an initial rebate is paid, the only mechanism for additional credit union rebates will be through subsequent distributions of funds in excess of the normal operating level. However, there is a disincentive for NCUA to lower NCUSIF operating expenses because once the Stabilization Fund is closed and its remaining assets and obligations are transferred to the NCUSIF the agency is entitled to retain any proceeds from the Legacy Assets that do not cause the equity ratio to exceed the normal operating level. Assuming the Legacy Assets continue to perform better than expected, after making an initial distribution to credit unions NCUA could simply rely on the Legacy Assets to buttress the equity ratio instead of making needed operational changes to improve the performance of the NCUSIF. NAFCU strongly believes that the agency should be focused on vigilant management of the NCUSIF in order to maximize total rebates to credit unions.