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NATIONAL CREDIT UNION ADMINISTRATION

Closing the Temporary Corporate Credit Union Stabilization Fund and Setting the Share Insurance Fund Normal Operating Level

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final Notice.

SUMMARY: In July 2017, the NCUA Board (Board) sought comments on its plan to close the Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund) in 2017, prior to its scheduled closing date in June 2021, and raise the normal operating level of the National Credit Union Share Insurance Fund (Insurance Fund) to 1.39 percent. This final notice provides a discussion of comments received and explains the Board's decision to close the Stabilization Fund in 2017. This notice also explains the Board's decision to set the normal operating level of the Insurance Fund to 1.39 percent.

FOR FURTHER INFORMATION CONTACT: Anthony Cappetta, Supervisory Financial Analyst, Amanda Parkhill, Loss/Risk Analysis Officer, or Kevin Tuininga, Senior Staff Attorney, at 1775 Duke Street, Alexandria, VA 22314, or telephone: (703) 518-1592.

SUPPLEMENTARY INFORMATION:

I. Background

On July 20, 2017, the Board approved a Notice and Request for Comment (July 2017 Notice) requesting comments on its plan to close the Stabilization Fund in 2017 and set the normal operating level at 1.39 percent. The notice appeared in the *Federal Register* on July 27, 2017.[1] Specific matters the Board sought comment on included whether the NCUA should:

- Close the Stabilization Fund in 2017, close it at some future date, or wait until it is currently scheduled to close in 2021.
- Set the normal operating level based on the Insurance Fund's ability to withstand a moderate recession without requiring assessments over a five-year period.
- Set the normal operating level based on the Insurance Fund's ability to withstand a severe recession without requiring assessments over a five-year period.

[1] Closing the Temporary Corporate Credit Union Stabilization Fund and Setting the Share Insurance Fund Normal Operating Level, 82 FR 34982 (July 27, 2017).

- Base the approach to setting the normal operating level on preventing the equity ratio from declining below 1.20 percent, or some other higher minimum level.

The Board requested comments by September 5, 2017, which would allow the Board sufficient time to permit closing before the end of 2017 and establish a distribution method to insured credit unions to the extent the closure caused the Insurance Fund's equity ratio to exceed its normal operating level, as of the end of 2017. In a separate but related proposal, also adopted on July 20, 2017, the Board requested comments on its regulation governing equity distributions from the Insurance Fund.[2]

A. Stabilization Fund Background

Public Law 111-22, the *Helping Families Save Their Homes Act of 2009* (Helping Families Act), signed into law by the President on May 20, 2009, created the Stabilization Fund. Congress provided the NCUA with this temporary fund to accrue the losses of the corporate credit union system and assess insured credit unions for such losses over time. This prevented insured credit unions from bearing a significant burden for losses associated with the insolvency of five corporate credit unions within a short period. Without creation of the Stabilization Fund, corporate credit union losses would have been borne by the Insurance Fund. The magnitude of losses would have exhausted the Insurance Fund's retained earnings and significantly impaired

[2] Requirements for Insurance; National Credit Union Share Insurance Fund Equity Distributions, 82 FR 35705 (Aug. 1, 2017).

credit unions' one percent contributed capital deposit.[3] The deposit impairment, along with premiums[4] that would have been necessary to restore the Insurance Fund's equity ratio, would have resulted in a significant, immediate cost to credit unions at a time when their earnings and capital were already under stress due to the Great Recession.[5] In June 2009, the Board formally approved use of the Stabilization Fund for the costs of the Corporate System Resolution Program.[6] Since then, all of these costs have been accounted for in the financial statements of the Stabilization Fund.

The Act specifies that the Stabilization Fund will terminate 90 days after the seven-year anniversary of its first borrowing from the U.S. Treasury.[7] The first borrowing occurred on June 25, 2009, making the original closing date September 27, 2016. However, the Act provided the Board, with the concurrence of the Secretary of the U.S. Treasury, authority to extend the closing date of the Stabilization Fund. In June 2010, the Board voted to extend the life of the Stabilization Fund and, on September 24, 2010, the NCUA received concurrence from the Secretary of the U.S. Treasury to extend the closing date to June 30, 2021.

Unlike in 2009, the Insurance Fund's $13.2 billion now exceeds both the corporate credit union Legacy Asset balance and NGN balance (as of June 30, 2017). Due primarily to the nearly $4

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[3] Prior to reassignment of these costs to the Stabilization Fund, the equity ratio of the Insurance Fund would have been only about 0.11 percent at year-end 2009 – resulting in a deposit impairment of 89 percent.
[4] Throughout this document, the terms "premium" and "assessment" are used interchangeably.
[5] Because the contributed capital deposit is reflected as an asset on the financial statements of insured credit unions, under applicable accounting rules any impairment results in an immediate expense to credit unions.
[6] For more details on the Corporate System Resolution Program, please see the NCUA Corporate System Resolution Costs webpage (https://www.ncua.gov/regulation-supervision/Pages/corporate-system-resolution.aspx).
[7] 12 U.S.C. § 1790e(h).

billion in net legal recoveries, the Stabilization Fund has a positive net position of approximately $2.0 billion as of June 2017. Additionally, there are no outstanding U.S. Treasury borrowings. Closing the Stabilization Fund in 2017 will, barring the unexpected, result in an equity distribution to insured credit unions in 2018, putting funds to work in the credit union system prior to its current scheduled closure in 2021.

B. Normal Operating Level Background

When contemplating closing the Stabilization Fund, the Board also had to consider whether a normal operating level of 1.30 percent would be sufficient to cover all of the Insurance Fund's resulting exposures. To determine this, the NCUA modeled the losses that would be expected under a moderate and a severe recession.[8] For the two recession scenarios, the agency modeled the:

- Impact on the equity ratio of the estimated decline in the value of the Insurance Fund's claims on the liquidated corporate credit unions' asset management estates – which would be driven by a reduction in the value of the Legacy Assets.
- Performance of the Insurance Fund based on the three primary factors that currently affect the Insurance Fund's equity ratio: insured share growth, yield on investments, and insurance losses.

[8] In estimating the equity ratio under various economic stress scenarios, the NCUA must make estimates and assumptions that affect the model output. Actual results could differ from the NCUA's estimates; however, the agency evaluates the reasonableness of such estimates when analyzing the model output.

The Insurance Fund was modeled over a five-year period and the Legacy Assets were modeled over their remaining life.[9] The NCUA used the applicable variables describing economic developments for the Adverse and Severely Adverse economic scenarios from the Federal Reserve Board's 2017 annual stress test supervisory scenarios.[10]

Based on this modeling, to withstand a moderate recession without the equity ratio falling below the statutory minimum of 1.20 percent,[11] the Insurance Fund's equity ratio needs to be high enough to withstand the following:

- A 13-basis-point decline in the equity ratio due to the impact on the three primary drivers of the Insurance Fund's performance.
- A 4-basis-point decline in the value of the Insurance Fund's claim on the corporate credit union asset management estates.
- A 2-basis-point decline in the equity ratio expected to occur prior to when the remaining NGNs begin to mature in 2020 and remaining exposure to the Legacy Assets can begin to be reduced. This helps ensure the 4 basis points of additional equity to account for the

[9] A five-year horizon (beginning at year-end 2017) was used to cover the cycle of an economic downturn and the life of the NGN Program.
[10] *Supervisory Scenarios for Annual Stress Test Required under the Dodd-Frank Act Stress Testing Rules and the Capital Plan Rule*, Feb. 10, 2017. (https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170203a5.pdf).
[11] 12 U.S.C. § 1782(c)(2).

potential decline in value of the claims on the asset management estates is maintained in the Insurance Fund until Legacy Assets can be sold.[12]

Therefore, the Board proposed setting the normal operating level at 1.39 percent.

II. Comments Received

The Board received 663 comment letters on its notice proposing to close the Stabilization Fund in 2017 and increase the Insurance Fund's normal operating level to 1.39 percent. Commenters included representatives of three national credit union trade associations; 15 credit union leagues or regional trade associations; 244 federal credit unions; 268 federally insured, state-chartered credit unions; and 133 individuals and organizations, including credit union service organizations. The majority of commenters expressly supported or did not oppose closing the Stabilization Fund in 2017 and expressly opposed increasing the Insurance Fund's normal operating level or advocated a "full rebate" of Stabilization Fund equity. A more detailed discussion of the comments follows.

A. Closing the Stabilization Fund

Approximately 170 commenters expressly supported the Board's proposal to close the Stabilization Fund in 2017. An additional two-thirds of all commenters omitted an express

[12] The Board must consider retaining this equity now because, as the equity ratio declines, the Board would be unable to replenish the equity through premium assessments as long as the equity ratio remains above 1.30 percent, per the Act. 12 U.S.C. § 1782(c)(2)(B).

opinion on whether to close the Stabilization Fund in 2017 and instead voiced more definite opinions on the Insurance Fund's normal operating level. Many commenters that did not make a statement supporting closure in 2017 nevertheless urged a near-term distribution of funds, indicating or implying either that they (a) did not oppose closing the Stabilization Fund in 2017 or (b) believed the Board could make a distribution to credit unions directly from the Stabilization Fund.

Supportive commenters generally expressed that closing the Stabilization Fund before 2021 would provide an earlier opportunity to expand business and increase the financial security of credit unions, particularly smaller credit unions. Multiple commenters also noted that closure would reduce the NCUA's costs for maintaining multiple funds.

As noted above, some commenters supporting closure in 2017, along with a few others that opposed closure, also suggested that the NCUA could make distributions to the Insurance Fund or to credit unions directly from the Stabilization Fund without closing it. Under one commenter's analysis, the NCUA would receive deference in making such distributions under the Supreme Court case *Chevron U.S.A., Incorporated v. Natural Resources Defense Council, Incorporated*[13] because the Act is silent on the subject. This commenter believed the Insurance Fund is owed a refund from the Stabilization Fund, which would provide a sufficient nexus with Stabilization Fund authorities to support a distribution to the Insurance Fund. At the same time, this commenter stated mingling funds from the Stabilization Fund with the Insurance Fund

[13] 467 U.S. 837 (1984).

would be unfair to credit unions. A few commenters suggested the NCUA could make distributions directly from the Stabilization Fund to former capital holders of the corporate credit unions.

A number of commenters supporting closing the Stabilization Fund in 2017 hedged their support if (a) closure was combined with an increase to the Insurance Fund's normal operating level or (b) Stabilization Fund money could not be accounted for separately after its closure. Many of these commenters believed Stabilization Fund equity should not be available to permanently increase the Insurance Fund's equity ratio (whether or not the normal operating level was increased) or for insurance losses related to natural person credit unions. These commenters stated it would be inappropriate to "repurpose" or "divert" Stabilization Fund equity for uses beyond losses related to the liquidated corporate credit unions. A common comment was that the Board should maintain separate operations for resolution of the corporate credit union estates after closing the Stabilization Fund and maintain income and equity attributable to the Stabilization Fund in a separate account payable to credit unions.

A number of commenters were concerned the Stabilization Fund's closure would affect the total distributions available to insured credit unions once the corporate credit union asset management estates were resolved. Many of these commenters were also concerned closure would affect the allocation of funds between credit unions that paid Stabilization Fund assessments and credit unions that hold certificates of claim against the asset management estates related to corporate credit union capital investments. A few commenters appeared to urge the NCUA to prioritize payments to former capital holders of the liquidated corporate credit unions over distributions to insured credit unions, while some others expressed concern that capital holders not receive priority over credit unions that paid assessments.

One commenter argued that the NCUA should treat the corporate asset management estates collectively for purposes of paying claims against the estates under 12 CFR § 709.5(b), governing priority of claims. This commenter observed that a collective approach would maximize reimbursements to the Stabilization Fund before any payments to capital holders of the corporate credit unions could occur. This commenter believed the Board had treated the asset management estates collectively by pooling their assets in NGN trusts and then departed from collective treatment with respect to payment of claims under § 709.5(b). This commenter recommended a new regulation providing that the corporate credit union asset management estates would be treated as one pool of assets for purposes of distributions under § 709.5(b).

Slightly under 30 commenters firmly opposed closing the Stabilization Fund in 2017. Many of these commenters were concerned that closing the Stabilization Fund, which would result in consolidation, would cause less than full transparency regarding Insurance Fund distributions to credit unions and payments to former capital holders of the liquidated corporate credit unions. One commenter voiced concern about volatility in the Insurance Fund's equity ratio and complications related to multiple small distributions.

B. Normal Operating Level

Just under 60 commenters supported or indicated some level of acceptance of an increase to the Insurance Fund's normal operating level, provided the increase was temporary. About one dozen of these commenters supported or appeared to accept an increase to 1.39 percent. One commenter advocated a permanent increase to 1.50 percent. An additional three dozen commenters supported a temporary increase to 1.34 percent to cover exposure to Legacy Assets. Three more commenters suggested an increase to 1.35 percent, while another seven commenters indicated some level of support for a temporary increase without specifying their preferred threshold. These commenters nearly universally advocated that any increase from 1.30 percent be temporary. Many commenters urged the Board to set a defined schedule or express specific intent to move the normal operating level back to 1.30 percent as exposure to Legacy Assets decreases. One commenter who advocated the Board set the normal operating level at 1.50 percent urged the NCUA to approach Congress for further authorities that would permit the Insurance Fund's equity ratio to reach 2.0 percent, similar to the Deposit Insurance Fund for banks.

One commenter supported a temporary increase of the Insurance Fund's equity ratio to 1.30 percent but only for so long as exposure to Legacy Assets remained. This commenter stated that all equity related to the Stabilization Fund should be distributed once Legacy Asset exposure subsided, including funds needed to increase the Insurance Fund's equity ratio to 1.30 percent. Thus, this commenter implied the Board should decrease the normal operating level below 1.30 percent to meet the equity ratio at the time of the Stabilization Fund's closure to permit distribution of all equity received from the Stabilization Fund.

Around 55 percent of all commenters expressly opposed any increase to the normal operating level. However, around 90 additional commenters urged a “full rebate” of Stabilization Fund equity, implying they also opposed any increase to the normal operating level that would decrease a distribution in 2018 or beyond. Many of these commenters contended no increase could be justified because a normal operating level of 1.30 percent had been sufficient to withstand the financial crisis. A large number of these commenters (as well as some that supported an increase) were concerned the Board would never again decrease the normal operating level if it increased it in 2017. Many commenters that opposed any increase to the normal operating level urged that, if the Board did increase it, the increase should sunset after one year and the Board should then substantiate any extension of a normal operating level above 1.30 percent. Some of these commenters suggested increasing the normal operating level would erode the NCUA’s motivations to control its operating expenses and that the NCUA’s operating budget and the overhead transfer rate had consumed most Insurance Fund investment returns in recent years. A common thread in the comments was that failure to return all Stabilization Fund equity would be contrary to prior assurances and promises from the Board.

Commenters opposing an increase often supported their position by noting that funds would be more productive and earn higher returns in the hands of credit unions than in the Insurance Fund. Many of these commenters acknowledged that near-term Insurance Fund assessments could be required and that this was an acceptable outcome. One commenter stated that 1.39 percent seemed arbitrary because the Insurance Fund would not have withstood the financial crisis even if its equity ratio had been at that level before the crisis began.

Numerous commenters noted the Insurance Fund's audit reports from December 2016 determined that an equity ratio of 1.24 percent was sufficient to cover all contingencies. With respect to the Stabilization Fund, these commenters cited the December 2016 audit report that stated "there were no probable losses for the guarantee of NGN's associated with the re-securitization transactions." These commenters argued the NCUA could therefore not, only nine months later, justify an increase to the normal operating level based on exposure to the Legacy Assets or for potential losses related to natural person credit unions.

Some commenters contended an increase to the normal operating level would be akin to credit unions over-reserving for loan losses, a practice NCUA examiners generally advise against. They noted the strength of the credit union industry, the recent strengthening of the NCUA's regulations related to capital, and more stringent supervisory tests as additional firewalls that reduced the need for an increase to the normal operating level. These commenters often pointed to loss estimates related to the Legacy Assets as a basis to doubt the NCUA's projections of the Insurance Fund's performance.

One commenter that characterized the Board's proposed closure of the Stabilization Fund as a "cash grab" alleged resulting distributions were an attempt to distract credit unions as the agency "hoards money for itself." According to this commenter, the NCUA intended to "raid" Stabilization Fund assets as an end-run around FCU Act restrictions that preclude assessments increasing the Insurance Fund's equity ratio above 1.30 percent. A few commenters contended using Stabilization Fund equity to increase the Insurance Fund's normal operating level above 1.30 percent was illegal because it was the equivalent of an assessment that the Act would not otherwise permit. Some commenters also expressed the sentiment that it would be improper to improve the Insurance Fund's equity position using dollars from credit unions that paid Stabilization Fund assessments.

Most commenters did not directly address whether they supported the NCUA lengthening the forecast horizon for Insurance Fund performance from two years to five years. Some that did address this opposed lengthening the forecast horizon because they believed a five-year horizon was significantly longer than the typical length of a recession. They also argued the NCUA had sufficient tools to manage the Insurance Fund, such as levying assessments, implementing a restoration plan, decreasing operating budgets, and altering investment strategies, without lengthening the forecast period.

C. Additional Comments

A number of commenters noted improved transparency in NCUA operations. But many commenters were also concerned closure of the Stabilization Fund and the distribution of its assets to the Insurance Fund would decrease transparency. A few commenters specifically requested more transparency on the Board's administration of the corporate credit union asset management estates.

A significant number of commenters attributed downward trends in the Insurance Fund's equity ratio to the cost of the NCUA's operations, recent increases in the NCUA's operating budget, and excessive Insurance Fund loss reserves. Many commenters also expressed a preference that the Board consider an increase to the Insurance Fund's normal operating level in a proposal completely separate from any related to closing the Stabilization Fund. Some of these commenters alleged an improper motive, or "sleight of hand," in considering the proposals together.

Multiple commenters stated no-near term Insurance Fund premiums would be required even if the Stabilization Fund was not closed in 2017. These commenters stated that models showed no circumstances where the Insurance Fund's equity ratio would fall below 1.20 percent within the next two to four years. On the other hand, one commenter was concerned about the loss of contingency funding after closure of the Stabilization Fund. This commenter recommended that the NCUA review its Central Liquidity Facility authorities and regulations with an eye toward improving contingency funding sources.

A material number of commenters, generally through variations of a form letter, stated that the "proposed method for closing the [Stabilization Fund] does nothing to address the excessive $1B charged since its creation to the [asset management estates] by the NCUA." Many commenters also submitted form letters stating that, if the NCUA did not distribute the maximum amount, it would be "dooming us to fail and claiming the hard won reserves our members have saved." Multiple commenters also argued that an increase to the Insurance Fund's equity ratio through an adjustment to the normal operating level was not warranted for Legacy Asset exposure because the distribution of Stabilization Fund equity to the Insurance Fund would cover such exposure. A few commenters requested or suggested more time to review and respond to the Board's proposal or lamented that they did not have more time to review and respond. One commenter proposed putting off the proposal until 2018 to permit more time for review.

Many commenters had an inaccurate understanding of one or more of the following: (a) the law governing credit union liquidations; (b) the difference between distributions from the Insurance Fund to insured credit unions and distributions to claimants from asset management estates; (c) whether the timing of the Stabilization Fund's closure could affect overall distributions to either insured credit unions or former capital holders of the corporate credit unions; (d) the interaction of the Insurance Fund's equity ratio and its normal operating level; and (e) how the 1.30 percent equity ratio and normal operating level survived the financial crisis without immediate and heavy assessments. Almost fifty commenters advocated or mentioned a particular distribution method under the Board's separate proposal to amend 12 CFR § 741.4.

III. The Board's Response to Comments

The Board considered all of the comments and provides responses below to the salient arguments and concerns commenters raised.

A. Closing the Stabilization Fund

In response to commenters that suggested the NCUA could make distributions to the Insurance Fund or to credit unions directly from the Stabilization Fund without closing it, the Board continues to see no legal basis for discretionary, non-closure distributions. This is true for either direct distributions to credit unions or non-closure distributions to the Insurance Fund. Commenters that urged non-closure distributions argued the NCUA would receive deference on its interpretation because the Act's silence on the subject creates ambiguity. However, these arguments are based on flawed legal, factual, and policy assumptions, which even substantial deference may not support.

First, the Stabilization Fund is not silent on distribution authority. The legislation expressly references distributions, but only in relation to two circumstances. One, the legislation expressly prohibits an otherwise required end-of-year distribution from the Insurance Fund to insured credit unions if the Stabilization Fund has an outstanding advance from the Treasury. And, two, the legislation requires a distribution of all funds and property in the Stabilization Fund when the Board closes the Fund. Nowhere does the legislation discuss optional, non-closure distributions to the Insurance Fund (or to credit unions directly) prior to the Stabilization Fund's closure. Instead, as the Board noted in the July 2017 Notice, the legislation makes direct and express reference to particular Insurance Fund authorities that also apply to the Stabilization Fund (insurance payments, special assistance payments, and administrative or other Title II expenses). These direct and express references exclude the authorities the Act provides with respect to equity distributions to insured credit unions from the Insurance Fund.

Second, the Act requires that, before the Board authorizes any non-closure payment from the Stabilization Fund, it must "certify that, absent the existence of the Stabilization Fund, the Board would have made the identical payment out of the [Insurance Fund]." The Board must report these certifications to specified congressional committees. Especially with respect to a non-closure distribution to the Insurance Fund (as at least one commenter now urges), it is unclear how the Board would certify that the Insurance Fund could have made such a payment to itself. These provisions make it unwise to assume a court (or Congress) would approve of an interpretation that the NCUA can distribute funds between the Stabilization Funs and Insurance Fund outside of the circumstances described in the Act.

Third, contrary to what one of the principal proponents of non-closure distributions from the Stabilization Fund contends, the Insurance Fund is not "owed a refund from the Stabilization Fund as a result of conserved and liquidated corporate credit unions." Other than the $1 billion capital note issued to U.S. Central Federal Credit Union, no material expenses related to the conserved and liquidated corporate credit unions were paid from the Insurance Fund. Immediately after Congress established the Stabilization Fund, the Board transferred the $1 billion capital note receivable to the Stabilization Fund, at which time the Insurance Fund received full payment on the capital note from the Stabilization Fund. These events are all reflected in public Board records and the audited 2009 financial statements for the Insurance Fund and Stabilization Fund, available on the NCUA's website. Until the Board votes to close the Stabilization Fund or it reaches its statutory expiration date, thus triggering the distribution of all Stabilization Fund assets and liabilities to the Insurance Fund, the Insurance Fund has no receivable from the Stabilization Fund to support a payment characterized as a refund.

Finally, the Board is skeptical Congress would approve of discretionary, non-closure distributions to credit unions or to the Insurance Fund because the Stabilization Fund has, at the Board's request, unhindered access to $6 billion in general tax revenues from the U.S. Treasury.

Nothing in the Stabilization Fund legislation informs when or how non-closure general distributions would or could take place. Although the Insurance Fund shares the same U.S. Treasury borrowing authority, the Act imposes multiple timing, amount, and circumstance limitations with respect to its equity distributions. The Board believes a loose interpretation with respect to non-closure Stabilization Fund distributions poses a high risk that such distributions would be viewed unfavorably, with potential adverse consequences.

A few commenters also argued the NCUA could make distributions directly from the Stabilization Fund to former capital holders of the corporate credit union asset management estates. This is not the case, however, because former capital holders have claims against the asset management estates, not against the Stabilization Fund or the Insurance Fund.[14] With respect to each asset management estate, capital holders can only receive payment after the Stabilization Fund has been fully reimbursed for payments made from the Stabilization Fund on behalf of the estate. This is because claims of the Stabilization Fund are senior to those of capital holders under 12 C.F.R. § 709.5(b), governing priority of payments in liquidation. Funds in the Stabilization Fund belong to the Stabilization Fund. These funds are not available to capital holders or any other claimants against the asset management estates.

A common comment was that the Board should maintain income and equity attributable to the Stabilization Fund in a separate account payable to credit unions and maintain separate operations for resolution of the corporate credit union estates after closing the Stabilization Fund.

[14] *See* 12 C.F.R. § 709.5(b) (listing "unsecured claims against the liquidation estate").

The Board assures commenters that corporate credit union asset management estates will continue to be administered as distinct entities, as the Act requires. However, the Board sees no basis on which it can maintain separate accounts for equity distributed from what was the Stabilization Fund to the Insurance Fund once the Stabilization Fund is closed.

Under the Act, all capital within the Insurance Fund contributes equally to its equity ratio if it is not a "direct liabilit[y] of the Fund or contingent liabilit[y] for which no provision for losses has been made."[15] Thus, distributions cannot become direct liabilities of the Insurance Fund to support some type of account-payable treatment until the Insurance Fund's equity ratio exceeds the normal operating level as of the end of a calendar year and the available assets ratio exceeds 1.0 percent.[16] Additionally, until an equity distribution occurs, all equity in the Insurance Fund is available for the purposes designated in the Act, including payments of insurance, special assistance, or administrative or other expenses incurred in carrying out the purposes of Title II of the Act.[17] There is no basis by which the Board can withhold equity transferred from the Stabilization Fund for a specific purpose. However, in its separate proposal on Insurance Fund distribution methods, the Board does attempt, to the extent possible, to treat distributions related to Stabilization Fund equity different from general equity distributions that might otherwise occur from the Insurance Fund.[18]

[15] 12 U.S.C. § 1782(h)(2).
[16] 12 U.S.C. § 1782(c)(3).
[17] 12 U.S.C. § 1783(a).
[18] Notice of Proposed Rulemaking "Requirements for Insurance; National Credit Union Share Insurance Fund Equity Distributions" 82 FR 35705 (Aug. 1, 2017).

In response to commenters concerned that consolidation of the funds would cause less than full transparency regarding Insurance Fund distributions to credit unions and payments to former capital holders of the liquidated corporate credit unions, the Board reiterates that is not the case.

As the Board noted in the July 2017 Notice, closing the Stabilization Fund will not change the accounting or reporting of the corporate credit union asset management estates. Each asset management estate is, and will always be, a separate legal entity and no claims against those estates will be affected by the closing. Additionally, corporate credit union asset management estates will be reported separately from natural person credit union asset management estates. The post-closure financial statements and note disclosures for the Insurance Fund will continue to provide the same level of detail about the Insurance Fund’s receivables from the corporate assets management estates and related fiduciary activities. Regularly updated information on the NCUA’s website for the NGNs, Legacy Assets, and asset management estates will continue to be provided after closure of the Stabilization Fund.

As for the transparency related to Insurance Fund distributions, the Board has taken recent actions to increase transparency of the distribution process. Any resulting Insurance Fund distributions would be conducted in accordance with the Act and Part 741 of the NCUA’s regulations. Interested stakeholders were provided an opportunity to comment on the proposed method for distributing equity from the Insurance Fund to insured credit unions in a Notice of Proposed Rulemaking approved by the Board in July 2017.[19]

Some commenters were concerned the Stabilization Fund's closure would affect the total distributions available to insured credit unions once the corporate credit union asset management estates were resolved, or the allocation of funds between credit unions that paid Stabilization Fund assessments and credit unions that hold certificates of claim against the asset management estates related to corporate credit union capital investments. However, these concerns are similarly unfounded.

Assuming all other potential equity ratio influences remain static, the Stabilization Fund's early closure will have no impact on the total distributions insured credit unions will receive once all corporate credit union legacy assets are resolved. This is because the amount of total receivables the Stabilization Fund holds against the asset management estates, which affects the amount that will eventually be distributed to credit unions depending on future performance of the Legacy Assets, will not change as a result of the closure. All receivables the Stabilization Fund holds as of October 1, 2017 will be distributed to the Insurance Fund and equity will build from those receivables in the Insurance Fund rather than building and remaining in the Stabilization Fund until its scheduled closure date in 2021. Equity that builds in the Insurance Fund will become available for future distributions to the extent the equity ratio exceeds the normal operating level at the end of a calendar year.

[19] "Requirements for Insurance; National Credit Union Share Insurance Fund Equity Distributions," 82 FR 35705 (Aug. 1, 2017).

Instead of affecting total distribution amounts, early closure means credit unions will see a portion of total distributions sooner than they would if the Board continued to hold equity in the Stabilization Fund. If the Board continues to hold equity in the Stabilization Fund, credit unions are more likely to see fewer but individually larger distributions after the Stabilization Fund is closed at some future date, Aggregate distributions will not change, however, based on when the Stabilization Fund is closed. Also, if the Stabilization Fund is not closed in 2017, credit unions may be subject to an Insurance Fund premium in the near future to maintain the equity ratio at a prudent level.

Although closure has no isolated impact on total distributions credit unions will eventually receive, future distribution amounts could change based on other factors, including but not limited to (a) greater than or less than expected losses to the Insurance Fund; (b) worse-than or better-than-expected Legacy Asset performance (which, along with legal recoveries, are the principal source for reimbursing Stabilization Fund claims against the asset management estates); (c) worse-than or better-than-expected investment returns; (d) insured share growth that is lower or higher than expected; or (e) changes to the Insurance Fund's normal operating level. Each of these factors, however, is independent of the Stabilization Fund's closure.

Although one commenter argued the NCUA should treat the corporate asset management estates collectively for purposes of paying claims against the estates under 12 C.F.R. § 709.5(b), governing priority of claims, this approach would not be consistent with the applicable statutory and regulatory provisions. Under the Act, the Board as liquidating agent must "pay all valid obligations of [a liquidated credit union] in accordance with the prescriptions and limitations of [the Act]."[20] With respect to liquidation priorities, the Act requires the Board to "retain for the account of the Board such portion of the amounts realized from any liquidation as the Board may be entitled to receive in connection with the subrogation of the claims of accountholders" and to "pay to accountholders and other creditors the net amounts available for distribution to them."[21] NCUA regulations further specify, consistent with principles that apply in general bankruptcies, that the administrative expenses associated with a liquidation receive priority over all other claims.[22] Finally, case law related to the unwinding of financial institutions imposes fiduciary like duties on the receiver for an insolvent financial institution (or in the NCUA's case, the liquidating agent).[23] Based on these applicable authorities and principles, the Board believes treating the asset management estates collectively for purposes of paying claims would cause material litigation risk. This litigation risk would arise because some estates would cover deficits in Stabilization Fund receivables related to other estates that suffered greater losses, potentially prejudicing subordinate creditors, including former capital holders.

Further, the commenter that raised this prospect is incorrect in stating that the Board already treated the five asset management estates as one entity for purposes of the NGN re-securitizations. On the contrary, consistent with the authority cited above, the Board initially accounted for and continues to account for each asset management estate on an individual basis throughout the NGN transactions. This includes tracking the ongoing performance of each

[20] 12 U.S.C. § 1787(b)(2)(F).
[21] 12 U.S.C. § 1787(b)(11).
[22] 12 CFR § 709.5(b).
[23] *See Golden Pac. Bancorp. v. F.D.I.C.*, 375 F.3d 196, 201 (2d Cir. 2004) ("It is undisputed that, as a receiver, the FDIC owes a fiduciary duty to the Bank's creditors and to Bancorp.").

security that each asset management estate contributed. It also includes, for any guaranty obligations that accrue, allocating the liability for reimbursement to particular estates based on the performance of the assets they contributed.

In line with this allocation practice, the legal documents related to each transaction, including owner trust certificates that represent a claim to residual assets, reflect the separate contributions of each asset management estate. Similarly, the Board, as liquidating agent, has allocated amounts from legal recoveries to individual asset management estates based on their ownership of securities to which the recovery relates. This process is described in more detail on the NCUA's website and reflects the Board's position that each asset management estate is, and should be, treated as a distinct legal entity.

B. Normal Operating Level

In response to the commenter that characterized the NCUA's proposed closure of the Stabilization Fund as a "cash grab," the Board reaffirms its position that the agency should maintain a resilient Insurance Fund for the mutual benefit of the credit union community and taxpayers. It is also important for the NCUA to avoid or minimize Insurance Fund premiums, especially during times of economic stress, to keep money at work in the credit union community when it is needed most.

To that end, as outlined in the July 2017 Notice, the Board's main objectives in setting the normal operating level are as follows:

- Retain public confidence in federal share insurance;
- Prevent impairment of the one percent contributed capital deposit; and
- Ensure the Insurance Fund can withstand a moderate recession without the equity ratio declining below 1.20 percent over a five-year period.

Therefore, the Board has set the normal operating level at 1.39 percent to account for:

- A 13-basis-point decline in the equity ratio due to the impact of the three primary drivers of the Insurance Fund's performance;
- A 4-basis-point decline in the value of the Insurance Fund's claims on the corporate credit union asset management estates; and
- A 2-basis-point decline in the equity ratio expected to occur prior to when the remaining NGNs begin to mature in 2020 and remaining exposure to the Legacy Assets can begin to be reduced. This helps ensure the 4 basis points of additional equity to account for the potential decline in value of the claims on the asset management estates is maintained in the Insurance Fund until Legacy Assets can be sold.[24]

Multiple commenters alleged it would be illegal for the NCUA to increase the Insurance Fund's equity ratio above 1.30 percent as a result of equity now held in the Stabilization Fund. This

[24] The Board must consider retaining this equity now because, as the equity ratio declines, the Board would be unable to replenish the equity through premium assessments as long as the equity ratio remains above 1.30 percent, per the Act. 12 U.S.C. § 1782(c)(2)(B).

argument leads to potentially two flawed conclusions: (1) the Board must choose between closing the Stabilization Fund and increasing the normal operating level and it cannot do both; and (2) the Board can never close the Stabilization Fund if its closure would, for any period, result in an equity ratio that exceeds 1.30 percent. Once again, this argument rests on faulty legal and factual assumptions.

With respect to closing the Stabilization Fund, the Act requires the Board to contemporaneously distribute Stabilization Fund assets to the Insurance Fund. This distribution requirement does not vary based on the effect it will have on the Insurance Fund's equity ratio. The Board thinks it unlikely a court would find it illegal for the Board to do what the Act unambiguously requires. Further, the Stabilization Fund assessments were legal at the time they were assessed, and the Board sees no means by which they would become illegal in 2017 as a result of a mandatory distribution to the Insurance Fund at the Stabilization Fund's closure.

With respect to the normal operating level, under the Act, the Board can designate the ratio at a level it deems appropriate at any time, from a minimum of 1.20 percent to a maximum of 1.50 percent. The Board's discretion to designate the normal operating level within that range is not limited (a) based on the source of funds that could increase the equity ratio above 1.30 percent or (b) by the NCUA's assessment authority. While the Board cannot impose an Insurance Fund assessment once the equity ratio is at or above 1.30 percent, the Board sees no reasonable argument that the equity the Stabilization Fund would distribute to the Insurance Fund is from (or becomes) an Insurance Fund assessment at the Stabilization Fund's closure.

Finally, these commenters' argument rests on an incorrect factual assumption: that equity presently in the Stabilization Fund is solely attributable to Stabilization Fund assessments as opposed to cash collected from receivables from the asset management estates. In fact, increases in the value of the receivables from the asset management estates (from legal recoveries and improvements in the value of the Legacy Assets) have contributed significantly to the Stabilization Fund's net position. The NCUA was unable to fully repay Stabilization Fund borrowings from the assessments that had been paid by insured credit unions, which were last charged in 2013. Since that time, the Stabilization Fund has collected approximately $3 billion from the asset management estates, principally funded from legal recoveries and asset sales. These funds enabled the NCUA to fully repay the U.S. Treasury in October 2016, and account for the Stabilization Fund's current cash position. As such, there is a compelling argument that equity in the Stabilization Fund as of 2017 consists of asset management estate receivables, not assessments.

For the same reasons, no additional amounts the Insurance Fund will continue to collect before the end of 2017 and that could contribute to increasing the Insurance Fund's equity ratio above 1.30 percent after 2017 (and result in additional distributions) will be attributable to assessments. Although prior assessments make present-day receivables available as equity for distribution to the Insurance Fund when the Stabilization Fund closes, whether the Board should raise the normal operating level in connection with the Fund's closure is a policy determination. There are no legal provisions that preclude the proposed increase in the Insurance Fund's normal operating level.

The Board understands commenters' concern that it is improper to improve the Insurance Fund's equity position using dollars from credit unions that paid Stabilization Fund assessments in the abstract, but believes it is factually unpersuasive. Under the Act, the group of credit unions required to pay a premium to the Insurance Fund or to the Stabilization Fund is identical.[25] The basis for calculating the premiums is also the same for both the Insurance Fund and the Stabilization Fund.[26] Further, for the Board to use the Stabilization Fund, the Act requires that it must have had the authority to make the same payment from the Insurance Fund.[27] Thus, the Insurance Fund's purposes and authorities completely envelope those related to the Stabilization Fund.

Finally, as a practical matter, there were only 21 credit unions that were chartered or that converted to federal insurance since the Stabilization Fund was created in 2009. Of these 21 credit unions, 17 filed a call report in the second quarter of 2017. These credit unions represent only 0.13 percent of total insured shares in the second quarter of 2017. Further, since joining the Insurance Fund, these credit unions have been subject to potential premiums, despite not existing at the time of corporate credit union losses.

As such, there is no strong legal or equitable basis to view Stabilization Fund equity, regardless of whether one considers it due to assessments or asset management estate receivables, as

[25] *See* 12 U.S.C. § 1782(c)(2) ("Each insured credit union shall . . . pay") *and* 12 U.S.C. § 1790e(d) (special premiums are assessed to "each insured credit union.").
[26] *See* 12 U.S.C. § 1782 ("in an amount stated as a percentage of insured shares (which shall be the same for all insured credit unions))" *and* 12 U.S.C. § 1790e ("percentage of insured shares, as represented on the previous call report for each insured credit union. The percentage shall be identical for each insured credit union.")).
[27] 12 U.S.C. § 1790e(b).

different from Insurance Fund equity. In addition, the Insurance Fund distributed funds to the Stabilization Fund in 2011, 2012, and 2013, in amounts of $278.6 million, $88.1 million, and $95.3 million, respectively, because the Act precluded Insurance Fund distributions to credit unions given then-outstanding borrowings from the U.S. Treasury. Efforts to distinguish the equity of the two funds on this basis do not hold up.

In response to commenters that urge a "full rebate" and those that believe failure to return all Stabilization Fund equity would be contrary to prior promises from the Board, the Board believes its plan to close the Stabilization Fund in 2017 and provide distributions to credit unions out of the Insurance Fund is consistent with information historically provided to stakeholders. Until 2013, when the projected assessment range became negative, the Board did not estimate that funds would be available to return to credit unions. Primarily due to the impact of legal recoveries, the agency started projecting negative assessments in 2013.

Consistent with information routinely published on the NCUA's website and presentations given at Board meetings, the projected negative assessment range was disclosed as subject to change. At no time has the projected negative assessment range included estimates sufficient to repay all assessments or a specified amount of former capital holders' claims. As the NCUA has repeatedly stated, the Wescorp asset management estate is not projected to ever be able to repay the Stabilization Fund (or Insurance Fund after closure). Therefore, it is unlikely a "full rebate" of Stabilization Fund assessments will ever be possible, consistent with previous statements from the NCUA regarding the potential for *some* return of funds to credit unions.

Therefore, the Board assumes that commenters are using the term "full rebate" to refer to a rebate of the entire amount of equity currently in the Stabilization Fund, rather than a rebate of all assessments ever paid into the Stabilization Fund. As noted in the July 2017 Notice, the Board believes it is prudent to retain some of the current Stabilization Fund equity to account for the Insurance Fund's existing and future risk exposures, which will ultimately benefit credit unions by eliminating or materially reducing the need for premiums during a moderate recession.

Additionally, the information on the NCUA's website and presented at open meetings of the Board is consistent with the statutory requirement that any distribution of Stabilization Fund equity to credit unions would occur after the Stabilization Fund is closed and to the extent the Insurance Fund's equity ratio exceeded the normal operating level.[28]

Many of the commenters that opposed any increase in the normal operating level contended no increase could be justified because a normal operating level of 1.30 percent had been sufficient to withstand the financial crisis. As outlined in the July 2017 Notice, the Stabilization Fund was created to accrue losses from corporate credit union failures and assess credit unions for such losses over time. This prevented insured credit unions from bearing a significant burden associated with the failure of five corporate credit unions within a short period. It did not shelter credit unions from being assessed for the losses, nor did it eliminate the need for Insurance Fund premiums to cover declines in the equity ratio from natural person credit union failures and insured share growth.

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[28] *See* NCUA's Q4 2016 Costs and Assessments Q&A (response to question 8), December 2016 Board Briefing *NGN Legacy Asset Disposition Strategy* (slides 24-29), NCUA's Assessment Range Update Video (approximately 8-9 minute mark), and the September 2014 open meeting of the Board.

At year-end 2008, the normal operating level was 1.30 percent. In January 2009, prior to creation of the Stabilization Fund, credit unions were instructed to impair the one percent capital deposit by 69 basis points and record a premium expense of 30 basis points to restore the Insurance Fund's equity ratio to above the 1.20 percent statutory minimum.[29] However, because Congress took extraordinary and unprecedented action that allowed the NCUA to account for the corporate credit union losses in the Stabilization Fund, the NCUA passed back credit unions' 69 basis point deposit impairment.[30]

During the Great Recession, the Insurance Fund's equity ratio fell below 1.20 percent even without the corporate credit union losses - that is, only for natural person credit union losses – resulting in two Share Insurance Fund premiums totaling 22.7 basis points. Actual premium charges were 10.3 basis points in 2009 and 12.4 basis points in 2010 and totaled nearly $1.7 billion. As some commenters noted, these premiums had to be charged during the trough of the business cycle, when many credit unions were already facing financial difficulties. Therefore, while the NCUA was able to maintain the Insurance Fund's equity ratio above 1.20 percent during the Great Recession, it was only because of an act of Congress (creation of the Stabilization Fund) and premiums paid by credit unions at a time when they could least afford the expense. In another significant recession, stakeholders should not assume the NCUA could or should prevail upon Congress to establish a fund similar to the Stabilization Fund to again

[29] *See* Letter to Credit Unions 09-CU-06 *Corporate Stabilization Program – Conservatorship of U.S. Central FCU and Western Corporate FCU* and NCUA Accounting Bulletin No. 09-2
[30] *See* Letter to Credit Unions 09-CU-14 *Corporate Stabilization Fund Implementation*

accrue significant near-term losses over time and avoid immediate assessments on insured credit unions.

For those commenters that cite the Insurance Fund and Stabilization Fund annual audits as support that there is no justification for raising the normal operating level, the Board would like to correct some misconceptions.

Similar to how credit union officials must make risk management decisions about the appropriate amount of capital to hold, the Board must make management decisions regarding the level of equity the Insurance Fund should maintain. A stronger capital position better enables the Insurance Fund to manage future uncertainties such as increased losses, high insured-share growth, and adverse economic cycles. While the amount of equity recorded and the calculation of the equity ratio are audited by an independent third party, the purpose of the audit is to ensure the Insurance Fund's financial statements are presented fairly, in all material respects, in accordance with the standards promulgated by the Federal Accounting Standards Advisory Board (FASAB). FASAB is designated by the American Institute of Certified Public Accountants as the source of generally accepted accounting principles for federal reporting entities.

The independent auditor's report of the Insurance Fund as of and for the years ended December 31, 2016 and 2015 discusses the equity ratio as a "significant financial performance measure in assessing the ongoing operations of the NCUSIF." The audit does not opine on whether the amount of equity retained meets the Board's objectives for managing risk to the Insurance Fund.

With respect to the Stabilization Fund, the Board notes that the latest audit report states, "there were no probable losses for the guarantee of NGNs associated with re-securitization transactions." However, the Board believes commenters failed to consider two factors.

First, the Legacy Assets underlying the NGNs *are expected to experience losses*, resulting in approximately $3.2 billion of estimated guarantee payments made by the NCUA. As stated in the audit report and excerpted below, the NCUA expects those payments related to Legacy Asset losses to be offset by reimbursements and residuals after the fact.

> As of December 31, 2016 and 2015, there were no probable losses for the guarantee of NGNs associated with the re-securitization transactions. Although the gross estimated guarantee payments were approximately $3.2 billion and $3.3 billion, respectively, these payments are estimated to be offset by:
>
> i) related reimbursements and interest from the Legacy Assets of the NGN Trusts received directly from contractual reimbursement rights pursuant to the governing documents of approximately $3.1 billion and $3.1 billion as of December 31, 2016 and 2015, respectively; and
>
> ii) indirectly by collections pursuant to NCUA's right as liquidating agent from portions of the AMEs' economic residual interests in NGN Trusts of up to approximately $2.4 billion and $3.4 billion as of December 31, 2016 and 2015, respectively, that are estimated to remain after all obligations of the NGN Trusts are satisfied.

However, as noted, the guarantee payments are *estimated* to be offset by the reimbursements. The actual amount of future reimbursements is not certain, but based on projections that may vary (and have varied) over time, especially in the case of an economic downturn.

Second, the guarantee payment discussion does not include potential fluctuations in values related to Legacy Assets that are no longer securitizing the NGNs. The un-securitized Legacy Asset values are also based on projections that may vary over time, especially in the case of an economic downturn.

The audited financial statements reflect the accounting and valuation of assets and liabilities as of a certain date. The statements do not account for potential future economic downturns that would negatively impact the values. Therefore, the financial statements in no way undermine the Board's view that, as the insurer, it is prudent to ensure the Insurance Fund's equity is sufficient to withstand a moderate recession with minimal or no premium assessments.

The Board also believes some commenters are confusing the equity ratio and normal operating level with the Insurance Fund's Insurance and Guarantee Program Liability by stating that raising the normal operating level is akin to a credit union over-reserving for loan losses. The Insurance Fund's equity ratio is a measure of equity (retained earnings and contributed capital) the Fund holds in relation to the amount of insured shares in federally insured credit unions. It is a similar concept to a credit union's net worth ratio, or a bank's capital ratio.

The Insurance Fund's Insurance and Guarantee Program Liability is a separate account. The Insurance and Guarantee Program Liability account is reported in accordance with Statement of Federal Financial Accounting Standard No. 5. The Insurance Fund records a contingent liability for probable losses relating to insured credit unions based on current economic and credit union-level data. The amount of this liability is adjusted based on changes in economic and credit union-level data. When economic conditions and credit union financial trends deteriorate, this liability will increase to reflect the increase in potential failures. However, if the NCUA is able to resolve problem credit unions without assistance from the Insurance Fund, the liability is no longer needed. Because the NCUA is unable to predict or quantify which credit unions may be resolved without assistance, the Insurance Fund must establish a contingent liability for all potential failures based on current data.

This account is similar to a credit union's reserve for loan losses and is audited annually by an independent third party. Thus, maintenance of the contingency liability must comply with accounting standards. This is different from maintenance of capital levels, which is a management decision. In addition, the Board's role as insurer is fundamentally different from that of a financial institution.

Further, to those commenters that cite the strength of the credit union system and recent regulatory changes as reason to retain 1.30 percent as the normal operating level, the Board agrees that the financial position of the credit union industry is strong. Additionally, the Board recognizes that supervisory requirements for large credit unions and restrictions for corporate credit unions help to reduce risk within the industry. However, the Board believes the risk profile of the credit union system continues to evolve with existing or known risks being replaced by new and emerging risks. From a risk management perspective, the Board believes it is prudent to consider both current and future risks and hold equity sufficient to mitigate the negative impact on credit unions – such as having to pay premiums when their financial position is not as strong.

In response to commenters that question the accuracy of loss estimates related to the Legacy Assets, the Board notes that the range of estimated aggregate resolution costs is lower than original estimates due to a number of factors, including the following:

- Better than expected recovery in the housing market;
- A sustained low interest rate environment; and
- Legal recoveries.

Resolution costs have declined significantly due to legal recoveries, which were not and could not be included in projections because they are inherently inestimable. The potential for legal recoveries increased materially when the NCUA initiated the Corporate System Resolution Program, which gave the asset management estates the benefit of the Act's extender statute. The extender statute preserved and strengthened a substantial portion of legal claims that otherwise may have expired. In addition, the NCUA's coordinated recovery efforts across the five failed corporates and its ability to coordinate with other government-related plaintiffs substantially increased recovery potential.

The impact legal recoveries had on the estimated resolution costs is significant. If legal recoveries are excluded, over the seven years since the NGNs were issued, the top of the projected range of costs has improved about 14 percent. The bottom of the projected range of costs has worsened by close to 3.8 percent. In light of their complexity and after adjustment for exogenous factors like legal recoveries, the cost projections have proven relatively accurate over a seven-year period. The legal recoveries allowed for full repayment of the U.S. Treasury borrowing. Without the legal recoveries, the NCUA would not have been able to fully repay the U.S. Treasury until 2021. Also, based on current estimates, without the legal recoveries there would be no surplus to fund a distribution.

The Board agrees with the commenter that pointed out that even a normal operating level of 1.39 percent would not have been sufficient to weather the Great Recession and absorb the losses from the failed corporate credit unions without assessing premiums. This fact only supports an increase. Determining the appropriate amount of capital to hold in the Insurance Fund is a risk management decision where the Board balances the need to maintain sufficient equity with the desire to keep money at work in the credit union community. While a normal operating level of 1.39 percent may not be sufficient for the Insurance Fund to withstand a *severe* recession without assessing premiums to credit unions or developing a restoration plan, it does align with the Board's objective of not having to assess premiums or develop a restoration plan during a *moderate* recession.

Additionally, if the Insurance Fund's equity ratio going into the Great Recession had been 1.39 percent instead of 1.30 percent, it may not have eliminated the need for premiums, but could have resulted in credit unions paying nearly $1 billion less in premiums during the middle of the financial crisis. The Board believes managing the Insurance Fund to be counter-cyclical by building up equity during prosperous times and allowing the equity to draw down during adverse economic conditions will enable credit unions to use funds at that time to serve members when they are needed the most.

The Board also agrees with those commenters that stated the assets transferred from the Stabilization Fund currently offset the liabilities transferred. For all intents and purposes, the net position of the Stabilization Fund is the difference between the book value of the assets and the book value of the liabilities – which is currently near $2.0 billion. Even if the Stabilization Fund is not closed, the value of the assets would decline in a moderate recession, while the value of the liabilities would remain the same or increase, resulting in a decrease to the net position under even a moderate recession.

Thus, once the Stabilization Fund is closed, the Insurance Fund's net position would decrease if the value of the transferred assets decreased. Therefore, the Board believes it is prudent to reserve $400 million (or approximately 4 basis points) of the existing $2.0 billion of the Stabilization Fund's equity to cover a potential decrease in the Insurance Fund's net position under a moderate recession.

A significant number of commenters attributed downward trends in the Insurance Fund's equity ratio to the cost of the NCUA's operations, recent increases in the NCUA's operating budget, and excessive Insurance Fund loss reserves. Operating expenses are not one of the three primary factors affecting the Insurance Fund's equity ratio—insured share growth, interest income on the fund's investment portfolio, and insurance losses. Operating expenses charged to the Insurance Fund have a significantly lower potential for altering the trend in the equity ratio. Without sacrificing the agency's mission, the NCUA has limited ability to make operating expense reductions that would have a material impact on the equity ratio.

Given the Insurance Fund's current size, a $100 million change in the numerator of the ratio (made up of retained earnings and contributed capital) will change the equity ratio by approximately one basis point. This means that if the NCUA's operating expenses charged to the fund decreased by $100 million, the equity ratio would increase by one basis point. For context, the NCUA's entire 2017 budget is $298.2 million, of which approximately $200 million is projected to be charged to the Insurance Fund. The Board would need to cut operating expenses charged to the Insurance Fund by 50 percent to offset a one basis point annual reduction in the equity ratio, all other things being equal. While the Board strives to minimize all costs related to agency operations, indiscriminately reducing the operating budget for the purpose of preserving Insurance Fund equity would be ill-advised and counterproductive. The bulk of NCUA's budget, in fact, goes to supporting one of the most important aspects of the agency's mission: Reducing the likelihood of catastrophic Insurance Fund losses.

Increasing the normal operating level is an action separate and distinct from approving the agency's operating budget and overhead transfer rate. The Board carefully balances the need to manage the agency's expenses with the need to ensure a safe-and-sound credit union system. During the last NCUA budget briefing on October 27, 2016, staff outlined various initiatives to increase efficiency and operational improvements. The most significant is the adoption of the recommendations of the NCUA's Examination Flexibility Initiative working group as part of the agency's 2017 and 2018 budgets. Among other things, this initiative will extend the examination cycle for eligible credit unions—those that have less than $1 billion in assets and are considered well-run and well-capitalized—resulting in a reduction of 47 full-time equivalent positions by the end of 2018.

Additionally, at the Board's July 20, 2017 closed meeting, it approved a long-range agency restructuring plan to enhance efficiency, responsiveness, and cost-effectiveness. Under the plan, the NCUA will consolidate the agency's five regional offices into three, eliminate four of the agency's five leased spaces, eliminate offices, and reduce the workforce through attrition. The Board has recently announced the process for another public budget briefing to be held in October 2017 and looks forward to receiving stakeholder input.

The Board disagrees with commenters that state the Insurance Fund's performance horizon should be two years instead of five. As outlined in the July 2017 Notice and discussed at the July 2017 Board meeting, a five-year horizon for modeling the Insurance Fund was selected for a number of reasons. One compelling reason is that the National Bureau of Economic Research – the not-for-profit research organization that establishes the beginning and end of U.S. business cycles – has calculated that the United States has averaged 69 months from the peak of one business cycle to the next. The Board elected to use a five-year horizon because it covers most of the business cycle, aligns with the remaining life of the NGN Program, and is consistent with the agency's strategic plan time horizon.

Though a recession may end, the economy may remain very weak during the recovery period. A struggling economy also poses risks to credit unions, and a thorough analysis of the Insurance

Fund’s equity position needs to account for the period of continued economic weakness, which more realistically reflects a recession’s effects on the credit union industry.

The Board agrees with commenters that noted the agency has various options available to manage the Insurance Fund. The Board continues to believe the most desirable option is to maintain a counter-cyclical posture for the Insurance Fund, which reduces the likelihood of burdening insured credit unions with premium expenses during an economic downturn. Requiring credit unions to pay premiums in the midst of a financial crisis is generally undesirable because many credit unions are facing earnings and other operational issues, and extraordinary premium expenses could increase failure rates. It is during the bottom of an economic cycle that it is most important to keep funds at work in the credit union system so they can continue to serve their members.

As outlined in the July 2017 Notice, the Board believes its authority to establish a Fund restoration plan in lieu of mandatory premiums should only be used for severe, unexpected circumstances. While the Board can develop a restoration plan to restore the Insurance Fund’s equity ratio to 1.20 percent within eight years (or longer in extraordinary circumstances), this could necessitate one or more relatively large premiums. It could also extend over multiple business cycles, resulting in a further extended effort to rebuild Insurance Fund equity. These circumstances could significantly erode public confidence in federal share insurance.

Some commenters supported a temporary increase to 1.34 percent to cover exposure to Legacy Assets, while others suggested an increase to 1.35 percent. The Board notes that both of these suggestions ignore that exposures to the Insurance Fund must be considered in total.

Because a moderate recession would affect both the traditional primary drivers of the Insurance Fund (yield on investments, insurance losses, and insured share growth) and the value of the Legacy Assets, the Board must account for both of these exposures. Therefore, it would be inconsistent to only account for the potential decline in value of the Legacy Assets under a moderate recession, and not the traditional exposures to the Insurance Fund, by setting the normal operating level at 1.34 percent. Conversely, setting the normal operating level at 1.35 percent would only account for the traditional exposures of the Insurance Fund. However, if the Stabilization Fund were closed, the Insurance Fund would be exposed to additional risk from the potential decline in the value of the Legacy Assets.[31]

Many commenters urged the Board to set a defined schedule or express specific intent to move the normal operating level back to 1.30 percent as exposure to Legacy Assets decreases. As outlined in the July 2017 Notice, the Board acknowledges that additional risk exposure from the Legacy Assets will only be present until the end of the NGN Program, assuming expedient Legacy Asset sales thereafter. Therefore, once the Insurance Fund's exposure to this risk

[31] During a recession, the value of the Legacy Assets is expected to decline, while the liabilities associated with these assets would remain the same or potentially increase. This would reduce the net position of the Insurance Fund and the equity ratio.

expires, additional equity for the Legacy Assets will no longer be necessary.[32] As outlined in the July 2017 Notice, the Board believes the NCUA should periodically review the equity needs of the Insurance Fund and provide this analysis to stakeholders. Thus, the Board intends for the normal operating level to be re-assessed periodically.

However, the Board believes it would be imprudent to arbitrarily set a future normal operating level based on current data. Instead, it is reasonable for a future Board to set the normal operating level to meet the objectives outlined in the Board's policy for setting the normal operating level based on contemporary data. Further, while the normal operating level has historically been 1.30 percent, it would be arbitrary to retain that number as the current or future normal operating level just because that is the number it has always been. Instead, the Board has elected to set the normal operating level by considering recent history and using a documented, consistent methodology to enhance transparency of the process.

One commenter supported a temporary increase of the Insurance Fund's equity ratio to 1.30 percent but only for so long as Legacy Asset exposure remained. This commenter stated that all equity related to the Stabilization Fund should be distributed once Legacy Asset exposure subsided, including funds needed to increase the Insurance Fund's equity ratio to 1.30 percent. Thus, this commenter implied the Board should decrease the normal operating level below 1.30 percent to meet the equity ratio at the time of the Stabilization Fund's closure to permit distribution of all equity received from the Stabilization Fund.

[32] If the Stabilization Fund is not closed, and the Board adopted this methodology for setting the normal operating level, staff would recommend the Board set the normal operating level at 1.33 percent.

In the Board's understanding, following the position of this commenter would require the Board to commit to reducing the normal operating level in 2021 to equal the Insurance Fund's sub-1.30 percent equity ratio as of October 1, 2017, the date of the Stabilization Fund's closing. This would, at the end of 2021, trigger a distribution of whatever amounts, if any, remained in the Insurance Fund above the newly lowered normal operating level. While the Board has the legal authority to make such a commitment, it could not bind future Boards to follow it. Further, this approach would only result in a distribution of equity to the extent insurance losses or other impacts on the Insurance Fund had not lowered the equity ratio below what it was at the Stabilization Fund's closure.

While the Board could reduce the normal operating level to as low as 1.20 percent to orchestrate a distribution, it could not, due to statutory constraints, lower the normal operating level below 1.20 percent to accommodate a certain distribution amount that might relate back to Stabilization Fund equity.[33] Thus, this commenter's suggestion provides no guarantee that a certain amount of equity can be returned in 2021. Finally, even if circumstances in 2021 are such that a distribution could be triggered, the Board thinks a reduction in the normal operating level at that time for the sole purpose of triggering a defined distribution amount would be an unwise policy choice. The Board believes the prudent approach at that time would be to consider where the normal operating level should be designated based on all relevant and contemporary data.

[33] Additionally, projections show the equity ratio will decline based on current trends. If the Board set the normal operating level at 1.20 percent and the equity ratio fell to 1.20 percent because of a distribution, the equity ratio would immediately be projected to fall below 1.20 percent, triggering a premium or restoration plan in accordance with the Act. 12 U.S.C. § 1782(c)(2).

C. Additional Comments

In response to those commenters that requested additional time to review and respond to the July 2017 Notice, the Board acknowledges the comment period was less than the customary 60 days (the actual comment period was 48 days). The comment period was accelerated to provide the Board enough time to consider comments and make a final determination of closing the Stabilization Fund by year-end 2017, to make it possible for a distribution to insured credit unions in 2018.[34] The Board made substantial efforts to ensure stakeholders were provided with sufficient support and data regarding the NCUA's proposal to close the Stabilization Fund and set the normal operating level at 1.39 percent. Further, some credit unions and trade organizations have been requesting the NCUA consider closing the Stabilization Fund for at least a year. The Board noted on multiple occasions since the beginning of 2017 that NCUA staff were researching the process and timing for prudently closing the Stabilization Fund. Thus, the proposal was not unexpected.

If the Board puts off the proposal further, equity will continue to build in the Stabilization Fund. Thus, the Board agrees with most commenters that see no reason to delay the proposal until a future date. As long as the NCUA maintains sufficient equity in the Insurance Fund to cover the remaining obligations from the Corporate System Resolution Program on top of its ongoing obligations, closing the Stabilization Fund now makes sense.

[34] In accordance with the Act, the Insurance Fund shall effect a pro rata distribution to insured credit unions after each calendar year if, as of the end of that calendar year, the equity ratio exceeds the normal operating level. 12 U.S.C. § 1782(c)(3).

The Board acknowledges the commenters' emphasis on transparency and agrees that the agency has a responsibility to provide stakeholders with as much information as possible without disclosing confidential supervisory information. This applies not only to the Stabilization Fund's operations, but also to how the corporate credit union asset management estates are administered. Because of the complexity and extent of information regarding the Legacy Assets, NGNs, and asset management estates, the NCUA has developed webpages on its public website dedicated to the corporate resolution and NGNs. The agency transparently described the equity ratio calculations, normal operating level, and Corporate System Resolution Program status in staff's presentations to the NCUA Board at its November 2016, December 2016, and July 2017 open meetings, in the request for comment published in the *Federal Register* in July 2017, during a webinar the NCUA hosted on this subject in August 2017, and in all the related materials that are posted on the NCUA's website.[35]

Subsequent to the July 2017 Notice, the NCUA enhanced its reporting to show the transactions and projections related to each corporate credit union asset management estate. The information on legal recoveries also receives regular updates, including information on how legal recoveries are allocated to each asset management estate.

[35] *See* https://www.ncua.gov/regulation-supervision/Pages/stabilization-fund-closure.aspx.

The Board continually seeks ways to ensure the information presented is clear, comprehensive, and useful. If stakeholders have questions or suggestions regarding the information available, the Board invites them to contact the NCUA at ngnquestions@ncua.gov.

Some commenters expressed a preference that the Board consider an increase to the Insurance Fund's normal operating level in a proposal completely separate from any related to closing the Stabilization Fund. Because closing the Stabilization Fund increases the risk to the Insurance Fund, evaluating the normal operating level is a necessary component of the decision to close the Stabilization Fund. Proposing both actions together in a fully transparent manner gave credit unions the opportunity to review and comment on the entire scope of the NCUA's plan related to closing the Stabilization Fund.

Contrary to what some comments seem to imply, the Board is not aware of any credit unions that would fail based simply on not receiving an Insurance Fund distribution next year. When Stabilization Fund assessments were collected, they were accounted for as expenses to credit unions and income to the Stabilization Fund. As the performance of the Legacy Assets improved and the NCUA collected legal recoveries, the *projected* assessment range became negative for the first time in 2013, indicating *projected* assessment rebates and recoveries of depleted corporate capital. At no time did the NCUA guarantee that assessment rebates would be made.[36] Rather, the Board noted that the assessment rebates were projections and subject to change.

[36] The agency is under no legal obligation to distribute any funds to insured credit unions other than amounts above where the NCUA Board sets the normal operating level. In accordance with the Act, the Board can only set the normal operating level as high as 1.50 percent. 12 U.S.C. 1782(h)(4).

Therefore, credit unions should not have been relying on a possible refund for managing their financial condition.[37]

A few commenters stated the "proposed method for closing the [Stabilization Fund] does nothing to address the excessive $1B charged since its creation to the [Asset Management Estates] by the NCUA." It is unclear what expenses these commenters are referring to. The losses related to the corporate credit unions are described on the NCUA's website. They include, among others, losses on investment securities (Legacy Assets), as well as costs of funding other pre-liquidation obligations the corporate credit unions had incurred. Every effort was made to keep the costs of resolving the failed corporate credit unions as low as possible.[38] However, the resolution of the corporate credit unions was necessary and allowed the NCUA and credit union community to contain the financial and operational impact of the crisis. In addition, without being conserved and liquidated, the corporate credit unions (1) would have been unable to extend operations for the time required to realize uncertain legal recoveries; and (2) would have been unable to recover the material amounts the Board was able to recover without the benefit of the Act's extender statute. Funds now available for distribution to credit unions are due principally to legal recoveries that enabled the asset management estates to repay some of the losses the Stabilization Fund incurred.

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[37] Credit unions must be able to operate under a business model that provides for positive earnings and the accumulation of net worth irrespective of potential one-time increases in income. By their nature, one-time payouts such as a distribution from the Insurance Fund, are unpredictable and non-recurring. Therefore, credit unions must be able to operate in a safe and sound manner through normal, routine operations.

[38] NCUA has provided details of the liquidation expenses and costs associated with each asset management estate on its website. *See* NCUA's Q4 2016 Costs and Assessments Q&A (response to question 15) and the Stabilization Fund's financial statements for additional information.

The Board appreciates commenters that considered how closing the Stabilization Fund might affect the NCUA's contingency funding. The Board reminds stakeholders that Public Law 111-22, *Helping Families Save Their Homes Act of 2009*, increased the NCUA's borrowing authority with the U.S. Treasury to $6 billion. This borrowing authority is shared by both the Stabilization Fund and the Insurance Fund. With closure of the Stabilization Fund, the Insurance Fund will retain the $6 billion borrowing authority. The Central Liquidity Facility's contingency funding ability is not altered by closure of the Stabilization Fund.

The Board will address comments on its separate proposal to amend the Insurance Fund distribution method in 12 CFR § 741.4 in a separate action.

IV. Final Action

After considering the comments received, the Board approves the following:

1. Closing the Stabilization Fund in 2017 and distributing its funds, property, and other assets and liabilities to the Insurance Fund on October 1, 2017.[39]
2. Setting the normal operating level of the Insurance Fund to 1.39 percent, effective September 28, 2017.[40]
3. Adopting the policy for setting the normal operating level, as outlined below.

[39] As noted in the July 2017 Notice, the Stabilization Fund will be audited as of September 30, 2017. The financial statements of the Insurance Fund will continue to be presented under standards promulgated by the Federal Accounting Standards Advisory Board and audited each calendar year. The post-closure financial statements and note disclosures for the Insurance Fund will continue to provide the same level of detail about the receivables from the corporate asset management estates and related fiduciary activities.

[40] As explained in the July 2017 Notice, an equity ratio of 1.39 percent will allow the Insurance Fund to withstand a moderate recession without the equity ratio falling below 1.20 percent over a five-year period.

Policy for Setting the Normal Operating Level

Periodically, the NCUA will review the equity needs of the Insurance Fund and provide this analysis to stakeholders. Board action is only necessary when this review suggests that a change in the normal operating level is warranted. Any change to the normal operating level of more than 1 basis point shall be made only after a public announcement of the proposed adjustment and opportunity for comment. In soliciting comment, the NCUA will issue a public report, including data supporting the proposal.

When setting the normal operating level, the Board will seek to satisfy the following objectives:

- Retain public confidence in federal share insurance;
- Prevent impairment of the one percent contributed capital deposit; and
- Ensure the Insurance Fund can withstand a moderate recession without the equity ratio declining below 1.20 percent over a five-year period.

By the National Credit Union Administration Board on September 28, 2017.

Gerard S. Poliquin,

Secretary of the Board.

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