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President & Chief Executive Officer

National Association of Federally-Insured Credit Unions

August 28, 2017

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: NCUA's proposal to close the temporary corporate credit union stabilization fund and set the share insurance fund normal operating level

Dear Mr. Poliquin:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally insured credit unions, I am writing to you regarding the National Credit Union Administration's (NCUA) proposal to close the temporary corporate credit union stabilization fund (TCCUSF or Stabilization Fund) and set the National Credit Union Share Insurance Fund's (NCUSIF or SIF) normal operating level (NOL) at 1.39 percent.

Although there could conceivably be short-term benefits to merging the Stabilization Fund with the SIF, NAFCU strongly believes such a move at this time would not be in the best interests of credit unions. Therefore, NAFCU and our members: (1) stand in opposition to NCUA's proposal to merge the funds at this time; (2) strongly oppose any increase to the NOL; and (3) advocate that the agency is not required to charge a premium in 2017.

If the agency hastily implemented the current proposal, credit unions would only receive approximately 40 percent of what is rightfully their money. This "cash grab" constitutes a 60 percent premium charged to the industry. In rushing such a complex proposal, NCUA is attempting to distract credit unions with the promise of dividends as the agency hoards nearly $800 million for itself by increasing the NOL to the highest level in the history of the SIF. That money should rightfully be returned to credit unions that made sacrifices as a result of the Stabilization Fund assessments.

Background

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 SIF. 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.

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.

During NCUA's July 2017 Board meeting, a proposal was announced whereby the Stabilization Fund would be closed and its assets and liabilities merged with the SIF. NCUA estimates that doing so would increase the equity ratio, and that any funds in excess of the NOL would result in a dividend for federally insured credit unions (FICUs). Furthermore, it would mean that a premium charge for the SIF would be avoided in 2017.

NCUA has the legal authority to distribute refunds now, without merging the funds

As an initial matter, the NCUA should reconsider its position that the Act limits its ability to refund assessments to credit unions except through the closure of the Stabilization Fund and subsequent transfer of assets to the SIF. In its analysis, NCUA cites section 1790e(b) of the Act, which states, "money in the Stabilization Fund shall be available upon requisition by the Board...for making payments for the purposes described in section 1783(a)," and that any expenditures must be related to administrative payments, conservatorship, liquidation, or threatened conservatorship or liquidation, of a corporate credit union.

The agency goes further, explaining that under section 1783(a), permissible uses include payments of insurance under section 1787 of the title, for providing assistance and making expenditures under section 1788 of the title in connection with the liquidation or threatened liquidation of insured credit unions, and for such administrative and other expenses

incurred in carrying out the purposes of the subchapter as the Board may determine to be proper.

NCUA spends the remainder of its analysis explaining why it does not believe that Stabilization Fund distributions meet the requirements of payments of insurance under section 1787, or providing assistance and making expenditures under section 1788. However, NAFCU believes there are several reasonable interpretations of the Act and Congressional intent that NCUA has not considered.

First, 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 Act was to stabilize the corporate credit union market without depleting the SIF. Refunding assessments in a manner that does not impair the financial condition of the Stabilization Fund or the SIF would not run counter to those purposes.

Additionally, the Board would be entitled to *Chevron* deference in adopting this reasonable approach. See Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 844-845. Under *Chevron*, courts must defer to NCUA's interpretation of the Act if (1) the court determines Congress has not directly addressed the precise question at issue, or, if the statue is silent or ambiguous, and (2) if the agency's action is based on a permissible construction of the statute. In evaluating the second prong of this test, a court must afford substantial deference to the agency's interpretation of statutory language.

Applied to the matter at hand, the Act is silent on this particular authority. Although § 1790e(h) of the Act is explicit in regards to distribution when the Stabilization Fund closes, it is silent as to whether those funds can be distributed to the SIF before closure (so long as the Stabilization Fund has no other outstanding borrowings).

The next question to consider is whether NCUA could reasonably interpret the Act to allow the Stabilization Fund to direct rebates to the SIF without closure. Here, such an interpretation would be reasonable. Pursuant to § 1790e(b) of the Act, NCUA is permitted to make expenditures from the Stabilization Fund so long as they qualify as being "connected to the conservatorship, liquidation, or threatened conservatorship or liquidation, of a corporate credit union."

Paying outstanding claims is a usual activity for a conservator or liquidating agent that is trying to resolve a failed entity. In this case, the SIF is owed a refund from the Stabilization Fund as a result of conserved and liquidated corporate credit unions. NAFCU believes that the refund owed to the SIF is clearly "connected" to the conservatorship and liquidation of corporate credit unions. Therefore, NCUA's authority to distribute rebates from the Stabilization Fund to the SIF is a reasonable interpretation.

Finally, aside from answering why it declines to interpret the Act in a reasonable manner, NCUA should also address why it had never invoked this claim previously. This limitation

was never raised or invoked when the agency had considered providing rebates from the Stabilization Fund during September 2014 and July 2014 Board meetings.

The proposal violates the statute and amounts to an impermissible premium assessment

NAFCU believes that the Board's proposal amounts to an impermissible end-run around provisions of the Act expressly restricting the use of premium assessments to raise the SIF's equity ratio above 1.30 percent. See 12 U.S.C. § 1782(c)(2)(B). While the Act permits the NOL to be set at an equity ratio above 1.30 percent, NCUA cannot achieve an equity ratio above 1.30 percent by raiding excess assets from the Stabilization Fund. Those excess assets reflect "special premiums" paid into the Stabilization Fund, and are properly owed to the credit unions that paid the premiums. Most distressing to NAFCU, using those assets to boost the SIF's equity ratio above 1.30 percent constitutes a *de facto* premium assessment on affected credit unions. Indeed, the Board's own justification for its proposal—that Stabilization Fund assets will shore up the SIF and avoid the need for future premium assessments—itself shows that the Board's proposal is tantamount to a premium assessment prohibited under § 1782(c)(2)(B).

Section 1782 of the Act sets forth the Board's authority to manage the SIF, and prescribes the means by which the NCUA may increase the fund's equity ratio. In particular, the statute defines the NOL as "an equity ratio specified by the Board, which shall be not less than 1.20 percent and not more than 1.5 percent." § 1782(h)(4). If the equity ratio falls below 1.20 percent, the Board is obligated to assess a premium charge, or develop a restoration plan, sufficient to restore the equity ratio to 1.20 percent. § 1782(c)(2)(C). When the equity ratio is between 1.20 and 1.30 percent, the Board may assess a premium charge but is not required to assess one. § 1782(c)(2)(B). Critically, however, the statute expressly prohibits the Board from assessing a premium if the equity ratio is equal to or greater than 1.30 percent. Id.

In other words, though the Board is permitted to set the NOL above 1.30 percent, it is not permitted to use premium assessments to achieve that target. As the Board itself recognizes, §§ 1782(h)(4) and 1782(c)(2) together should be read to provide that the Board may achieve an NOL of between 1.30 and 1.50 percent through prudent management and investment of the Insurance Fund, but not by assessing a premium. See NCUA Board Briefing, Closing the Stabilization Fund and Setting the Share Insurance Fund Normal Operating Level, at 19 (July 20, 2017) (once the equity ratio reaches 1.30 percent, the Board "[c]an only increase equity ratio through retained earnings"). The Board has historically set the NOL at 1.30 percent. National Credit Union Share Insurance Fund Improvements, NCUA White Paper, at 7 (Sept. 2013).

Further, § 1790e(h) provides that upon the Stabilization Fund's closure, any remaining assets shall be distributed to the SIF. Although the statutory regime does not specify how these assets are to be distributed once placed in the SIF, the Board itself has recognized that the assets properly belong to those credit unions that paid special premiums to the

Stabilization Fund. See Requirements for Insurance; National Credit Union Share Insurance Fund Equity Distributions, 82 Fed. Reg. 35705, 35710 (proposed Aug. 1, 2017). The Board has, in fact, referred to the return of Stabilization Fund assets as a "rebate" to credit unions that paid assessments. NCUA Board Briefing at 44.

NAFCU believes that there is no substantive difference between assessing a premium to achieve an equity ratio above 1.30 percent and withholding Stabilization Fund assets to accomplish the same result. Both approaches rely on funding from credit union assets, contrary to what the Act contemplates. See 12 U.S.C. § 1782(c)(2)(B)(i) ("The Board may assess a premium charge *only if* the Fund's equity ratio is less than 1.30 percent." (emphasis added)). The Board itself has recognized that it "can only increase the equity ratio" of the SIF above 1.30 percent "through retained earnings" of the fund. See NCUA Board Briefing at 19. Yet the Board's proposal does not rely on retained earnings to achieve a 1.39 percent NOL, but rather on a windfall of available assets from the closure of the Stabilization Fund—assets that are traceable to "special premiums" paid by credit unions and owed to those credit unions. See 12 U.S.C. § 1790e(d).

The Board's proposal recognizes that the excess assets of the Stabilization Fund properly belong to contributing credit unions, but fails to appreciate the significance of this fact. The Board therefore proposes, appropriately, that distributions from the Stabilization Fund "should first go towards repaying those FICUs that paid special premiums, generally referred to as corporate assessments." 82 Fed. Reg. at 35710. This approach recognizes that 12 U.S.C. § 1782(c)(3)(B), which provides for a pro rata distribution of excess SIF assets, does not apply in this circumstance because the distribution of excess Stabilization Fund assets is distinct from the distribution of excess SIF assets.

Yet, even as NCUA recognizes this distinction, the proposal takes those same Stabilization Fund assets and uses them to increase the SIF's equity ratio, leaving affected credit unions even worse off than under a typical SIF premium assessment. In effect, the proposal would boost the SIF's financial condition by burdening only those credit unions who contributed to the Stabilization Fund. In a standard SIF premium assessment, all credit unions would be required to a pay the assessment consistent with the formula prescribed in § 1782(c)(2). This result is plainly inequitable and contrary to the FCUA's statutory scheme: credit unions eligible for Stabilization Fund distributions are in effect required to subsidize the SIF for everyone else. See 82 Fed. Reg. at 35710 (proposed Aug. 1, 2017). ("[A] FICU that has not paid a corporate assessment would not be entitled to receive an NCUSIF equity distribution related to the Corporate System Resolution Program unless all such corporate assessments are first repaid in full."). The Board has failed to explain how this disparate treatment can be justified or reconciled with the statute. See Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43, (1983) ("an agency rule would be arbitrary and capricious if the agency . . . entirely failed to consider an important aspect of the problem").

In restricting premium assessments, Congress made clear that the Board is limited in what it can do to achieve an equity ratio above 1.30 percent. And the Board itself has explained

that it "can only increase the equity ratio" above 1.30 percent "through retained earnings." NCUA Board Briefing at 19. The Board may lament these restrictions (see NCUA White Paper, at 4), but they are fundamental to the statutory scheme in 12 U.S.C. § 1782. NAFCU urges NCUA not to use excess Stabilization Fund assets to circumvent those restrictions as it would defy both the letter and purpose of what Congress enacted.

The current NOL is appropriate

Regardless of whether NCUA decides to merge the funds, NAFCU does not believe that NCUA's proposal to raise the NOL to 1.39 percent is necessary to protect the SIF from dropping below 1.20 percent. Raising the NOL to such a drastic level ignores the fact that the current NOL served credit unions well during the biggest financial crisis since the Great Depression. NCUA's proposal builds a buffer to lay on-top another buffer, especially when considering the large amount of cash that the Stabilization owes to the SIF.

NCUA's rationale for a 1.39 percent NOL is based, in part, on the adverse scenario forecast in Figure 1, below. Through 2022, NCUA's adverse forecast shows a 13 basis points decline. Rather than charge credit unions a premium *if* the equity ratio falls to 1.20 percent, NCUA would rather increase the NOL by 3 basis points and hold onto that money for the speculative adverse scenario. Apparently, NCUA's proposal assumes that the agency would be a better custodian of credit unions' money to prepare for the possibility of an economic downturn. NAFCU disagrees with this presumption, and urges NCUA to reconsider and acknowledge that credit unions can account for economic events and plan accordingly. Between the current NOL and regulatory capital requirements, there is sufficient buffer in the system to withstand economic contractions.

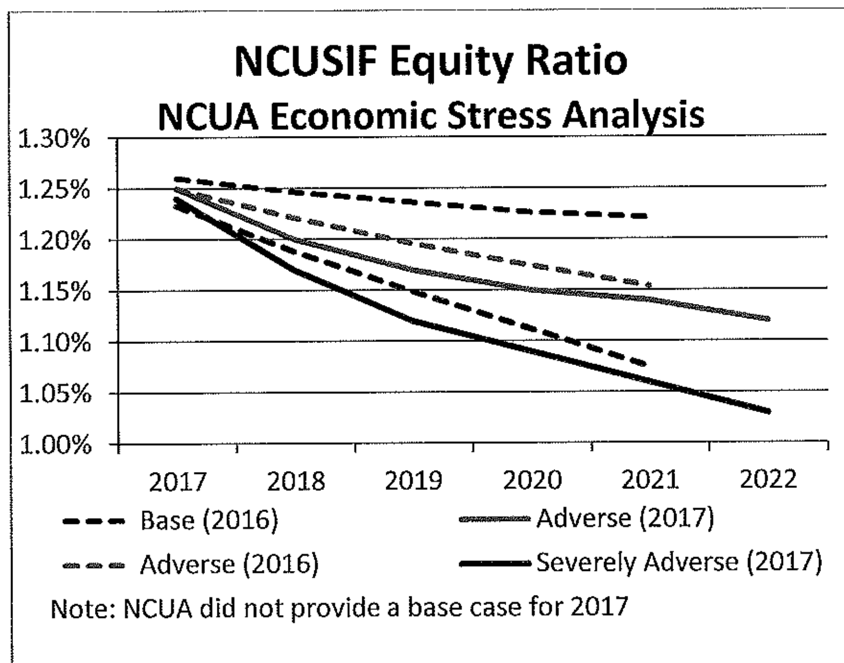

Figure 1

In addition to protecting the SIF from fluctuations in economic cycles, if NCUA decides to merge the funds, NCUA proposes to add 4 basis points to the NOL to cover exposure to the corporate legacy assets. Noting that projected cash flows from legacy assets may drop in the event of an economic downturn, NCUA is concerned that the SIF may receive a lower return than currently projected. However, given the fact that NCUA does not include a plan for reducing the NOL as the downside risk lessens, NAFCU does not support this provision.

Lastly, 2 basis points are added to proposed NOL increase to account for, in essence, advancing NCUA's forecast forward by 2 years. According to the proposal, the reason for doing so is that the majority of the outstanding NGNs will be retired in 2020. Therefore, NCUA wants to account for the anticipated decline in the equity ratio in 2018 and 2019, so that the fund is positioned at that time with the full amount of the aforementioned layers of protection (13 basis points for general trends in the SIF and 4 basis points for volatility in the legacy assets). NCUA's base case in its standard projection shows a 2 basis points decline over the next two years. Therefore, NCUA added that amount to its proposed NOL.

NAFCU believes that the proposal would reserve for a decline under the adverse scenario, and then add a second layer of protection to account for the estimated decline under the base case. NAFCU objects to this "double-counting," and notes that credit unions are prohibited from engaging in similar activity, such as ramping-up loan reserves in preparation for CECL.

Credit unions deserve a fair plan

NAFCU strongly urges NCUA to develop a plan that is fair and equitable to all credit unions, regardless of their asset size. NAFCU believes that mingling the funds of the Stabilization Fund with those of the SIF is unfair to those credit unions that paid corporate credit union assessments. Along with NCUA's current proposal, the agency has issued a proposal which attempts to deal with this issue as it pertains to a potential dividend. However, of the roughly 22-24 basis points of projected equity being merged into the SIF, the dividend is only 6-8 basis points of that. NAFCU believes that the rest is essentially a premium charged on corporate credit union stabilization refunds.

If the agency did not merge the funds and instead used a SIF premium to raise the equity ratio, the amount each credit union paid would vary from the approximate 17 basis points of the Stabilization Fund refunds that are being retained in the SIF.

Finally, NAFCU believes that too many questions still exist regarding the final disposition of the Asset Management Estates (AMEs), and the payment priority of capital note holders. NCUA's proposed plan does not clearly articulate whether, upon the unwinding of the AMEs, note holders would be paid before the rest of the industry is made whole for their Stabilization Fund assessments. In such a scenario, NAFCU is concerned that credit unions would be short-changed in their assessment rebates.

Regardless of whether the funds are merged, NCUA does not need to charge a premium

In November 2016, the NCUA Board announced that a SIF premium range for 2017 of 3 to 6 basis points might be necessary to maintain the equity ratio at an adequate level. This determination was based on trends within the four primary drivers of the equity ratio: investment yield, insurance losses, insured share growth, and NCUA operating expenses.

Because NCUA deems these trends as being likely to continue, and forecasts a further decline in the equity ratio over the next five years, NCUA announced the possibility of a premium charge. Despite the trends, however, there are several reasons why NAFCU does not believe that NCUA needs to charge a premium.

First, if nothing changes and trends continue as projected, NAFCU's models indicate that the equity ratio will not fall below 1.20 percent until after 2019. Even NCUA's own base case models do not project the equity ratio falling below 1.20 percent through 2021 (see Figure 1, above).

Second, NAFCU believes that NCUA has the ability to slow, and even reverse, the equity ratio's downward trend through adjustments made to a few of its primary drivers:

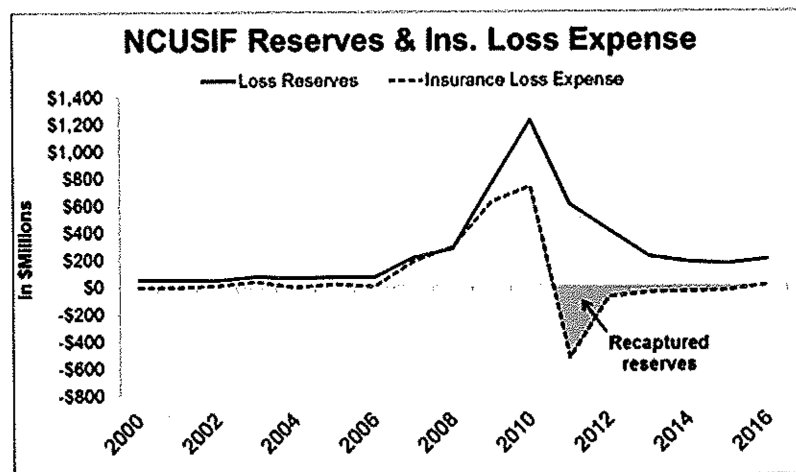

Figure 2

Insurance Losses
During the Great Recession, SIF reserves grew from $70 million in 2006 to over $1.2 billion in 2010. Insurance loss expense climbed as high as $735 million in 2010. As a result, the SIF recorded sizable losses during these years which drove down the equity ratio. However, from 2011 through 2015 the fund recorded negative insurance losses totaling over $700 million. The bulk of the negative charges to insurance loss expense represents reserve recapture, as loss reserves declined significantly over that period (see Figure 2). While it is unreasonable to

expect perfect reserving against future losses, NCUA's excessive buildup of reserves during the crisis resulted in premium charges for credit unions that were higher than necessary. NCUA has indicated its desire that the SIF be more resilient during times of economic distress so that credit unions do not face premium charges when they can least afford them. One obvious way for the agency to reduce the impact on credit unions during a hypothetical recession would be to better calibrate the reserving process with actual risk.

Operating Expenses
In recent years, operating expenses for the NCUSIF have risen dramatically. This reflects both the rise in agency expenses – which have grown by an annual average of roughly 7 percent from 2007 through 2017. Although recent progress has been made, this trend is untenable, and a change is required. NAFCU believes that employing strategies to further control these costs will lead to reduced operating expenses that would help increase the equity ratio.

Finally, even if NCUA's adjustment of the equity ratio drivers fails to reverse the downward movement of the equity ratio, the agency still would not be statutorily required to charge a premium if the equity ratio dropped below 1.20 percent.

Pursuant to § 1782(c)(2)(D) of the Act, when the Board projects the equity ratio will fall below 1.20 percent within 6 months, or when the equity ratio actually falls below 1.20 percent, the Board must establish and implement a restoration plan within 90 days. The plan must restore the equity ratio of the NCUSIF to at least 1.20 percent before the end of an eight year period. Congress's intent is clear on this matter; NCUA need only develop a restoration plan if the equity ratio falls below 1.20 percent.

NAFCU believes if the Board projects the ratio falling to below 1.20 percent, or if the ratio actually does fall below that threshold, then a restoration plan would contemplate the unencumbered assets that would be transferred to the SIF when the Stabilization Fund statutorily closes in 2021. At that point in time, the NGNs will have retired all their outstanding payment obligations, and the underlying assets securing the notes would be available to infuse cash into the SIF without the liability that presently exists. This would be in addition to NCUA's $6 billion borrowing authority conferred by Congress.

Further, even under NCUA's severely adverse scenario, the agency only projects an 11 basis points decline in the equity of the Stab Fund relative to the SIF's equity ratio. Based on NCUA's own estimates, there would still be more than enough equity to increase the equity ratio from at or below 1.20 percent back to the 1.30 percent NOL. NCUA would no longer be able to argue that it would have to raise the NOL to offset the NGN payment liabilities, and more of the money that is owed to credit unions can be refunded.

Conclusion

NAFCU strongly urges the agency to avoid increasing the NOL for the Share Insurance Fund. The equity ratio is separate and distinct from corporate stabilization rebates, and NAFCU's goal is to get as much money as possible back to the industry, and to see it distributed as fairly as possible. Should you have any questions or would like to discuss these issues further, please contact me, or Carrie Hunt, NAFCU's Executive Vice President of Government Affairs and General Counsel, at (703) 842-2234 or chunt@nafcu.org.

Sincerely,

B. Dan Berger
President and CEO

cc: The Honorable Mark J. McWatters, Chairman
The Honorable Rick Metsger, Board Member
Mr. Mark A. Treichel, Executive Director
Mr. Michael McKenna, General Counsel
Mr. Larry Fazio, Director of the Office of Examination and Insurance