BOARD ACTION MEMORANDUM

TO: NCUA Board

DATE: September 10, 2010

FROM: Director, Office of Examination and Insurance

SUBJ: NCUSIF Premium

ACTION ITEM: Assess each federally insured credit union a premium of 0.1242 percent of federally insured shares for the *reporting period* as defined by Section 741.4(b)(5) of NCUA Rules and Regulations, as provided under Section 202(c)(2) of the Federal Credit Union Act (Act). The premium will also constitute the restoration plan as required by Section 202(c)(2)(D) of the Act.

ACTION DATE: September 16, 2010

OTHER OFFICES CONSULTED: Office of General Counsel, Office of Corporate Credit Unions and the Office of the Chief Financial Officer

VIEWS OF OTHER OFFICES CONSULTED: Concur

SUBMITTED TO THE INSPECTOR GENERAL FOR REVIEW: Yes

BUDGET IMPACT, IF ANY: NCUSIF receipt of $933 million in premium charges.

RESPONSIBLE STAFF MEMBERS: Melinda Love, Director Office of Examination and Insurance; Mary Ann Woodson, Chief Financial Officer

SUMMARY: The National Credit Union Share Insurance Fund's (NCUSIF) August 31, 2010 financial statement discloses the NCUSIF's equity ratio, including the mid-year adjustment for insured shares, declined to 1.176 percent. An equity ratio of less than 1.20 percent triggers the requirement for the Board to establish and implement a plan within 90 days that restores the equity ratio to at least 1.20 percent before the end of an eight year period.[1]

The recommended premium will increase the NCUSIF's equity ratio to 1.30 percent, but the equity ratio will immediately begin to decline. The forward looking analysis shows the premium is sufficient to maintain the level above 1.20 percent through June 30, 2011 while falling to 1.17 percent by year-end 2011. The following chart shows the projected trend in the equity ratio assuming a premium sufficient to restore the current equity ratio to 1.30 percent. This determination applies assumptions including anticipated insurance fund expenses and growth in insured shares. However, with an increased number of credit unions with more adverse CAMEL codes, a struggling

[1] Section 202(c)(2)(D) of the Federal Credit Union Act (12 U.S.C. 1782(c)(2)(D)).

economy, high unemployment and lingering concerns over housing, the actual extent of NCUSIF insurance fund losses is uncertain.

Scenario	Equity Ratio		
	12/31/2010	06/30/2011	12/31/2011
Optimistic	1.28%	1.25%	1.22%
Base	1.25%	1.20%	1.17%
Pessimistic	1.22%	1.17%	1.12%

Background

The Helping Families Save Their Homes Act of 2009 revised the insurance premium charges section of the Federal Credit Union Act. Prior to the change, a premium adequate to restore and maintain an equity ratio of 1.20 percent was required if the equity ratio fell below 1.20 percent. Under the revision to 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, or such longer period as the Board may determine to be necessary due to extraordinary circumstances.

The NCUSIF's August 31, 2010 financial statements disclose an equity ratio below 1.20 percent, triggering the requirement for a restoration plan which must be published in the Federal Register.

Since the NCUSIF's net earnings are projected to remain negative in the near future, the premium is necessary to absorb potential losses in natural person credit unions and maintain public confidence in the federally insured credit union system. The Board may assess a premium charge only if the NCUSIF's equity ratio is less than 1.30 percent, and the premium charge cannot exceed the amount necessary to restore the equity ratio to 1.30 percent at the time of the charge.

<u>NCUSIF Premium Assessment</u>

In November 2009, NCUA announced a projected NCUSIF premium of 10 to 25 basis points for 2010. The recommended premium is at the low end of this projection with the actual amount based on:

1. Actual losses in failed natural person credit unions;
2. Exposure to losses indicated by trends in troubled CAMEL codes;
3. Earnings on the NCUSIF's assets; and
4. Growth in insured shares.

All four factors have adversely impacted the direction of the equity ratio in 2010 with a continuation of these trends anticipated in the near-term. The realized losses in failed credit unions and continued increase in negative trends in credit union CAMEL codes have resulted in the NCUSIF recording $642 million in provision for insurance loss expenses year-to-date through August. This provision for insurance loss expense, combined with low earnings on NCUSIF assets, resulted in a $570 million reduction in the NCUSIF's Retained Earnings. Insured shares grew at a moderate pace of 3.34 percent during the first half of 2010 to $751 billion.

The projected trend in the NCUSIF equity ratio is based on several assumptions. The negative trend in CAMEL code assets and the pending resolution of larger troubled credit unions will continue to place downward pressure on the equity ratio into 2011. While it is difficult to project, the provision for insurance loss expense is projected at $350 million for the remainder of 2010. Insured share growth in the last half of the year is projected near 2.0 percent, which would equate to annual share growth of between 5 and 6 percent.

The CAMEL coding in credit unions has a material impact on the NCUSIF's required reserve level. As of June 30, 2010, there were 366 federally insured credit unions with total assets of $48.8 billion designated as problem institutions for safety and soundness purposes (defined as those credit unions having a composite CAMEL rating of "4" or "5"). This compares to 291 problem credit unions with total assets of $28 billion on June 30, 2009. Additionally, the number and asset size of CAMEL "3" rated credit unions has increased. As of June 30, 2010, there were 1,739 CAMEL "3" rated credit unions with total assets of $149.8 billion compared to 1,485 credit unions with total assets of $86 billion on June 30, 2009.

The Act limits the maximum premium level to the amount needed to return the equity ratio to 1.30 percent using the most current data. Using the assumption that the contributed capital comprises 1.00 percent of the NCUSIF's equity, the maximum amount of any premium would increase the retained earnings to 0.30 percent of insured shares, calculated as follows:

$750,943,021,449 Total Insured Shares X 0.30% = $2,252,829,064 Maximum Retained Earnings (RE)

$2,252,829,064 Maximum RE - $1,319,945,218 RE balance = $932,883,846 Maximum Premium

$932,883,846 Maximum Premium ÷ $750,943,021,449 Total Insured Shares = 0.1242% Rate

A premium of $933 million will return the NCUSIF's equity ratio to 1.30 percent using the most current data for insured shares. However, with the projected level of insurance loss expenses for the remainder of 2010, the year-end equity ratio is expected to be near 1.25 percent, but could range from a low of 1.225 percent to a high of 1.28 percent. Staff will continue to prepare forward looking analyses of the NCUSIF equity ratio and provide periodic reports to the Board.

Staff carefully considered the issuance of a smaller premium. A premium of $181.9 million (0.0242 percent of insured shares) would increase retained earnings to 0.20 percent of insured shares, but the NCUSIF equity ratio would quickly fall below 1.20 percent. A premium of $557 million (0.0742 percent of insured shares) would increase the retained earnings to 0.25 percent of insured shares. With a $557 million premium and the expected level of expenses and insured share growth, the equity ratio is projected to decline to 1.20 percent by year-end 2010 and would decline below 1.20 percent in early 2011 with a projection of 1.157 percent by June 30, 2011.

The recommended premium is $206 million more than the NCUSIF premium charged in 2009, which returned the NCUSIF's equity ratio to 1.30 percent of June 30, 2009 insured shares. The assessment rate was 0.1027 percent of insured shares at that time.

Impact of Premium

The June 2010 call reports disclose modest improvement in the operating condition of federally insured credit unions. Credit quality remains a concern with continued high levels of delinquent loans and charge-offs, along with increasing inventories of foreclosed assets. In the aggregate, credit unions reported a Return on Assets (ROA) before assessments of 0.62 percent for the first half of 2010.

The recommended premium reduces the projected ROA for 2010 by 10.4 basis points. The immediate impact of the premium reduces the national aggregate net worth ratio by 9 basis points from 9.88 percent to 9.79 percent. Additional analysis of the impact of the premium discloses:

- By projecting mid-year results for the entire year, 392 FICUs out of the 5,332 (7.35%) credit unions with positive core net income at June 30, 2010 may experience negative core net income for 2010 due to the premium. Core net income excludes any accrual for potential NCUA assessments, gain on sale of investment and fixed assets and merger-related gains.

- 60 FICUs out of the 6,997 (0.9%) with a net worth ratio over 7 percent as of June 30, 2010 may experience a decline in net worth to less than 7 percent from the premium, subjecting them to the earnings retention requirement of Prompt Corrective Action (PCA).

- 19 FICUs may experience a decline in net worth to below 6 percent, requiring them to prepare a net worth restoration plan as required by PCA.

Combined Impact of Premium and Stabilization Fund Assessment

The combined recommended NCUSIF premium and the Stabilization Fund assessment approved in June 2010 total 0.2582 percent of insured shares with a total cost of

$1.9 billion for 2010 and represents 2.3 percent of federally insured credit union net worth as of December 31, 2009. This combined charge to federally insured credit unions is within the combined range of 0.15 to 0.40 percent of insured shares projected by NCUA in November 2009. The combined assessment will reduce the ROA for 2010 by 22 basis points. Based on core earnings trends through mid-year, 855 FICUs may experience negative net income for 2010 due to the impact of the combined premium and stabilization fund assessment.[2]

Restoration Plan

The Helping Families Save Their Homes Act of 2009 established a NCUSIF restoration plan period requiring implementation of a plan under certain conditions. The conditions include whenever the NCUA Board projects that the NCUSIF equity ratio will fall below 1.20 percent within 6 months or the actual calculated ratio falls below 1.20 percent. The Board must establish and implement a plan within 90 days. The plan must outline the actions to restore the NCUSIF equity ratio to at least 1.20 percent before the end of an eight year period. The Board must publish in the Federal Register a detailed analysis of the factors considered and the basis for the actions taken with regard to the plan.[3]

In calculating the NCUSIF equity ratio, the most current and accurate data available must be used.[4] Based on the NCUSIF's August 31, 2010 financial statements, the NCUSIF equity ratio is 1.176 percent and requires the development and implementation of a restoration plan.

Staff recommends the Board adopt and implement the attached restoration plan. In summary, the premium is the restoration plan.

RECOMMENDED ACTION

The NCUA Board authorize:

1. Charging a premium of 0.1242 percent of federally insured shares for the *reporting period* as defined by Section 741.4(b)(5) of NCUA Rules and Regulations as provided under Section 202(c)(2) of the Federal Credit Union Act.

2. Publishing the attached restoration plan.

ATTACHMENT

Restoration Plan

[2] The group of 855 FICUs have aggregate assets of $51 billion and an aggregate net worth ratio of 9.64% after the impact of the assessment and premium.
[3] Section 202(c)(2) of the Federal Credit Union Act (12 U.S.C. 1782(c)(2)).
[4] Section 202(c)(4) of the Federal Credit Union Act (12 U.S.C. 1782(c)(4)).