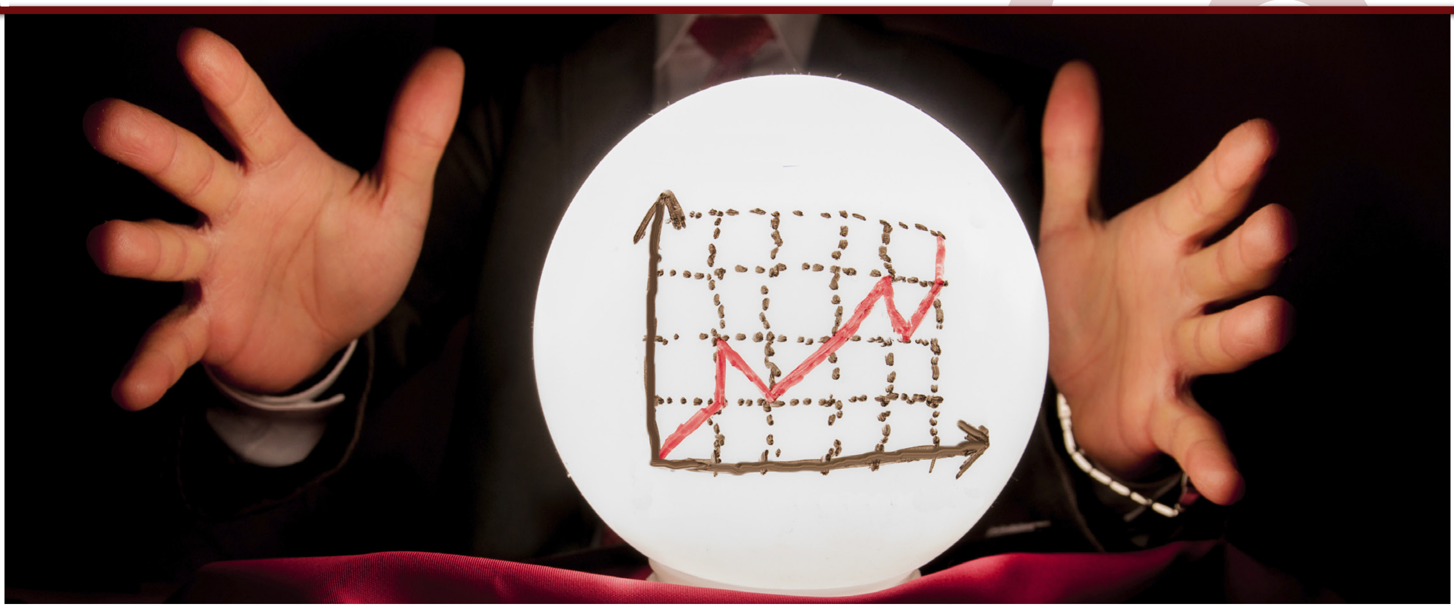
MAY 2015 | VOL. 30 | NO. 5

the
CALLAHAN REPORT
At the Leading Edge of Credit Unions



NCUA IS CONFUSED ABOUT THE STATE OF THE TCCUSF

Data from different sources documents discrepant views about the Temporary Corporate Credit Union Stabilization Fund.

BY CHIP FILSON, CO-FOUNDER AND CHAIRMAN OF THE BOARD, CALLAHAN & ASSOCIATES

The NCUA has released the 2014 TCCUSF audit, and a look at the figures reveals something disturbing. Taken together, the individual financial statements for the five corporate asset management estates (AMEs) and an updated schedule of NCUA guaranteed notes (NGN) and legacy asset values show very different outcomes for the same group of investment assets.

How can that be? And how can credit unions find better answers?

AN $850 MILLION IMPROVEMENT AND PAYOUT PROSPECTS

According to NCUA data, all five AMEs increased in value during 2014 by a total of more than $850 million. In each situation, the corporate's legacy assets that collateralized the NGN refinancing gained in value.

Three of the estates have positive net balances: U.S. Central at $1.1 billion;

The Fiduciary Net Capital Of The 5 AMEs ($000s)

ASSET MANAGEMENT ESTATES	DEC. 21, 2013	DEC. 31, 3014	CHANGE IN $
U.S. CENTRAL	$668,265	$1,067,392	$381,127
WESCOR	($4,515,967)	($4,199,871)	$316,096
MEMBERS UNITED	($8,658)	$62,488	$71,146
SOUTHWEST	$65,863	$138,625	$72,762
CONSTITUTION	($24,961)	($16,025)	$8,936
TOTAL	**($3,797,458)**	**($2,947,391)**	**$850,067**

Source: NCUA AMAC

continued on page 2 »

> "Where should credit unions, Congress, and the public look for an explanation of why the audited statements and unaudited reports are so far apart?"

Southwest at $138.6 million; and Members United at $62.5 million. All shareholders with receiver's certificates for these three should expect a distribution from their respective corporate's estate.

Furthermore, in the case of Constitution Corporate Federal Credit Union, the prospect of recovery still exists. Constitution's actual losses on legacy assets through March 2015 liquidation are just $67 million against an OTTI reserve of $159 million.

NGN INVESTMENTS EXCEED REMAINING BALANCES BY $2.4 BILLION

In a separate table, NCUA reports the remaining NGN balance liability and the market value as well as book value of the legacy investments from which the NGNs are paid. As of December 2014, the $930 million in cash held by the trustee plus the $16.672 billion market value of the remaining legacy assets exceeds the $15.213 billion balance due on the NGN note program by $2.4 billion.

This $2.4 billion surplus is a $1.2 billion increase from the December 2013 total of cash on hand and market value, which at that time was $1.162 billion greater than the remaining NGN liability.

Moreover, this latest market value of the remaining assets is almost $3.0 billion less than the ending legacy asset book balance of $19.6 billion (after all write-downs). This suggests more funds than the $2.4 billion surplus will return to the corporate estates, according to where each legacy assets was originally taken.

TCCUSF AUDIT SHOWS NET IMPROVEMENT INCREASE OF ONLY $380.7 MILLION

These two separate statements showing the $850 million improvement in the net position of the AMEs and the $1.2 billion gain in the value of the legacy assets versus remaining NGN liabilities are both much greater than the total improvement of only $380.7 million in the TCCUSF's net worth position.

Credit unions need answers. Given that the primary source of all value for the TCCUSF is the legacy assets (except for recoveries from legal settlements, which were nil in 2014), why is there such a difference between the reported audit net gain versus the improvements in NCUA's other legacy reports? Why would the audit report show in footnote six a significantly smaller reduction of only $328 million in the "receivable bad debt expense" from the AMEs versus the $850 million gain the AMEs themselves are collectively reporting? And what about the $1.2 billion increase in value in securities versus remaining NGN liabilities?

WHO IS RESPONSIBLE FOR CLEARING UP THESE DIFFERENCES?

The NCUA board appointed a three-person oversight committee to ensure the NGN program meets all legal obligations. The committee includes:

- Larry Fazio, director, Office of Examination and Insurance
- Mike Barton, director, Asset Management and Assistance Center
- Rendell Jones, chief financial officer, NCUA

Moreover, James W. Hagen, inspector general, is responsible for reviewing the auditor's work. But with the extraordinary differences documented in the various reports about the program, where should credit unions, Congress, and the public look for an explanation of why the audited statements and unaudited reports are so far apart? Who will step up with answers?

A LEGACY OF MISLEADING AND ERRONEOUS ESTIMATES

The confusion from comparing the latest updates and audits repeats an NCUA pattern of misleading numbers. In the Resolution Costs Detail report, NCUA clearly pinpoints the error in its original TCCUSF cost projections. The difference between the July 2010 and December 2014 mid-range loss estimates is $6.2 billion. This $6.2 billion divided by the mean remaining estimate of $8.8 billion is an error greater than 70%. That's assuming this latest estimate is even close to correct.

This $6.2 billion overestimate — to date — of losses using NCUA's own models as well as the expertise of independent securities valuation firm BlackRock should provide a lesson about predicting the future: There are no future facts.

The hard truth is NCUA used these erroneous projections to liquidate institutions and assess unnecessary premiums.

Chairman Debbie Matz continues

this NCUA legacy of faux numbers in a March 16, 2015, press release that discusses the 2014 TCCUSF audit: "The stabilization fund has saved credit unions from over $40 billion in potential losses since 2009."

Making vacant claims and pulling numbers out of thin air instead of dealing with actual facts characterizes NCUA's approach. And that is unfortunate.

Again, it begs more questions: Why is the agency continuing this misleading loss methodology when actual losses and real experience are a far better way of tracking the outcomes of this oversight? Why is the auditor continuing to rely on misleading models and historically inaccurate external expertise? How, in good conscience, can they review an NGN/legacy asset schedule that shows a $2.4 billion cash and market-value surplus against remaining NGN liabilities yet opine that the net position of the TCCUSF is only $238 million?

Never have six years of "clean audit opinions" been so riddled with red flags and incomplete information. Is it time for a new audit firm?

Page 35 of the TCCUSF audit report provides an example of double talk and confusion.

Look especially at the last sentence, which implies that if NCUA changed its assumptions, there would have been a different TCCUSF balance sheet at December 2014.

What kind of audit report would try to explain numbers that aren't really the numbers they should be?

- Required Supplementary Information (unaudited)
- Risk Assumed Information
- Sensitivity, Risks and Uncertainties of the Assumptions

While certain parts of the credit market have seen recent improvements, the performance of asset-and mortgage-backed securities, such as the Legacy Assets, remains uncertain. The longer-term outlook for borrower and loan performance is uncertain. Uncertainty around housing prices, interest and employment rates, legal and regulatory actions, and the relationship of these factors to prepayment. Loss severity, default and delinquency rates will likely change over time. Legacy Asset

performance continues to be challenging to predict, and the external model used to derive the expected losses to the TCCUSF from the guarantee of the NGNs is sensitive to assumptions made about Legacy Asset Performance.

For example, changing the assumptions for reasonably possible variations in certain macroeconomic factors such as a decline in housing prices from the most recent peak in the external model would have resulted in no expected losses, net of estimated guarantor reimbursements and the economic residual interests in the NGN trusts (but exclusive of the estimated guarantee fees of the remaining term of the NGNs) associated with the thirteen re-securitization transactions, under any scenario as of December 31, 2014.

<u>However such changes in the assumptions would have resulted in an amount for the Receivables form the AMEs, Net that differed from the recognized amount on the TCCUSF's Balance Sheet as of December 31, 2014.</u> (emphasis added)

WHAT TO DO NOW INSTEAD OF WAITING SIX MORE YEARS?

Credit unions have billions of dollars tied up in the TCCUSF bureaucracy. Refunds are highly probable for share-owners of three of the AMEs, and enough excess is already documented to rebate at least one, perhaps more, of the premiums to credit unions.

Yet there is no ongoing oversight that is accountable to credit unions or the public. NCUA is unsure how to handle the growing surplus, except to say it can't do anything until 2021. This delay kicks the can six more years down the road and further increases the actual costs to credit unions.

When NCUA liquidated the five corporates, three reported positive net worth. That positive net worth was after all five had collectively "reserved" for projected OTTI losses on their investments of $11.6 billion, of which $10.5 was unused. With total real and implied write-downs of $7.9 billion from NCUA's latest NGN update, there are still substantial unused reserves in at least four of the five corporate AMEs. It's easy to determine the precise amount remaining for each AME from the spreadsheets of the legacy assets.

3 SUGGESTIONS FOR REAL TRANSPARENCY AND MORE EFFECTIVE SOLUTIONS

1. Hire a new auditor.

It's time for a fresh look.

continued on page 4 »

> "Credit unions have billions of dollars tied up in the TCCUSF bureaucracy. NCUA is unsure how to handle the growing surplus, except to say it can't do anything until 2021."

2. Recast the oversight committee.
Add at least two representatives from the holders of the receiver's certificates to provide quarterly updates on the status of each AME and potential recoveries for the credit union system.

3. Form a shareholders' working group.
This group would develop options for resolving the NGN and legacy asset liquidity prior to the 2021 termination date. It should include officials from shareholder credit unions that are willing to consider refinancing legacy assets on their own balance sheets.

The agenda for the TCCUSF working group could include topics such as:

- Using the cooperative design advantage of being able to take the long view to maximize recoveries for all shareholders and creditors of the five corporates.
- Refinancing the NGNs with credit union funds and the NCUA guarantee; this would avoid the Wall Street-dictated overcollateralization, which ties up available cash.
- Proposing new ways to structure the CLF (with or without legislation) and restore its role as the primary source for cooperative liquidity.
- Re-engaging the corporate system as the primary correspondents for credit unions and the aggregators of system liquidity.

MAKE NCUA A BETTER STEWARD OF MEMBER ASSETS

The cooperative system is different from banking institutions in that every penny is ultimately owed to a member-owner at a credit union.

NCUA, like the credit unions themselves, is a steward of the assets of others. NCUA's oversight of the TCCUSF fund's assets is that of a fiduciary, which is an even higher standard of responsibility.

By now, NCUA could have learned from the past and become an ally with credit unions to resolve a situation that was misunderstood and, unfortunately, greatly exaggerated from the beginning.

History has shown that those who can't learn and adjust from misreading events are likely to repeat it in a different context.

There is still time to start anew, but that will only happen with enlightened leadership at the NCUA and credit unions that press for a fresh approach.

CHIP FILSON,
CHAIRMAN OF THE BOARD
Book Chip for your next planning session or special event. Call us at 202.223.3920.

COMMENTS | editor@callahan.com
EDITOR | Alix Patterson
MANAGING EDITOR | Aaron Pugh
ASSOCIATE EDITOR | Rebecca Wessler

CALLAHAN & ASSOCIATES

1001 Connecticut Avenue, NW Ste. 1001
Washington DC 20036
(P) 800.446.7453 | (F) 800.878.4712