

# Merging the TCCUSF with the NCUSIF: Doing The Right Thing, The Right Way

August 29, 2017

Chip Filson, Chairman

Callahan & Associates, Inc.

**CALLAHAN**  
ASSOCIATES  
*the credit union company*

Knowledge. Insight. Strategy.

# Today's Agenda

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- The Critical Issues
- Why Merger Makes Sense-if done right
- A New Chapter in NCUA/Industry Relationship
- Acting as Owners

# Critical Issues To Consider

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- Owners' comments due Sept 5
- Should TCCUSF recoveries be retained for NCUA's use or returned in full for credit union members?
- NCUA's flawed premise: retaining funds is due to increased risk arising from merger
- Creating a new chapter in NCUA-CU cooperation

# 3 Reasons Your Comments Really Matter

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- NCUA is listening
- \$2.4B is at stake-initially
- You are an owner of the NCUSIF-This is NCUA's account payable to return the premiums you sent to fund the TCCUSF

Let's Cut to the Chase:

## The Right Way To Merge The Funds

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- Refund all \$2.2-2.4 billion to benefit members (\$2,400 per million of insured shares)
- Re-affirm the 1.20 to 1.3% Normal Operating Level (NOL) range of NCUSIF
- Track/report TCCUSF income separately from NCUSIF assets-Create TCCUSF *account payable* for cu refunds
- Increase transparency, lower costs, simplify administration, improve accountability
- Re-tether NCUSIF financial results to actual events
- Expedite payments to AME Receiver's certificate holders (eg. Southwest has no payable to TCCUSF)

# Why Close the TCCUSF?

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- Will allow rebates of excess TCCUSF premiums earlier than June 2021
- Simplifies reporting of AME's and reduces costs
- Provides more flexibility winding down the program
- As much as \$3.2B rebate of TCCUSF premium assessments will be available
- \$1.7B return to capital shareholders of four corporate AMEs (not WesCorp) and all active CCUs that hold receiver's certificates

# The Merger Math

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NCUSIF balance at June 30	\$ 13.2 bn
TCCUSF net position March	\$ 1.8 bn
Additional TCCUSF funds	\$ 1.0 bn
Plus additional 1% true-ups	
Estimated combined Fund balances at Dec 2017	<hr/> \$16.0 bn

# How to Calculate NOL Value/Return

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Total Fund Balances of \$16bn

\$1.1 trillion Insured Shares

**= 1.47 NCUSIF NOL**

Therefore,

each .01 of NOL equals \$109 million



## NCUA Staff Proposal for the TCCUSF Surplus

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Raise NOL 4 pts to 1.30	\$436 million
Retain 4 NOL pts for NGN	\$436 million
Retain 5 NOL pts to offset NCUSIF operating trends	\$545 million
Pay members just 8 NOL pts	\$872 million

**Bottom line:** NCUA retains 13 NOL (62%) and 8 NOL (38%) returned to cu members from TCCUSF recoveries

# Context for Decisions

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- Industry results and economic trends continue to be very favorable
- 95.2% credit union assets are CAMEL 1-2: highest % for over a decade
- 2 failures so far in '17 vs five year average of 17 per year
- NCUSIF equity 1.26% + \$208 million loss allowance (June 2017) is equal to 16x the 2016 net cash losses

## U.S. Credit Union Industry Increases growth momentum as of June 2017 data

	As of 06/30/2017	12-mo. Growth 2Q 2017	12-mo. Growth 2Q 2016
Assets	\$1.4T	7.7%	7.4%
Loans	\$924.0B	10.9%	10.5%
Shares	\$1.2T	8.2%	7.3%
Investments	\$374.9B	1.9%	0.4%
Capital	\$153.0B	5.8%	7.8%
Members	110.8M	4.4%	3.8%

Source: Callahan's Peer-to-Peer Analytics

# NCUA's Proposal Uses 2 False Narratives

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As shown in following data slides:

- The contingent liability risk for the NGN guarantee is negligible
- NCUA's financial "modeling" for both TCCUSF and NCUSIF has not been close to real outcomes

# Retaining 4 NOL for NGN contingent liability is unsupported by audits or NCUA's own models

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- Dec 15 and Dec 16 KPMG audit's assessments explicitly state no need for contingency liability reserve:

*During 2016, the TCCUSF was principally responsible for guarantees related to the NGNs. As of December 31, 2016 and 2015, NCUA estimated no insurance losses for the NGN program (page 3);*

*The TCCUSF recorded no contingent liabilities on the TCCUSF's balance sheet as of December 31, 2016 and 2015. . . There were no probable losses for the guarantee of NGN's associated with re-securitization transactions. (footnote 8, page 25)*

# But, NCUA's new model suggest there might be a loss: NCUA's modeling history

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- Read the full quote on NCUA's use of models, page 125/6 KPMG 2016 audit: **Bottom line there is no contingency needed and a \$2.4 billion excess coverage today.**

*NCUA's new modeling using Federal Reserve assumptions:*

*“Federal Reserve officials are looking under the hood of their most basic inflation models and starting to ask if something is wrong. Minutes from the July 25-26 Federal Open Market Committee meeting showed. . . the debate over resource slack models and whether standard sources were telling the whole story showed convictions about their forecast are fraying.”*

*(source: Bloomberg News August 16, 2017: Fed Starts to Wonder if Cornerstone Inflation Model Still Works)*

## NCUA's Financial Modeling legacy for TCCUSF

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- TCCUSF KPMG audited contingent loss models at 12/09 for the entire corporate network loss projections: **\$6.4 billion**
- Setting up TCCUSF removed this deficit liability from the NCUSIF's balance sheet
- Important because WesCorp and US Central had been conserved by NCUSIF- should their shortfalls be consolidated?

# THE WALL STREET JOURNAL.

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## Bailout Plan Rejected, Markets Plunge, Forcing New Scramble to Solve Crisis

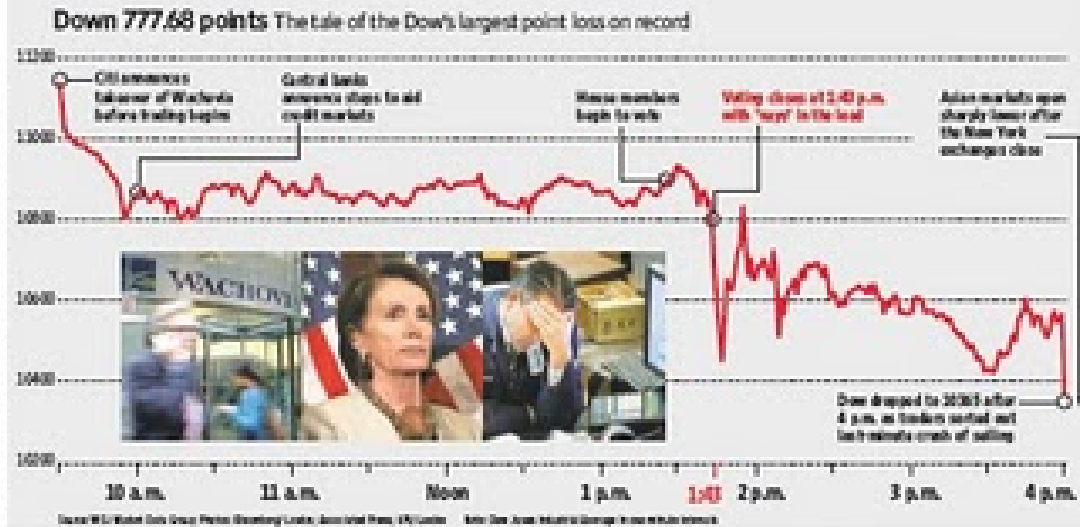
By SARAH LEECH, DOMINIC PASTERNA AND GREG DEY

**WASHINGTON**—The House of Representatives defeated the White House's \$700-billion financial-rescue package—a stunning vote reversal that sent the stock market into a tailspin and added to concerns that the U.S. faces a prolonged recession if the legislation isn't passed.

The Dow Jones Industrial Average finished its biggest point drop in history and its biggest closing decline since the day the market re-opened after the Sept. 11, 2001, terrorist attacks. The Dow, which had opened sharply lower on fears of more possible bank failures, finished the day down 777.68 points, its largest point drop in 2008. All three major stock indexes finished down 3%.

The passage was a 219-232 vote, a reversal of earlier votes by what's called "the fear bloc," which in its highest form is by 20-year-olds. It came on the day of a 10-year anniversary of the 9/11 attacks, and other markets also were down.

The 2007-2008 run, which started a full-year ahead from the president and the Treasury secretary, marked a stark moment in a market that has shaken the financial system to its core and forced the government to take action. It has threatened to shake up confidence in the nation's top corporations, including the likes of Microsoft Corp. and Citigroup Inc., while the Federal Reserve joined



other central banks in injecting more funds into credit markets. The bailout was designed to help to get financial institutions lending again, including the banks and other lenders that have failed or are in trouble. If credit markets continue to fail, the impact on businesses and consumers could be widespread. House is to vote on the bill, including spending and investment. Economists said the credit crunch could

lead to increased layoffs in the U.S. and prompt a better view on the Federal Reserve. "The legislation may have failed," said House Speaker Nancy Pelosi, a California Democrat. "The crisis is still with us." The House vote passed the House Department in a 219-232 vote. Offshoots there considered the vote as an early indicator to vote up with a bipartisan approach to tackling the financial crisis. The Treasury and the Fed are working on a plan to address the crisis.

The Treasury is likely to return to addressing problems associated by the Treasury, according to a Treasury spokesman with the Treasury. The Treasury is likely to return to addressing problems associated by the Treasury, according to a Treasury spokesman with the Treasury. The Treasury is likely to return to addressing problems associated by the Treasury, according to a Treasury spokesman with the Treasury.

Other than Mr. Pasterina, the proposal was widely criticized. The rescue package had helped lower financial markets. But it also sparked lower prices among investors' what would be an unprecedented government intervention in the private sector.

The White House is likely to be the nation's position. Both Democrats and Republicans leaders in Congress and the White House had been seen in page 22.

What's News —

**Citi, U.S. Rescue Wachovia**  
Latest Shotgun Deal Creates Nation's Third-Largest Bank

**Industry Is Remade**

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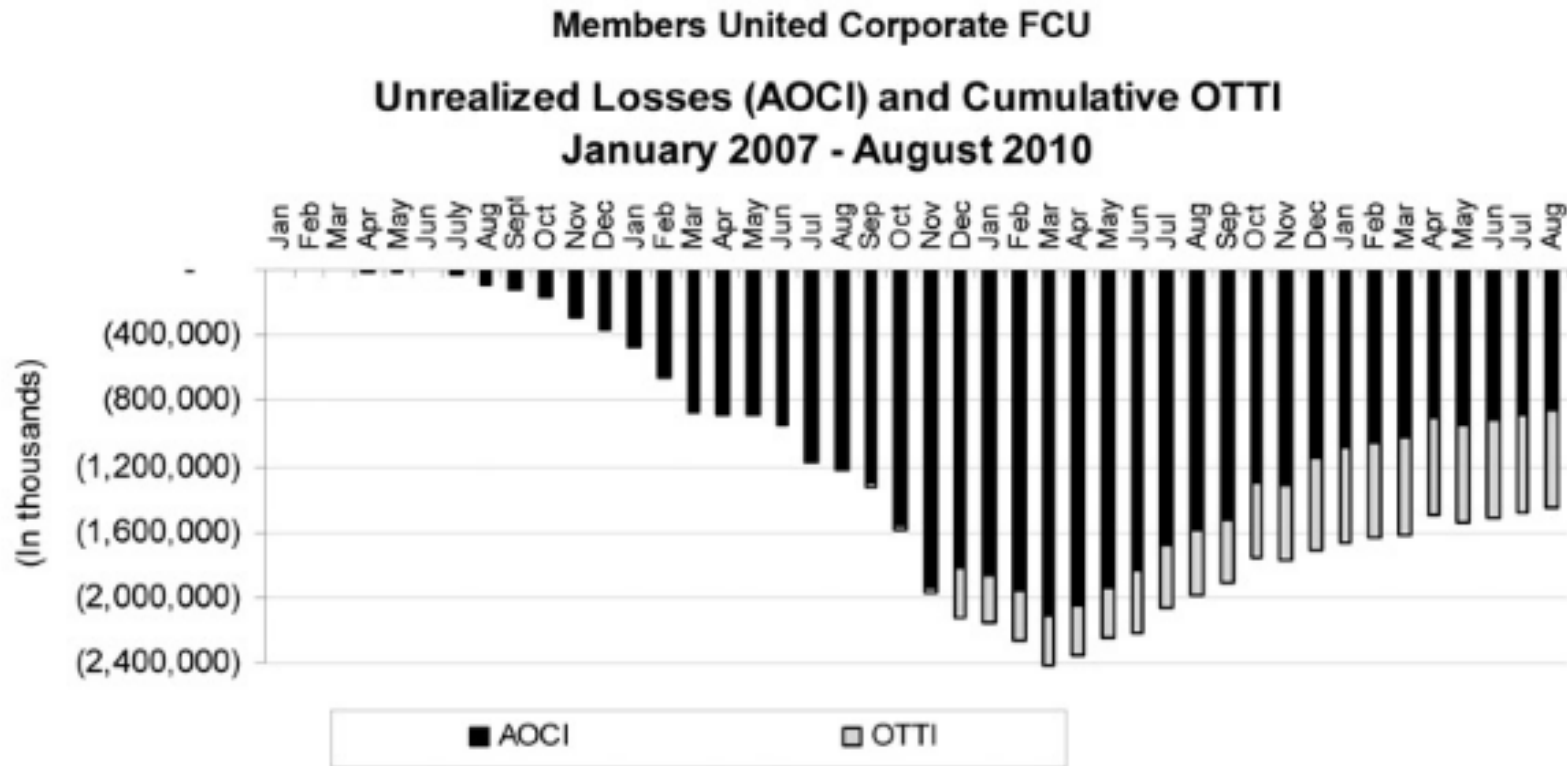


# Corporate CU System Recovery Was Underway June 2009 – June 2010

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- Shares and borrowings ↓ \$12B
- Assets (leverage) ↓ \$3B
- Equity ↑ \$9B

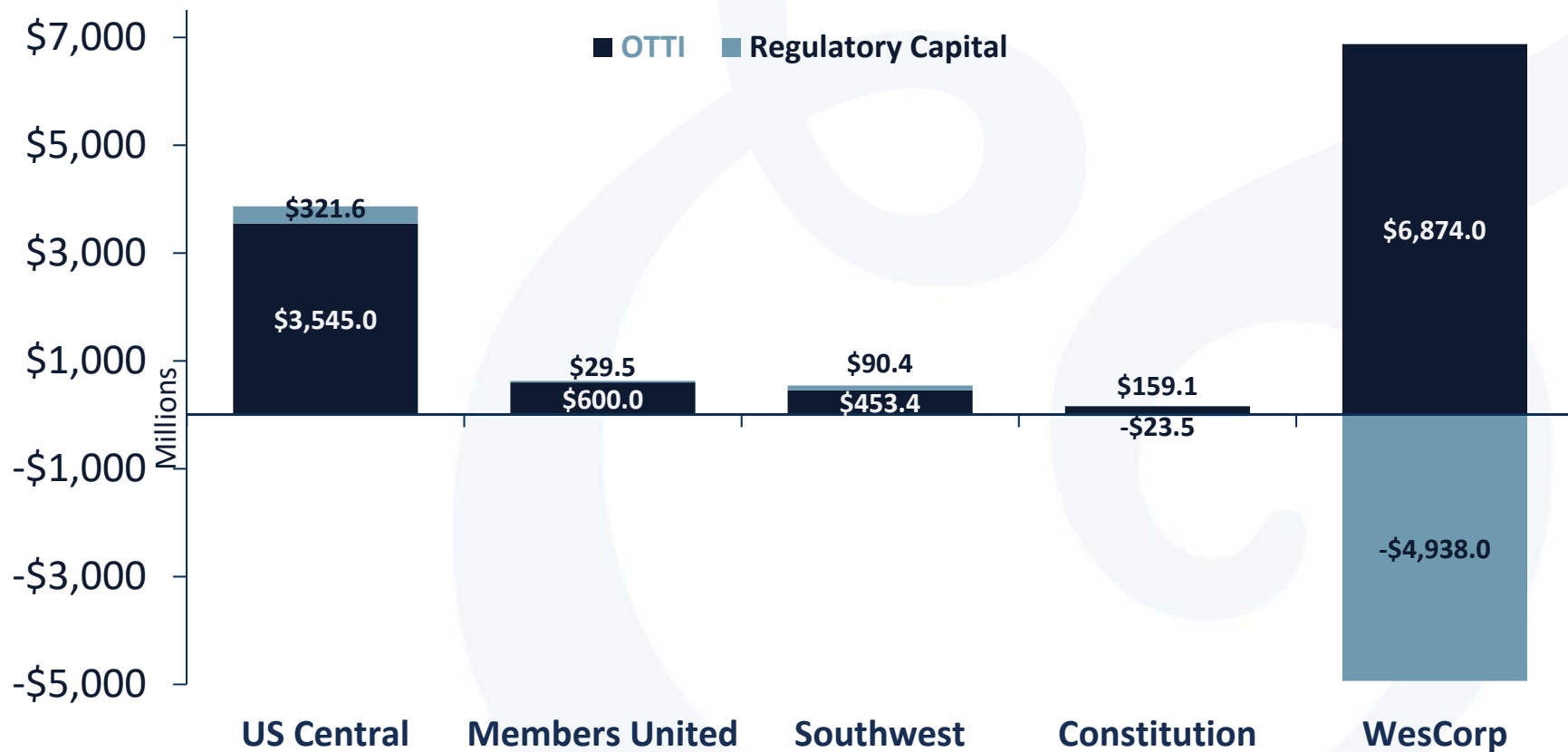
# Members United Reported Monthly Progress- *(\$571 million improvement in AOCI in its last 12 months)*



Source: *Callahan Report Corporate Crisis & Regulatory Reform.*

# 3 of the 5 liquidated corporates reported positive regulatory capital in August 2010

Regulatory Capital and Unused OTTI Reserves  
Data as of 08.30.2010



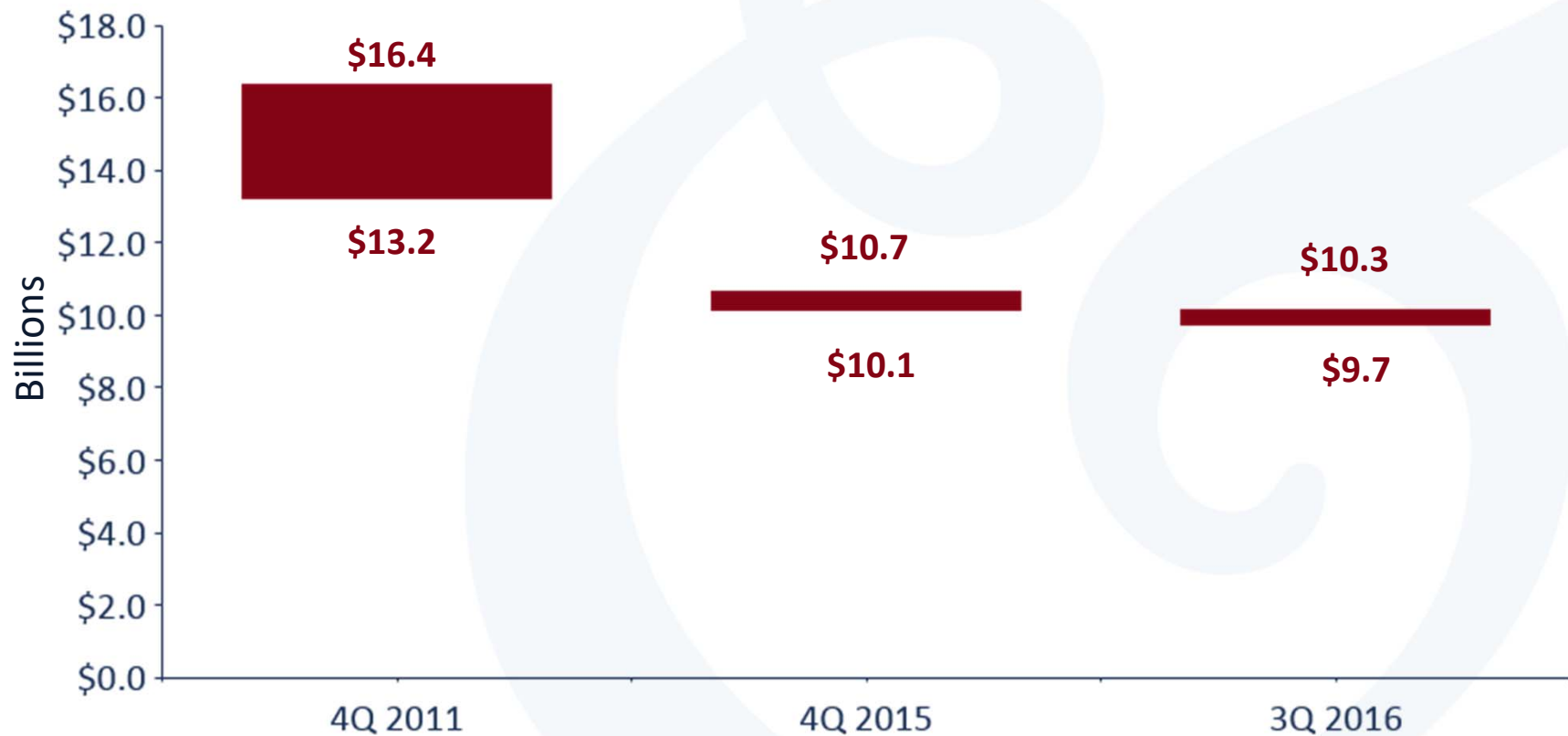
# Status of Capital and OTTI at August 30, 2010

Corporate	Regulatory Capital Per 5310 Call Rpt	Unused OTTI
US Central	\$321.6 million	\$3,544.8 million
WesCorp	(\$4,937.8 million)	\$6,874.3 million
Southwest	\$90.4 million	\$600.0 million
Members United	\$29.5 million	\$453.4 million
Constitution	(\$23.5 million)	\$159.1 million
Totals	(\$4,519.80 million)	\$11,631.6 million

OTTI Write-downs/  
Losses Not Incurred

# A Moving Target: NCUA's Projections

Projected Lifetime Legacy Asset Defaults  
Data as of 12.31.2016



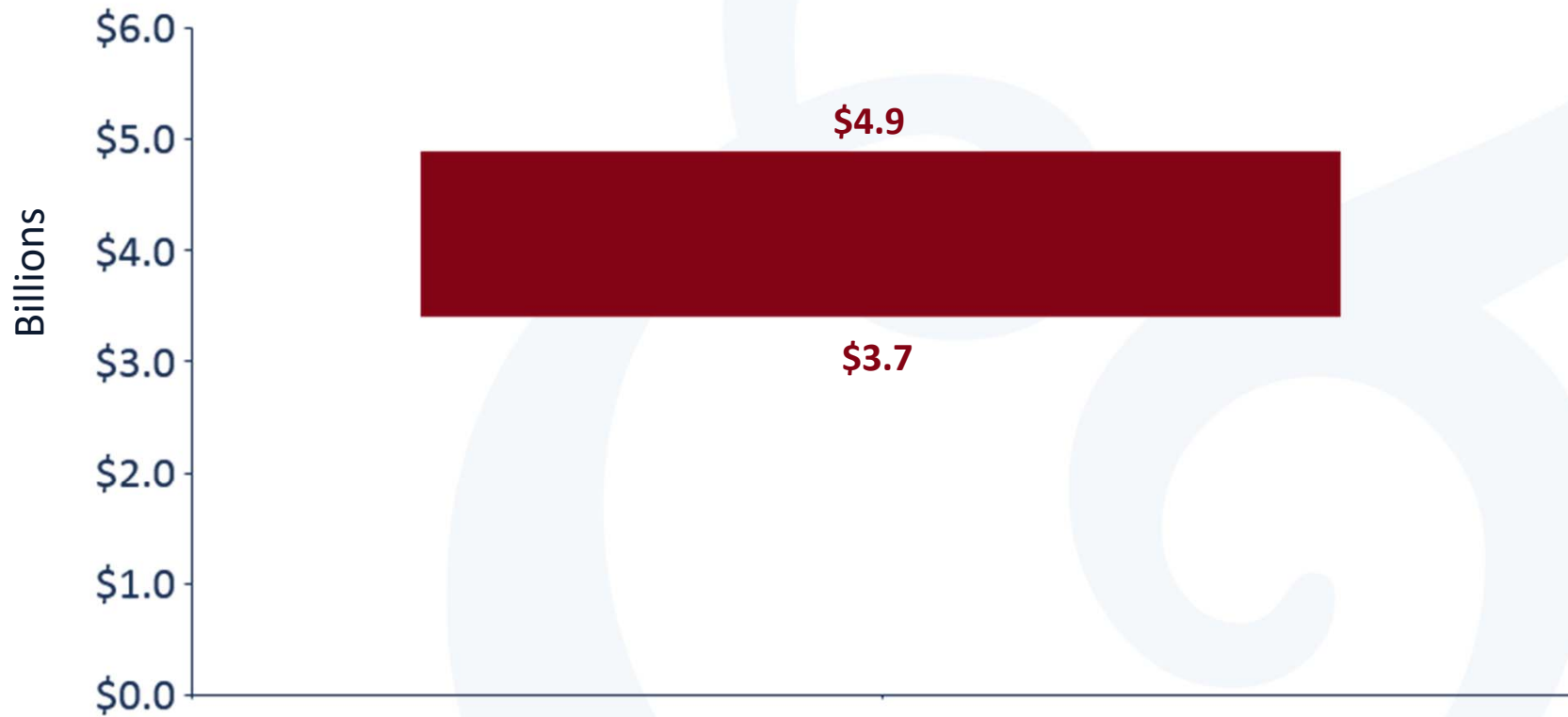
## NCUA's 2010 Liquidations added \$1.4 billion to the Projected Corporate losses

*“The increase in aggregate contingent loss from 2009 to 2010 of **approximately \$1.4 billion** (\$6.4-\$7.8bn) is primarily the result of increased losses in the previously conserved CCU's and three additional CCU's, all five of which were placed in AME status in 2010.”*



(page 24 KPMG audit)

# NCUA now projects up to \$4.9B in refunds

Projected Range of Refunds  
Data as of 09.30.2016



Claim Receipts for  
Member capital:  
March 31,'17 NCUA  
estimates \$2.5 bn in  
positive AME equity  
for member capital  
less \$1.0bn to  
TCCUSF from USC

CLAIM RECEIPT FOR MEMBER CONTRIBUTED CAPITAL	
November 12, 2010	
CHICAGO PATROLMENS FCU 1407 W Washington Blvd Chicago, IL 60607	
TO: CHICAGO PATROLMENS FCU	
By Order issued October 31, 2010, the National Credit Union Administration Board ("NCUA Board") placed Members United Corporate Federal Credit Union ("Members United") into liquidation and appointed itself Liquidating Agent. 12 U.S.C. 1787(a)(1)(A).	
As you know, the capital contributed by members to Members United was fully depleted prior to liquidation to absorb losses in excess of retained earnings. 12 C.F.R. 704.2. The depletion was due primarily to the required recognition of unrealized investment losses based on projected future bond defaults.	
In the event of liquidation of a corporate credit union, member Paid-In Capital ("PIC") and Membership Capital Accounts ("MCA") are payable only after satisfaction of all liabilities of the liquidation estate as prescribed in 12 C.F.R. 709.5(b), based on the circumstances that exist on the date of liquidation. Id. §709.5(c).	
Under normal circumstances, a member of Members United is required to file a claim against the liquidation estate to recover its depleted capital on the basis of, for example, an "error in accounting estimation." In recognition of credit unions' concerns about the depletion of their capital, however, the NCUA Board has chosen to issue this "Claim Receipt for Member Contributed Capital" representing the value of your PIC and MCA balances for September 30, 2009 ("the record date"). Based on Members United's account records, I have determined that CHICAGO PATROLMENS FCU had PIC and MCA balances of:	
PIC \$ .00	MCA \$1,500,000.00
Upon final resolution of the Members United liquidation estate, this Claim Receipt will enable you to share <i>pro rata</i> in the net proceeds, if any, to the extent of your PIC and MCA balances as of the record date. No further action is required on your part to file or activate a liquidation claim.	
This Claim Receipt supersedes any prior certification, record or statement of member PIC and MCA balances.	
If you have any questions, please feel free to contact us at 512-231-7900.	
	Sincerely,  Mike Barton, Liquidating Agent for Members United Corporate Federal Credit Union



# NCUA's Est. \$2.5 bn AME Distributions: March 2017

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Corporate Shareholders	Estimated AME Distributions
US Central	\$1.8 billion (\$1.0 to NCUSIF)
WesCorp	(\$3.1 billion)
SouthWest	\$400 million + USC share
Members United	\$273 million + USC share
Constitution	\$0 + USC share

# DOES TCCUSF MERGER INCREASE NCUSIF'S "TRADITIONAL" RISK?

# The NCUA's "Logic" for Raising the NOL

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- NOL is 1.26 at June 30, 2017
- NCUA wants to add 9 more basis points for contingencies based on new models
- Would keep almost \$1 billion TCCUSF recoveries for NCUSIF investment in US Treasuries

# KPMG Opinion of NCUSIF Equity Ratio

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*In our opinion the financial statements...  
**presented fairly, in all material respects, the**  
financial position of the NCUSIF as of December  
31, 2016 and 2015 and its net costs, changes in  
net position etc. (pg 99)*

The “fairly presented” equity ratio:

*The NCUSIF-calculated equity ratio of 1.24% and  
1.26% as of December 31, 2016 and 2015 was  
below the normal operating level of 1.3%;  
therefore, the NCUSIF did not estimate or record  
a distribution. (page 121)*

## KPMG Opinion of NCUSIF Equity Ratio Sufficiency

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*In accordance with SFFAS No. 5 all federal insurance programs should recognize a liability for:*

*Unpaid claims incurred . . .*

*When an existing condition, situation or set of circumstances involving uncertainty as to probable loss exists. . .*

*A future outflow or other sacrifice of resources that is probable. (pg 111)*

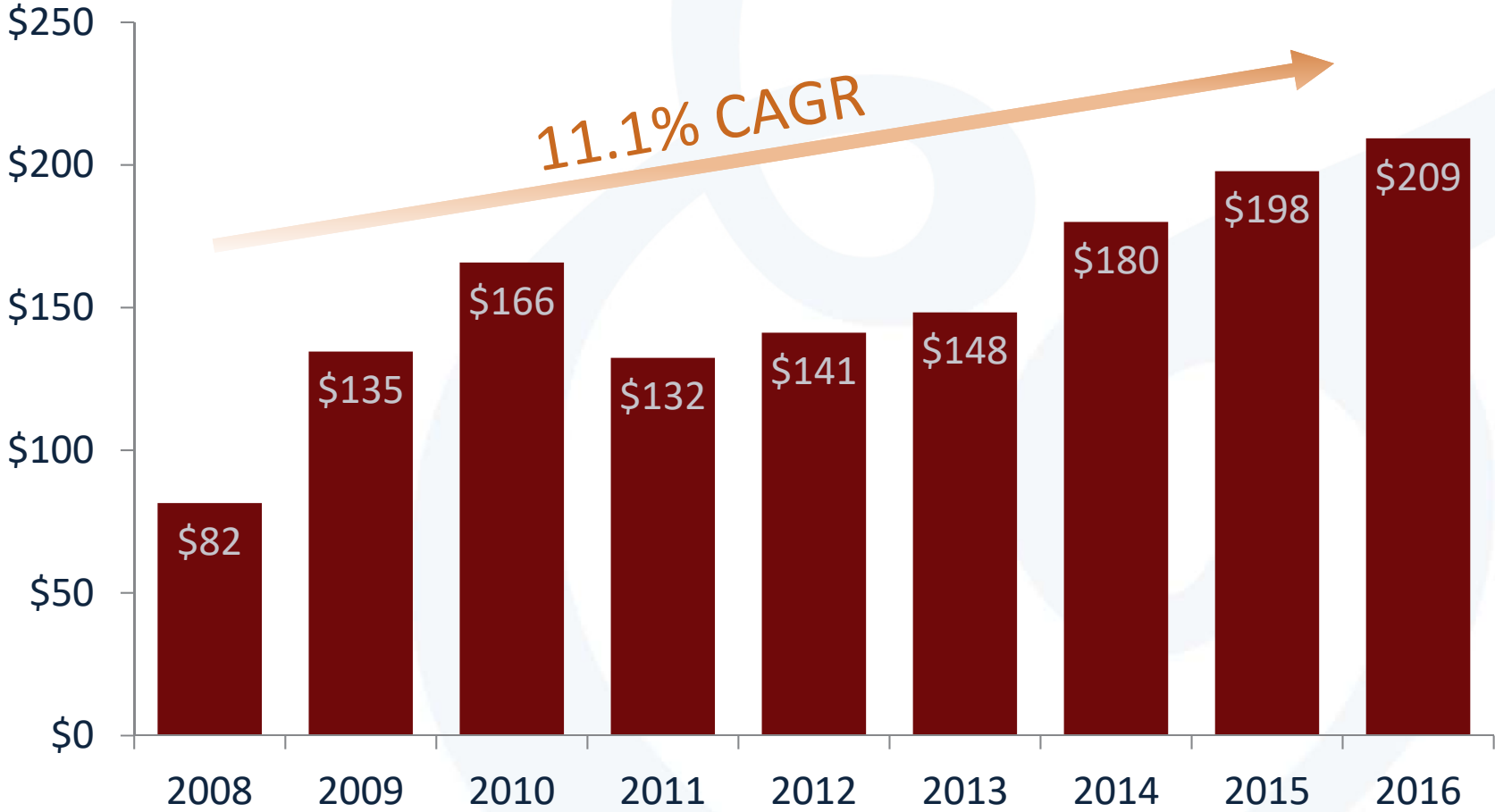
## KPMG 2016 Opinion of NCUSIF Equity Ratio

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*Further. . . The year-end contingent liability is derived by using an internal econometric model that applies estimated probability of failure and loss rates that take into account the historical loss history, CAMEL ratings, credit union level financial ratios and other conditions.* (page 111 NCUA Annual Report)

A BRIEF FINANCIAL HISTORY OF THE  
NCUSIF (2008-2016)- *"FROM AN  
INSURANCE FUND TO BECOMING NCUA'S  
OPERATING CASH REGISTER"*

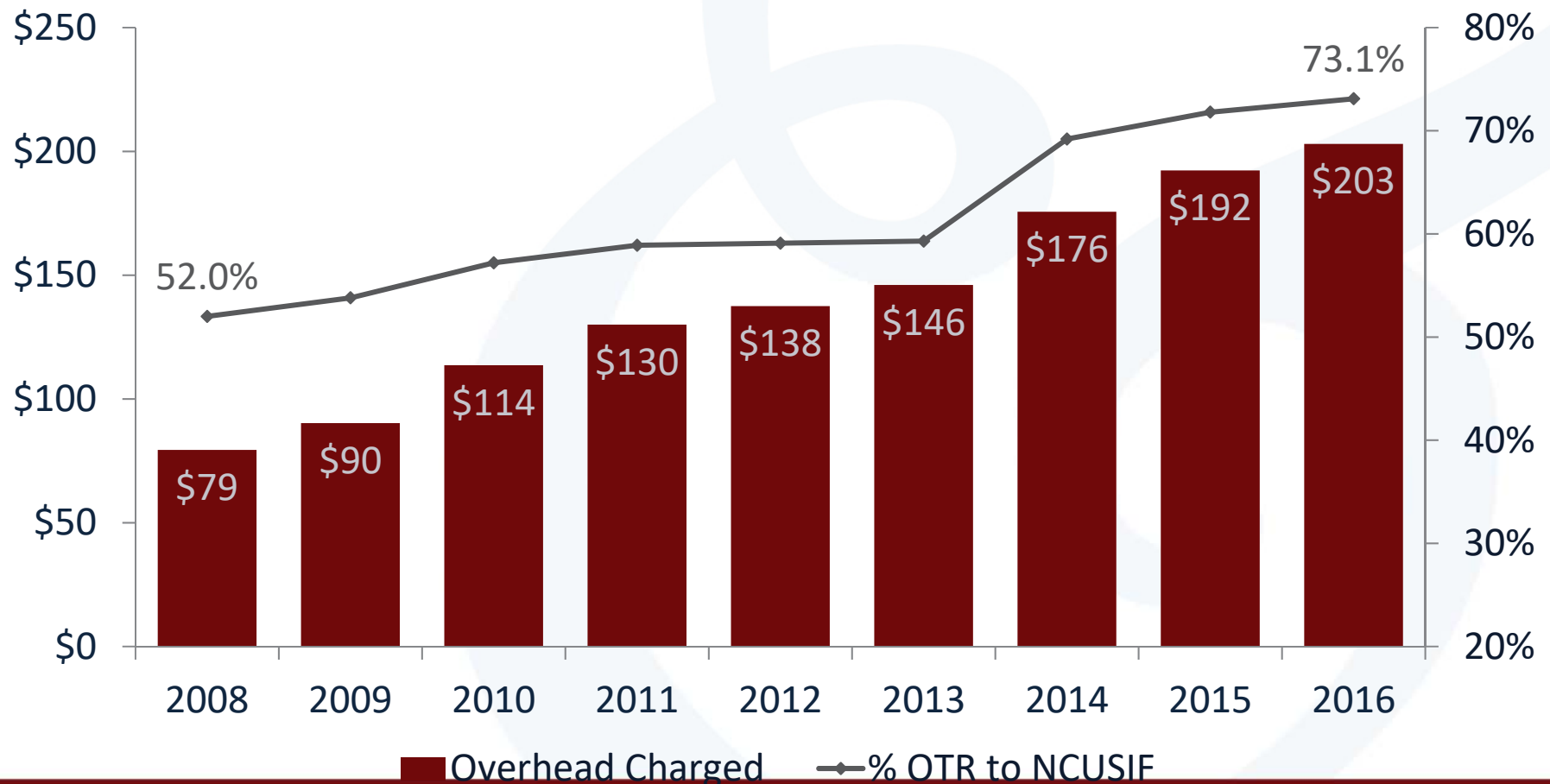
# Total NCUSIF Operating Expenses (2008-2016)





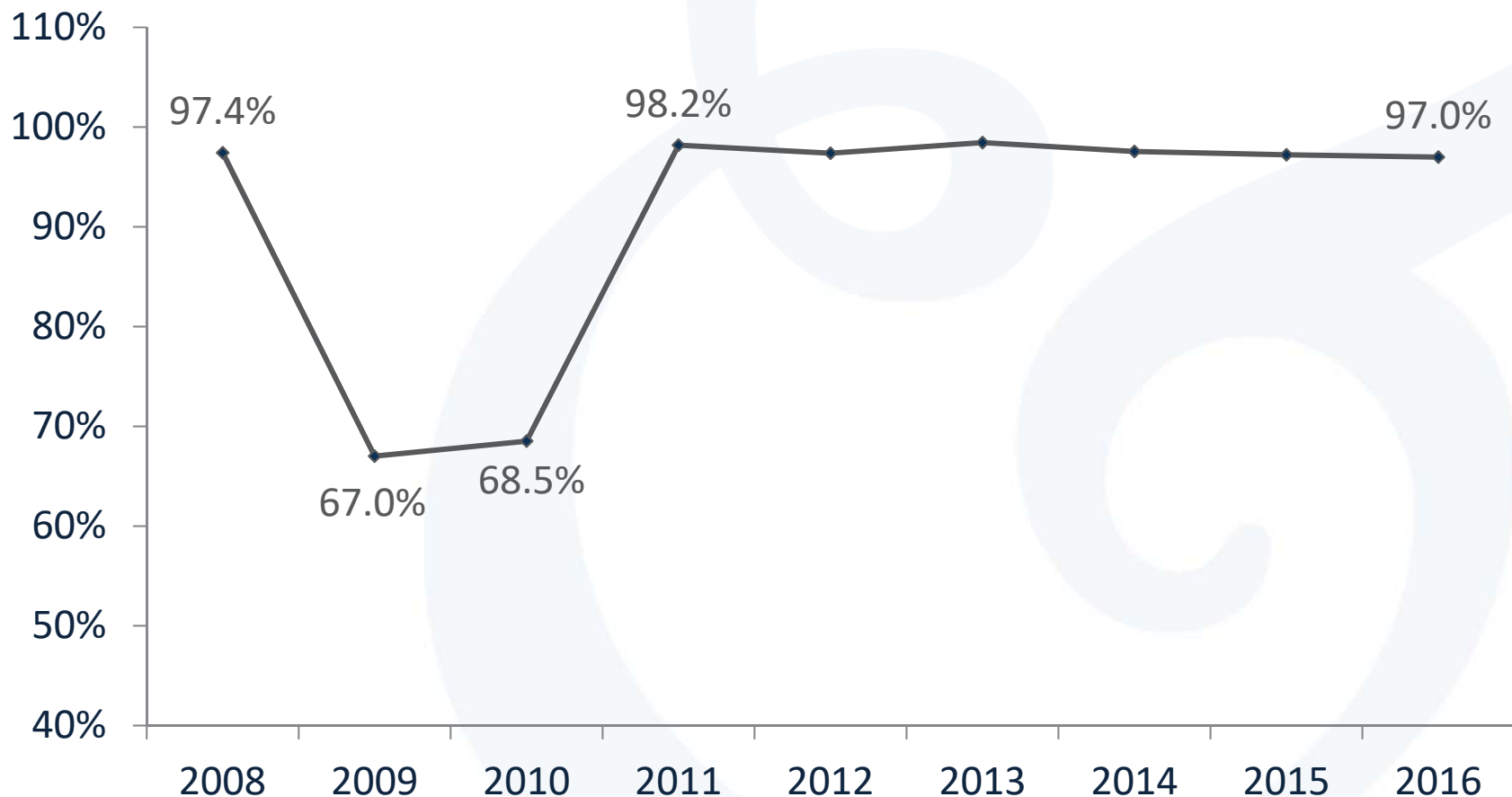
# Annual OTR % and Total \$ Charged to NCUSIF for NCUA Operating Expenses

Overhead Charged & % OTR to NCUSIF



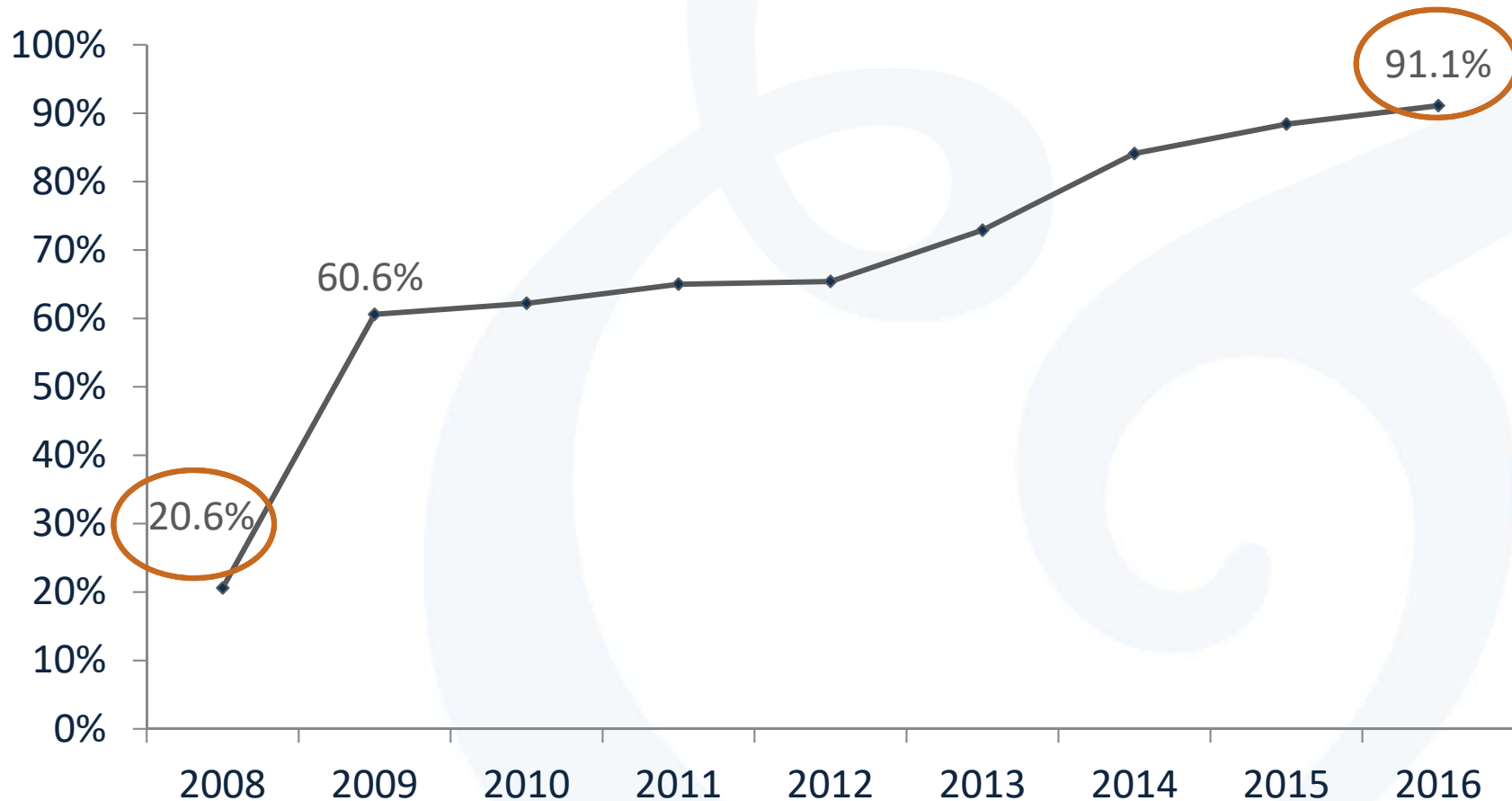
# NCUA's Overhead Transfer Now Takes Almost All NCUSIF Operating Expenses (2008-2016)

\$ Overhead Charged to Total NCUSIF Operating Expense



# Increasing NCUA Expense Transfers Now Use Almost All of the NCUSIF's Total Annual Income

Operating Expense to Total Income



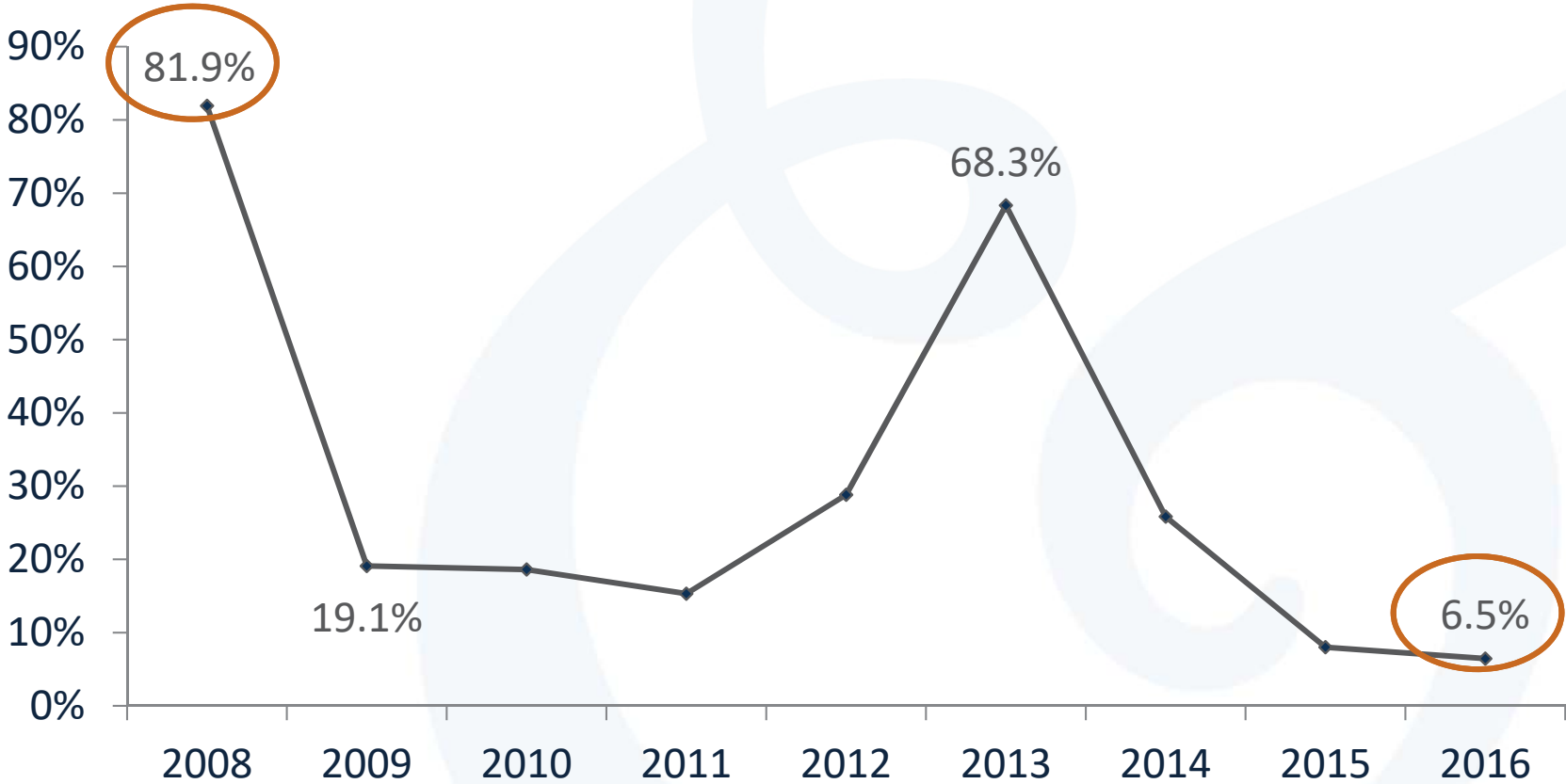
## The Result: NCUA Uses NCUSIF Revenue to Pay for Increases in Its Operations

	2008	2016	8 Year Change
% NCUA OTR transfer rate	52%	73.1%	+ 22.1% (increase of 42%)
<b>Net NCUA Operating Expense</b>	\$74.3 m	\$74.7 m	+ \$400,00
<b>Total Annual NCUSIF OpEx</b>	\$79.4 m	\$203.0 m	+ \$123.6 m (increase of 156%)
NCUA \$OTR/ Total \$ NCUSIF OpExp	20.6%	91.1%	+70.5%

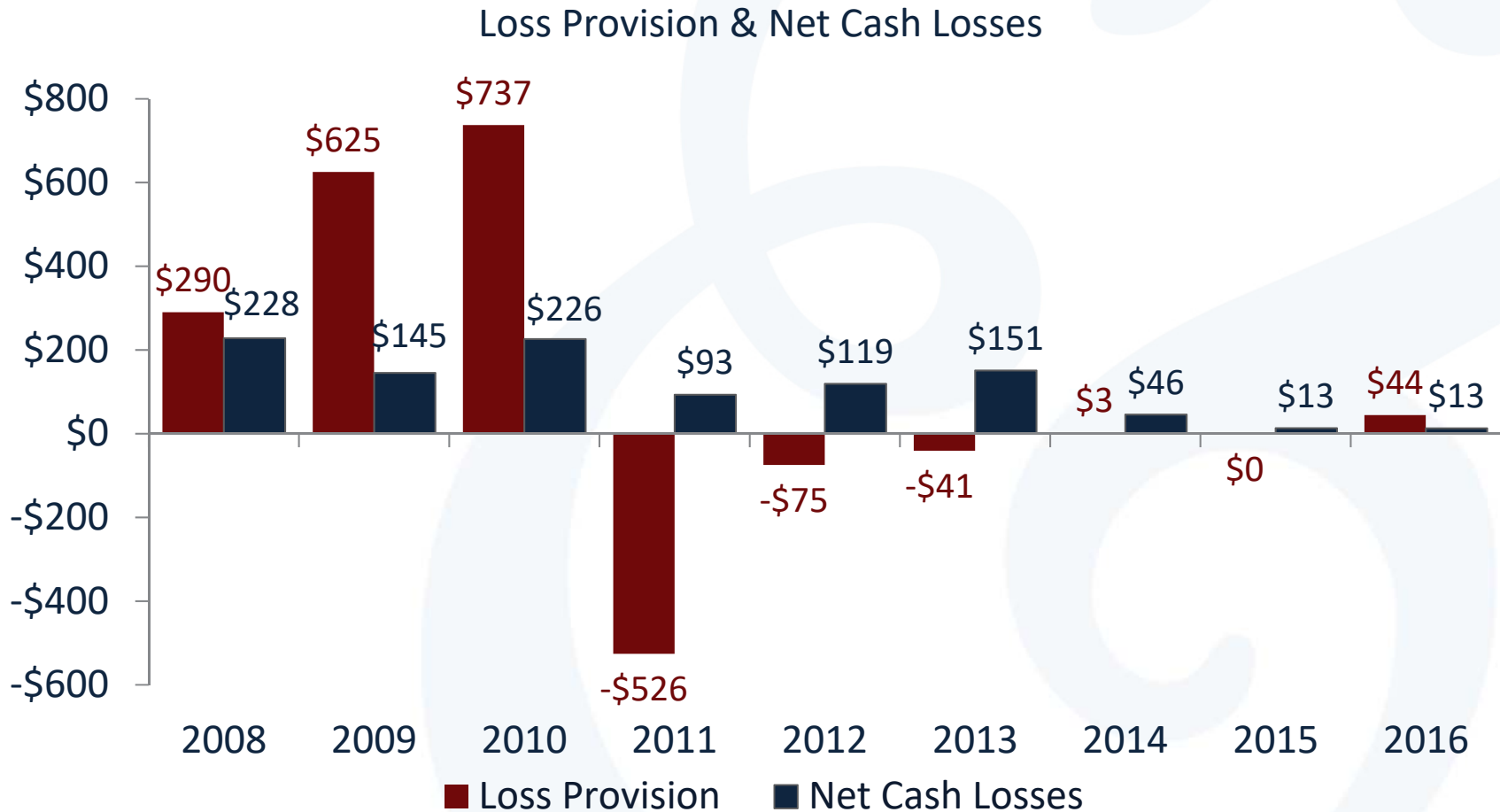
**NCUSIF (2008-2016) shows same model  
accounting flaws as TCCUSF results**

# NCUSIF's Net Cash Losses show no relation to Yearend Loss Reserves: Models are flawed

Net Cash Losses to Loss Reserve Balance at Year-End



# NCUSIF's Loss Provision Expense & Actual Net Cash Losses show no relationship (2008-2016)





What actions should you take right now?



## Conclusion:

# There Is No Basis to Increase the NCUSIF's NOL

- Auditors and NCUA confirmed sufficiency of 1.24 NOL in December '16: 1.26 as of 6-30-17
- NCUSIF Expense Transfer growing 11% per year-staff forecasts continued 4.5% growth
- NCUSIF does not have a shortage of reserves or capital-NCUA has created an expense structure swallowing up most income.
- Reason for higher NCUSIF NOL is to pay for increased spending, not losses.

## Conclusion:

### Learn From the Past to Do The Right Thing Today

- Owners must act like owners: the \$2.4 billion is your credit union's account receivable;
- Failure to comment is defaulting to NCUA staff to decide what to do with your money;
- The criteria to decide the “right thing”? *What's is in the members' best interest!*
- Confront the “Black Box Syndrome” – modeling futures cannot absolve NCUA's responsibility to align actual events and accounting statements

*Continued...*

## Conclusion:

### Learn From Our Past: Transforming NCUA-CU Relations

- Crisis Mindset → Manage Real-World Events
- Despair & Dystopia → Build on Positive Changes & Results
- Cashing Out Problems → Workouts, Saving Charters with cooperative “patience”
- Hiding Behind Models → Apply Models Appropriately

# And Finally...

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- Put the money to work for your members!



# Write a Letter – Today!

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- Opening – how much do your members pay in premiums and did you lose in Membership Capital? Include the \$
- Clearly state your position:
  - Merge funds-but do it right
  - Keep NOL 1.20 - 1.30
  - Keep TCCUSF income/recoveries in separate account payable on NCUSIF books
- Provide your RTN for NCUA to return funds

# Spread the Word-Now!

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- Contact your league to demand support
- Reach out to your CEO network directly
- Copy Congressmen on your letter to NCUA
- CC McWatters and Metsger: *I welcome your Comments*
- Finally, plan your innovation strategy – how are you going to invest this money to help your membership grow?

# How to Submit A Comment Letter

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By Email: Address to [BoardComments@NCUA.gov](mailto:BoardComments@NCUA.gov)

Subject Line: “[Your Name] – Comments on Stabilization Fund Closure”

By Fax: 703-518-6319

Subject Line: “[Your Name] – Comments on Stabilization Fund Closure”

By Mail: Must ARRIVE by September 5.

Gerard Poliquin

Secretary of the Board

National Credit Union Administration

1775 Duke Street

Alexandria, VA 22314-3428

# Our Contact Information

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