National Credit Union Share Insurance Fund Assessment Analysis

The establishment of a National Credit Union Share Insurance Fund (NCUSIF) premium includes the following four distinct processes:

1) Determine the NCUSIF's equity level at a given point in time;
2) Estimate how the equity level will trend over the next year;
3) Complete a scenario analysis of the impact of different assessment levels on credit unions; and
4) Develop a recommendation on the targeted equity level.

Each process has associated variables. The following discuss each of these processes.

Determine the NCUSIF's Equity Level

There are 3 major variables to determining the NCUSIF's equity ratio at a point in time:

1) **Earnings in the NCUSIF** – NCUA's Chief Financial Officer reports on the earnings every month, and the financials are available on NCUA's website.

2) **Insured share growth** - The insured share growth is shown each quarter through the call reports, and credit unions can find that number by ordering an aggregate Financial Performance Report off NCUA's website. Normally, share growth tapers off as the year progresses, so the first quarter's statistics are historically higher than the overall rate by the end of the year.

3) **Level of loss reserves** - The reserve is the item with the highest number of variables impacting the estimates. The NCUSIF reserving process is similar to a credit union's Allowance for Loan & Lease Losses (ALLL). There are two basic pieces to the NCUSIF reserve:

    a. The general reserve is similar to a credit unions historical loss reserve; and

    b. Specific reserves are similar to the reserves of estimated losses on an individual troubled loan.

The general reserve is based on the historical loss levels from credit union failures and the amount of assets in each CAMEL rating category. For each CAMEL rating category, there is a historically based probability of loss for a credit union with that rating. The more adverse the CAMEL rating, the higher the probability of loss. As a result, the migration of CAMEL ratings is important in establishing the general reserve and forecasting the trend in reserves. For example, the probability of failure for a Code 1 is very small and the probability for a Code 5 is very large. As credit unions migrate to lower ratings (higher number), the amount of the dollars in that bucket increases, requiring a higher level of general reserves. So using the ALLL analogy, it's like an indirect auto portfolio. There is an inherent historic loss level for indirect auto loans that are rated A,B,C,D, & E; and as the amount of each portfolio grows, the historic reserve related to that portfolio also grows.

For the specific reserves, once a troubled credit union looks to be a loss to the NCUSIF, NCUA develops analytics estimating the loss level. These analytics are used to establish a specific dollar reserve for that credit union and remove the assets from the general reserve pool. The estimates are based on a variety of factors including potential merger partners, asset quality, market factors in the trade area, field of membership, and quality of records. Again, back to the ALLL analogy, when a credit union is going to foreclose on a property, an ALLL reserve is carried specifically for that property based on the loan to value, the property's upkeep, costs to market the home, costs of filings, etc. None of those estimates are fixed quantities early in the process, but many of them can be estimated based on the credit unions' experience.

Estimate the Equity Level Trend

After the equity ratio is determined for a specific time, projections are developed to estimate where the ratio may be headed over the next year or more. Factors considered include the results of industry and individual credit union stress testing, the trending in credit union CAMEL ratings, the general health of the credit union system, changes in the economy, and potential credit union failures. A variety of "what-if" scenarios are conducted to develop an expected case, best case, and worse case projection.

Complete Credit Union Impact Analysis

Once the current equity level is determined and the future equity level is projected, numerous funding scenarios are developed to determine the impact of an assessment on credit unions. Part of that scenario analysis includes looking at the impact on aggregate and individual credit union earnings levels, the migration of credit unions into lower PCA categories due to the assessments, and the impact on aggregate net worth levels.

Develop Equity Level Recommendation

Finally, using the current and forward view of the equity ratio and the impact of assessments on credit unions, the optimal equity level is determined.