Questions and Answers

Second Quarter of 2016 Corporate System Resolution Costs and Assessment Range

This document addresses frequently asked questions about the NCUA Board's projected assessment range for federally insured credit unions in 2016. These assessments are one component of NCUA's broader strategy to provide funding through the Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund) to cover the costs of the corporate system resolution program, a program approved by the NCUA Board in September 2010 to address the failure of five corporate credit unions (corporates).

The corporate system resolution cost and NCUA Guaranteed Note (NGN) projections in this document represent a point-in-time estimate generated as of the end of the second quarter of 2016. NCUA updates this information on its website twice per year, based on the most recent analysis of the performance of legacy assets from the five failed corporates. The cost projections are subject to change based on asset performance, future legal recoveries, and key loss modeling variables such as unemployment, home prices, and other factors.

For clarification of terms used in this document, visit this website location:

Terms and Glossary
http://www.ncua.gov/regulation-supervision/Pages/guaranteed-notes/glossary.aspx

Table 1. Resolution Costs and Net Remaining Assessments (in Billions)[1]

Formula	a	- b	= c	- d	= e
Resolution Costs	Total Projected Resolution Costs	Credit Union Member Capital in Corporates	Remaining Projected Resolution Costs	Total Assessments Paid to Date	Net Remaining Projected Assessments over the Life of the Stabilization Fund
2010 July	$13.9 to $16.1	$5.6	$8.3 to $10.5	$1.3	$7.0 to $9.2
2011 Q2	$10.8 to $15.1	$5.6	$5.2 to $9.5	$3.3	$1.9 to $6.2
2011 Q4	$11.6 to $14.9	$5.6	$6.0 to $9.3	$3.3	$2.7 to $6.0
2012 Q2	$11.6 to $14.5	$5.6	$6.0 to $8.9	$4.1	$1.9 to $4.8
2012 Q4	$11.3 to $13.6	$5.6	$5.7 to $8.0	$4.1	$1.6 to $3.9
2013 Q2	$10.2 to $12.0	$5.6	$4.6 to $6.4	$4.8	-$0.2 to $1.6
2013 Q4	$8.4 to $9.8	$5.6	$2.8 to $4.2	$4.8	-$2.0 to -$0.6
2014 Q2	$8.2 to $10.2	$5.6	$2.6 to $4.6	$4.8	-$2.2 to -$0.2
2014 Q4	$7.9 to $9.7	$5.6	$2.3 to $4.1	$4.8	-$2.5 to -$0.7
2015 Q2	$7.5 to $9.4	$5.6	$1.9 to $3.8	$4.8	-$2.9 to -$1.0
2015 Q4	$7.2 to $8.8	$5.6	$1.6 to $3.2	$4.8	-$3.2 to -$1.6
2016 Q2	$6.4 to $8.0	$5.6	$0.8 to $2.4	$4.8	-$4.0 to -$2.4

For further discussion of resolution costs, visit this website location:

Corporate System Resolution Costs
http://www.ncua.gov/regulation-supervision/Pages/corporate-system-resolution.aspx

[1] Negative assessments represent projected refunds of both assessments paid to date and credit union member capital in corporates.

__Q1. What are the cumulative losses to date on the legacy assets once held by the failed corporates?__

The legacy assets included in the NGN portfolio have incurred $8.2 billion in losses (realized losses and implied write-downs) since the inception of the NGN program and through the second quarter of 2016. These cumulative losses exceed the $5.6 billion of credit union member capital in the failed corporates (see the last row of the column labeled "b" in Table 1), underscoring that those institutions were insolvent. At this point, the projected total lifetime losses on the legacy assets in the NGN portfolio range from $9.9 billion to $10.4 billion, meaning that about 80 percent of the total projected losses have been realized.

__Q2. What is the total projected range of resolution costs over the life of the Stabilization Fund? Why do total resolution costs differ from cumulative legacy asset losses?__

As of the second quarter of 2016, NCUA projects the total corporate system resolution costs to range from $6.4 billion to $8.0 billion. (See the last row of the column labeled "a" in Table 1.)

Costs are a few billion less than the cost of the defaults on the underlying securities because of direct and indirect legal recoveries, as well as a beneficial spread between the lower NGN coupon rates and the underlying coupon rates of the legacy assets that partially offsets some of the corporate system resolution costs. Thus, in addition to preventing losses and stabilizing the credit union system, the corporate system resolution, including the NGN program, provided a beneficial spread and preserved several billion dollars in additional legal recoveries.

__Q3. Why has the total projected range of resolution costs declined from the initial projections in 2010?__

Total costs are lower than original estimates due to a number of factors, including:

- Better than expected recovery in the housing market;
- Sustained low interest rate environment; and
- Gross legal recoveries of approximately $3.2 billion.[2,3]

Furthermore, the NGN program provides excess spread between the lower NGN coupon rates and the underlying coupon rates of the legacy assets that offsets some of the corporate system resolution costs.

__Q4. How much have federally insured credit unions collectively paid to cover corporate system resolution costs?__

Credit unions with membership shares (capital) in the failed corporates have borne losses in corporate capital investments totaling $5.6 billion. In addition, all federally insured credit unions

[2] NCUA has received $695 million of gross legal recoveries in 2016, bringing the total gross legal recoveries to approximately $3.2 billion.
[3] Uncertain legal recoveries are not included in projections, as they are inherently inestimable.

have paid Stabilization Fund assessments of $4.8 billion in total. Thus, the cumulative cost borne by credit unions through assessments and the loss of corporate capital investments is $10.4 billion. (See the last row of the columns labeled “b” and “d” in Table 1.)

The total Stabilization Fund assessment amount of $4.8 billion should not be confused with the separate National Credit Union Share Insurance Fund (Share Insurance Fund) insurance premium charges, which are not part of the corporate system resolution costs.

Q5. Why did NCUA assess $4.8 billion? How were those assessments used?

As discussed in the 2011 through 2013 Board Action Memorandums linked below, total assessments of $4.8 billion were driven by cash and contingent liquidity needs of the Stabilization Fund. There were large debt obligations of the failed corporates’ estates maturing through 2012 that had to be repaid. Even with the assessments, NCUA had to borrow from its $6 billion Treasury line, with the outstanding balance peaking at $5.1 billion in 2012.

The purpose of the assessment in 2013 was to restore more of the available borrowing line with Treasury, given the potential for unexpected liquidity needs. It was only after collection of the 2013 assessment that NCUA received the $1.4 billion JP Morgan Chase gross legal settlement, the proceeds of which allowed the agency to further pay down the Treasury borrowing.

For further detail on each of the assessments, visit these website locations:

Board Action Memorandums

http://www.ncua.gov/About/Documents/Agenda%20Items/AG20110829Item3.pdf
http://www.ncua.gov/About/Documents/Agenda%20Items/AG20120724Item5.pdf
http://www.ncua.gov/About/Documents/Agenda%20Items/AG20130725Item5.pdf

Q6. How much more in Stabilization Fund assessments does NCUA project federally insured credit unions will have to pay?

As of the second quarter of 2016, NCUA projects there will likely be no need for future assessments. In fact, the projected net assessments range of negative $4.0 billion to negative $2.4 billion indicates the possibility of a refund at the end of the Stabilization Fund, which expires in 2021. (See the last row of the column labeled “e” in Table 1.)

The assessment range is generated using projected legacy asset cash flows. (See question 7.) NCUA expects to receive these cash flows over time, but they have not been realized and could vary significantly from projections.

Q7. How are the future legacy asset cash flows projected? What are the key drivers?

The future cash flows of the legacy assets are projected by BlackRock based on proprietary models that consider key macro-economic factors, such as housing prices, interest rate environment, and unemployment level, as well as a wide variety of current characteristics and historical performance variables at the loan level.

For example, for the non-agency Residential Mortgage Backed Securities (RMBS) that represent the majority of the legacy assets, performance is projected in terms of probabilistic prepayments, defaults, and loss given borrower default. Some important inputs include borrower credit score, current combined loan-to-value (LTV) ratio, loan size, and time since last payment.

Q8. As the assessment range is negative, will credit unions receive a refund in 2016?

No. NCUA has $1.0 billion in outstanding borrowings from Treasury, as well as NGN principal and interest and other obligations of the Stabilization Fund that must be fully paid before any funds would be distributed to credit unions. This is not likely to occur prior to expiration of the Stabilization Fund in 2021 and may be later than 2021 depending upon asset disposition strategies.

Q9. Given that the net remaining projected assessments range from negative $4.0 billion to negative $2.4 billion, why is the Stabilization Fund's net position approximately $1 billion as of the second quarter of 2016?

The core financial statements of the Stabilization Fund present the assets and liabilities that belong to the fund. The core financial statements exclude Asset Management Estate (AME) assets that can be claimed by third parties, as well as assets that have been written off. The related net position as of June 30, 2016, indicates that the fund's assets exceed its liabilities at that point in time by approximately $1 billion.

In contrast, the net remaining projected assessment range is a forward-looking all-inclusive economic measure, based on expectations about the amount and timing of payments to and from the Stabilization Fund until it expires in 2021. The differences are primarily related to the following:

- Credit scenarios and asset management strategies used at the endpoints of the range;
- Exclusion of assets that can be claimed by third parties, such as the AMEs;
- Accounting rules requiring receipt of cash for written off debts; and
- Accounting treatment of projected cash flows, such as guarantee fee income and interest on Treasury borrowings.

In summary, the net position is an accounting measure at a point in time, and the projected assessment range is an all-inclusive economic measure.

Q10. What do the endpoints of the assessment range represent? What differentiating factors and assumptions are included at each end of the range?

The assessment range represents a spectrum for both the projected performance of the legacy assets once held by the failed corporates and the asset management strategy followed by NCUA to liquidate the legacy assets after the NGN deals mature.

As shown in Table 2, the optimistic scenario used for the lower end of the assessment range (negative $4.0 billion) is based on projections under both a strong future credit environment and an asset management strategy of realizing full intrinsic value over a very long period of time (hold to maturity). The pessimistic scenario used for the upper end of the assessment range (negative $2.4 billion) is based on projections under a weaker future credit environment and an asset management strategy of prompt, orderly liquidation.

The assessment range is generated using BlackRock's legacy asset cash flow projections. NCUA expects to receive these cash flows over time, but they have not been realized and could vary significantly from projections.

Table 2. Projected Net Remaining Assessment Range[4]

	Credit Environment[5]	
NGN Residual Disposition Method	Strong Credit Scenario	Weak Credit Scenario
With Residual Assets Monetized after NGN Maturities[6]	-$2.7B	-$2.4B
Without Monetizing Residual Assets after NGN Maturities[7]	-$4.0B	-$3.5B

Q11. How will NCUA determine its asset management strategy for the legacy assets of the NGN program? What are the considerations associated with each strategy?

While the assessment range represents the spectrum of asset management strategies with holding the legacy assets indefinitely at one end and selling them promptly on the other end, NCUA will most likely employ a combination of these strategies to achieve the optimal outcome for stakeholders.

When the NGNs mature, NCUA will consider all available options to dispose of the legacy assets in an orderly manner to satisfy Stabilization Fund and asset management estate obligations. Options may include, but are not limited to, the following:

- Holding the legacy assets to maturity.
- Selling the legacy assets into the market.
- Re-securitizing the remaining expected cash flows from the legacy assets in a manner similar to the NGN Program, but without an NCUA guarantee.

To do this, NCUA will perform a bond-by-bond analysis as the legacy assets become available for active management to determine the appropriate strategy for each security, while also

[4] Point in time estimates. Amounts remaining once all other senior obligations met. Negative values represent refund to credit unions and some capital note holders.
[5] Defined by forecasted macroeconomic conditions including underlying asset prepayment, default, and severity rates.
[6] Future projected legacy asset cash flows discounted at forward interest rates at valuation date.
[7] Assumes re-securitization or holding of legacy assets for maturing NGNs funded at NCUA Guaranteed Note rates.

recognizing NCUA's duty to repay Treasury as soon as practical. Considerations will include such factors as:

- Differences between market value, intrinsic value, and par value.
- Remaining expected life of the asset.
- Legal remedies in progress as well as potential future legal remedies.
- Risk involved with holding the security over the long term.

Q12. What is the expected timing with respect to each strategy? When would potential refunds be paid?

The majority of the NGN deals will not mature until 2020 and 2021, which is the earliest that the NGN program could be concluded and any remaining proceeds from the sale of legacy assets could begin to be refunded to credit unions.

The prompt, orderly liquidation strategy of the legacy assets would result in an end to the need to oversee the legacy assets, a reduction in risk, and a quicker refund. However, the estimated projected refund would be lower under this strategy, as represented by the upper end of the projected remaining net assessment range.

A strategy of holding the legacy assets until they naturally pay down would take until 2038 to realize all the underlying cash flows. Uncertainty and risk related to realization of the projected values would remain for a long period. However, the nominal projected amount of the refund could be greater under this strategy, as represented by the lower end of the assessment range.

Q13. Once Treasury and the NGN investors have been repaid, how will residual cash flows be allocated between refunds of assessments paid to date and credit union member capital in corporates?

Allocation of legacy asset cash flows and other recoveries must follow the mandated payout priorities for involuntary liquidation for each AME of the failed corporates, as listed below.[8]

A1 – Secured Creditors
B1 – Liquidation Expenses
B2 – Wages and Salaries Expenses
B3 – Taxes Due to the Government
B4 – Debt Due to the Government
B5 – General Creditors
B6 – Repayment of Share Insurance Payouts
B7 – Membership Capital of Corporate Credit Unions
B8 – Secondary Capital Accounts
B9 – Paid-in Capital

[8] 12 C.F.R. § 709.5

Cash is advanced during the liquidation process to each of the AMEs. The cash is repaid to the Stabilization Fund according to the payout priority schedule. The Stabilization Fund has actual or contingent claims at the B1, B4, and B6 level, depending on the reason cash was advanced to the AMEs.

Substantially all of the remaining claims at the B1 to B6 level in the payout priority are due to the Stabilization Fund, so as the residual cash flows are received by the AMEs, they flow to the Stabilization Fund. These funds then become available for potential refund of assessments to credit unions, after Treasury, the NGN investors, and all other obligations of the Stabilization Fund have been met.

Once an individual AME's residual cash flows have fully repaid its liquidation expenses and all other debts owed at levels A1 through B6, refunds of capital may occur at levels B7 through B9.

Q14. How are losses allocated to each AME? How much are the projected refunds to the capital note holders of each AME? How do these compare to pre-failure capital?

Losses are allocated based on the amount and performance of the specific legacy assets owned by each AME. As such, the projected refunds or recoveries will vary significantly across the AMEs due to their differing circumstances. Table 3 and Table 4 provide the approximated losses and projected recoveries for each AME as of the second quarter of 2016.

Table 3. AME Losses and Projected Recoveries (Strong Credit Scenario in Billions)[9]

	A	B	C	D	E	F	G	H	I
Asset Management Estate	Corporate Capital Pre-Failure	Depleted Member Capital	Corporate Assets Pre-Failure	Legacy Asset Realized Losses[10]	Projected Amount Not Repaid[11]	Projected Recovery to Capital Note Holders	Pre-Failure Capital Lost (%) ((A-E-F)/A)	Member Capital Recovered (%) (F/B)[12]	Total Projected Losses Realized (%)[13]
US Central[14]	$1.97	$1.99	$26.12	$2.30	$0.00	$0.81	59.1%	40.6%	84.7%
WesCorp	$1.95	$1.14	$17.41	$5.94	($3.34)	$0.00	271.7%	0.0%	96.1%
Members United	$0.87	$0.57	$7.10	$0.28	$0.00	$0.31	64.8%	53.3%	87.4%
Southwest	$0.73	$0.40	$9.15	$0.32	$0.03	$0.46	32.9%	100.0%	82.5%
Constitution	$0.12	$0.07	$1.21	$0.10	$0.00	$0.00	99.2%	1.4%	85.2%
Total	$5.63	$4.17		$8.94					

[9] Generated using projected legacy asset cash flows that have not been realized. Actual cash flows could vary significantly from projections.
[10] Losses on both securitized and un-securitized legacy assets since conservatorship.
[11] Cash advances made by the Stabilization Fund to the AMEs that have not been repaid.
[12] Member capital recoveries are limited to 100% of depleted member capital.
[13] Total lifetime legacy asset losses (realized plus projected) range from $9.9 to $10.4 billion.
[14] Includes the $1.0 billion capital note provided by NCUA that is senior in the payout priority to member capital.

Table 4. AME Losses and Projected Recoveries (Weak Credit Scenario in Billions)[9]

	A	B	C	D	E	F	G	H	I
Asset Management Estate	Corporate Capital Pre-Failure	Depleted Member Capital	Corporate Assets Pre-Failure	Legacy Asset Realized Losses[10]	Projected Amount Not Repaid[11]	Projected Recovery to Capital Note Holders	Pre-Failure Capital Lost (%) ((A-E-F)/A)	Member Capital Recovered (%) (F/B)[12]	Total Projected Losses Realized (%)[13]
US Central[14]	$1.97	$1.99	$26.12	$2.30	$0.00	$0.00	100.0%	0.0%	77.4%
WesCorp	$1.95	$1.14	$17.41	$5.94	($3.82)	$0.00	296.6%	0.0%	93.7%
Members United	$0.87	$0.57	$7.10	$0.28	$0.00	$0.17	80.8%	29.0%	79.4%
Southwest	$0.73	$0.40	$9.15	$0.32	$0.03	$0.32	52.1%	78.7%	74.3%
Constitution	$0.12	$0.07	$1.21	$0.10	($0.01)	$0.00	108.9%	0.0%	78.0%
Total	$5.63	$4.17		$8.94					

As the tables show, four of the AMEs are projected to receive a refund in the strong credit scenario. However, in the weak credit scenario, only two of the AMEs are expected to receive a refund. If the capital holders of the AMEs do receive a capital refund, it will most likely be a fraction of the original capital lost, as shown in column H. That is, the member capital holders would receive a proportional share of their full claim.

Q15. Why do the financial statements for the Stabilization Fund show a smaller net assets number than the combined financial statements of the AMEs?

The AMEs of the failed corporates hold more assets than the Stabilization Fund. The AMEs are legally separate entities in which NCUA holds a fiduciary responsibility to third-party claimants (such as general creditors, member capital holders). Assets of the AMEs are managed for the benefit of claimants. The Stabilization Fund is the largest claimant, primarily due to payments it made on NCUA guarantee programs (such as Temporary Corporate Credit Union Liquidity Guarantee Program, Temporary Corporate Credit Union Share Guarantee Program, and NCUA Guaranteed Notes program).

In its financial statements, the Stabilization Fund can only recognize a net claims receivable where recovery is probable. In addition, accounting rules limit recognition of recovery where certain assets have been written off by the Stabilization Fund (such as $1 billion capital note to U.S. Central). The Stabilization Fund's core financial statements only reflect the assets and liabilities that belong to the government. In essence, the core financial statements for the Stabilization Fund exclude AME assets that can be claimed by third parties, as well as assets that have been written off. Note 13, Fiduciary Activities, to the Stabilization Fund financial statements includes all of the economic activity of the AMEs.

Q16. What is the Stabilization Fund assessment range for 2016? What is the timetable for announcing, billing, and collecting assessments?

At the November 2015 NCUA Board meeting, the agency announced there would be no Stabilization Fund assessment for 2016. In addition, as long as both ends of the range remain negative, no future assessments are likely. However, if adverse conditions develop, the NCUA Board may have to consider an assessment.

The timetable for assessments has generally worked as follows: the Board determines the assessment range in November of the preceding year, announces the exact amount of any assessment the following July, bills for the assessment in August, and collects the assessment in September and October. Future NCUA Boards can change this timetable at their discretion.

Q17. How many more years will federally insured credit unions have to pay Stabilization Fund assessments?

As long as both ends of the remaining assessment range remain negative, no future assessments are likely. However, when setting the annual Stabilization Fund assessment, the NCUA Board will determine the plan to manage potential assessments over time, weighing legacy asset performance, public policy considerations, interest and principal payments to the Treasury, legal recoveries, and credit union performance, among other factors.

Q18. Why does NCUA need to borrow from the U.S. Treasury for the Stabilization Fund? How will the remaining borrowings be repaid?

NCUA can and has used funds borrowed from the Treasury to manage the costs of the corporate system resolution program. These costs are driven by losses on the legacy assets, management and disposal of other assets acquired in liquidation, bridge corporate transition expenses, interest on borrowings, expenses associated with monitoring the re-securitized legacy assets, and other liquidation costs.

Due to better performance of the legacy assets in an improving economy, a number of significant legal recoveries, and the absence of short term cash obligations, NCUA did not borrow from the U.S. Treasury in 2013, 2014, or 2015. However, NCUA may need to borrow again when NGN maturity payments begin.

NCUA's corporate system resolution program ensures there is no loss to the taxpayer; all losses are and will be borne by federally insured credit unions. Therefore, in order to repay the Treasury borrowings, which stand at $1.0 billion as of June 2016, NCUA may use:

- proceeds from the sale of remaining assets of the failed corporates,
- legal recoveries,
- residual value remaining from the legacy assets collateralizing the NGNs, and
- periodic credit union assessments.

Following the May 2016 repayment of $700 million, NCUA owes $1.0 billion to the Treasury at an adjustable interest rate (0.48 percent as of June 2016) tied to the 1-year Treasury rate. For a complete history of Treasury borrowings, repayments, and associated interest expense, visit this website location:

Borrowing Costs

http://www.ncua.gov/regulation-supervision/Pages/corporate-system-resolution/borrow-cost.aspx

Q19. How will lawsuits NCUA has filed against Wall Street firms and any related settlements or recoveries affect the Stabilization Fund and credit union assessments?

The impact depends on the nature of the settlement or recovery. If proceeds are received by the legacy asset trusts, they will be distributed to individual bond-level certificate holders as specified by deal documents. In this situation, the cash flows from the legacy assets will increase, but the value received will not necessarily be dollar for dollar.

If proceeds are received by NCUA, they will directly reduce the net amount NCUA is required to assess credit unions. However, proceeds received by NCUA are first used to repay Treasury borrowings and any other obligations of the Stabilization Fund. Thus, they do not necessarily accelerate the timing of potential refunds.

NCUA has received $695 million in gross recoveries in 2016, bringing the total gross recoveries from the pursuit of legal claims against securities underwriters to approximately $3.2 billion, as shown in Table 5.

Table 5. Gross Legal Recoveries (in Billions)

Counterparty	Amount	Date Announced
Deutsche Bank Securities	$0.145	November 14, 2011
Citigroup	$0.021	November 14, 2011
HSBC	$0.005	March 12, 2012
Bank of America	$0.165	April 2, 2013
JP Morgan Chase	$1.417	November 19, 2013
Royal Bank of Scotland	$0.130	September 16, 2015
Barclay's Capital	$0.325	October 19, 2015
Wachovia	$0.053	October 19, 2015
Morgan Stanley	$0.225	December 10, 2015
Goldman	$0.575	April 11, 2016
Credit Suisse	$0.050	April 12, 2016
UBS	$0.070	April 15, 2016
Total	**$3.180**	

Q20. How often will NCUA update the actual losses and future projections? Where can I find these updates?

NCUA posts updates on the NCUA website at least twice per year, typically in April and November. For updates and more detailed information, visit these website locations:

Corporate System Resolution Costs

http://www.ncua.gov/regulation-supervision/Pages/corporate-system-resolution.aspx

NGN Program Information

http://www.ncua.gov/regulation-supervision/Pages/guaranteed-notes.aspx