

Big Bang: Can Your Strategic Plan Accommodate The Special Assessment in 2010 and Beyond?

By Peter Duffy

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As credit union management and boards learn more about the amount of toxic assets in corporate and natural person credit unions, their conclusion about assessments changes from "something we have to live with" to "we can't live with that."

Becoming better informed has not been easy because credit union managements have been frustrated by an opaque process and its uncertain outcome. Focused primarily on running a financial institution, many CUs have given up trying to understand. Further frustrating management is the fact that assessments will not be announced until September. Thus, healthy credit unions have to wait to see how much it will cost them to pay for the mistakes of others. Meanwhile, the hope that the economy experiences a V-shaped recovery leading to a marked improvement in damaged assets is fading. Years from now, the final tally will be known, but it will be too late.

In May 2009, the Federal Reserve Board and the NCUA completed their respective Treasury Supervisory Capital Assessment stress tests. The Fed publicly released its analysis and discussed it with the banks. The NCUA did not release its stress test (nor was US Central's 2008 financial report released) until September 2009. (I spoke at five credit union conferences in the second half of 2009 and asked approximately 800 attendees if anyone had heard of the CU stress test. Three had heard of it.)

This is why several large CUs asked us to help them determine the total size of the risk in order to consider what changes should be made to their strategic plans. Both the NCUA's stress test and our own analysis point to a potentially huge total resolution (assessment) that will be far greater than 100 bps. Indeed, after a more thorough review of our research, credit unions expect the top end of the NCUA's announced 2010 range—40+ bps—as a reality for years to come.

We can't be sure how large due to the lack of detail regarding investments in USC and Wescorp, the methodology used for the NCUA stress test, the cost of troubled mergers borne by the NCUSIF and the (not released) 2008 NCUA financials.

As a result of our continuing analysis, many healthy CUs are discussing strategic alternatives (and everything is on the table) because healthy banks are accessing capital and using it to acquire competitors and branches at rock-bottom prices. These CUs know that incremental earnings are much more a function of asset growth (not margin) and believe their credit union's value proposition is threatened by this troubling trend. The market (consumers and competitors) won't be sympathetic to crippling assessments, deserved or not.

What is clear is that the relative risk in banks and credit unions is not the same. The CAMEL 4 and 5 banks have assets equal to 3% of total bank industry assets, compared to 5.5% for similarly rated natural person credit unions. This figure does not include the corporate credit unions and their \$16 billion in unrealized losses, according to FDIC and NCUA statistics. Also, the insurance fund's exposure to the too big to fail institutions is greater in CUs than in banks because the FDIC is shielded by TARP and by the shareholders and debt holders of many banks. Creditors and investors stand first in line to lose their investment before the FDIC takes losses.

For example, the top 10 banks are all public companies and represent 51% of bank industry assets (therefore pay roughly 51% of total industry insurance) and accessed TARP in 2009. By contrast, USC and Wescorp represent a direct lien on credit union capital and have already hit the NCUSIF for billions.

The U.S. economic calamity is the result of total system failure, including the consumer running up household debt equal to 125% of disposable income, according to Department of Commerce statistics, leading to a toxic asset problem that is bigger than the resources available and will take years to correct. As a result, perhaps we're headed for a current-day version of the Resolution Trust Corp.. Let's call it Plan B. Plan B would recognize healthy and well-managed banks, thrifts and CUs equally as they partner with the FDIC in the cleaning up of America's lending institutions.

The healthy institutions and the FDIC would enter into mutually fair and transparent loss-share agreements. Healthy CUs above a certain asset size might be transitioned to a mutual savings bank charter (much like the Treasury Blueprint for financial regulatory reform, previously announced in spring 2008) since no mechanism exists for secondary capital, often a part of FDIC deals.

Small, healthy credit unions could be left alone and retain their credit union charters if they wished.

Further justification for Plan B is the apparent lack of a resolution for corporate and natural person credit union toxic assets other than either a taxpayer bailout or the draining of capital from some of the best community lenders in America—large, healthy credit unions. Neither scenario helps the economy recover.

Some credit unions worry that Plan B will take too long to come to market, such as with the resolution of the S&L debacle in the late 1980s, resulting in franchise-crippling assessments. For example, Treasury Secretary Timothy Geithner recently told lawmakers, "We've just got a lot of things going on and...to do [GSE overhaul] right, we wanted to go through a process of more careful consideration." The Treasury hasn't completed its analysis of the GSEs, let alone submitted a plan 18 months after conservatorship of FNMA and FHLMC.

Another worry is that there is no Plan B at all.

Healthy credit unions, with a better understanding of the risk and interested in protecting their franchise, are not counting on divine intervention or a V-shaped recovery. They're developing contingency plans.

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