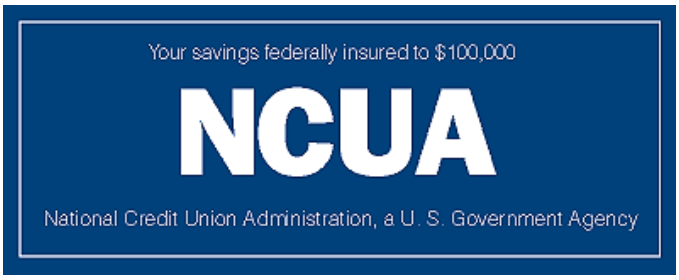


DEPOSIT INSURANCE SYSTEM LEGISLATION ANALYSIS

Office of the Chief Financial Officer

April 8, 2002

Attached is an analysis of the projected impact to the NCUSIF given proposed legislative changes to the current level of federal deposit insurance coverage. The analysis presents 4 scenarios that project the impact of legislation, including shares shifting from uninsured to insured, and attracting new deposits. The difference between the 4 scenarios relates to the timing of when the doubling of IRAs occurs – 1 year, 2 years, 5 years, or 10 years.

Attachment

DEPOSIT INSURANCE SYSTEM LEGISLATION ANALYSIS

Background

New legislation has been introduced to overhaul the deposit insurance system. The measures include increasing the current coverage limit for insured deposits above $100,000, approximately doubling the coverage limits for individual retirement accounts (IRAs), indexing future coverage limits to inflation periodically, and modifying the insurance fund's ratio of reserves to insured deposits to a new range.

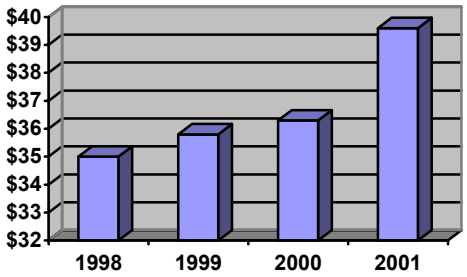
Deposit Insurance Increase

Current legislation proposes increasing deposit insurance from $100,000 to approximately $130,000 for regular deposits, and about double that amount, or $250,000, for IRAs.

IRA Deposits Could Increase Substantially

The most significant impact of increasing deposit coverage would likely be on IRA deposit balances. An increase in the amount of deposit insurance coverage would likely spur an inflow of IRA deposits. It is estimated that IRA balances could eventually double in 10 years or less as a result of an increase in deposit insurance. Currently, IRA deposits account for $39.6 billion as of the last full Call Report cycle dated December 2001.
[See Figure 1]

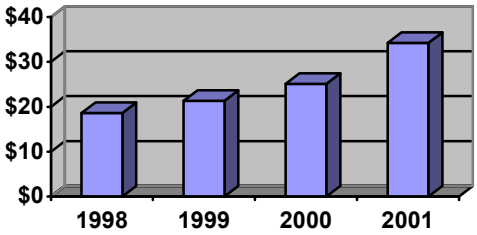
[Figure 1]
IRA/KEOGH Accounts (in billions)



Uninsured Shares Become Insured Shares

In addition, an increase in deposit insurance would likely cause some uninsured shares to become insured shares. Currently, deposit insurance covers the first $100,000; deposits in excess of $100,000 are currently not insured. However, by increasing the insurance above $100,000, a portion of the previously uninsured shares would immediately become insured. It is estimated that the impact would approximate 10 percent of the current uninsured share deposits. As of December 31, 2001, uninsured shares did equal $34.2 billion. **[See Figure 2]**

[Figure 2]
Total Uninsured Shares & Deposits (in billions)



New Share Deposits Attracted

A higher level of deposit insurance could attract new share deposits. It is estimated that insured share deposits would increase by about 1 percent.

Increased Deposits Could Dilute the NCUSIF Equity Ratio

The equity ratio was 1.25 percent as of December 31, 2001. By year-end 2002, the equity ratio is projected to be 1.32 percent.

New legislation could result in an inflow of deposits, and result in a number of different scenarios that impact the equity ratio. The increased deposits would create larger insured shares, which is the denominator in the equity ratio. The equity ratio of the insurance fund's capitalization includes: insured credit unions' 1 percent capitalization deposits and retained earnings of the Fund, divided by the aggregate amount of insured shares in all insured credit unions. Thus, an inflow of deposits would dilute the equity ratio below the current level.

The reserve requirement was changed in 2000 due to the provisions of HR 1151 (the Kanjorski-LaTourette Credit Union Membership Access Act signed into law on August 7, 1998, P.L. 105-219) **[See Figure 3]**, which required the "normal operating level", an equity ratio specified by the Board, to be not less than 1.2 percent and not more than 1.5 percent. In recent years, it has been NCUA's goal to maintain a 1.30 percent equity ratio. For 2002, the normal operating level was set at 1.30 percent prior to the beginning of the calendar year.

[Figure 3] President Clinton signed HR 1151 into law on August 7, 1998.

Given a ratio below 1.20 percent, the NCUA Board would be ***required*** by the FCU Act Sec. 1782a Sec. 202(c)(1)(A)(2)(C) to assess a premium to restore the equity ratio to 1.20 percent.

In addition, the FCU Act states that the Board ***may*** assess a premium to restore the equity ratio to 1.30 percent. Given a ratio of between 1.20 and 1.30 percent, an assessment may be required. This insurance premium would restore the equity ratio to the normal operating level of 1.30 percent, and allow a potential future dividend.

In either scenario, a ratio of less than 1.30 percent could trigger an insurance premium assessment, and would certainly result in no dividend payout.

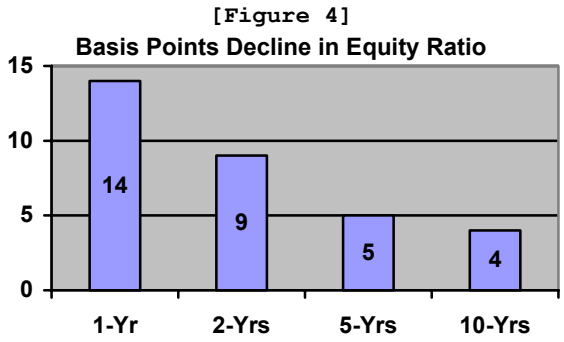
Scenarios

There is a range of scenarios that could occur as a result of increasing deposit insurance coverage. Insured share deposits could increase immediately (over a 1-year period), or over a range of years. Various growth scenarios are analyzed below.

Impact on Equity Ratio

An increase in deposit insurance coverage, could fuel additional share deposit growth of 12 percent or over $82 billion over a period of years. This share growth would dilute the equity ratio. The share growth scenario over a period of 1, 2, 5 or 10 years, and the resulting basis point decline in the equity ratio for 2002 are shown **[See Figure 4]**:

[Figure 4]



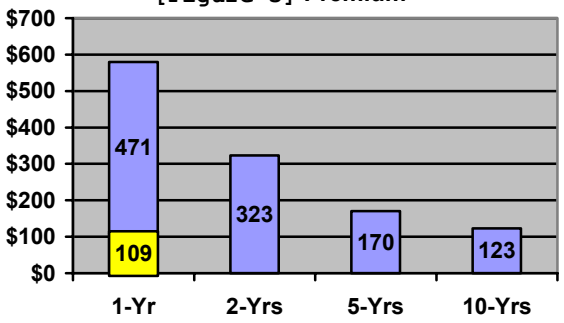
- 1-year scenario = 14 basis points decline in equity ratio
- 2-year scenario = 9 basis points decline in equity ratio
- 5-year scenario = 5 basis points decline in equity ratio
- 10-year scenario = 4 basis points decline in equity ratio

Annual Deposit Adjustments

Credit unions make annual deposit adjustments so that their investment in the NCUSIF is always equal to 1 percent of insured shares. As a result of new legislation triggering additional insured shares, the incremental impact on the deposit adjustment is 25 percent higher or $800 million (about 1 percent of the additional insured share growth) over the next 10 years. These funds invested in the NCUSIF by individual credit unions would not be available for member loans and other revenue generating investments by the credit unions. However, these funds will serve to increase the NCUSIF by the estimated amount of $800 million over the next 10-year period. This increase in the NCUSIF will increase earnings on the fund by $290 million as the funds are invested, thus mitigating somewhat the dilution of the equity ratio over the 10-year period.

Premium Assessment

[Figure 5] Premium



In only one of the scenarios provided would an insurance premium be required. In the unlikely event that all share growth occurs in year 1, the NCUA Board would be *required* to assess an insurance premium of $109 million or 0.02 percent of insured shares **[See Figure 5]**. This would be required to restore the equity ratio to 1.20 percent. An optional additional assessment of $471 million or 0.10 percent of insured shares would be necessary to restore the equity ratio to 1.30 percent and allow a potential future dividend **[See Figure 5]**.

In the remaining growth scenarios (2, 5, and 10 years), the equity ratio would fall below 1.30 percent, but stay above 1.20 percent. In this circumstance, the law provides that the NCUA Board *may* assess an insurance premium, in order to restore the equity ratio to 1.30 percent. Should the NCUA Board elect to assess a premium, the amount of premium by year, to restore the equity ratio to 1.30 percent would be **[See Figure 5]**:

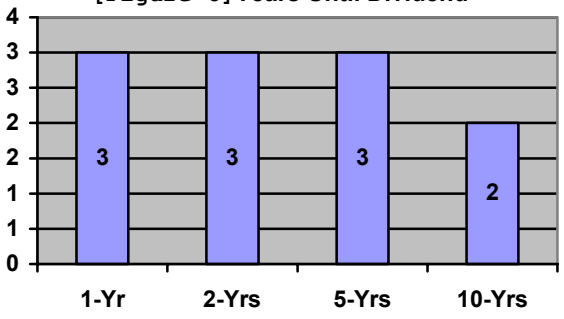
- 2-Years Scenario = Premium of $323 million or 0.07% of insured shares
- 5-Years Scenario = Premium of $170 million or 0.04% of insured shares
- 10-Years Scenario = Premium of $123 million or 0.03% of insured shares

After 10 years, all 4 scenarios result in an equity ratio that is about 6 basis points lower than if the legislation had no impact.

Under the Federal Credit Union Act, any insurance premium assessment would be charged to all federally insured credit unions since premiums are not risk-based. Insurance premiums are expenses to credit unions and therefore, would have some impact on their "bottom line."

Dividends

[Figure 6] Years Until Dividend



In all four scenarios, no dividend would be paid at the end of 2002. The approximate number of years to restore the equity ratio, and allow a dividend is shown **[See Figure 6]**:

- 1-Year Scenario = 3 Years
- 2-Years Scenario = 3 Years
- 5-Years Scenario = 3 Years
- 10-Years Scenario = 2 Years

Other Issues

An increase in share deposits will require credit unions to manage these inflows within their investment portfolios. Current investment policies and procedures at credit unions are considered adequate to accommodate the potential inflows.

As a result of an insured deposit limit, credit unions could receive inflows from Public Unit Accounts and other non-member deposits. Our analysis indicates credit unions currently have the ability to absorb these inflows. Non-member deposits are relatively small and currently equal $1.3 billion or 0.3 percent of total savings and deposits.

Conclusion

Although the exact impact is unknown, an increase in deposit insurance coverage would likely spur an increase in share deposit growth. This share deposit growth could occur all at once (in a 1-year time period), although not likely, or more likely over a number of years. When share deposit growth occurs over a shorter period of time, insurance premium assessments become more likely and result in higher dollar amounts. These premiums are required when necessary to restore the equity ratio to 1.20 percent, and may be assessed to restore the equity ratio to 1.30 percent. It should be noted that premiums impact all federally insured credit unions since premiums are not risk-based and are classified as an expense for the individual credit union. Finally, any scenario would likely result in no dividends for 2 to 3 years; the time it would take to restore the equity ratio to 1.30 percent.