**Your Credit Union's Contingent Liquidity
and the Central Liquidity Facility
Frequently Asked Questions**

August 2012

The Central Liquidity Facility (CLF) is a special NCUA-operated lending facility for the credit union industry. Currently, whether aware of it or not, approximately 6,019 federally insured credit unions have indirect access to the CLF. Indirect access is a byproduct of membership in a corporate credit union that is in turn part of the agent group headed by U.S. Central Bridge Corporate Federal Credit Union (U.S. Central Bridge). The CLF can serve as a 100% reliable emergency liquidity backstop source for member credit unions in the event of a financial crisis.

On July 24, 2012, the NCUA Board issued for public comment a targeted proposed rule on the need for federally insured credit unions to have contingency funding plans that clearly set out strategies for addressing liquidity shortfalls in emergency situations. The proposed rule would require credit unions over $100 million in total assets to have access to a backup liquidity source. The public comment period on this proposed rule runs until September 28, 2012.

This proposed rule and the coming closure of U.S. Central Bridge makes the discussion about the future of the CLF timely. This set of Frequently Asked Questions responds to a need for greater awareness and understanding of how the CLF can fit into a credit union's liquidity risk management.

Will my credit union have access to the CLF in the future?

U.S. Central Bridge currently holds CLF stock on behalf of the whole agent group, but U.S. Central Bridge will wind down and close by October 31, 2012. When U.S. Central Bridge redeems CLF stock as part of the closure process, *credit unions currently enjoying CLF access through the agent relationship will no longer have this source of backup liquidity*.

As part of its orderly resolution, U.S. Central Bridge will discontinue its role as CLF agent-group representative in conjunction with the wind down of operations. Accordingly, the existing agent group arrangement will also terminate. When that occurs, natural person credit unions that are not regular CLF members will need to evaluate the possibility of establishing new membership arrangements, as either a regular member or with a new agent, such as another corporate credit union, if they intend to utilize the CLF as their contingent liquidity source. The closure of U.S. Central Bridge on October 31, 2012, necessitates a corresponding redemption of CLF stock, which NCUA expects to occur no later than October 25, 2012.

Can my corporate credit union continue to serve as my liquidity backstop?

Possibly. It depends on your corporate credit union. As corporate credit unions have changed their business strategies and in some cases shrunk assets to meet capital requirements, their access to liquidity markets has diminished. Their ability to fund large lines of credit to their members has correspondingly diminished. Additionally, during the widespread instability experienced during the recent financial crisis, even healthy financial institutions (including corporate credit unions) used emergency liquidity facilities when lending institutions became risk adverse, limiting a financial institution's access to traditional liquidity sources.

Could my corporate credit union facilitate access to the CLF for me?

Possibly. Again, it depends on your corporate credit union. Some corporate credit unions may choose to become agents by subscribing to CLF stock on behalf of their natural person credit union members.

NCUA is working with corporate credit unions to allow for an orderly transfer of the corresponding portion of CLF capital stock now held by U.S. Central Bridge. When the existing agent-group arrangement with U.S. Central Bridge terminates, those natural person credit unions without regular (direct) membership will not have CLF access for contingent liquidity unless their corporate credit union has purchased stock on their behalf. Corporate credit unions have long facilitated CLF loan transactions through their duties as agent intermediaries.

Even if a corporate credit union ceases to be part of a CLF agent group, it may still serve in a correspondent capacity to advise its members and assist them with questions about joining the CLF and/or applications for liquidity advances.

Could the Federal Reserve serve as my new federal liquidity backstop?

Yes. A credit union can use the Federal Reserve Discount Window to meet its contingent liquidity needs. However, only credit unions holding liabilities subject to reserve requirements may establish borrowing privileges at the Federal Reserve.

It can take up to a week for an institution with no Federal Reserve relationship to file the necessary paperwork and pre-position collateral to borrow. Purchasing stock in a regional Federal Reserve Bank is not necessary to establish borrowing privileges at the Discount Window. Accessing the window requires filing an application with a Federal Reserve Bank and pre-positioning collateral. For a complete discussion of the process of accessing the Discount Window, see http://www.frbdiscountwindow.org/index.cfm.

Is the NCUA considering including Federal Home Loan Banks (FHLBanks) as entities that can serve as "emergency liquidity providers" to satisfy the proposed requirement for pre-arranged access to emergency liquidity?

No. The Board has proposed that only the CLF or the Federal Reserve Discount Window satisfy this requirement.

The Board believes it is important to draw a distinction between ordinary funding and emergency liquidity. Well-diversified sources of external funding are central to sound liquidity risk management. FHLBank membership is certainly one way a credit union can diversify to guarantee a smooth flow of funding for ordinary operations.

Another key element of liquidity risk management, however, is reliable emergency funding. Institution-specific issues and market conditions can combine to quickly deplete a credit union's on-balance sheet liquidity reserve. In such situations, the CLF and the Discount Window stand ready to lend on pre-specified terms as long as a credit union meets minimal borrowing standards and possesses eligible collateral.

The FHLBanks can and do offer short-term loans, in addition to longer-term advances. The Board recognizes, however, that the FHLBanks are private institutions that are not obligated and may not be able to meet emergency liquidity demands in the same way the CLF and the Discount Window are statutorily designed to do. Accordingly, the Board has not included FHLBank membership as an emergency liquidity option in the proposed rule. The Board notes, however, that FHLBanks can provide valuable services to credit unions of all sizes and encourages credit unions to consider the merits of FHLBank membership.

In any event, only members of an FHLBank can borrow from an FHLBank, and just under 15 percent of natural person credit unions are FHLBank members. These credit unions tend to be large, with a considerable mortgage-lending business. Smaller credit unions tend to have fewer assets backed by real estate, making FHLBank membership far less attractive.

If my corporate will not be a CLF agent, could my credit union become a direct member of the CLF? How much would it cost?

One option for a federal liquidity backstop is to become a direct member of the CLF, as 96 credit unions are today.

There is no explicit membership fee, but a credit union must subscribe to the capital stock of the CLF and complete certain documentation. The required stock subscription amount equals 1/2 of 1 percent of the credit union's paid-in and unimpaired capital and surplus. One-half of this sum must be sent to the CLF (it is "paid in") while the remaining portion is on call by the NCUA Board. In return, the CLF pays a dividend based on its earnings and short-term interest rates. In 2011, dividends averaged 16 basis points.

What is the CLF? How does the CLF work?

The CLF is an NCUA-operated corporation designed to enhance the financial stability of credit unions by providing liquidity for short-term, seasonal, and long-term needs. A mixed-ownership government corporation, the CLF is somewhat similar to the Federal Reserve Discount Window.

Historically, the CLF has focused on providing short-term collateralized loans to safe and sound natural person credit unions. During recent financial turbulence, the CLF played a more systemic role and made a broader range of loans to ensure a smooth flow of financial services to credit unions and their members, just as the Federal Reserve Discount Window provided a broader range of liquidity services for other financial institutions and their customers.

Congress created the CLF in 1979. At the time, natural person credit unions could not borrow from the Discount Window. Therefore, they needed a liquidity backstop. Although the Depository Institutions Deregulation and Monetary Control Act of 1980 opened the Discount Window to all depository institutions, most natural person credit unions chose not to establish a borrowing relationship with the Federal Reserve, opting instead to satisfy their short-term liquidity needs through the CLF or their corporate credit union.

As of March 31, 2012, only 5.9 percent of federally insured natural person credit unions had filed the necessary paperwork and pre-pledged collateral to borrow at the Discount Window.

What is the formal structure of the CLF?

The CLF operates within NCUA and is managed by the NCUA Board. The Director of the Division of Capital and Credit Markets in NCUA's Office of Examination and Insurance serves as the CLF President and reports directly to the NCUA Board.

The CLF belongs to member credit unions. Membership is voluntary and open to all natural person credit unions—federally or privately insured—willing to purchase the statutorily prescribed amount of CLF stock (regular members). A credit union or group of credit unions primarily serving other credit unions, such as a corporate credit union, may also purchase stock on behalf of all of its natural person credit unions members (agent members).

How does CLF stock ownership work?

As noted above, CLF membership is open to all natural person credit unions willing to purchase the statutorily prescribed amount of CLF stock. The prescribed amount of CLF stock is 1/2 of 1 percent of the natural person credit union's paid-in and unimpaired capital and surplus, of which at least one-half must be transferred to the CLF. The

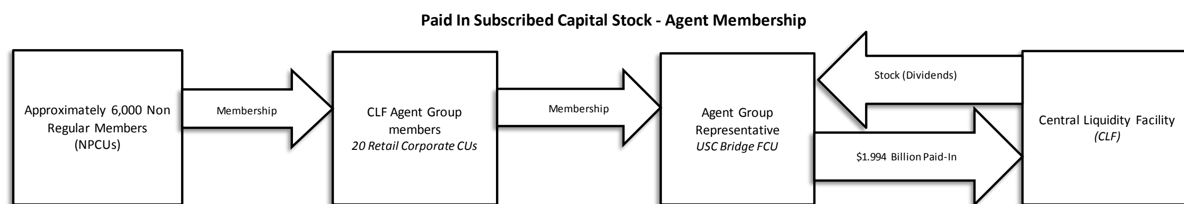
natural person credit union must hold the remainder pending call by the NCUA Board. Natural person credit unions holding CLF stock directly are called “regular” members.

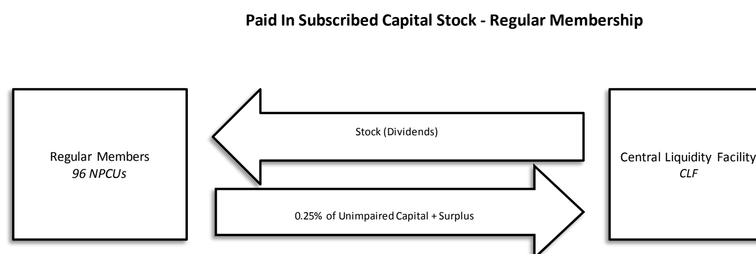
A credit union primarily serving other credit unions (such as a corporate credit union) can also join as an agent on behalf of their natural person credit union members by purchasing CLF stock equal to 1/2 of 1 percent of all its member paid-in and unimpaired capital and surplus. The amount of stock is adjusted annually to reflect changes in member balance sheets. Stockholders may earn a quarterly dividend, which CLF management sets based on earnings and short-term interest rates.

As of March 2012, 93 out of roughly 7,000 federally insured credit unions were regular members of the CLF. Additionally, three privately insured natural person credit unions were regular members for total regular membership of 96 credit unions. Today, these regular members hold roughly 4 percent of outstanding CLF stock.

Roughly 6,000 other natural person credit unions have access to the CLF through 21 agent members, the largest of which is U.S. Central Bridge. NCUA has announced plans to liquidate U.S. Central Bridge by October 31, 2012.

The following diagrams illustrate the differences between regular membership (directly owning CLF stock) and agent membership (owning stock on behalf of other natural person credit unions). Under the agent group arrangement, the agent group representation acquires and holds the stock for natural person credit unions. Dividends earned on the stock are paid to the agent or agent group representative (U.S. Central Bridge). Under the regular member arrangement, individual natural person credit unions acquire and hold the stock.





How does CLF lending work?

CLF loans are designed to help natural person credit unions meet short-term liquidity needs. CLF loans may not be used to expand the asset portfolio.

A creditworthy CLF member that has a liquidity need may request a "liquidity needs" loan at any time by submitting the required paperwork to the CLF or a CLF agent (a corporate credit union). The CLF has up to five business days to act on a loan request. The CLF determines if the liquidity-needs criteria is met and evaluates the creditworthiness of the borrowing member. Loan approval is contingent on meeting both the liquidity need and creditworthiness criteria. Once approved, CLF borrows the identical amount from the Federal Financing Bank and subsequently funds the loan to the credit union. The Federal Financing Bank is a government corporation established to centralize and reduce the cost of federal borrowing, as well as federally assisted borrowing from the public.

Like the Federal Reserve Discount Window, the CLF charges an interest rate slightly above comparable short-term market rates. Specifically, the CLF rate is the greater of the Federal Reserve primary credit rate or the Federal Financing Bank advance rate. As is the case for Discount Window loans, CLF borrowers must be creditworthy, and loans must be secured by eligible collateral.

How much in the aggregate can the CLF lend?

The CLF's lending limit is a function of how much it can borrow plus any funds it has on hand. Specifically, the CLF may lend up to 12 times total subscribed capital stock and surplus, plus any funds available from operations (such as cash and investments).

As of May 31, 2012, the CLF lending limit was roughly $46.2 billion and the CLF had no outstanding borrowings. For perspective, at March 31, 2012, federally insured credit unions collectively held $1.0 trillion in total assets. During the height of the recent financial crisis, actual CLF lending for liquidity-needs purposes peaked in October 2008 at $1.69 billion.

U.S. Central Bridge currently holds CLF stock on behalf of the whole agent group but will wind down and close by October 31, 2012. When U.S. Central Bridge redeems CLF stock as part of the closure process, the CLF lending limit could shrink by as much as $44.3 billion. Viewed another way, without an increase in direct membership, CLF lending authority will diminish to roughly $1.9 billion.

Besides liquidity needs loans, what other loans has the CLF made?

In November 2008, the NCUA Board determined expanded CLF-lending authority for "other than liquidity needs" (OTLN) was necessary and in the national economic interest. These loans—though still designed to provide natural person credit unions with funding—were broader in scope than traditional "liquidity needs" loans.

In December 2008 after receiving concurrence from the Board of Governors of the Federal Reserve System and the Secretary of the Treasury, the NCUA Board announced two temporary CLF lending initiatives—the Credit Union System Investment Program (CU SIP) and the Credit Union Homeowners Affordability Relief Program (CU HARP). The Federal Financing Bank, which the U.S. Department of the Treasury operates, funded both initiatives. The CLF began making OTLN loans under the CU SIP and CU HARP in January 2009.

The CU SIP allowed the CLF to lend to creditworthy natural person credit unions that were required to then invest the proceeds in corporate credit union notes guaranteed by NCUA (and thereby receive a guaranteed 25 basis-point spread). NCUA designed the program to help corporate credit unions maintain credit flows to their members. CLF loans under the CU SIP program reached $8.2 billion by March 2009 and remained at that figure throughout the year. By March 2010, the program had wound down and had no outstanding loans.

The CU HARP was a two-year, $2 billion program intended to reward natural person credit unions that assisted homeowners facing delinquency, default, or foreclosure. The program allowed creditworthy credit unions to borrow from the CLF and receive as much as an additional 100 basis-point spread over the cost of borrowing if they modified at-risk mortgages. CLF loans under the CU HARP program jumped to $164.0 million in January 2009 before beginning to wind down. By year-end 2010, participating natural person credit unions had repaid all CU HARP loans.

In addition to making CU SIP and CU HARP loans, the CLF advanced $10 billion to the National Credit Union Share Insurance Fund (NCUSIF) in March 2009 to stabilize the liquidity of two troubled corporate credit unions in conjunction with their being placed in conservatorship (U.S. Central and WesCorp). This loan was fully retired in October 2010.

In March 2009, total CLF lending peaked at $19.2 billion. By May 2010, total CLF lending was down to $10.1 billion—most of which was the loan to the NCUSIF. No CLF loans were outstanding as of June 30, 2012.

What does the current CLF balance sheet look like?

As of May 31, 2012, the CLF held total assets of $1.943 billion. The overwhelming majority of assets were cash and short-term investments. In fact, cash and cash equivalents accounted for 99.2 percent of total assets. The average maturity of the investment portfolio including the overnight Treasury investment was 15 days, and annualized yield was 0.09 percent.

The CLF has an investment committee that meets at least quarterly to review inflows and outflows, and update the overall investment strategy. Since April 2011, this

strategy has involved targeting very short-term maturities to afford maximum flexibility to deal with U.S. Central Bridge-related stock redemption.

Why did the NCUA Board issue a proposed rule on the need for a federal liquidity backstop?

At its December 2011 open meeting, the NCUA Board issued an advance notice of proposed rulemaking seeking public comment on a potential requirement that federally insured credit unions maintain access to a backup federal liquidity provider—a federal liquidity backstop. Subsequently, the NCUA Board issued a targeted proposed rule at its July 2012 open meeting that set forth a tiered set of liquidity risk-management requirements based upon certain credit union asset-size thresholds.

To some in the credit union industry, the rationale for the proposed rule might seem unclear at this time, in that federally insured credit unions have enjoyed large deposit inflows in the wake of the recent financial crisis. For a credit union, liquidity has two dimensions: the ability to balance inflows and outflows over time and the ability to draw on an emergency reserve when outflows unexpectedly spike relative to inflows—as can occur during a systemic liquidity event. A large pool of shares offers many benefits, but serving as an emergency liquidity reserve is not necessarily among them if the funds are invested in assets that cannot be sold quickly with little loss of value.

Absent a federal liquidity backstop, unforeseen systemic shocks could force asset "fire sales," the losses from which have the potential to turn illiquidity into insolvency. The Federal Financial Institutions Examination Council's Interagency Policy Statement on Funding and Liquidity Risk Management issued March 2010 states:

> "Recent events illustrate that liquidity risk management at many financial institutions is in need of improvement. Deficiencies include insufficient holdings of liquid assets, funding risky or illiquid asset portfolios with potentially volatile short-term liabilities, and a lack of meaningful cash flow projections and liquidity contingency plans."

As detailed in the table below, the bulk of the credit union industry has no emergency backup liquidity source beyond indirect CLF membership. Only 1.3 percent of federally insured credit unions—representing 3.4 percent of total FICU assets—belong directly to the CLF. Additionally, 5.9 percent of federally insured credit unions—representing 44.1 percent of FICU assets—have filed an application to access the Federal Reserve Discount Window.

U.S. Treasury obligations are a key alternative source of contingent liquidity as they are readily marketable, even in times of widespread economic distress. Federally insured credit unions, however, hold only 0.3 percent of assets in U.S. Treasuries, and 91.1 percent of federally insured credit unions—accounting for 60.9 percent of FICU assets—do not report holding any Treasury obligations.

Credit Union Group	Number	Percent of All FICUs	Average Assets (millions)	Percent of Total FICU Assets	Average U.S. Government Obligations to Total Assets
All FICUs	7,019	100.0%	$142.7	100.0%	0.3%
No Federal Reserve Relationship	6,602	94.1%	$84.4	55.9%	0.3%
No U.S. Government Investments	6,394	91.1%	$95.6	60.9%	0.0%
Direct CLF Member*	96	1.3%	$333.6	3.4%	0.6%

Source: Call Report data (March, 31, 2012)

The NCUA Board believes it is important to explore avenues for preserving credit union access to emergency liquidity in a world without the longstanding agent group headed by U.S. Central Bridge. Hence, the advance notice of proposed rulemaking sought industry views on establishing a new framework for the CLF, as well as other potential sources of liquidity during times of emergency. Based in part on the public comments to the advance notice of proposed rulemaking, the recently issued proposed rule refines the approach.

What would the proposed rule on emergency liquidity require?

The proposed rule on emergency liquidity incorporates a three-tiered approach, based on the size of the federally insured credit union:

- Credit unions under $10 million in assets would have to maintain a written liquidity policy approved by their board. The policy would provide a basic framework for managing liquidity and having a list of contingent liquidity sources in emergency situations.
- Credit unions with more than $10 million in assets would have to establish a formal contingency funding plan that clearly sets out strategies for addressing liquidity shortfalls in emergency situations.
- Credit unions with more than $100 million in assets would also have to demonstrate access to at least one of the following three options for a backup federal liquidity source:
  - becoming a member of the CLF;
  - becoming a CLF member through a CLF agent; or
  - establishing direct borrowing access to the Federal Reserve Discount Window.

The NCUA Board issued the proposed rule on July 24, 2012. The proposed rule is available at http://go.usa.gov/GnL. The public comment period runs until September 28, 2012.

How can I get more information about the CLF?

You can find out more information about the CLF by going to the CLF page of the NCUA web site at http://www.ncua.gov/Resources/CLF/Pages/default.aspx. The site contains a document on "How to Apply for Regular CLF Membership—A Brief Overview." In addition, the webpage has links to pertinent sections of the Federal Credit Union Act, the NCUA Rules and Regulations, and provides contact phone numbers.

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