PRIVATE SHARE INSURANCE AND DUAL CHARTERING

A report prepared for
American Share Insurance
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April 2025

EXECUTIVE SUMMARY

The dual chartering system for credit unions, in which credit unions operate with either a state or federal charter, has existed since 1934 when the first federal credit union was chartered. Prior to that, a state charter was the only option. Currently, almost 40% of credit unions operate with state charters, and they account for almost half of credit union assets and members. Dual chartering imparts substantial benefits to the credit union system, and American Share Insurance, the sole provider of private share and deposit insurance in the US, plays an important role in supporting and strengthening dual chartering.

The dual chartering system has benefits for many: state policy makers and state economies, state and federal credit unions, and the overall credit union system. The existence of state credit unions provides state policy makers a tool to tailor the provision of financial services to the unique needs of their state's constituents and economy. For state credit unions, a state charter offers local regulation and supervision, access to policy makers, greater investment authorities, more flexible field of membership regimes, a broader palate of incidental powers, lower operating fees and the possibility of board member compensation. These benefits vary from state to state. Federal credit unions benefit from greater flexibility, likely from NCUA due to the existence of a state charter alternative. The entire system benefits from the innovation that is spurred by individual states operating as laboratories for the testing and proving of better ways to supervise credit unions and to serve credit union members.

The benefits of dual chartering are enhanced by the existence of a private share and deposit insurance alternative in the form of American Share Insurance. Federal share insurance for a state-chartered credit union brings a substantial amount of additional federal regulation and supervision, for example, the requirement to be examined by both federal and state supervisors. A privately insured state credit union can more fully enjoy the flexibility provided by a state charter by not being subject to that greater federal regulation.

American Share Insurance's (ASI) value to dual charting can only exist if it is sufficiently robust to earn and maintain the trust of credit union members, state policy makers and credit union leaders. In ASI's almost fifty years of operation, no credit union member has suffered a loss of insured shares. ASI is very well capitalized and has a history of very low insurance losses. There are several drivers behind ASI's success: it insures only credit unions, which are risk-averse cooperatives; ASI only provides insurance to credit unions that meet its safety and soundness requirements and it routinely monitors their condition once insured; ASI's insurance exposure is geographically diversified; and ASI is supervised and examined by the Ohio Department of Insurance. Also, the financial condition of ASI-insured credit unions compares favorably with federally insured credit unions, both of which groups have caused much lower insurance losses than banks due to the risk-averse nature of cooperative enterprises.

Although ASI has fewer resources at its disposal than NCUA, it also has far fewer institutions to supervise and a narrower focus: just share insurance. ASI's largest insured credit union is smaller in proportion to the fund's size than is the case for NCUA, suggesting no "tall tree" problem at ASI compared to NCUA. Concern about whether credit union members are willing to accept private share insurance is allayed by the fact that asset growth rates are similar at privately and federally insured credit unions.

Compelling evidence of the financial strength and sustainability of ASI is found in its handling of the problems that arose during the Great Financial Crisis of 2007 to 2009 and its aftermath. Although geographically diversified, a disproportionate amount of ASI's share insurance exposure was in Nevada and California, two of the state's worst hit by the Crisis. Several of ASI's insured credit unions were stressed, and insurance losses rose, but ASI managed with aplomb and resourcefulness. How ASI survived and remained well capitalized throughout this episode can only inspire confidence in it as a reliable provider of credit union share and deposit insurance well into the future.

INTRODUCTION

The dual chartering system for credit unions, in which a credit union can operate under either a state or federal charter, has existed since 1934 when the first federal credit union was chartered following passage of the Federal Credit Union Act. Prior to that, since 1908, all credit unions operated under state charters. Today, slightly less than 40% of credit unions have a state charter. However, state-chartered credit unions are on average larger than their federal counterparts so that almost half of U.S. credit union assets are in state credit unions, and slightly less than half of credit union members belong to state credit unions (Table 1). Legislation providing for the chartering and supervision of state credit unions exists in all states except Delaware, South Dakota, Wyoming, and the District of Columbia. Although Arkansas has enabling legislation, all credit unions there have chosen federal charters.

Table 1
State and Federal Credit Unions as of December 2024

	All Credit Unions		State Credit Unions		Federal Credit Unions	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
No of CUs	4,550	100%	1,756	38.6%	2,794	61.4%
Assets ($ Trillions)	$2.33	100%	$1.15	49.5%	$1.18	50.5%
Members (Millions)	143.7	100%	67.2	46.8%	76.5	53.2%

BENEFITS OF DUAL CHARTERING

The credit union dual chartering system creates benefits for state policy makers and state economies, state-chartered credit unions, and the larger credit union system including federal credit unions.

Benefits for State Policy Makers

Elected state officials are judged in part on the condition of the state's economy. The operation of a state's financial institutions--through the provision of consumer loans, business and agricultural loans, transactions services, and savings opportunities can have a major impact on a state's economy. The ability of a state's policy makers, both elected and appointed, to improve economic conditions in their state is enhanced by their power to influence the operation of credit unions and other financial institutions through legislation and regulation that is tailored to the unique needs of a state's economy. With these additional levers, state officials can enhance local economic development, improving the wellbeing of state residents.

The value of being able to adapt credit union regulation and supervision to local conditions is driven by the idiosyncratic nature of state economies. For example, agriculture accounts for more than 10% of state GDP in only five states, and agricultural lending is a very small portion of lending at credit unions nationwide. Therefore, supporting and enhancing the provision of loans to farmers is not likely to be a major emphasis at a federal regulator. In fact, lack of familiarity with such lending suggests it will likely be viewed with skepticism during examinations by federal examiners. However, in states where agriculture is a particularly important economic sector, state supervisors are more likely to understand agricultural lending and support this type of lending by credit unions. Not surprisingly, although state credit unions account for about half of total credit union assets, they hold over three quarters (77%) of credit union agricultural loans. Likewise, the demand for small business loans can vary from state to state. Being able to tailor credit union supervision to such a reality can benefit a state's economy. In 2023, 8.3% of assets in state credit unions were devoted to business lending compared to only 5.8% at federal credit unions. The proportion at privately insured credit unions was more than twice the federal credit union average, at 12.2%.

The relative importance of different industries across states can influence the demographics of credit union members, for example hospitality employees in states like Hawaii, Nevada and Florida. This may place different requirements on their credit unions than auto workers in Michigan, Indiana, Ohio, Kentucky and Tennessee. A state supervisory authority is more likely to be cognizant of the particular opportunities and threats posed by the dominant economic sectors of a state than a national supervisor and therefore would be more likely to be prepared to deal with those opportunities and threats as they are manifested in credit unions.

Lending for residential real estate has become a major component of credit union portfolios. Although mortgage interest rates are for the most part determined in national secondary markets, other characteristics of residential real estate markets, such as home prices and availability, are very local. Real estate booms tend to be concentrated in relatively few states, as do real estate busts. And often the list of states in the boom-and-bust group vary from one cycle to the next. How financial institutions respond to these cycles can affect the length and magnitude of the booms and busts, and their effects on state residents and the state economy. Once again, being able to apply local knowledge to these trends can be an important tool for state policy makers.

In short, not having a vibrant group of state-chartered credit unions means passing on a powerful tool for economic development for state's policy makers.

Benefits for State Credit Unions

State-chartered credit unions have much to gain from the existence of dual chartering. The primary benefits are:

- Local regulation and supervision. A state supervisory authority is much more likely to be attuned to local conditions of a state's economy, industrial conditions, consumer trends and financial institution markets than the less granular understanding of a nationally based regulator. Incorporating that knowledge into examination and supervision can only benefit state credit unions. For example, a state examiner's assessment of a credit union will be influenced by the examiner's knowledge of conditions in other, similar, nearby credit unions and not by their recent experience at credit unions in completely different markets.

- Access to policy makers. From time-to-time issues can arise concerning exams or the interpretation of laws or rules. Often, these issues can best be resolved with face-to-face dialogue with senior representatives of the legislature or regulator. Such communication is far easier to engage in at the state than at the national level.
- Greater investment authorities. Many state supervisory authorities provide wider investment authorities than the narrowly restricted options provided in the Federal Credit Union Act for federal credit unions. Federal credit unions are essentially limited to US Treasury and Agency securities, investments in federally insured depository institutions, and some mortgage-backed securities. By contrast, in some states, state credit unions also have access to corporate bonds and equities. The closer supervision provided by state supervisory authorities allows access to these securities in a safe and sound manner.
- Field of Membership. Many state laws and regulations allow state credit unions to operate with less restrictive fields of membership than those permitted to federal credit unions. The most significant distinctions involve less restrictive definitions of "community" and the ability to include both multiple groups and geographic areas (communities) in the same field of membership.
- Incidental powers. Many state credit unions have access to incidental powers not available to federal credit unions. The specific powers vary considerably by state, but may include such activities as: broader real estate investment and development activities, more flexibility in business lending, expanded investment and insurance services for members, serving legal cannabis enterprises, etc.
- Lower operating fees. In many states, operating fees are lower than for federally chartered credit unions.
- Board member compensation. In several states, credit unions have the option to compensate board members.

Benefits for the Broader Credit Union System, Including Federal Credit Unions

The overall credit union system benefits from dual chartering. The supervision of credit unions involves a constructive tension between ensuring the safety and soundness of institutions on the one hand and permitting them the flexibility to best serve the needs of their members on the other. In the absence of charter choice, a single national supervisory authority, especially one mandated by Congress to minimize losses to the share insurance system, would naturally err on the side of safety and soundness rather than operational flexibility for regulated institutions. Put simply, a federal authority will be less proscriptive and prescriptive for both federally chartered and federally insured state institutions when charter choice exists.

This creates a "competition in flexibility" that benefits credit unions, their members and the economy. Critics have suggested that this could also generate a "competition in laxity" that could lead to a less safe and sound credit union system. However, there are protections against this occurring. The National Association of State Credit Union Supervisors (NASCUS) operates a rigorous Accreditation Program which applies national standards of performance to a state's supervisory program. Individual states have a strong incentive to encourage rigor throughout the system because a significant failure in any state system would reflect poorly on all state supervisors. In addition, the cooperative structure of credit unions, in which credit union leaders do not have stock options or face pressure from stockholders for quarterly results, means credit unions tend to be more risk averse than leaders of stock-owned institutions. Credit unions are less likely to exhibit risky behavior. This militates against the exploitation of a competition in laxity by credit unions because they have less incentive to pressure either federal or state agencies to relax supervision.

This is evident in the lower insurance loss experience of credit union share insurance funds (both NCUA and ASI) compared to the bank fund (FDIC) described below (Table 3).

The most important benefit of dual chartering is that it fosters innovation in both the operation of regulated institutions and in the way such institutions are supervised. At a national level, the risk of allowing new practices by regulated institutions or testing modifications in regulation and supervision are risky given the scale involved. A nationwide experiment that fails can lead to a major nationwide economic problem. On the other hand, a state supervisory authority is more aware of local conditions and therefore is more able to consider innovations both in powers permitted to credit unions and in its own practices. With smaller scale at the state level, a state supervisory authority can closely monitor experiments and quickly alter or curtail them if necessary.

This process can substantially benefit the entire credit union system as it permits Congress and the national regulators to follow the lead of states and adopt successful innovations tested and proven in one or more states, while avoiding experiments that do not prove successful. Throughout history, many of the major innovations in credit unions started out first in one or a few states before being adopted nationwide. Indeed, the very beginning of credit unions in the US was pioneered in a single state in 1908, spread state by state in the following years, and was only adopted at the federal level in 1934. Other examples of innovations in credit union practices and powers that for the most part received their start in just a few states are agricultural and business lending, share drafts, mortgage lending, the use of secondary capital, and more recently prize-linked savings.

PRIVATE SHARE INSURANCE AND THE DUAL CHARTERING SYSTEM

Private share insurance as offered by American Share Insurance (ASI) provides significant support to the dual chartering system. It makes the choice between a federal and state charter far more consequential. Although federally insured state credit unions benefit from charter choice, the benefits of a state charter are amplified by the existence of a private share insurance alternative for state credit unions.

Federal share insurance extends federal regulation and supervision to state chartered credit unions. Congress requires NCUA to enforce federally insured state credit unions several provisions unrelated to safety and soundness. These provisions also apply to privately insured state credit unions, but enforcement lies with state supervisory authorities or other federal agencies such as the Internal Revenue Service, the Financial Crimes Enforcement Network (FinCEN, a bureau of the U.S. Treasury Department), and the Federal Trade Commission. These other federal agencies often delegate enforcement to or engage in information sharing with state credit union supervisors.

Perhaps the most significant supervisory disadvantage of a state vs. federal charter is the requirement for a federally insured state credit union to be examined by both state and federal credit union supervisors. That means being exposed to either two exams or a joint exam. A joint examination may reduce disruption, but even a joint exam involves subjecting the operation of the credit union to different viewpoints. State and federal examiners do not always agree on their evaluation of a credit union and there can be differing recommendations of actions required by the credit union. This can complicate life for a federally insured state credit union.

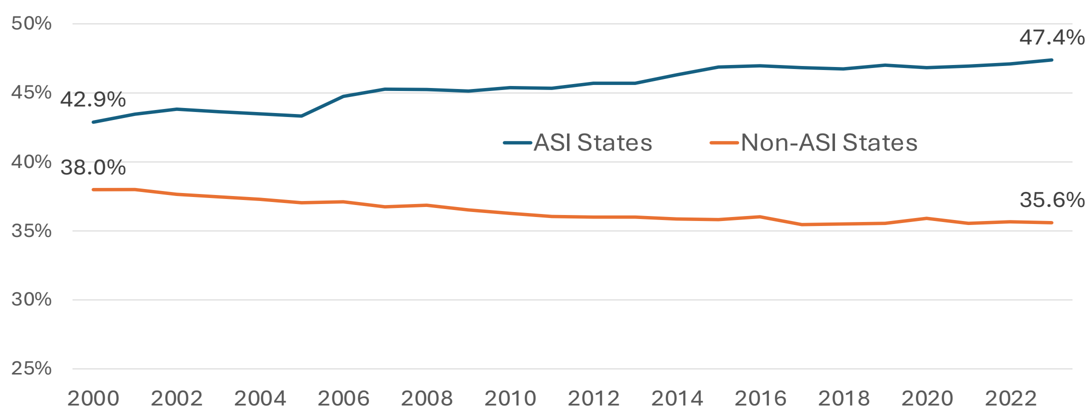
In 2013 the Credit Union National Association (CUNA) in cooperation with the state credit union leagues conducted a survey of credit unions' experiences with examinations. One question dealt with the credit union's satisfaction with its most recent exam. On a five-point scale, exams conducted solely by a state agency received the highest satisfaction rating of 3.7. NCUA exams were close behind at 3.5. The lowest rating was recorded for joint exams at 3.1.

Examining Agency	Average Satisfaction
State Agency	3.7
NCUA	3.5
Both (Joint Exam)	3.1
Overall	3.5

The only governmental supervisory exam for a privately insured state credit union is conducted by its state agency. These credit union are also subject to insurance exams by American Share Insurance, but ASI's exams focus exclusively on insurance and related issues (safety and soundness). For federally insured state credit unions, in addition to safety and soundness, NCUA exams can also cover such things as compliance with Bank Secrecy Act and Anti-Money Laundering requirements, Truth in Lending, Fair Credit Opportunity Compliance, other consumer compliance issues, information technology and cyber security, and member services and community impact. These are of course important areas for a credit union to address, but with private insurance the supervision of the credit union in these areas is generally in the hands of one government agency, not two.

Evidence of the value that private share insurance imparts to state charters can be found in a review of trends in the proportion of state vs. federal charters in states with and without the private share insurance option. Since 2000, the proportion of US credit unions with a state charter has held steady at around 40%. However, the proportion has risen in states served by ASI and declined in the rest. As shown in Chart 1, in 2000 in the seven states with a significant ASI presence, 42.9% of credit unions had state charters. That was 4.9% more than the 38% of credit unions with state charters in all other states. From 2000 to 2023, the proportion of credit unions with state charters in ASI states rose to 47.4% while in other states it declined to 35.6%. Therefore, over the period the gap between the proportion of state charters in ASI states to state charters in non-ASI states more than doubled, from 4.9% to 11.8%. This of course is likely not due simply to the availability to ASI share insurance in these states, but the private insurance option is very likely to have played a role. One thing is sure: a privately insured credit union is much less likely to convert to a federal charter than a federally insured state credit union would because of the greater increase in regulatory burdens that a privately insured credit union would face.

Chart 1: State Charters are Growing in Popularity in States Served by ASI



AMERICAN SHARE INSURANCE AS A PRIVATE INSURANCE PROVIDER

This report has shown that the benefits dual chartering creates for state policy makers, credit unions, and the economy are considerable, and private share insurance strengthens and enhances the dual chartering system. However, these benefits will only be available if the private share insurance system is sufficiently robust to earn and maintain the trust of credit union members, policy makers, and credit union leaders. Because ASI is a mutual share insurance company, the strength of the system depends crucially on the financial conditions and operations of both ASI and privately insured credit unions themselves. We begin with the condition of ASI.

The Condition of American Share Insurance

American Share Insurance, currently the only provider of private share insurance in the US, was founded as the Ohio Credit Union Shareholders' Guaranty Association in 1974 to provide share insurance to state credit unions in Ohio.[1] Soon after its founding, ASI began to offer share insurance in other states, increasing the geographic diversification of its insurance exposure. It currently provides primary share insurance in 10 states. In 1982 ASI began offering "excess insurance" to federally insured credit unions, allowing credit unions to offer insured accounts above the NCUA maximum (currently $250,000). It now offers excess insurance in 36 states and the District of Columbia. Since its inception in 1974, no insured depositor has ever suffered a loss on deposits in an ASI insured credit union, from either primary or excess insurance.

Forty years ago, there were more than a dozen private credit union share and deposit insurance funds, almost all serving credit unions in just one state. Only one of these state systems failed. The Rhode Island Share and Deposit Indemnity Corporate (RISDIC) failed in 1991. Unlike all the other private credit union share insurance companies, RISDIC also insured thrifts, and indeed it was the failure of an insured thrift that brought down RISDIC. All the other private insurers other than ASI were closed successfully in the 1980s

[1] Throughout its history the company has operated under several names, becoming ASI in 1991.

and 1990s as solvent institutions with no losses to state governments or insured credit unions.

Reasons for American Share Insurance's Success

There are several reasons why ASI has persevered with robust financial performance:

- ASI insures only credit unions. As previously mentioned, under the cooperative business model, credit union boards and managers have far less incentive to expose their institutions to risk than is the case for investor-owned businesses. In the absence of stock ownership and stock options, the primary financial incentive to agents of a cooperative enterprise is the continuation of the firm rather than maximizing profits in the short term with high risk, high return ventures. A private insurer for commercial banks would face more risk from adventuresome institutions than ASI does from credit unions.
- ASI carefully underwrites new credit unions when they apply for insurance. ASI is not required to provide insurance to any credit union that applies and therefore can consider each potential applicant on a case-by-case basis with a view to minimizing risk to the insurance fund. Most state-level, non-federal credit unions share insurers that closed in the 1980s and 1990s operated in only one state and many were sponsored by their state government, which imposed requirements on which institutions the insurer had to cover. ASI is under no such requirements. In practice, when a credit union expresses interest in ASI coverage, ASI conducts a pre-application review and discourages the submission of an application if it feels the credit union is unlikely to meet its standards.
- ASI routinely monitors the condition of insured credit unions. In addition to regular reviews or exams, ASI receives detailed financial reports quarterly. ASI also coordinates with state supervisory authorities in tracking the safety and soundness of insured credit unions. ASI can thus see potential problems early and take actions to minimize them. ASI's ability to enforce corrective action should it be necessary is based on its power to terminate insurance coverage.
- ASI insures credit unions in several states. This diversifies the risks that arise from local economies. ASI currently offers primary insurance in ten states, with most of their insured institutions located in six of those states, and excess insurance in 36 states and the District of Columbia.
- ASI is well capitalized. Both the NCUA and ASI are very well capitalized with funding derived both from capitalization deposits from insured credit unions and retained earnings.

ASI's Capitalization

Primary insured credit unions maintain capitalization contributions of 1.3% of insured deposits. Credit unions with excess insurance maintain "premium deposits" equal to 1% of the coverage amount of their excess insurance contracts. Both the capitalization contributions and premium deposits are available to cover insurance losses if reserves and retained earnings are insufficient. Table 2 highlights the capital and loss absorbing capacity for primary insurance at both ASI and NCUA relative to their primary insured shares exposures.

Table 2
Loss Absorbing Capacity for Primary Insurance
Percentages of Insured Shares, December 31, 2023

	ASI	NCUA
Credit Union Capital Contributions	1.30%	1.00%
+ Retained Earnings*	0.31%	0.30%
= Net Worth**	1.61%	1.30%
+ Reserves for Losses	0.14%	0.01%
+ Total Loss Absorbing Capacity	1.75%	1.31%
Loss Absorbing Capacity Excluding Capital Contributions	0.45%	0.31%
Average Annual Cash Insurance Losses, 2004 to 2023	0.020%	0.012%

* ASI's retained earnings reported here are reduced by $9 million (0.05% of insured shares), the maximum retained loss before reinsurance covers losses on excess insurance contracts.

** Net worth as reported here does not include unrealized gains or losses on securities holdings, as these losses fluctuate with interest rates and are not realized if securities are held to maturity. As of December 2023, unrealized losses were 0.11% of insured shares at ASI and 0.07% of insured shares at NCUA.

In addition to credit union capital contributions, the primary component of capital is retained earnings. Retained earnings at ASI were 0.36% of primary insured shares and 0.30% of insured shares at NCUA. However, ASI's retained earnings could also be called on to meet losses from its excess insurance business. ASI maintains a reinsurance policy which limits the exposure of the company's retained earnings to $9 million from losses in the excess insurance program. After losses totaling $9 million, reinsurance would cover the next $9 million. Should losses exceed $18 million, further losses would be charged against the 1% premium deposits of excess insured credit unions (separate from the capital contributions of primary insured credit unions). Therefore, in the table above, ASI's retained earnings have been reduced by 5 basis points to conservatively represent the amount available to the primary insurance program if the full $9 million in retained loss were incurred in the excess insurance program.

In this analysis, reserves for losses are added to net worth to show total loss absorbing capacity. These reserves are amounts expensed to cover future known or expected cash losses. They have both a specific and general component. Specific reserves are provided for particular credit unions known to be in some difficulty for which a fund's managers believe a future actual insurance outlay by the fund is likely. General reserves are determined based on an analysis of the entire body insured credit unions, taking into account their safety and soundness metrics (CAMELS ratings) and historical loss experience. For both ASI and NCUA, these funded loss reserves are essentially prepaying potential future actual cash outlays. They are the front line of loss absorbing capacity. Also, in both cases these reserves are almost entirely general, i.e., not based on expected losses in any specific, troubled credit unions. That is why they are included as part of loss absorbing capacity. In the case of NCUA, the 0.1% Reserve for Guarantee Losses is approximately the average of its annual loss experience over the past two decades. For ASI, the Reserve for Guarantee Losses is seven times the annual average loss experience over the same period. These greater loss reserves at ASI compared to NCUA are not because ASI is aware of additional significant specific troubled credit unions. Rather, ASI must follow the reserving requirement mandated by the Ohio Department of Insurance, and these requirements are designed for property and casualty insurance companies and generally mandate greater general (nonspecific) reserves.

The total loss absorbing capacity at ASI (the amount available to cover future actual cash losses) amounted to 1.75% of insured shares as of the end of 2023. This compares to ASI's actual average annual insurance losses during the 20 years ending in 2023 of only 0.020%. At NCUA, total loss absorbing capacity was 1.31% and average losses over the preceding two decades were only 0.012%. This means that both ASI and NCUA are very well capitalized, with sufficient capital and reserves to meet losses equal to 86 times average annual losses at ASI and 113 times at NCUA. Focusing just on loss absorbing capacity before penetrating credit unions' capitalization deposits, ASI has coverage of 0.45% of insured shares (equivalent to 22 times average annual losses) and NCUA has coverage of 0.31% (28 times average annual losses).

Historical Insurance Losses

The long-term history of insurance losses of a deposit insurance fund reveals a great deal about the quality of the management of the fund, its relationship to its insured institutions, and the characteristics of the insured institutions themselves. During the period 2003 to 2023, annual insurance losses at ASI and NCUA have been very low: 2 basis points of insured shares for ASI and 1.1 basis points for NCUA. Over the same period, annual losses at the FDIC were considerably higher at 7 basis points. This comparison does not mean that FDIC, with its vast resources, is not as effective as ASI or NCUA in managing insurance losses. Instead, it reflects the greater appetite for risk taking on the part of FDIC's insured institutions, commercial banks, driven by their for-profit business model.

Table 3
Comparative Insurance Loss Experience From 2003 to 2023
And During and After the Great Financial Crisis
Average Ratio of Annual Losses to Insured Shares/Deposits

	ASI	NCUA	FDIC
2003 to 2023	0.020%	0.011%	0.070%
2007 to 2012	0.100%	0.031%	0.205%
2013 to 2023	-0.018%	0.004%	0.022%

Insurance loss rates so far in the 21st century have been heavily influenced by the Great Financial Crisis of 2007 to 2009 and its aftermath. This was the most difficult period for depository institutions and deposit insurance funds since the savings and loan crisis of the 1980s. The Crisis was driven by the collapse of the household mortgage market. It caused large losses in the residential real estate portfolios of financial institutions and triggered the Great Recession. Deposit insurance loss rates during the years surrounding the Crisis, from 2007 to 2012, were elevated for all three funds, to 10 basis points at ASI, 3.1 basis points at NCUA[2], and 20.5 basis points at FDIC. Since the financial crisis, loss rates at all three funds have been negligible: 2.2 basis points at FDIC, 0.4 basis points at NCUA and a negative 1.8 basis points at ASI due to cash recoveries from some of the losses recorded during the Crisis.[3]

[2] These insurance loss comparisons do not include the substantial losses incurred at NCUA due to the conservatorship of several corporate credit unions. Including those losses, NUCA's average loss experience from 2007 to 2012 would be 12 basis points, slightly greater than ASI's experience. The corporate credit union losses are excluded from the comparisons to focus on a comparison of NCUA and ASI with respect to natural person credit unions.
[3] In other words, the 10-basis point average loss rate for ASI from 2007 to 2012 somewhat overstates it actual losses during that period.

ASI's losses during the Great Recession were larger than NCUA's because of the geographic distribution of its insured credit unions. The eight states most negatively affected in terms of real estate foreclosure rates and home price declines during the crisis were (in order of highest annual foreclosure rate): Nevada, Florida, Arizona, California (the so-called sand states), Michigan, Georgia, Illinois and Idaho. As of 2007, fully 67.6% of shares insured by ASI were in the four of these states served by ASI: Nevada, California, Illinois, and Idaho, with the majority in Nevada and California. In contrast, just 32.5% of federally insured shares were to be found in these eight states.

It is indeed a testament to ASI's ability to withstand a severe shock and survive as a viable institution that it came through the Great Recession given its significant exposure to Nevada and California. The fund's underwriting, monitoring, and troubled credit union assistance programs proved very effective in this episode.

Financial Condition of ASI Insured Credit Unions

The health and stability of a share and deposit insurance fund depends not only on the capitalization and operations of the fund, but also on the general health of the institutions it insures. Charts 2 to 4 show comparative via data on ASI's insured credit unions compared to similarly sized federally insured state credit unions (FISCUs) and federal credit unions (FCUs) in the six states where ASI had at least 8 insured credit unions as of 2007. The charts cover three of the most important indicators of credit union safety and soundness, corresponding to the Capital, Asset Quality and Earnings components of the CAMELS supervisory rating system. The data is presented over two time periods. The first, from 2006 to 2012 covers the lead-in to the Great Financial Crisis, the Crisis itself and its aftermath. This was a period of great stress for all financial institutions, including credit unions. The second period, from 2013 to 2023, covers the eleven years that followed the Crisis. This was a more stable period representing a "normal" environment for financial institutions, even if it does include the COVID-19 episode.

Chart 2 shows credit union capital-to-asset ratios over the two periods. Capital is the cushion that a credit union has available to absorb losses. Despite the stresses of the Financial Crisis, capital ratios averaged more than 10% at all three groups of credit unions from 2006 to 2012. Since then, capital ratios have averaged closer to 11%. In both periods, ASI credit unions maintained capital ratio above those of federally insured state credit unions in the six states.

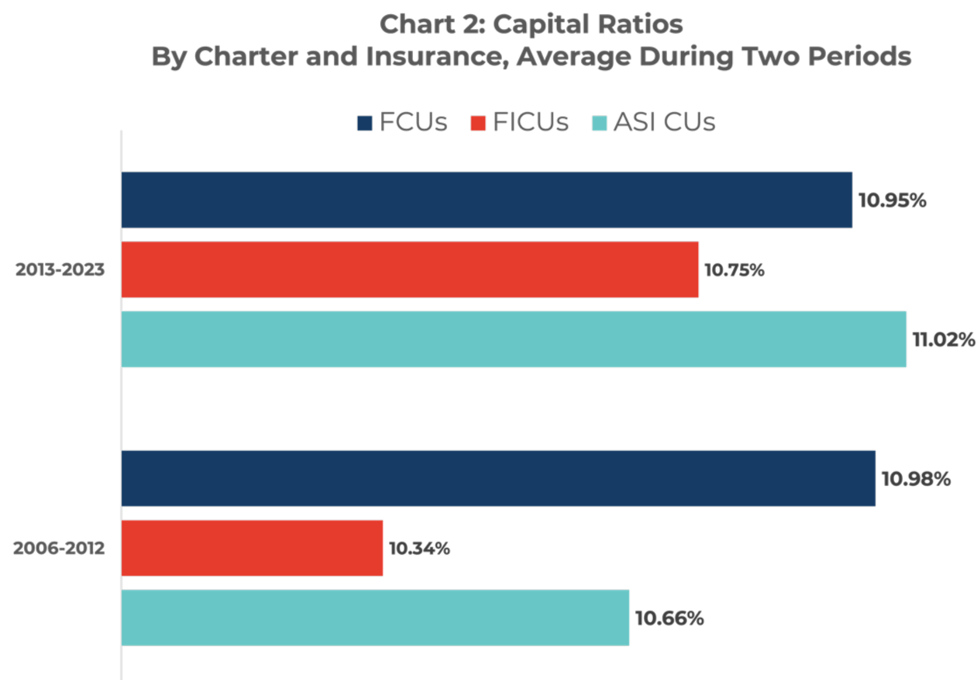


Chart 3 deals with asset quality. The most significant assets on a credit union's balance sheet are loans, often comprising over 70% of total assets. The loan delinquency rate shows the percentage of loans with payments at least two months past due. It is an indicator of future loan losses. During the Financial Crisis, which included high unemployment due to the Great Recession, delinquency was elevated at most credit unions, averaging 1.85% at ASI credit unions, 1.4% at FISCUs and 1.29% at FCUs. Since then, delinquency rates have been much lower and have averaged roughly 0.7% of loans at each of the credit union groups.

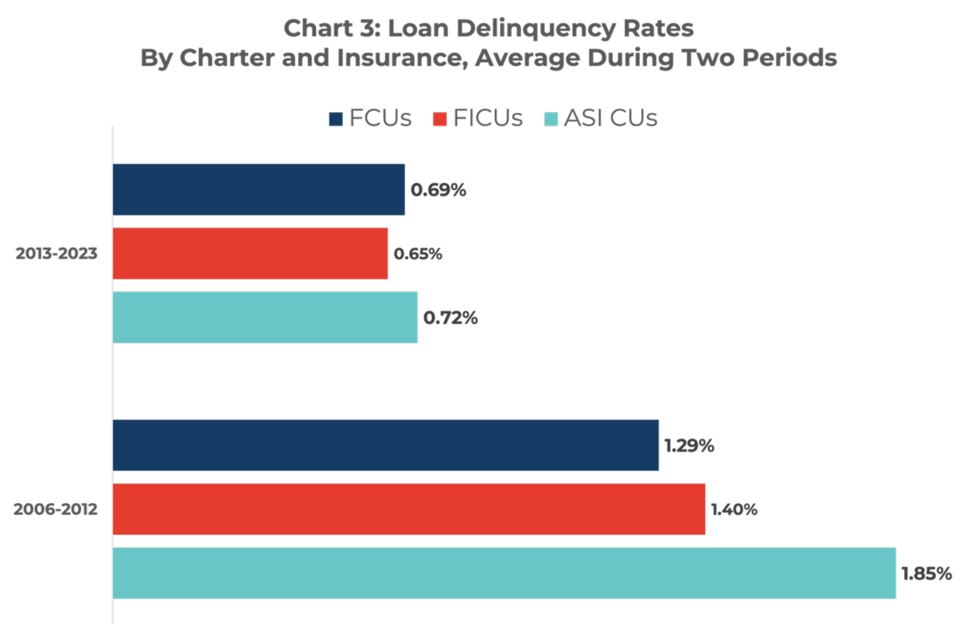
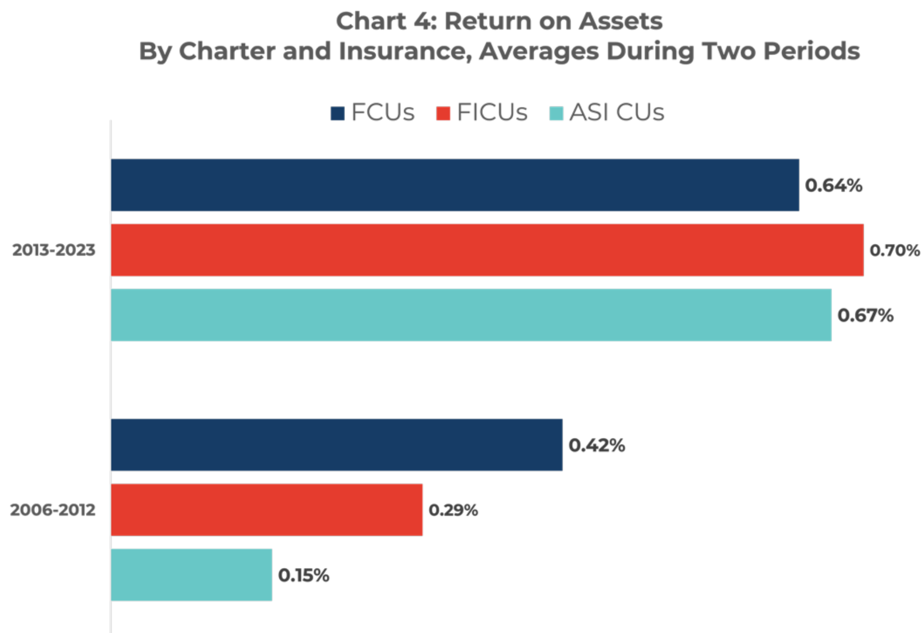


Chart 4 provides information on credit union earnings. Return on assets (ROA) is annual net income divided by average assets. Net income is in most cases the only source of capital (retained earnings) for a credit union. ROA therefore shows the ability of a credit union to operate with positive net income: to cover all operating expenses, loan losses and dividends on savings with enough leftover to build and maintain capital. A credit union with sufficient capital can withstand a loss (negative return on assets) for a short period (that is why having sufficient capital is important), but over the long run positive earnings are essential. In the period since the Great Financial Crisis, annual earnings have averaged approximately 70 basis points (0.70%) at all three charter types. During the Crisis earnings were depressed at all three groups.



Data from credit unions during the past two decades shows that in "normal" times there is very little difference in the safety and soundness measures of credit union operations among ASI insured credit unions, FISCUs and FCUs. During the Great Financial Crisis, ASI insured credit unions were more negatively affected. That's because even though the data used in these tables is restricted to only the six states in which ASI was active, within these six states a greater proportion of ASI's insured shares were in Nevada, the most severely affected state in the crisis, than were NCUA's.

Issues with Private Share Insurance

Some have expressed concerns about the viability of private share insurance. Indeed, the number of private share insurance funds has declined from a peak of sixteen over four decades ago to just ASI as the sole survivor. It is worth recalling that only one of those private share insurance funds failed, RISDIC. It ensured both credit unions and thrifts and its failure was caused by the demise of a thrift. All of the other funds that ceased operations served credit unions only. Each operated in just one or a small number of states, and each was closed as a solvent institution, without causing any losses.

Today ASI is diversified, providing primary insurance to credit unions in ten states and excess insurance to credit unions in 36 states and the District of Columbia. Nevertheless, because it is so unique, some have expressed concerns about ASI and private share insurance.

One concern is that ASI does not have the substantial resources that NCUA, a much larger entity, does. While NCUA is indeed much more generously resourced than ASI, it also has a much larger and more diverse set of missions over which it must deploy those resources. ASI's single mission is to provide credit union share and deposit insurance. On the other hand, in addition to share insurance, NCUA has been tasked with enforcing Congressional mandates beyond safety and soundness. For that and other reasons, NCUA operates the following offices: Consumer Protection, Credit Union Resources and Expansion, Business Innovation, Minority and Women Inclusion, Ethics Council, Ombudsman, and the Central Liquidity Facility. These other operations, and the far greater number of credit unions it supervises, account for its greater resources. Proof of the adequacy of ASI's resources, both human and financial, is how successfully it dealt with the Great Financial Crisis.

Another concern is the" tall tree" problem. This refers to the fact that the failure of a single institution could overwhelm the capital of an insurance fund. The issue arises because the size of the NCUA insurance fund (NCUSIF) is so much larger (70 times) than ASI's fund. However, the insured shares in NCUA's largest credit union are even larger in proportion. They are 91 times those of ASI's largest credit union. The comparative "tall tree" issues as of December 2023 are shown in Table 4.

Table 4
"Tall Tree" Exposure

	ASI	NCUA
Loss Absorbing Capacity / Largest CU's Insured Shares	23.2%	17.2%
Amount of Loss Absorbing Capacity Consumed by a 10% Loss at Largest Insured Credit Union	43%	58%

As of December 2023, ASI's loss absorbing capacity (Table 2) amounted to 23.2% of the insured shares in its largest insured credit union. NCUA's loss absorbing capacity amounted to 17.2% of its largest credit union's insured shares. In other words, ASI had sufficient loss absorbing capacity for a 23.2% loss at its largest insured credit union and NCUA had sufficient loss absorbing capacity for a 17.2% loss at its largest credit union.

A conservate figure for the largest likely possible loss from a large credit union is 10%. Loss rates at smaller institutions can be much greater than 10%, but this is usually due to fraud on the part of one or a few insiders and lack of internal controls. Loss rates at larger credit unions that have failed tend to be much lower than 10% except in cases of credit unions with very high concentrations in undiversified assets. The very largest credit unions have sophisticated internal controls and receive greater scrutiny from regulators and insurers. Because of this closer supervision, issues at larger credit unions tend to be resolved well before major losses accumulate and therefore tend to be small compared to total assets. Therefore, the 10% loss rate used in the table would represent an unusually large loss for a very large credit union. A 10% loss at ASI's largest credit union would consumer 43% of its loss absorbing capacity. A similar loss for NCUA would consume 58% of its loss absorbing capacity.

Given the ubiquity and popularity of federal deposit insurance from both NCUA and FDIC, some have suggested that credit union members simply will not be comfortable placing their hard-earned funds in a privately insured credit union. There no doubt are some households for which this is the case, but leaders of privately insured credit unions do not report headwinds in attracting deposits even with federal requirements to prominently disclose that funds are not insured by the federal government. In addition, the greater operational flexibility available to privately insured credit unions may well provide them with the opportunity to offer a more attractive value proposition to members, attracting more deposits in the process.

In any event, the data suggests that privately insured credit unions attract deposits at almost the same rate as their federally insured peers. Considering only those states in which ASI is active, over the past three decades, which included various economic and financial environments, the merger-adjusted annual asset growth rate at privately insured credit unions was 5.6% compared to 6.3% at similarly sized federally insured credit unions.

ASI's Performance During the Great Financial Crisis

Perhaps the most compelling evidence of the strength and viability of ASI is its experience during the Great Financial Crisis. This Crisis placed financial institutions under more stress than any time since the 1930s, when Congress created the FDIC in response to a rash of bank failures. We have previously seen that insurance losses rose at both ASI and NCUA, and even more at FDIC during this period. However, they were contained and manageable, and well within the loss absorbing capacity of each of the funds. Of note is that for ASI, the Great Financial Crisis was relatively stressful due to the location of many of its insured credit unions. The crisis was caused by the collapse of the residential mortgage market in the US, and the correction in housing prices was far worse in a few states than in the rest of the country. This caused much more severe economic consequences in those states. As noted previously, two thirds of ASI insured shares and deposits at the beginning of the crisis were in four of the eight states whose economies were most seriously affected by the crisis. Despite this, ASI emerged from the crisis as resilient as ever. ASI managed this situation by determining on a credit union by credit union basis the chance of survival and whether a purchase and assumption transaction was necessary, or if providing direct financial assistance would be a better, lower cost solution.

A particularly revealing case is that of Silver State Schools Credit Union in Las Vegas. Nevada suffered the highest state mortgage foreclosure rate during the Crisis, reaching over 10% of homes just in 2009. The state's 60% decline in home prices in the Crisis topped all other states, and its peak unemployment rate at 13.9% was among the highest in the nation. Silver State Schools Credit Union, with over $1 billion in assets and headquartered in Las Vegas, suffered rapid deterioration in its financial condition due primarily to losses in its $180 million portfolio of near-prime indirect auto loans. It's capital ratio quickly fell below a level that the state regulator deemed sufficient for continued operation. Following a thorough analysis, ASI determined that other than the near-prime auto loan portfolio the credit union was basically sound. Rather than liquidating the credit union, ASI injected a total of $26.4 million in capital and installed an on-site chief restructuring officer who drove several efficiencies. Silver State Schools began repaying the capital injections in 2012 and completed repayment in 2016, well ahead of the expected timeframe. It is now a strong, well capitalized credit union serving over sixty thousand members.

There are some lessons to be learned from how ASI handled Silver State Schools Credit Union. First, ASI found a creative way to save the credit union by injecting capital. This followed a rigorous evaluation of the credit union leading to the conclusion that it was indeed basically sound. Second, ASI forced corrective action at the credit union by, among other things, requiring the engagement of a chief restructuring officer. Third, because of this creative approach, the credit union was rehabilitated and survived rather than being merged or liquidated. It is highly likely that a credit union in a similar situation would have been conserved by NCUA.[4] ASI's management of the situation required the close involvement of ASI senior staff, which ASI was willing and able to provide.

CONCLUSION

This report has demonstrated that:

- credit union dual chartering provides significant benefits to state policy makers, state and federal credit unions.
- the existence of private share insurance for credit unions from American Share Insurance strengthens and enhances dual chartering.
- throughout its history, American Share Insurance has operated as a strong institution without imposing a loss on any insured member.
- American Share Insurance is currently a well-capitalized, robust institution well able to meet the challenges of providing primary and excess share insurance to credit unions.

[4] Three Nevada credit unions were liquidated by NCUA in 2009.