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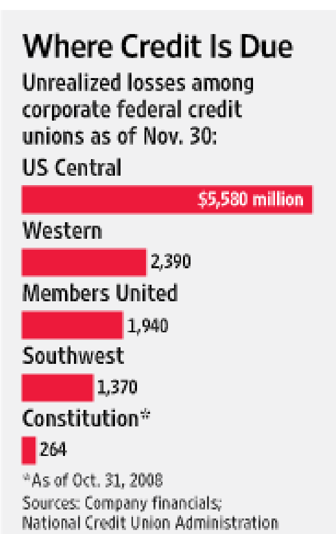
U.S. Moves to Bail Out Credit Union Network

By MARK MAREMONT

In the latest effort to prop up a sector of the finance industry, federal regulators on Wednesday guaranteed $80 billion in uninsured deposits at the powerful institutions that service the nation's credit unions -- a maneuver that shows how the economic crisis continues to ripple across the U.S.

Regulators also injected $1 billion of new capital into the largest of these wholesale credit unions, U.S. Central Federal Credit Union of Lenexa, Kan., after the firm on Wednesday posted an unexpected $1.1 billion loss for 2008. U.S. Central serves essentially as a main clearinghouse for the others in the network.



The vast majority of regular credit unions -- the bank-like cooperatives familiar to millions of account-holders nationwide -- are considered financially sound. Wednesday's moves affect only these wholesale credit unions, which number 28 and operate in the background to service regular credit unions.

In general, credit unions are considered to be among the most conservatively managed financial institutions. Nevertheless, a few of the wholesale credit unions have been hurt by losses on mortgage investments. As a result, regulators took action to minimize the chances of pain spreading.

The National Credit Union Administration, the industry's federal regulator, announced the steps late Wednesday after a special board meeting called at short notice. "We are trying to institute confidence in the system, and we think this will do so," said Michael E. Fryzel, NCUA's chairman, in an interview.

Mr. Fryzel also said the agency will hire investment-management firm Pimco to evaluate the investment portfolios of the wholesale credit unions. The goal will be to gauge the depth of the industry's losses on mortgage-backed securities and other investments.

Though smaller than the likes of Citigroup or Bank of America, credit unions reach into virtually every community in the nation. Some 90 million Americans held accounts at credit unions at the end of 2007, according to an industry trade group. Credit unions, some affiliated with individual corporations, trade groups or geographic regions, are common sources for auto loans, mortgages and other products.

The little-known network of wholesale, or "corporate," credit unions affected by Wednesday's move provide financing, check-clearing and other tasks for the retail institutions. These wholesale credit unions are owned by their retail credit-union members.

Some of the biggest wholesale credit unions have been grappling with substantial paper losses on investments, primarily mortgage-backed securities. As of the end of November, five of the largest such institutions posted unrealized losses on their investments of $11.6 billion, up from $9.4 billion just a month earlier and about double the level of last May.

U.S. Central, the institution that posted the loss Wednesday, said it was due to a decision to writedown $1.2 billion in losses on its portfolio. U.S. Central previously had reported $5.6 billion in paper losses on its investments, but until recently believed it wasn't necessary to write down some of those on a permanent basis.

NCUA's Mr. Fryzel said regulators found out about the losses on Monday, and immediately began to plan how to cope. He said the size of the losses "gave us greater concern" that other wholesale credit unions might accelerate their withdrawal of funds from U.S. Central.

NCUA's board voted to inject $1 billion in new capital into U.S. Central. The money will come from the industry's $7 billion insurance fund, which is funded by a fee on credit unions and is separate from that run for banks by the Federal Deposit Insurance Corp.

Mr. Fryzel said the fund had been used to bail out retail credit unions, but had never before been used to recapitalize one of their wholesale brethren.

To further shore up confidence, the NCUA also issued the blanket guarantee of the $80 billion in uninsured deposits in the network of wholesale credit unions. (Depositors in federally insured retail credit unions already have their accounts guaranteed up to $250,000.)

Mr. Fryzel said some retail credit unions had been withdrawing funds from the corporate system, and the guarantee is designed to keep that trend from accelerating in light of the U.S. Central losses.

NCUA said the initial guarantee would last through February 2009. After that, each wholesale credit union would be included on a voluntary basis for a new guarantee program that would last to Dec. 31, 2010. Mr. Fryzel said he expected all the wholesale credit unions would join that voluntary program.

Although the guarantee covers far more in deposits than the industry's $7 billion insurance fund, Mr. Fryzel said it was backed by the "full faith and credit of the United States government."

To fund the $1 billion bailout of U.S. Central, regulators are increasing the insurance fee levied on all credit unions.

David Dickens, an executive vice president at U.S. Central, said the $1.2 billion write-down came after further deterioration in some of its mortgage-backed securities. He stressed that the bonds continue to pay principal and interest, but that the company believes it will eventually suffer some losses on the securities. He put the current estimate of the losses at $420 million, but said accounting rules require U.S. Central to write down the bonds to their current market value, which he said is artificially depressed.

Major ratings agencies recently downgraded debt of some of the biggest wholesale credit unions, citing risks associated with investment losses. In downgrading U.S. Central in late December, Moody's Investors Service said the company's ratings would have been even lower if not for the "very high prospect" that it would be bailed out by the U.S. government and other wholesale credit unions.

Moody's also noted that U.S. Central's deposits shrank by 22% between October 2007 and October 2008. Banking experts say that's a sign that other credit unions were nervous about U.S. Central's financial health.

For the most part, the troubled wholesale credit unions have insisted that their investments are more conservative than those that have wreaked havoc on Wall Street. Some have retained outside firms to value their holdings.

In hiring Pimco to evaluate those same investments, NCUA's Mr. Fryzel said he wants an independent check. "I'd feel a lot better if the individuals who are giving those numbers are working directly for me," he said. He said the valuations would "give us a pretty good idea of what other actions the board needs to take."

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