

7535-01-U

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 702

RIN 3133-AD__

Prompt Corrective Action; Amended Definition of Low-Risk Assets

AGENCY: National Credit Union Administration (NCUA).

ACTION: Interim final rule with request for comments.

SUMMARY: NCUA is issuing this Interim Final Rule to amend the definition of “low-risk assets” for regulatory capital purposes. Assets in this category receive a risk-weighting of zero, reflecting the absence of credit risk. The amendment will expand the definition of “low-risk assets” to include debt instruments on which the payment of principal and

interest is unconditionally guaranteed by NCUA as an agency of the Executive Branch of the United States.

DATES: This rule is effective [INSERT date of publication in the FEDERAL REGISTER]. Comments must be received on or before [INSERT DATE 30 days from the date of publication in the FEDERAL REGISTER].

ADDRESSES: You may submit comments by any of the following methods (**Please send comments by one method only**):

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- NCUA Web Site:
<http://www.ncua.gov/Resources/RegulationsOpinionsLaws/ProposedRegulations.aspx>. Follow the instructions for submitting comments.
- E-mail: Address to regcomments@ncua.gov. Include “[Your name] Comments on Risk Portfolio Defined” in the e-mail subject line.
- Fax: (703) 518-6319. Use the subject line described above for e-mail.
- Mail: Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.
- Hand Delivery/Courier: Same as mail address.

FOR FURTHER INFORMATION CONTACT: Steven W. Widerman, Trial Attorney, at the above address, or telephone: (703) 518-6557.

SUPPLEMENTARY INFORMATION:

PUBLIC INSPECTION OF COMMENTS: All public comments are available on the agency's website at:

<http://www.ncua.gov/Resources/RegulationsOpinionsLaws/RegulationComments.aspx>

as submitted, except as may not be possible for technical reasons. Public comments will not be edited to remove any identifying or contact information. Paper copies of comments may be inspected in NCUA's law library at 1775 Duke Street, Alexandria, Virginia 22314, by appointment weekdays between 9:00 a.m. and 3:00 p.m. To make an appointment, call (703) 518-6546 or send an e-mail to

OGCMail@ncua.gov.

A. Background

1. Prompt Corrective Action. In 1998, the Credit Union Membership Access Act, Pub. L. No. 105-219, 112 Stat. 913, mandated a system of regulatory capital standards for natural person credit unions entitled "Prompt Corrective Action" ("PCA"). 12 U.S.C. 1790d *et seq.* PCA imposes minimum capital standards and corresponding remedies to improve a credit union's net worth. *Id.* The NCUA Board implemented a comprehensive system of PCA primarily under Part 702.¹ 12 C.F.R. 702 *et seq.*

¹ Part 702 has been amended five times since it was originally adopted in 2000: First, to incorporate limited technical corrections. 65 FR 55439 (Sept. 14, 2000). Second, to delete sections made obsolete by adoption of a uniform quarterly schedule for filing Call Reports. 67 FR 12459 (March 19, 2002). Third, to incorporate a series of revisions and adjustments to improve and simplify PCA implementation. 67 FR 71078 (Nov. 29, 2002). Fourth, to add a third risk-weighting tier to the standard risk-based net worth

Under PCA, a natural person credit union's "net worth ratio" determines its classification among five statutory net worth categories. 12 U.S.C. 1790d(c); 12 C.F.R. 702.102. A credit union's minimum required "net worth ratio" is based upon a risk-weighting applied to each of eight different portfolios of credit union assets.² *Id.* §702.104. As a credit union's "net worth ratio" declines, so does its classification among the five net worth categories, thus subjecting it to an expanding range of mandatory and discretionary supervisory actions. 12 U.S.C. 1790d(e), (f) and (g); 12 C.F.R. 702.204(a)-(b).

2. Corporate System Resolution. In response to the unprecedented disruption in the nation's credit markets over the last two years, NCUA and other federal banking regulators have taken a series of steps to preserve the nation's confidence in financial institutions. Through its Corporate Stabilization Program, NCUA has taken specific actions to stabilize the corporate credit union ("CCU") system and to address problems associated with the impact of the economic downturn on CCUs. Chief among these problems is the substantial devaluation of the mortgage-backed and asset-backed securities ("the distressed assets") held in the investment portfolios of CCUs. In several cases, the realization of losses on these distressed assets has driven the CCU into insolvency, requiring NCUA to place the CCU into liquidation.

component for member business loans. 68 FR 56537, 56546 (Oct. 1, 2003). A proposal to modify the criteria for filing a net worth restoration plan, 67 FR 7113 (Nov. 29, 2002), was never adopted. Fifth, to implement a statutory amendment allowing the acquirer in a merger of credit unions to combine the merging credit union's retained earnings with its own to determine the acquirer's post-merger "net worth." 73 FR 72688 (Dec. 1, 2008).

² "Long-term real estate loans," "Member Business Loans ("MBL") outstanding," "Investments," "Low-risk assets," "Average-risk assets," "Loans sold with recourse," "Unused MBL commitments" and "Allowance." 12 C.F.R. 702.104.

To monetize the distressed assets held by the liquidated CCUs, NCUA has embarked on a Corporate System Resolution Program primarily to sell those distressed assets to a trust established by NCUA. The trust will then resecure the distressed assets in the form of senior debt instruments denominated “NCUA Guaranteed Notes” (“NGNs”) that will be offered to public investors, including financial institutions.³ The trust will pass through to the NGN-holders the monthly cash flows produced by the underlying distressed assets. The NGNs will benefit from the credit enhancement provided by the overcollateralization and excess interest generated by the underlying distressed assets.

3. NCUA Guaranty. As a further incentive to instill investor confidence in the NGNs, NCUA, as an agency of the Executive Branch of the United States, has fully and unconditionally guaranteed to investors the timely payment of principal and interest (“the NCUA Guaranty”). As is the case with debt issued and guaranteed by other federal financial institution regulators, the NCUA Guaranty is backed by the full faith and credit of the United States. As a result of the NCUA Guaranty, the NGNs are legally permissible investments for federal credit unions. For state-chartered credit unions, the NGNs are legally permissible investments if they comply with state law at the time of purchase. Currently, the NGNs are permissible investments for CCUs, but may be

³ The first offering of this senior debt consists of \$3.8 billion in fixed- and floating-rate “NCUA Guaranteed Notes 2010-R1.” The underlying distressed assets of this debt are the residential mortgage-backed securities held by the liquidation estate of U.S. Central Federal Credit Union. Credit unions purchased a significant proportion of the first NGN offering. NCUA anticipates a series of similar NGN offerings.

purchased by CCUs only with NCUA prior approval once the recently adopted Part 704 final rule takes effect on January 18, 2011.⁴ See 75 FR 64786 (October 20, 2010).

4. Risk-Weighting of Guaranteed Notes. Under PCA as it exists today, the NGNs held by a natural person credit union would fall within the “investments” risk portfolio, consisting of investments “[a]s defined by federal regulation or applicable State law.” 12 C.F.R. 702.104(c). The minimum risk-weighting applied to assets in that portfolio, based on their weighted average life, is 3 percent. *Id.* §702.106(c)(1). The “investments” portfolio does not permit a risk-weighting of zero to be applied to an investment even when it carries no credit risk. The “Low-risk assets” risk portfolio, in contrast, *does* apply a risk-weighting of zero, but the NGNs presently do not fall within its scope. *Id.* §702.106(d). Only “Cash on hand . . . and the NCUSIF deposit” meet the definition of “Low-risk assets.” *Id.* §702.104(d).

Recognizing that an obligation supported by the full faith and credit of the United States carries no credit risk, the four other federal financial institution regulators--the Board of Governors of the Federal Reserve System (“Federal Reserve Board”), the Office of the Comptroller of the Currency (“OCC”), the Federal Deposit Insurance Corporation (“FDIC”) and the Office of Thrift Supervision (“OTS”)--have jointly confirmed that their respective institutions may apply a zero percent risk-weighting to the NGNs the institutions purchase because of the direct, unconditional guaranty by NCUA.⁵ The

⁴ CCUs that purchase the NGNs prior to January 18, 2011 will not be required to divest provided the NGNs pose no safety and soundness concerns when assessed as part of the credit union’s overall business strategy and balance sheet structure.

⁵ See joint letter dated October 13, 2010, from the Federal Reserve Board, OCC, FDIC and OTS to Director, Division of Supervision, NCUA Office of Examination and Insurance.

purpose of the Interim Final Rule is to accord the same zero percent risk-weighting to NGNs purchased by natural person credit unions.

To that end, the Interim Final Rule expands the PCA definition of “Low-risk assets” to extend that risk portfolio’s zero percent risk weighting to “debt instruments unconditionally guaranteed by the National Credit Union Administration,” such as the NGNs, and thus backed by the full faith and credit of the United States. Were the definition not expanded to include guaranteed debt instruments, potential credit union investors in the NGNs would face a disincentive to invest: a minimum 3 percent risk-weighting—and the adverse effect on PCA net worth—even though the NGNs are free of credit risk.

C. Interim Final Rule and Immediate Effective Date

NCUA is issuing this rulemaking as an Interim Final Rule effective upon publication. The Administrative Procedure Act (“APA”), 5 U.S.C. 553, requires that before a rulemaking can be finalized, it must first be published as a notice of proposed rulemaking with the opportunity for public comment, unless the agency for good cause finds that notice and public comment are impracticable, unnecessary, or contrary to the public interest. Except for good cause, the APA further requires a final rule to have an effective date no earlier than 30 days from the date of publication.

In this rulemaking, NCUA invokes the good cause exception to the requirements of the APA. Good cause exists to issue as an interim final rule effective immediately

that expands the “Low-risk assets” risk portfolio to include the NGNs that NCUA already has begun offering to investors, including credit unions. A series of similar NGN offerings is expected. To maximize credit union participation in these offerings of risk-free debt—beginning with the first one, which is set to close imminently—it is essential to implement a rule immediately expanding the “Low-risk assets” definition to include the NGNs, thus relieving credit unions of the risk-weighting disincentive explained above.

In this rulemaking, NCUA has determined that the APA’s usual requirements for public notice and participation before a regulation may take effect would be contrary to the public interest and, further, that good cause exists to waive the customary 30-day period preceding the effective date. Nonetheless, NCUA believes it would benefit from public comments on the Interim Final Rule before adopting a permanent Final Rule. The public is therefore invited to submit comments during a 30-day comment period commencing on the date this Interim Final Rule is published. NCUA plans to revise Interim Final Rule, where appropriate, to reflect the public comments it receives.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a rule may have on a substantial number of small entities (primarily those under ten million dollars in assets). The rule will not have a significant economic impact on a substantial number of small credit unions. Thus, a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

NCUA has determined that this rule will not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on State and local interests. NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily adheres to the fundamental federalism principles addressed by the Executive Order. This rule would not have a substantial direct effect on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Accordingly, this rule does not constitute a policy that has federalism implications for purposes of the Executive Order.

Treasury and General Government Appropriations Act, 1999

NCUA has determined that the rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub.L. 105-277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub.L. 104–121) (SBREFA) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the APA. 5 U.S.C. 551. NCUA does not believe this interim final rule is a

“major rule” within the meaning of the relevant sections of SBREFA. NCUA has submitted the rule to the Office of Management and Budget for its determination in that regard.

List of Subjects in 12 CFR Part 702

Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on October 21, 2010.

Mary F. Rupp
Secretary of the Board

For the reasons discussed above, 12 CFR part 702 is amended as follows:

PART 702 — PROMPT CORRECTIVE ACTION

1. The authority citation for Part 702 continues to read as follows:

Authority: 12 U.S.C. 1766(a), 1790d.

2. Amend § 702.104 by revising paragraph (d) to read as follows:

§ 702.104 Risk portfolios defined.

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(d) *Low-risk assets.* Cash on hand (e.g., coin and currency, including vault, ATM and teller cash), the NCUSIF deposit, and debt instruments unconditionally guaranteed by the National Credit Union Administration;

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