

7535-01-U

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 704

RIN 3133-AD95

Corporate Credit Unions

AGENCY: National Credit Union Administration (NCUA).

ACTION: Proposed Rule with Request for Comments.

SUMMARY: NCUA is issuing proposed amendments to its rule governing corporate credit unions (corporates). The proposed amendments would: (1) delete the definition of “daily average net risk-weighted assets” in §704.2; (2) revise the definition of “net assets” in §704.2 to exclude Central Liquidity Facility (CLF) stock subscriptions; (3) revise §704.6 to clarify certain requirements regarding investment action plans; (4) clarify the weighted average life (WAL) tests in §704.8; (5) revise the consequences of WAL violations in §704.8; (6) substitute the term “core capital” for the phrase “the sum of retained earnings and paid-in capital” in §704.18; (7) correct the heading of §704.19; and (8) correct a date contained in Model Form D of Appendix A to part 704.

DATES: Comments must be received by [INSERT DATE 30 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]. The NCUA Board does not expect significant comment on these amendments and so is issuing the proposal with a 30-day comment period.

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 website:

<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 “Proposed Rule -- Corporate Credit Unions” 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.

Public Inspection: All public comments are available on the agency’s website at <http://www.ncua.gov/Resources/RegulationsOpinionsLaws/ProposedRegulations.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 a.m. and 3 p.m. To make an appointment, call (703) 518-6546 or send an e-mail to OGCMail@ncua.gov.

FOR FURTHER INFORMATION CONTACT: Lisa Henderson, Staff Attorney, Office of General Counsel, at the address above or telephone (703) 518-6540; or David Shetler, Deputy Director, Office of Corporate Credit Unions, at the address above or telephone (703) 518-6640.

SUPPLEMENTARY INFORMATION:

A. Background and Proposed Amendments

In 2010, NCUA published a final rule containing extensive revisions to its corporate rule at 12 CFR part 704. 75 FR 64786 (October 20, 2010). NCUA subsequently issued technical corrections to the final rule and further revisions to part 704. 76 FR 16235 (March 23, 2011); 76 FR 23861 (April 29, 2011). In order to clarify certain provisions and relieve regulatory burden, the NCUA Board is proposing additional changes to part 704. The proposed changes are explained below.

§704.2 Definition of “daily average net risk-weighted assets”

Prior to the 2010 final rule, the NCUA Board issued a proposed rule to revise part 704 in 2009. 74 FR 65210 (December 9, 2009). The 2009 proposal defined the denominator of two new risk based capital ratios as moving “daily average net risk-weighted assets” (DANRA). Some commenters on the proposal questioned the burden of daily risk weighting to produce the moving DANRA figure. The Board agreed that a daily calculation was not necessary and in the final rule replaced the denominator for both new ratios with a new “moving monthly average net risk weighted assets” (MMANRA). 75 FR at 64796. The term “DANRA” is not used in part 704, and its inclusion in §704.2 was an oversight. This proposal removes the DANRA definition from §704.2.

§704.2 Definition of “net assets”

Section 704.2 defines “net assets,” in relevant part, as “total assets less loans guaranteed by the NCUSIF and member reverse repurchase transactions.” The Board is proposing to amend the definition to also exclude CLF stock subscriptions. The Board believes the credit risk of carrying this asset is negligible and warrants such treatment, as CLF stock is puttable at par. Further, the Board strongly believes that all

natural person credit unions should have access to a back-up liquidity provider that can meet their liquidity demands in the event of a wide-spread market disruption. The CLF can supply this liquidity if its borrowing authority is not diminished by a reduction of its stock subscriptions. This proposed change should encourage continued CLF participation by corporates, which in turn will facilitate corporates providing a systemic liquidity benefit to natural person credit unions through offering CLF access as agents.

§704.6 Requirements for investment action plans

Section 704.10 sets out consequences, potentially including the preparation of a written investment action plan, for possessing an investment that fails to meet a requirement of part 704. 12 CFR §704.10. Sections 704.6(c)(3) and (f)(4) trigger these consequences for violations of certain concentration limits and credit rating requirements. 12 CFR §704.6(c)(3) and (f)(4). To clarify the applicability of these triggering provisions, the Board proposes to move them to a new paragraph at §704.6(h). Under proposed §704.6(h), an investment will be subject to the requirements of §704.10 if it violates any of the concentration limits or credit rating requirements of §704.6.

The Board notes that §704.6(f)(4)(i) provides that an investment is subject to the requirements of §704.10 if its credit rating is downgraded, after purchase, “below the minimum rating requirements of this part.” 12 CFR §704.6(f)(4)(i). However, section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act requires NCUA to review its regulations for any references to using credit ratings to assess the creditworthiness of an investment, remove those references, and substitute other standards of creditworthiness.¹ On February 17, 2011, the NCUA Board issued a

¹ Public Law 111-203, §939A (2010).

Notice of Proposed Rulemaking (NPRM) to implement Section 939A. 76 FR 11164 (March 1, 2011). The NPRM recodified §704.6 (f)(4)(i) at §704.6(f)(3)(i) and revised it to state that an investment is subject to §704.10 if “[t]here is reason to believe that the obligor no longer has a very strong capacity to meet its financial obligations for the remaining projected life of the security.” *Id.* at 11171. Although the NCUA Board has not finalized the February 2011 NPRM, this proposed rule includes the proposed revised language at new §704.6(h)(1).

§704.8 Clarifying the WAL tests

Sections 704.8(f) and 704.8(g) establish certain WAL limits for corporate loan and investment portfolios and require each corporate to test those assets periodically for compliance. 12 CFR §§704.8(f) and (g). NCUA intended to allow corporates to include cash in the WAL calculation, and the proposed rule clarifies that intent. The proposed rule substitutes the phrase “loan and investment portfolio” in paragraphs (f) and (g) with the phrase “financial assets, consisting of cash, investments, and loans.” The proposed rule retains the current rule’s exclusion of derivative contracts and equity investments from the WAL calculation.

§704.8 Consequences of WAL violations

Section 704.8(j) provides consequences for a corporate’s violation of the interest rate sensitivity and WAL conditions of §704.8 (d), (f), and (g). 12 CFR §704.8(j). These consequences can include reporting requirements, preparation of a written action plan, and capital category reclassification under §704.4. To reduce regulatory burden, the NCUA Board has determined that violations of WAL conditions should not be subject to capital category reclassification and proposes exempting such violations from the requirements of §704.8(j)(2)(ii) and (iii). However, persistent WAL violations could still trigger the reporting and action plan requirements of §704.8(j)(1) and (2)(i).

§704.18 Fidelity bond maximum deductible

Section 704.18(e)(1) provides a table for corporates to calculate the maximum deductible allowed for fidelity bonds purchased for employees and officials. 12 CFR §704.18(e)(1). The maximum deductible is based on a corporate's core capital ratio and a percentage of the sum of its retained earnings and paid-in capital. The 2010 revision to part 704 changed the term "paid-in capital" to "perpetual contributed capital," but neglected to change the reference in §704.18. See 75 FR 64786 (October 20, 2010).

The NCUA Board is now proposing to change the phrase "the sum of its retained earnings and paid-in capital" to the term "core capital." Section 704.2 defines "core capital" as "the sum of: (1) Retained earnings; (2) Perpetual contributed capital; (3) The retained earnings of any acquired credit union, or of an integrated set of activities and assets, calculated at the point of acquisition, if the acquisition was a mutual combination; and (4) Minority interests in the equity accounts of CUSOs that are fully consolidated. However, minority interests in consolidated ABCP programs sponsored by a corporate credit union are excluded from the credit union's core capital or total capital base if the corporate credit union excludes the consolidated assets of such programs from risk-weighted assets pursuant to Appendix C of this part." 12 CFR §704.2. The Board is proposing this substitution, rather than simply replacing "paid-in capital" with "perpetual contributed capital" because the table already requires the calculation of core capital in deriving the core capital ratio.

§704.19 Correction to section heading

The 2009 proposed revisions to part 704 added new §704.19, "Disclosure of executive and director compensation." 74 FR at 65210, 65252 (December 9, 2009). The proposal would have required corporates to disclose annually the compensation, in dollar terms, of each senior executive officer and director. Id. at 65275. In response to comments, the NCUA Board determined to limit the disclosure requirement to approximately the top ten percent of employees with, generally, a minimum of three

employees who must disclose and a maximum of five. In addition, the Board determined to remove the reference to directors, stating that it was highly unlikely that a director, in his or her capacity as a director, would be among the most highly compensated individuals at the corporate. 75 FR 64786, 64818 (October 20, 2010). This was done in the text of §704.19 but not in the heading. The correction would harmonize the two by removing the words “and director” from the heading.

Appendix A, Model Form D

The 2010 final rule included an incorrect date instruction on Model Form D in Appendix A. *Id.* at 64851. Model Form D included introductory text indicating that the form was for use before October 20, 2011. In fact, because Model Form D deals with nonperpetual capital accounts, the form should be used only on and after October 20, 2011. The proposed correction would replace the word “before” with the phrase “on and after.”

B. Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact any proposed regulation may have on a substantial number of small entities (those under \$10 million in assets). The proposed rule applies only to corporate credit unions, all of which have assets well in excess of \$10 million. Accordingly, the proposed rule will not have a significant economic impact on a substantial number of small credit unions, and a regulatory flexibility analysis is not required.

Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) applies to rulemakings in which an agency by rule creates a new paperwork burden on regulated entities or modifies an existing burden. 44 U.S.C. 3507(d); 5 CFR part 1320. For purposes of the PRA, a paperwork burden may take the form of either a reporting or a recordkeeping requirement, both referred to as information collections. This proposed rule does not impose any new paperwork burden.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order.

The proposed rule would not have substantial direct effects on the states, on the connection between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999--Assessment of Federal Regulations and Policies on Families

NCUA has determined that this proposed 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).

List of Subjects in 12 CFR part 704

Credit unions, Corporate credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on August 29, 2011.

Mary F. Rupp
Secretary of the Board

For the reasons stated above, the National Credit Union Administration proposes to amend 12 CFR part 704 as set forth below:

PART 704--CORPORATE CREDIT UNIONS

1. The authority citation for part 704 continues to read as follows:

Authority: 12 U.S.C. 1762, 1766(a), 1772a, 1781, 1789, and 1795e.

2. Amend §704.2 by removing the definition of “daily average net risk-weighted assets” and revising the definition of “net assets” to read as follows:

§704.2 Definitions.

* * * * *

Net assets means total assets less Central Liquidity Facility (CLF) stock subscriptions, loans guaranteed by the NCUSIF, and member reverse repurchase transactions. For its own account a corporate credit union’s payables under reverse repurchase agreements and receivables under repurchase agreements may be netted out if the GAAP conditions for offsetting are met. Also, any amounts deducted from core capital in calculating adjusted core capital are also deducted from net assets.

* * * * *

3. Amend §704.6 by removing §704.6(c)(3) and §704.6(f)(4) and adding new §704.6(h) to read as follows:

§704.6 Credit risk management.

* * * * *

(h) Requirements for investment action plans.

An investment is subject to the requirements of §704.10 of this part if:

(1) There is reason to believe that the obligor no longer has a very strong capacity to meet its financial obligations for the remaining projected life of the security; or

(2) The investment is part of an asset class or group of investments that exceeds the issuer, sector, or subsector concentration limits of this section. For purposes of measurement, each new credit transaction must be evaluated in terms of the corporate credit union's capital at the time of the transaction. An investment that fails a requirement of this section because of a subsequent reduction in capital will be deemed non-conforming. A corporate credit union is required to exercise reasonable efforts to bring nonconforming investments into conformity within 90 calendar days. Investments that remain nonconforming for more than 90 calendar days will be deemed to fail a requirement of this section and the corporate credit union will have to comply with §704.10 of this part.

4. Amend §704.8 by:

a. Revising the first two sentences in paragraphs (f) and (g); and

b. Revising (j)(2)(ii) and (iii).

The revisions read as follows:

§704.8 Asset and liability management.

* * * * *

(f) * * * The weighted average life (WAL) of a corporate credit union's financial assets, consisting of cash, investments, and loans, but excluding derivative contracts and equity investments, may not exceed 2 years. A corporate credit union must test its financial assets at least quarterly, including once on the last day of the calendar quarter, for compliance with this WAL limitation. * * *

(g) * * * The weighted average life (WAL) of a corporate credit union's financial assets, consisting of cash, investments, and loans, but excluding derivative contracts and equity investments, may not exceed 2.25 years when prepayment speeds are reduced by 50 percent. A corporate credit union must test its financial assets at least quarterly, including once on the last day of the calendar quarter, for compliance with this WAL limitation. * * *

* * * * *

(j) * * *

(2) * * *

(ii) If presently categorized as adequately capitalized or well capitalized for prompt corrective action purposes, and the violation was of paragraph (d) of this section, immediately be recategorized as undercapitalized until the violation is corrected, and

(iii) If presently less than adequately capitalized, and the violation was of paragraph (d) of this section, immediately be downgraded one additional capital category.

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5. Amend §704.18 by revising the table at §704.18(e)(1) to read as follows:

§704.18 Fidelity bond coverage.

* * * * *

(1) * * *

Core capital ratio	Maximum deductible
Less than 1.0 percent	7.5 percent of core capital
1.0 – 1.74 percent	10.0 percent of core capital
1.75 – 2.24 percent	12.0 percent of core capital
Greater than 2.25 percent	15.0 percent of core capital

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6. Amend §704.19 by revising the section heading to read as follows:

§704.19 Disclosure of executive compensation.

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7. Amend the introductory note in Model Form D, Appendix A, to read as follows:

Appendix A to Part 704 – Capital Prioritization and Model Forms

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Model Form D

Note: This form is for use on and after October 20, 2011, in the circumstances where the corporate credit union has determined that it will give newly issued capital priority over older capital as described in Part I of this Appendix.

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