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the Federal Credit Union Act (12 U.S.C. 1757(8)).

*Securities lending* means lending a security to a counterparty, either directly or through an agent, and accepting collateral in return.

*Senior management employee* means a chief executive officer, any assistant chief executive officer (e.g., any assistant president, any vice president or any assistant treasurer/manager), and the chief financial officer (controller).

*Settlement date* means the date originally agreed to by a corporate credit union and a counterparty for settlement of the purchase or sale of a security.

*Short sale* means the sale of a security not owned by the seller.

*Small business related security* means a security as defined in section 3(a)(53) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(53)), e.g., a security that is rated in 1 of the 4 highest rating categories by at least one nationally recognized statistical rating organization, and represents an interest in 1 or more promissory notes or leases of personal property evidencing the obligation of a small business concern and originated by an insured depository institution, insured credit union, insurance company, or similar institution which is supervised and examined by a Federal or State authority, or a finance company or leasing company. This definition does not include Small Business Administration securities permissible under § 107(7) of the Act.

*Stripped mortgage-backed security* means a security that represents either the principal or interest only portion of the cash flows of an underlying pool of mortgages.

*Trade date* means the date a corporate credit union originally agrees, whether orally or in writing, to enter into the purchase or sale of a security.

*Weighted average life* means the weighted-average time to the return of a dollar of principal, calculated by multiplying each portion of principal received by the time at which it is expected to be received (based on a reasonable and supportable estimate of that time) and then summing and dividing by the total amount of principal.

*When-issued trading* means the buying and selling of securities in the period between the announcement of an offering and the issuance and payment date of the securities.

*Wholesale corporate credit union* means a corporate credit union which primarily serves other corporate credit unions.

[62 FR 12938, Mar. 19, 1997, as amended at 67 FR 65651, Oct. 25, 2002; 69 FR 39832, July 1, 2004; 73 FR 72692, Dec. 1, 2008]

### § 704.3 Corporate credit union capital.

(a) *Capital plan.* A corporate credit union must develop and ensure implementation of written short- and long-term capital goals, objectives, and strategies which provide for the building of capital consistent with regulatory requirements, the maintenance of sufficient capital to support the risk exposures that may arise from current and projected activities, and the periodic review and reassessment of the capital position of the corporate credit union.

(b) *Requirements for membership capital—(1) Form.* Membership capital funds may be in the form of a term certificate or an adjusted balance account.

(2) *Disclosure.* The terms and conditions of a membership capital account must be disclosed to the recorded owner of the account at the time the account is opened and at least annually thereafter.

(i) The initial disclosure must be signed by either all of the directors of the member credit union or, if authorized by board resolution, the chair and secretary of the board; and

(ii) The annual disclosure notice must be signed by the chair of the corporate credit union. The chair must sign a statement that certifies that the notice has been sent to member credit unions with membership capital accounts. The certification must be maintained in the corporate credit union's files and be available for examiner review.

(3) *Three-year remaining maturity.* When a membership capital account has been placed on notice or has a remaining maturity of less than three years, the amount of the account that can be considered membership capital

is reduced by a constant monthly amortization that ensures membership capital is fully amortized one year before the date of maturity or one year before the end of the notice period. The full balance of a membership capital account being amortized, not just the remaining non-amortized portion, is available to absorb losses in excess of the sum of retained earnings and paid-in capital until the funds are released by the corporate credit union at the time of maturity or the conclusion of the notice period.

(4) *Release.* Membership capital may not be released due solely to the merger, charter conversion or liquidation of a member credit union. In the event of a merger, the membership capital transfers to the continuing credit union. In the event of a charter conversion, the membership capital transfers to the new institution. In the event of liquidation, the membership capital may be released to facilitate the payout of shares with the prior written approval of the OCCU Director.

(5) *Sale.* A member may sell its membership capital to another member in the corporate credit union's field of membership, subject to the corporate credit union's approval.

(6) *Liquidation.* In the event of liquidation of a corporate credit union, membership capital is payable only after satisfaction of all liabilities of the liquidation estate, including uninsured share obligations to shareholders and the National Credit Union Share Insurance Fund (NCUSIF), but excluding paid-in capital.

(7) *Merger.* In the event of a merger of a corporate credit union, membership capital transfers to the continuing corporate credit union. The minimum three-year notice period for withdrawal of membership capital remains in effect.

(8) *Adjusted balance accounts:*

(i) May be adjusted no more frequently than once every six months; and

(ii) Must be adjusted in relation to a measure, *e.g.*, one percent of a member credit union's assets, established and disclosed at the time the account is opened without regard to any minimum withdrawal period. If the measure is other than assets, the corporate

credit union must address the measure's permanency characteristics in its capital plan.

(iii) *Notice of withdrawal.* Upon written notice of intent to withdraw membership capital, the balance of the account will be frozen (no further adjustments) until the conclusion of the notice period.

(9) *Grandfathering.* Membership capital issued before the effective date of this regulation is exempt from the limitation of § 704.3(b)(8)(i).

(c) *Requirements for paid-in capital—(1) Disclosure.* The terms and conditions of any paid-in capital instrument must be disclosed to the recorded owner of the instrument at the time the instrument is created and must be signed by either all of the directors of the member credit union or, if authorized by board resolution, the chair and secretary of the board.

(2) *Release.* Paid-in capital may not be released due solely to the merger, charter conversion or liquidation of a member credit union. In the event of a merger, the paid-in capital transfers to the continuing credit union. In the event of a charter conversion, the paid-in capital transfers to the new institution. In the event of liquidation, the paid-in capital may be released to facilitate the payout of shares with the prior written approval of the OCCU Director.

(3) *Callability.* Paid-in capital accounts are callable on a pro-rata basis across an issuance class only at the option of the corporate credit union and only if the corporate credit union meets its minimum level of required capital and NEV ratios after the funds are called.

(4) *Liquidation.* In the event of liquidation of the corporate credit union, paid-in capital is payable only after satisfaction of all liabilities of the liquidation estate, including uninsured share obligations to shareholders, the NCUSIF, and membership capital holders.

(5) *Merger.* In the event of a merger of a corporate credit union, paid-in capital shall transfer to the continuing corporate credit union.

(6) *Paid-in capital.* Paid-in capital includes both member and nonmember paid-in capital.

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(i) Member paid-in capital means paid-in capital that is held by the corporate credit union's members. A corporate credit union may not condition membership, services, or prices for services on a credit union's ownership of paid-in capital.

(ii) Nonmember paid-in capital means paid-in capital that is not held by the corporate credit union's members.

(7) *Grandfathering.* A corporate credit union's authority to include paid-in capital as a component of capital is governed by the regulation in effect at the time the paid-in capital was issued. When a grandfathered paid-in capital instrument has a remaining maturity of less than 3 years, the amount that may be considered paid-in capital is reduced by a constant monthly amortization that ensures the paid-in capital is fully amortized 1 year before the date of maturity. The full balance of grandfathered paid-in capital being amortized, not just the remaining non-amortized portion, is available to absorb losses in excess of retained earnings until the funds are released by the corporate credit union at maturity.

(d) *Capital ratio.* A corporate credit union will maintain a minimum capital ratio of 4 percent, except as otherwise provided in this part. A corporate credit union must calculate its capital ratio at least monthly.

(e) *Individual capital ratio requirement—(1)* When significant circumstances or events warrant, the OCCU Director may require a different minimum capital ratio for an individual corporate credit union based on its circumstances. Factors that may warrant a different minimum capital ratio include, but are not limited to:

(i) An expectation that the corporate credit union has or anticipates losses resulting in capital inadequacy;

(ii) Significant exposure exists, unsupported by adequate capital or risk management processes, due to credit, liquidity, market, fiduciary, operational, and similar types of risks;

(iii) A merger has been approved; or

(iv) An emergency exists because of a natural disaster.

(2) When the OCCU Director determines that a different minimum capital ratio is necessary or appropriate

for a particular corporate credit union, he or she will notify the corporate credit union in writing of the proposed capital ratio and the date by which the capital ratio must be reached. The OCCU Director also will provide an explanation of why the proposed capital ratio is considered necessary or appropriate.

(3)(i) The corporate credit union may respond to any or all of the items in the notice. The response must be in writing and delivered to the OCCU Director within 30 calendar days after the date on which the corporate credit union received the notice. The OCCU Director may shorten the time period when, in its opinion, the condition of the corporate credit union so requires, provided that the corporate credit union is informed promptly of the new time period, or with the consent of the corporate credit union. In its discretion, the OCCU Director may extend the time period for good cause.

(ii) Failure to respond within 30 calendar days or such other time period as may be specified by the OCCU Director shall constitute a waiver of any objections to any item in the notice. Failure to address any item in a response shall constitute a waiver of any objection to that item.

(iii) After the close of the corporate credit union's response period, the OCCU Director will decide, based on a review of the corporate credit union's response and other information concerning the corporate credit union, whether a different minimum capital ratio should be established for the corporate credit union and, if so, the capital ratio and the date the requirement must be reached. The corporate credit union will be notified of the decision in writing. The notice will include an explanation of the decision, except for a decision not to establish a different minimum capital ratio for the corporate credit union.

(f) *Failure to maintain minimum capital ratio requirement.* When a corporate credit union's capital ratio falls below the minimum required by paragraphs (d) or (e) of this section, or appendix B to this part, as applicable, operating management of the corporate credit

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union must notify its board of directors, supervisory committee, and the OCCU Director within 10 calendar days.

(g) *Capital restoration plan.* (1) A corporate credit union must submit a plan to restore and maintain its capital ratio at the minimum requirement when either of the following conditions exist:

(i) The capital ratio falls below the minimum requirement and is not restored to the minimum requirement by the next month end; or

(ii) Regardless of whether the capital ratio is restored by the next month end, the capital ratio falls below the minimum requirement for three months in any 12-month period.

(2) The capital restoration plan must, at a minimum, include the following:

(i) Reasons why the capital ratio fell below the minimum requirement;

(ii) Descriptions of steps to be taken to restore the capital ratio to the minimum requirement within specific time frames;

(iii) Actions to be taken to maintain the capital ratio at the minimum required level and increase it thereafter;

(iv) Balance sheet and income projections, including assumptions, for the current calendar year and one additional calendar year; and

(v) Certification from the board of directors that it will follow the proposed plan if approved by the OCCU Director.

(3) The capital restoration plan must be submitted to the OCCU Director within 30 calendar days of the occurrence. The OCCU Director will respond to the corporate credit union regarding the adequacy of the plan within 45 calendar days of its receipt.

(h) *Capital directive.* (1) If a corporate credit union fails to submit a capital restoration plan; or the plan submitted is not deemed adequate to either restore capital or restore capital within a reasonable time; or the credit union fails to implement its approved capital restoration plan, NCUA may issue a capital directive.

(2) A capital directive may order a corporate credit union to:

(i) Achieve adequate capitalization within a specified time frame by taking any action deemed necessary, including but not limited to the following:

(A) Increase the amount of capital to specific levels;

(B) Reduce dividends;

(C) Limit receipt of deposits to those made to existing accounts;

(D) Cease or limit issuance of new accounts or any or all classes of accounts;

(E) Cease or limit lending or making a particular type or category of loans;

(F) Cease or limit the purchase of specified investments;

(G) Limit operational expenditures to specified levels;

(H) Increase and maintain liquid assets at specified levels; and

(I) Restrict or suspend expanded authorities issued under appendix B of this part.

(ii) Adhere to a previously submitted plan to achieve adequate capitalization.

(iii) Submit and adhere to a capital plan acceptable to NCUA describing the means and a time schedule by which the corporate credit union shall achieve adequate capitalization.

(iv) Meet with NCUA.

(v) Take a combination of these actions.

(3) Prior to issuing a capital directive, NCUA will notify a corporate credit union in writing of its intention to issue a capital directive.

(i) The notice will state:

(A) The reasons for the issuance of the directive; and

(B) The proposed content of the directive.

(ii) A corporate credit union must respond in writing within 30 calendar days of receipt of the notice stating that it either concurs or disagrees with the notice. If it disagrees with the notice, it must state the reasons why the directive should not be issued and/or propose alternative contents for the directive. The response should include all matters that the corporate credit union wishes to be considered. For good cause, including the following conditions, the response time may be shortened or lengthened:

(A) When the condition of the corporate requires, and the corporate credit union is notified of the shortened response period in the notice;

(B) With the consent of the corporate credit union; or

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(C) When the corporate credit union already has advised NCUA that it cannot or will not achieve adequate capitalization.

(iii) Failure to respond within 30 calendar days, or another time period specified in the notice, shall constitute a waiver of any objections to the proposed directive.

(4) After the closing date of the corporate credit union's response period, or the receipt of the response, if earlier, NCUA shall consider the response and may seek additional information or clarification. Based on the information provided during the response period, NCUA will determine whether or not to issue a capital directive and, if issued, the form it should take.

(5) Upon issuance, a capital directive and a statement of the reasons for its issuance will be delivered to the corporate credit union. A directive is effective immediately upon receipt by the corporate credit union, or upon such later date as may be specified therein, and shall remain effective and enforceable until it is stayed, modified, or terminated by NCUA.

(6) A capital directive may be issued in addition to, or in lieu of, any other action authorized by law in response to a corporate credit union's failure to achieve or maintain the applicable minimum capital ratios.

(7) Upon a change in circumstances, a corporate credit union may request reconsideration of the terms of the directive. Requests that are not based on a significant change in circumstances or are repetitive or frivolous will not be considered. Pending a decision on reconsideration, the directive shall continue in full force and effect.

(i) *Earnings retention requirement.* A corporate credit union must increase retained earnings if the prior month-end retained earnings ratio is less than 2 percent.

(1) Its retained earnings must increase:

(i) During the current month, by an amount equal to or greater than the monthly earnings retention amount; or

(ii) During the current and prior two months, by an amount equal to or greater than the quarterly earnings retention amount.

(2) Earnings retention amounts are calculated as follows:

(i) The monthly earnings retention amount is determined by multiplying the earnings retention factor by the prior month-end moving daily average net assets; and

(ii) The quarterly earnings retention amount is determined by multiplying the earnings retention factor by moving daily average net assets for each of the prior three month-ends.

(3) The earnings retention factor is determined as follows:

(i) If the prior month-end retained earnings ratio is less than 2 percent and the core capital ratio is less than 3 percent, the earnings retention factor is .15 percent per annum; or

(ii) If the prior month-end retained earnings ratio is less than 2 percent and the core capital ratio is equal to or greater than 3 percent, the earnings retention factor is .10 percent per annum.

(4) The OCCU Director may approve a decrease to the earnings retention amount if it is determined a lesser amount is necessary to avoid a significant adverse impact upon a corporate credit union.

(5) Operating management of the corporate credit union must notify its board of directors, supervisory committee, the OCCU Director and, if applicable, the state regulator within 10 calendar days of determining that the retained earnings ratio has declined below 2 percent. If the decline in the retained earnings ratio is due, in full or in part, to a decline in the dollar amount of retained earnings and the retained earnings ratio is not restored to at least 2 percent by the next month end, a retained earnings action plan is required to be submitted within 30 calendar days.

(6) The retained earnings action plan must be submitted to the OCCU Director and, if applicable, the state regulator and, at a minimum, include the following:

(i) Reasons why the dollar amount of retained earnings has decreased;

(ii) Description of actions to be taken to increase the dollar amount of retained earnings within specific time frames; and

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(iii) Monthly balance sheet and income projections, including assumptions, for the next 12-month period.

[62 FR 12938, Mar. 19, 1997, as amended at 67 FR 65652, 65659, Oct. 25, 2002]

### § 704.4 Board responsibilities.

(a) *General.* A corporate credit union's board of directors must approve comprehensive written strategic plans and policies, review them annually, and provide them upon request to the auditors, supervisory committee, and NCUA.

(b) *Policies.* A corporate credit union's policies must be commensurate with the scope and complexity of the corporate credit union.

(c) *Other requirements.* The board of directors of a corporate credit union must ensure:

(1) Senior managers have an in-depth, working knowledge of their direct areas of responsibility and are capable of identifying, hiring, and retaining qualified staff;

(2) Qualified personnel are employed or under contract for all line support and audit areas, and designated backup personnel or resources with adequate cross-training are in place;

(3) GAAP is followed, except where law or regulation has provided for a departure from GAAP;

(4) Accurate balance sheets, income statements, and internal risk assessments (*e.g.*, risk management measures of liquidity, market, and credit risk associated with current activities) are produced timely in accordance with §§ 704.6, 704.8, and 704.9;

(5) Systems are audited periodically in accordance with industry-established standards;

(6) Financial performance is evaluated to ensure that the objectives of the corporate credit union and the responsibilities of management are met; and

(7) Planning addresses the retention of external consultants, as appropriate, to review the adequacy of technical, human, and financial resources dedicated to support major risk areas.

[62 FR 12938, Mar. 19, 1997, as amended at 67 FR 65654, Oct. 25, 2002]

### § 704.5 Investments.

(a) *Policies.* A corporate credit union must operate according to an investment policy that is consistent with its other risk management policies, including, but not limited to, those related to credit risk management, asset and liability management, and liquidity management. The policy must address, at a minimum:

(1) Appropriate tests and criteria for evaluating investments and investment transactions before purchase; and

(2) Reasonable and supportable concentration limits for limited liquidity investments in relation to capital.

(b) *General.* All investments must be U.S. dollar-denominated and subject to the credit policy restrictions set forth in § 704.6.

(c) *Authorized activities.* A corporate credit union may invest in:

(1) Securities, deposits, and obligations set forth in Sections 107(7), 107(8), and 107(15) of the Federal Credit Union Act, 12 U.S.C. 1757(7), 1757(8), and 1757(15), except as provided in this section;

(2) Deposits in, the sale of federal funds to, and debt obligations of corporate credit unions, Section 107(8) institutions, and state banks, trust companies, and mutual savings banks not domiciled in the state in which the corporate credit union does business;

(3) Corporate CUSOs, as defined in and subject to the limitations of § 704.11;

(4) Marketable debt obligations of corporations chartered in the United States. This authority does not apply to debt obligations that are convertible into the stock of the corporation; and

(5) Domestically-issued asset-backed securities.

(d) *Repurchase agreements.* A corporate credit union may enter into a repurchase agreement provided that:

(1) The corporate credit union, directly or through its agent, receives written confirmation of the transaction, and either takes physical possession or control of the repurchase securities or is recorded as owner of the repurchase securities through the Federal Reserve Book-Entry Securities Transfer System;