

National Credit Union Administration

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(9) Internal control procedures that will be implemented, including audit requirements.

(c) A third-party seeking approval of an investment pilot program must submit a request to the Director of the Office of Capital Markets and Planning that addresses the following items:

(1) A complete description of the activities with specific examples of how a credit union will conduct and account for them, and how they will benefit a Federal credit union;

(2) A description of any risks to a Federal credit union from participating in the program; and

(3) Contracts that must be executed by the Federal credit union.

(d) A Federal credit union need not obtain individual written approval to engage in investment activities prohibited by this part but permitted by statute where the activities are part of a third-party investment program that NCUA has approved under this section.

[68 FR 32960, June 3, 2003, as amended at 69 FR 39832, July 1, 2004; 70 FR 55517, Sept. 22, 2005]

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AUTHORITY: 12 U.S.C. 1766(a), 1781, 1789.

SOURCE: 62 FR 12938, Mar. 19, 1997, unless otherwise noted.

§ 704.1 Scope.

(a) This part establishes special rules for all federally insured corporate credit unions. Non federally insured corporate credit unions must agree, by written contract, to both adhere to the requirements of this part and submit to examinations, as determined by NCUA, as a condition of receiving shares or deposits from federally insured credit unions. This part grants certain additional authorities to federal corporate credit unions. Except to the extent that they are inconsistent with this part, other provisions of NCUA's Rules and Regulations (12 CFR chapter VII) and the Federal Credit Union Act apply to federally chartered corporate credit unions and federally insured state-chartered corporate credit unions to the same extent that they apply to other federally chartered and federally insured state-chartered credit unions, respectively.

(b) The Board has the authority to issue orders which vary from this part. This authority is provided under Section 120(a) of the Federal Credit Union Act, 12 U.S.C. 1766(a). Requests by state-chartered corporate credit unions for waivers to this part and for expansions of authority under appendix B of this part must be approved by the state regulator before being submitted to NCUA.

§ 704.2 Definitions.

Adjusted trading means any method or transaction whereby a corporate credit union sells a security to a vendor at a price above its current market price and simultaneously purchases or commits to purchase from the vendor another security at a price above its current market price.

Asset-backed security (ABS) means a security that is primarily serviced by the cashflows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the securityholders. This definition excludes mortgage related securities.

Capital means the sum of a corporate credit union's retained earnings, paid-in capital, and membership capital. For a corporate credit union that acquires another credit union in a mutual combination, capital includes the retained earnings of the acquired credit union, or of an integrated set of activities and assets, at the point of acquisition.

Capital ratio means the corporate credit union's capital divided by its moving daily average net assets.

Collateralized mortgage obligation (CMO) means a multi-class mortgage related security.

Core capital means the sum of a corporate credit union's retained earnings, and paid-in capital. For a corporate credit union that acquires another credit union in a mutual combination, core capital includes the retained earnings of the acquired credit union, or of an integrated set of activities and assets, at the point of acquisition.

Core capital ratio means the corporate credit union's core capital divided by its moving daily average net assets.

Corporate credit union means an organization that:

- (1) Is chartered under Federal or state law as a credit union;
- (2) Receives shares from and provides loan services to credit unions;
- (3) Is operated primarily for the purpose of serving other credit unions;
- (4) Is designated by NCUA as a corporate credit union;
- (5) Limits natural person members to the minimum required by state or federal law to charter and operate the credit union; and
- (6) Does not condition the eligibility of any credit union to become a member on that credit union's membership in any other organization.

Daily average net assets means the average of net assets calculated for each day during the period.

Derivatives means any derivative instrument as defined under generally accepted accounting principles (GAAP).

Dollar roll means the purchase or sale of a mortgage backed security to a counterparty with an agreement to resell or repurchase a substantially identical security at a future date and at a specified price.

Embedded option means a characteristic of certain assets and liabilities which gives the issuer of the instrument the ability to change the features such as final maturity, rate, principal amount and average life. Options include, but are not limited to, calls, caps, and prepayment options.

Exchangeable collateralized mortgage obligation means a class of a collateralized mortgage obligation (CMO) that, at the time of purchase, represents beneficial ownership interests in a combination of two or more underlying classes of the same CMO structure. The holder of an exchangeable CMO may pay a fee and take delivery of the underlying classes of the CMO.

Fair value means the amount at which an instrument could be exchanged in a current, arms-length transaction between willing parties, as opposed to a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value. If a quoted market price in an active market is not available, fair value may be estimated using a valuation technique that is reasonable and supportable, a quoted market price in an active market for a similar instrument, or a current appraised value. Examples of valuation techniques include the present value of estimated future cash flows, option-pricing models, and option-adjusted spread models. Valuation techniques should incorporate assumptions that market participants would use in their estimates of values, future revenues, and future expenses, including assumptions about interest rates, default, prepayment, and volatility.

Federal funds transaction means a short-term or open-ended unsecured transfer of immediately available funds by one depository institution to another depository institution or entity.

Foreign bank means an institution which is organized under the laws of a country other than the United States, is engaged in the business of banking, and is recognized as a bank by the banking supervisory authority of the country in which it is organized.

Forward settlement of a transaction means settlement on a date later than regular-way settlement.

Immediate family member means a spouse or other family member living in the same household.

Limited liquidity investment means a private placement or funding agreement.

Member reverse repurchase transaction means an integrated transaction in which a corporate credit union purchases a security from one of its member credit unions under agreement by that member credit union to repurchase the same security at a specified time in the future. The corporate credit union then sells that same security, on the same day, to a third party, under agreement to repurchase it on the same date on which the corporate credit union is obligated to return the security to its member credit union.

Membership capital means funds contributed by members that: are adjustable balance with a minimum withdrawal notice of 3 years or are term certificates with a minimum term of 3 years; are available to cover losses that exceed retained earnings and paid-in capital; are not insured by the NCUSIF or other share or deposit insurers; and cannot be pledged against borrowings.

Mortgage related security means a security as defined in section 3(a)(41) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(41), e.g., a privately-issued security backed by mortgages secured by real estate upon which is located a dwelling, mixed residential and commercial structure, residential manufactured home, or commercial structure that is rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization.

Moving daily average net assets means the average of daily average net assets exclusive of identifiable intangibles and goodwill for the month being measured and the previous eleven (11) months.

Mutual combination means a transaction or event in which a corporate credit union acquires another credit union, or acquires an integrated set of activities and assets that is capable of being conducted and managed as a credit union.

NCUA means NCUA Board (Board), unless the particular action has been delegated by the Board.

Net assets means total assets less Central Liquidity Facility (CLF) stock subscriptions, CLF loans guaranteed by the NCUSIF, U.S. Central CLF certificates, 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 Generally Accepted Accounting Principles (GAAP) conditions for offsetting are met.

Net economic value (NEV) means the fair value of assets minus the fair value of liabilities. All fair value calculations must include the value of forward settlements and embedded options. The amortized portion of membership capital and paid-in capital, which do not qualify as capital, are treated as liabilities for purposes of this calculation. The NEV ratio is calculated by dividing NEV by the fair value of assets.

Obligor means the primary party obligated to repay an investment, e.g., the issuer of a security, the taker of a deposit, or the borrower of funds in a federal funds transaction. Obligor does not include an originator of receivables underlying an asset-backed security, the servicer of such receivables, or an insurer of an investment.

Official means any director or committee member.

Paid-in capital means accounts or other interests of a corporate credit union that: are perpetual, non-cumulative dividend accounts; are available to cover losses that exceed retained earnings; are not insured by the NCUSIF or other share or deposit insurers; and cannot be pledged against borrowings.

Pair-off transaction means a security purchase transaction that is closed out or sold at, or prior to, the settlement or expiration date.

Quoted market price means a recent sales price or a price based on current bid and asked quotations.

Regular-way settlement means delivery of a security from a seller to a buyer within the time frame that the securities industry has established for immediate delivery of that type of security. For example, regular-way settlement of a Treasury security includes settlement on the trade date ("cash"), the business day following the trade date

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(“regular way”), and the second business day following the trade date (“skip day”).

Repurchase transaction means a transaction in which a corporate credit union agrees to purchase a security from a counterparty and to resell the same or any identical security to that counterparty at a specified future date and at a specified price.

Residual interest means the remainder cash flows from a CMO or ABS transaction after payments due bondholders and trust administrative expenses have been satisfied.

Retained earnings means the total of the corporate credit union’s undivided earnings, reserves, and any other appropriations designated by management or regulatory authorities. For purposes of this regulation, retained earnings does not include the allowance for loan and lease losses account, accumulated unrealized gains and losses on available for sale securities, or other comprehensive income items.

Retained earnings ratio means the corporate credit union’s retained earnings divided by its moving daily average net assets. For a corporate credit union that acquires another credit union in a mutual combination, the numerator of the retained earnings ratio also includes the retained earnings of the acquired credit union, or of an integrated set of activities and assets, at the point of acquisition.

Section 107(8) institution means an institution described in Section 107(8) of 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]

EFFECTIVE DATE NOTES: 1. At 75 FR 64826, Oct. 20, 2010, § 704.2 was revised, effective Jan. 18, 2011. For the convenience of the user, the revised text is set forth as follows:

§ 704.2 Definitions.

As used in this part:

Adjusted trading means any method or transaction whereby a corporate credit

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union sells a security to a vendor at a price above its current market price and simultaneously purchases or commits to purchase from the vendor another security at a price above its current market price.

Asset-backed security (ABS) means a security that is primarily serviced by the cashflows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the security holders. Mortgage-backed securities are a type of asset-backed security.

Available to cover losses that exceed retained earnings means that the funds are available to cover operating losses realized, in accordance with generally accepted accounting principles (GAAP), by the corporate credit union that exceed retained earnings net of equity acquired in a combination. Likewise, *available to cover losses that exceed retained earnings and perpetual contributed capital (PCC)* means that the funds are available to cover operating losses realized, in accordance with GAAP, by the corporate credit union that exceed retained earnings net of equity acquired in a combination and PCC. Any such losses must be distributed *pro rata* at the time the loss is realized first among the holders of paid-in capital (PIC), and when all PIC is exhausted, then *pro rata* among all MCAs, all subject to the optional prioritization described in appendix A of this Part. To the extent that any contributed capital funds are used to cover losses, the corporate credit union must not restore or replenish the affected capital accounts under any circumstances. In addition, contributed capital that is used to cover losses in a calendar year previous to the year of liquidation has no claim against the liquidation estate.

Capital means the sum of a corporate credit union's retained earnings, paid-in capital, and membership capital. For a corporate credit union that acquires another credit union in a mutual combination, capital includes the retained earnings of the acquired credit union, or of an integrated set of activities and assets, at the point of acquisition.

Capital ratio means the corporate credit union's capital divided by its moving daily average net assets.

Collateralized debt obligation (CDO) means a debt security collateralized by mortgage-backed securities, asset-backed securities, or corporate obligations in the form of loans or debt. Senior tranches of Re-REMIC's consisting of senior mortgage- and asset-backed securities are excluded from this definition.

Collateralized mortgage obligation (CMO) means a multi-class mortgage-backed security.

Commercial mortgage-backed security (CMBS) means a mortgage-backed security collateralized primarily by multi-family and commercial property loans.

Compensation means all salaries, fees, wages, bonuses, severance payments, current year contributions to employee benefit plans (for example, medical, dental, life insurance, and disability), current year contributions to deferred compensation plans and future severance payments, including payments in connection with a merger or similar combination (whether or not funded; whether or not vested; and whether or not the deferred compensation plan is a qualified plan under Section 401(a) of the IRS Code). Compensation also includes expense accounts and other allowances (for example, the value of the personal use of housing, automobiles or other assets owned by the corporate credit union; expense allowances or reimbursements that recipients must report as income on their separate income tax return; payments made under indemnification arrangements; and payments made for the benefit of friends or relatives). In calculating required compensation disclosures, reasonable estimates may be used if precise cost figures are not readily available.

Contributed capital means either paid-in capital or membership capital accounts.

Core capital means the sum of:

- (1) Retained earnings;
- (2) Paid-in capital; and
- (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.

Core capital ratio means the corporate credit union's core capital divided by its moving daily average net assets.

Corporate credit union means an organization that:

- (1) Is chartered under Federal or state law as a credit union;
- (2) Receives shares from and provides loan services to credit unions;
- (3) Is operated primarily for the purpose of serving other credit unions;
- (4) Is designated by NCUA as a corporate credit union;
- (5) Limits natural person members to the minimum required by state or federal law to charter and operate the credit union; and
- (6) Does not condition the eligibility of any credit union to become a member on that credit union's membership in any other organization.

Daily average net assets means the average of net assets calculated for each day during the period.

Derivatives means a financial contract whose value is derived from the values of one or more underlying assets, reference rates, or indices of asset values or reference rates. Derivative contracts include interest rate

derivative contracts, exchange rate derivative contracts, equity derivative contracts, commodity derivative contracts, credit derivative contracts, and any other instrument that poses similar counterparty credit risks.

Dollar roll means the purchase or sale of a mortgage-backed security to a counterparty with an agreement to resell or repurchase a substantially identical security at a future date and at a specified price.

Embedded option means a characteristic of certain assets and liabilities which gives the issuer of the instrument the ability to change the features such as final maturity, rate, principal amount and average life. Options include, but are not limited to, calls, caps, and prepayment options.

Equity investments means investments in real property, equity securities, and any other ownership interests, including, for example, investments in partnerships and limited liability companies.

Equity security means any security representing an ownership interest in an enterprise (for example, common, preferred, or other capital stock) or the right to acquire (for example, warrants and call options) or dispose of (for example, put options) an ownership interest in an enterprise at fixed or determinable prices. However, the term does not include convertible debt or preferred stock that by its terms either must be redeemed by the issuing enterprise or is redeemable at the option of the investor.

Exchangeable collateralized mortgage obligation means a class of a collateralized mortgage obligation (CMO) that, at the time of purchase, represents beneficial ownership interests in a combination of two or more underlying classes of the same CMO structure. The holder of an exchangeable CMO may pay a fee and take delivery of the underlying classes of the CMO.

Fair value means the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. If there is a principal market for the asset or liability, the fair value measurement is the price in that market (whether that price is directly observable or otherwise determined using a valuation technique), even if the price in a different market is potentially more advantageous at the measurement date. In the absence of a principal market, the fair value measurement occurs in the most advantageous market for the asset or liability. The fair value of the asset or liability shall be determined based on the assumptions that market participants would use in pricing the asset or liability. In developing those assumptions, the corporate need not identify specific market participants. Rather, the corporate should identify characteristics that distinguish market participants generally, considering factors specific to all of the following: the asset or liability;

the principal (or most advantageous) market for the asset or liability; and market participants with whom the corporate would transact in that market. To increase consistency and comparability in fair value measurements and related disclosures, the fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Examples of valuation techniques include the present value of estimated future cash flows, option-pricing models, and option-adjusted spread models.

Federal funds transaction means a short-term or open-ended unsecured transfer of immediately available funds by one depository institution to another depository institution or entity.

Foreign bank means an institution which is organized under the laws of a country other than the United States, is engaged in the business of banking, and is recognized as a bank by the banking supervisory authority of the country in which it is organized.

Immediate family member means a spouse or other family member living in the same household.

Limited liquidity investment means a private placement or funding agreement.

Member reverse repurchase transaction means an integrated transaction in which a corporate credit union purchases a security from one of its member credit unions under agreement by that member credit union to repurchase the same security at a specified time in the future. The corporate credit union then sells that same security, on the same day, to a third party, under agreement to repurchase it on the same date on which the corporate credit union is obligated to return the security to its member credit union.

Membership capital means funds contributed by members that: are adjustable balance with a minimum withdrawal notice of 3 years or are term certificates with a minimum term of 3 years; are available to cover losses that exceed retained earnings and paid-in capital; are not insured by the NCUSIF or other share or deposit insurers; and cannot be pledged against borrowings.

Mortgage-backed security (MBS) means a security backed by first or second mortgages secured by real estate upon which is located a dwelling, mixed residential and commercial structure, residential manufactured home, or commercial structure.

Moving daily average net assets means the average of daily average net assets for the month being measured and the previous eleven (11) months.

Mutual combination means a transaction or event in which a corporate credit union acquires another credit union, or acquires an

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integrated set of activities and assets that is capable of being conducted and managed as a credit union.

Nationally Recognized Statistical Rating Organization (NRSRO) means any entity that has applied for, and been granted permission to be considered an NRSRO by the United States Securities and Exchange Commission.

NCUA means NCUA Board (Board), unless the particular action has been delegated by the Board.

Net assets means total assets less 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 off-setting are met.

Net economic value (NEV) means the fair value of assets minus the fair value of liabilities. All fair value calculations must include the value of forward settlements and embedded options. Paid-in capital, and the unamortized portion of membership capital, that is, the portion that qualifies as capital for purposes of any of the total capital ratio, is excluded from liabilities for purposes of this calculation. The NEV ratio is calculated by dividing NEV by the fair value of assets.

Net interest margin security means a security collateralized by residual interests in collateralized mortgage obligations, residual interests in real estate mortgage investment conduits, or residual interests in other asset-backed securities.

Obligor means the primary party obligated to repay an investment, *e.g.*, the issuer of a security, such as a Qualified Special Purpose Entity (QSPE) trust; the taker of a deposit; or the borrower of funds in a federal funds transaction. Obligor does not include an originator of receivables underlying an asset-backed security, the servicer of such receivables, or an insurer of an investment.

Official means any director or committee member.

Paid-in capital means accounts or other interests of a corporate credit union that: are perpetual, non-cumulative dividend accounts; are available to cover losses that exceed retained earnings; are not insured by the NCUSIF or other share or deposit insurers; and cannot be pledged against borrowings.

Pair-off transaction means a security purchase transaction that is closed out or sold at, or prior to, the settlement or expiration date.

Private label security means a security that is not issued or guaranteed by the U.S. government, its agencies, or its government-sponsored enterprises (GSEs).

Quoted market price means a recent sales price or a price based on current bid and asked quotations.

Repurchase transaction means a transaction in which a corporate credit union agrees to purchase a security from a counterparty and to resell the same or any identical security to that counterparty at a specified future date and at a specified price.

Residential mortgage-backed security (RMBS) means a mortgage-backed security collateralized primarily by mortgage loans on residential properties.

Residential properties means houses, condominiums, cooperative units, and manufactured homes. This definition does not include boats or motor homes, even if used as a primary residence, or timeshare properties.

Residual interest means the ownership interest in remainder cash flows from a CMO or ABS transaction after payments due bondholders and trust administrative expenses have been satisfied.

Retained earnings means retained earnings as defined under Generally Accepted Accounting Principles (GAAP).

Retained earnings ratio means the corporate credit union's retained earnings divided by its moving daily average net assets. For a corporate credit union that acquires another credit union in a mutual combination, the numerator of the retained earnings ratio also includes the retained earnings of the acquired credit union, or of an integrated set of activities and assets, at the point of acquisition.

Section 107(8) institution means an institution described in Section 107(8) of 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 executive officer mean 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). This term also includes employees of any entity hired to perform the functions described above.

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 that is rated in 1 of the 4 highest rating categories by at least one Nationally Recognized Statistical Rating Organization (NRSRO), and represents an interest in one 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

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does not include Small Business Administration securities permissible under §107(7) of the Act.

State means any one of the several states of the United States of America, the District of Columbia, Puerto Rico, and the territories and possessions of the United States.

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

Subordinated security means a security that, at the time of purchase, has a junior claim on the underlying collateral or assets to other securities in the same issuance. If a security is junior only to money market fund eligible securities in the same issuance, the former security is not subordinated for purposes of this definition.

Total assets means the sum of all a corporate credit union's assets as calculated under GAAP.

Total capital means the sum of a corporate credit union's core capital and its membership capital accounts.

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.

Trigger means an event in a securitization that will redirect cash-flows if predefined thresholds are breached. Examples of triggers are delinquency and cumulative loss triggers.

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. The calculation of weighted average life for interest only securities means the weighted-average time to the return of a dollar of interest, calculated by multiplying each portion of interest 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 interest to be received.

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.

2. At 75 FR 64829, Oct. 20, 2010, §704.2 was revised, effective Oct. 20, 2011. For the convenience of the user, the revised text is set forth as follows:

§ 704.2 Definitions.

As used in this part:

Adjusted core capital means core capital modified as follows:

(1) Deduct an amount equal to the amount of the corporate credit union's intangible assets that exceed one half percent of the cor-

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porate credit union's moving daily average net assets, but the NCUA, on its own initiative, upon petition by the applicable state regulator, or upon application from a corporate credit union, may direct that a particular corporate credit union add some or all of these excess intangibles back to the credit union's adjusted core capital;

(2) Deduct investments, both equity and debt, in unconsolidated credit union service organizations (CUSOs);

(3) If the corporate credit union, on or after October 20, 2011, contributes any perpetual contributed capital (PCC), or maintains any NCAs, at another corporate credit union, deduct an amount equal to this PCC or NCA;

(4) Beginning on October 20, 2016, and ending on October 20, 2020, deduct any amount of perpetual contributed capital (PCC) that causes PCC minus retained earnings, all divided by moving daily net average assets, to exceed two percent; and

(5) Beginning after October 20, 2020, deduct any amount of PCC that causes PCC to exceed retained earnings.

Adjusted trading means any method or transaction whereby a corporate credit union sells a security to a vendor at a price above its current market price and simultaneously purchases or commits to purchase from the vendor another security at a price above its current market price.

Applicable state regulator means the prudential state regulator of a state chartered corporate credit union.

Asset-backed commercial paper program (ABCP program) means a program that primarily issues commercial paper that has received a credit rating from an NRSRO and that is backed by assets or other exposures held in a bankruptcy-remote special purpose entity. The term *sponsor of an ABCP program* means a corporate credit union that:

- (1) Establishes an ABCP program;
- (2) Approves the sellers permitted to participate in an ABCP program;
- (3) Approves the asset pools to be purchased by an ABCP program; or
- (4) Administers the ABCP program by monitoring the assets, arranging for debt placement, compiling monthly reports, or ensuring compliance with the program documents and with the program's credit and investment policy.

Asset-backed security (ABS) means a security that is primarily serviced by the cashflows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the security holders. Mortgage-backed securities are a type of asset-backed security.

Available to cover losses that exceed retained earnings means that the funds are available

to cover operating losses realized, in accordance with generally accepted accounting principles (GAAP), by the corporate credit union that exceed retained earnings net of equity acquired in a combination. Likewise, *available to cover losses that exceed retained earnings and perpetual contributed capital (PCC)* means that the funds are available to cover operating losses realized, in accordance with GAAP, by the corporate credit union that exceed retained earnings net of equity acquired in a combination and PCC. Any such losses must be distributed *pro rata* at the time the loss is realized first among the holders of PCC, and when all PCC is exhausted, then *pro rata* among all nonperpetual capital accounts (NCAs) and unconverted membership capital accounts, all subject to the optional prioritization described in appendix A of this Part. To the extent that any contributed capital funds are used to cover losses, the corporate credit union must not restore or replenish the affected capital accounts under any circumstances. In addition, contributed capital that is used to cover losses in a calendar year previous to the year of liquidation has no claim against the liquidation estate.

Capital means the same as *total capital*, defined below.

Capital ratio means the corporate credit union's capital divided by its moving daily average net assets.

Collateralized debt obligation (CDO) means a debt security collateralized by mortgage-backed securities, asset-backed securities, or corporate obligations in the form of loans or debt. Senior tranches of Re-REMIC's consisting of senior mortgage- and asset-backed securities are excluded from this definition.

Collateralized mortgage obligation (CMO) means a multi-class mortgage-backed security.

Commercial mortgage-backed security (CMBS) means a mortgage-backed security collateralized primarily by multi-family and commercial property loans.

Compensation means all salaries, fees, wages, bonuses, severance payments, current year contributions to employee benefit plans (for example, medical, dental, life insurance, and disability), current year contributions to deferred compensation plans and future severance payments, including payments in connection with a merger or similar combination (whether or not funded; whether or not vested; and whether or not the deferred compensation plan is a qualified plan under Section 401(a) of the IRS Code). Compensation also includes expense accounts and other allowances (for example, the value of the personal use of housing, automobiles or other assets owned by the corporate credit union; expense allowances or reimbursements that recipients must report as income on their separate income tax return; payments made under indemnification arrangements; and

payments made for the benefit of friends or relatives). In calculating required compensation disclosures, reasonable estimates may be used if precise cost figures are not readily available.

Consolidated Credit Union Service Organization (Consolidated CUSO) means any corporation, partnership, business trust, joint venture, association or similar organization in which a corporate credit union directly or indirectly holds an ownership interest (as permitted by § 704.11 of this Part) and the assets of which are consolidated with those of the corporate credit union for purposes of reporting under Generally Accepted Accounting Principles (GAAP). Generally, consolidated CUSOs are majority-owned CUSOs.

Contributed capital means either perpetual or nonperpetual capital.

Core capital means 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 unions' 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.

Core capital ratio means the corporate credit union's core capital divided by its moving daily average net assets.

Corporate credit union means an organization that:

- (1) Is chartered under Federal or state law as a credit union;
- (2) Receives shares from and provides loan services to credit unions;
- (3) Is operated primarily for the purpose of serving other credit unions;
- (4) Is designated by NCUA as a corporate credit union;
- (5) Limits natural person members to the minimum required by state or federal law to charter and operate the credit union; and
- (6) Does not condition the eligibility of any credit union to become a member on that credit union's membership in any other organization.

Credit-enhancing interest-only strip. (1) Credit-enhancing interest-only strip means an on-balance sheet asset that, in form or in substance:

- (i) Represents the contractual right to receive some or all of the interest due on transferred assets; and
- (ii) Exposes the corporate credit union to credit risk directly or indirectly associated with the transferred assets that exceeds its

pro rata share of the corporate credit union's claim on the assets whether through subordination provisions or other credit enhancement techniques.

(2) NCUA reserves the right to identify other cash flows or related interests as a credit-enhancing interest-only strip. In determining whether a particular interest cash flow functions as a credit-enhancing interest-only strip, NCUA will consider the economic substance of the transaction.

Daily average net assets means the average of net assets calculated for each day during the period.

Daily average net risk-weighted assets means the average of net risk-weighted assets calculated for each day during the period.

Derivatives means a financial contract whose value is derived from the values of one or more underlying assets, reference rates, or indices of asset values or reference rates. Derivative contracts include interest rate derivative contracts, exchange rate derivative contracts, equity derivative contracts, commodity derivative contracts, credit derivative contracts, and any other instrument that poses similar counterparty credit risks.

Dollar roll means the purchase or sale of a mortgage-backed security to a counterparty with an agreement to resell or repurchase a substantially identical security at a future date and at a specified price.

Eligible ABCP liquidity facility means a legally binding commitment to provide liquidity support to asset-backed commercial paper by lending to, or purchasing assets from any structure, program or conduit in the event that funds are required to repay maturing asset-backed commercial paper and that meets the following criteria:

(1)(i) At the time of the draw, the liquidity facility must be subject to an asset quality test that precludes funding against assets that are 90 days or more past due or in default; and

(ii) If the assets that the liquidity facility is required to fund against are assets or exposures that have received a credit rating by an NRSRO at the time the inception of the facility, the facility can be used to fund only those assets or exposures that are rated investment grade by an NRSRO at the time of funding; or

(2) If the assets that are funded under the liquidity facility do not meet the criteria described in paragraph (1) of this definition, the assets must be guaranteed, conditionally or unconditionally, by the United States Government, its agencies, or the central government of an Organization for Economic Cooperation and Development (OECD) country.

Embedded option means a characteristic of certain assets and liabilities which gives the issuer of the instrument the ability to change the features such as final maturity, rate, principal amount and average life. Op-

tions include, but are not limited to, calls, caps, and prepayment options.

Equity investment means investments in real property, equity securities, and any other ownership interests, including, for example, investments in partnerships and limited liability companies.

Equity security means any security representing an ownership interest in an enterprise (for example, common, preferred, or other capital stock) or the right to acquire (for example, warrants and call options) or dispose of (for example, put options) an ownership interest in an enterprise at fixed or determinable prices. However, the term does not include convertible debt or preferred stock that by its terms either must be redeemed by the issuing enterprise or is redeemable at the option of the investor.

Exchangeable collateralized mortgage obligation means a class of a collateralized mortgage obligation (CMO) that, at the time of purchase, represents beneficial ownership interests in a combination of two or more underlying classes of the same CMO structure. The holder of an exchangeable CMO may pay a fee and take delivery of the underlying classes of the CMO.

Fair value means the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. If there is a principal market for the asset or liability, the fair value measurement is the price in that market (whether that price is directly observable or otherwise determined using a valuation technique), even if the price in a different market is potentially more advantageous at the measurement date. In the absence of a principal market, the fair value measurement occurs in the most advantageous market for the asset or liability. The fair value of the asset or liability shall be determined based on the assumptions that market participants would use in pricing the asset or liability. In developing those assumptions, the corporate need not identify specific market participants. Rather, the corporate should identify characteristics that distinguish market participants generally, considering factors specific to all of the following: the asset or liability; the principal (or most advantageous) market for the asset or liability; and market participants with whom the corporate would transact in that market. To increase consistency and comparability in fair value measurements and related disclosures, the fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Examples of valuation techniques include the present value of estimated future cash flows,

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option-pricing models, and option-adjusted spread models.

Federal funds transaction means a short-term or open-ended unsecured transfer of immediately available funds by one depository institution to another depository institution or entity.

Foreign bank means an institution which is organized under the laws of a country other than the United States, is engaged in the business of banking, and is recognized as a bank by the banking supervisory authority of the country in which it is organized.

Immediate family member means a spouse or other family member living in the same household.

Intangible assets means assets considered to be intangible assets under GAAP. These assets include, but are not limited to, core deposit premiums, purchased credit card relationships, favorable leaseholds, and servicing assets (mortgage and non-mortgage). Interest-only strips receivable are not intangible assets under this definition.

Leverage ratio means, before October 21, 2013, the ratio of total capital to moving daily average net assets. This is the interim leverage ratio.

Leverage ratio means, on or after October 21, 2013, the ratio of adjusted core capital to moving daily average net assets. This is the permanent leverage ratio.

Limited liquidity investment means a private placement or funding agreement.

Member reverse repurchase transaction means an integrated transaction in which a corporate credit union purchases a security from one of its member credit unions under agreement by that member credit union to repurchase the same security at a specified time in the future. The corporate credit union then sells that same security, on the same day, to a third party, under agreement to repurchase it on the same date on which the corporate credit union is obligated to return the security to its member credit union.

Mortgage-backed security (MBS) means a security backed by first or second mortgages secured by real estate upon which is located a dwelling, mixed residential and commercial structure, residential manufactured home, or commercial structure.

Moving daily average net assets means the average of daily average net assets for the month being measured and the previous eleven (11) months.

Moving monthly average net risk-weighted assets means the average of the net risk-weighted assets for the month being measured and the previous eleven (11) months. Measurements must be taken on the last day of each month.

Mutual combination means a transaction or event in which a corporate credit union acquires another credit union, or acquires an integrated set of activities and assets that is

capable of being conducted and managed as a credit union.

Nationally Recognized Statistical Rating Organization (NRSRO) means any entity that has applied for, and been granted permission, to be considered an NRSRO by the United States Securities and Exchange Commission.

NCUA means NCUA Board (Board), unless the particular action has been delegated by the Board.

Net assets means total assets less 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.

Net economic value (NEV) means the fair value of assets minus the fair value of liabilities. All fair value calculations must include the value of forward settlements and embedded options. Perpetual contributed capital, and the unamortized portion of non-perpetual capital that is, the portion that qualifies as capital for purposes of any of the minimum capital ratios, is excluded from liabilities for purposes of this calculation. The NEV ratio is calculated by dividing NEV by the fair value of assets.

Net interest margin security means a security collateralized by residual interests in collateralized mortgage obligations, residual interests in real estate mortgage investment conduits, or residual interests in other asset-backed securities.

Net risk-weighted assets means risk-weighted assets less Central Liquidity Facility (CLF) stock subscriptions, CLF 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 risk-weighted assets.

Nonperpetual capital means funds contributed by members or nonmembers that: are term certificates with an original minimum term of five years or that have an indefinite term (*i.e.*, no maturity) with a minimum withdrawal notice of five years; are available to cover losses that exceed retained earnings and perpetual contributed capital; are not insured by the NCUSIF or other share or deposit insurers; and cannot be pledged against borrowings. In the event the corporate is liquidated, the holders of nonperpetual capital accounts (NCAs) will claim equally. These claims will be subordinate to all other claims (including NCUSIF claims), except

that any claims by the holders of perpetual contributed capital (PCC) will be subordinate to the claims of holders of NCAs.

Obligor means the primary party obligated to repay an investment, *e.g.*, the issuer of a security, such as a Qualified Special Purpose Entity (QSPE) trust; the taker of a deposit; or the borrower of funds in a federal funds transaction. Obligor does not include an originator of receivables underlying an asset-backed security, the servicer of such receivables, or an insurer of an investment.

Official means any director or committee member.

Pair-off transaction means a security purchase transaction that is closed out or sold at, or prior to, the settlement or expiration date.

Perpetual contributed capital (PCC) means accounts or other interests of a corporate credit union that: are perpetual, non-cumulative dividend accounts; are available to cover losses that exceed retained earnings; are not insured by the NCUSIF or other share or deposit insurers; and cannot be pledged against borrowings. In the event the corporate is liquidated, any claims made by the holders of perpetual contributed capital will be subordinate to all other claims (including NCUSIF claims).

Private label security means a security that is not issued or guaranteed by the U.S. government, its agencies, or its government-sponsored enterprises (GSEs).

Quoted market price means a recent sales price or a price based on current bid and asked quotations.

Repurchase transaction means a transaction in which a corporate credit union agrees to purchase a security from a counterparty and to resell the same or any identical security to that counterparty at a specified future date and at a specified price.

Residential mortgage-backed security (RMBS) means a mortgage-backed security collateralized primarily by mortgage loans on residential properties.

Residential properties means houses, condominiums, cooperative units, and manufactured homes. This definition does not include boats or motor homes, even if used as a primary residence, or timeshare properties.

Residual interest means the ownership interest in remainder cash flows from a CMO or ABS transaction after payments due bondholders and trust administrative expenses have been satisfied.

Retained earnings means retained earnings as defined under Generally Accepted Accounting Principles (GAAP).

Risk-weighted assets means a corporate credit union's risk-weighted assets as calculated in accordance with appendix C of this part.

Section 107(8) institution means an institution described in Section 107(8) of 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.

Securitization means the pooling and repackaging by a special purpose entity of assets or other credit exposures that can be sold to investors. Securitization includes transactions that create stratified credit risk positions whose performance is dependent upon an underlying pool of credit exposures, including loans and commitments.

Senior executive officer 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). This term also includes employees of any entity hired to perform the functions described above.

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 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 one 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.

State means any one of the several states of the United States of America, the District of Columbia, Puerto Rico, and the territories and possessions of the United States.

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

Subordinated security means a security that, at the time of purchase, has a junior claim on the underlying collateral or assets to other securities in the same issuance. If a security is junior only to money market fund eligible securities in the same issuance, the former security is not subordinated for purposes of this definition.

Supplementary Capital means the sum of the following items:

- (1) Nonperpetual capital accounts, as amortized under § 704.3(b)(3);
- (2) Allowance for loan and lease losses calculated under GAAP to a maximum of 1.25 percent of risk-weighted assets; and
- (3) Forty-five percent of unrealized gains on available-for-sale equity securities with readily determinable fair values. Unrealized

gains are unrealized holding gains, net of unrealized holding losses, calculated as the amount, if any, by which fair value exceeds historical cost. The NCUA may disallow such inclusion in the calculation of supplementary capital if the NCUA determines that the securities are not prudently valued.

Tier 1 capital means adjusted core capital. *Tier 1 risk-based capital ratio* means the ratio of Tier 1 capital to the moving monthly average net risk-weighted assets.

Tier 2 capital means supplementary capital plus any perpetual contributed capital deducted from adjusted core capital.

Total assets means the sum of all a corporate credit union's assets as calculated under GAAP.

Total capital means the sum of a corporate credit union's adjusted core capital and its supplementary capital, less the corporate credit union's equity investments not otherwise deducted when calculating adjusted core capital.

Total risk-based capital ratio means the ratio of total capital to moving monthly average net risk-weighted assets.

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.

Trigger means an event in a securitization that will redirect cash-flows if predefined thresholds are breached. Examples of triggers are delinquency and cumulative loss triggers.

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. The calculation of weighted average life for interest only securities means the weighted-average time to the return of a dollar of interest, calculated by multiplying each portion of interest 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 interest to be received.

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.

3. At 75 FR 71528, Nov. 24, 2010, § 704.2 was amended by revising the definition of "collateralized debt obligation", effective Jan. 18, 2011. For the convenience of the user, the added and revised text is set forth as follows:

§ 704.2 Definitions.

* * * * *

Collateralized debt obligation (CDO) means a debt security collateralized by mortgage-backed securities, other asset-backed securities, or corporate obligations in the form of nonmortgage loans or debt. For purposes of part 704, the term CDO does not include:

(1) Senior tranches of Re-REMIC's consisting of senior mortgage-and asset-backed securities;

(2) Any security that is fully guaranteed as to principal and interest by the U.S. Government or its agencies or its sponsored enterprises; or

(3) Any security collateralized by other securities where all the underlying securities are fully guaranteed as to principal and interest by the U.S. Government or its agencies or its sponsored enterprises.

* * * * *

4. At 75 FR 71528, Nov. 24, 2010, § 704.2 was amended by revising revise the definition of "collateralized debt obligation", effective Oct. 20, 2011. For the convenience of the user, the added and revised text is set forth as follows:

§ 704.2 Definitions.

* * * * *

Collateralized debt obligation (CDO) means a debt security collateralized by mortgage-backed securities, other asset-backed securities, or corporate obligations in the form of nonmortgage loans or debt. For purposes of Part 704, the term CDO does not include:

(1) Senior tranches of Re-REMIC's consisting of senior mortgage-and asset-backed securities;

(2) Any security that is fully guaranteed as to principal and interest by the U.S. Government or its agencies or its sponsored enterprises; or

(3) Any security collateralized by other securities where all the underlying securities are fully guaranteed as to principal and interest by the U.S. Government or its agencies or its sponsored enterprises.

* * * * *

§ 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

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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 pay-

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out 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.

(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 amor-

tized, 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 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

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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

(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

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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
- (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]

EFFECTIVE DATE NOTE: At 75 FR 64829, Oct. 20, 2010, § 704.3 was revised, effective Oct. 20, 2011. For the convenience of the user, the revised text is set forth as follows:

§ 704.3 Corporate credit union capital.

(a) *Capital requirements.* (1) A corporate credit union must maintain at all times:

- (i) A leverage ratio of 4.0 percent or greater;
- (ii) A Tier 1 risk-based capital ratio of 4.0 percent or greater; and
- (iii) A total risk-based capital ratio of 8.0 percent or greater.

(2) To ensure it meets its capital requirements, 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.

(3) Beginning with the first call report submitted on or after October 21, 2013, a corporate credit union must calculate and report to NCUA the ratio of its retained earnings to its moving daily average net assets. If this ratio is less than 0.45 percent, the corporate credit union must, within 30 days, submit a retained earnings accumulation plan to the NCUA for NCUA's approval. The plan must contain a detailed explanation of how the corporate credit union will accumulate earnings sufficient to meet all its future minimum leverage ratio requirements, including specific semiannual milestones for accumulating retained earnings. In the case of a state-chartered corporate credit union, the NCUA will consult with the appropriate state supervisory authority (SSA) before making a determination to approve or disapprove the plan, and will provide the SSA a copy of the completed plan. If the corporate credit union fails to submit a plan acceptable to NCUA, or fails to comply with any element of a plan approved by NCUA, the corporate will immediately be classified as significantly undercapitalized or, if already significantly undercapitalized, as critically undercapitalized for purposes of prompt corrective actions. The corporate credit union will be subject to all the associated actions under § 704.4.

(b) *Requirements for nonperpetual capital accounts (NCAs)*—(1) Form. NCA funds may be in the form of a term certificate or a no-maturity notice account.

(2) Disclosure. The terms and conditions of a nonperpetual 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 NCA 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 all entities with NCAs. The certification must be maintained in the corporate credit union's files and be available for examiner review.

(3) Five-year remaining maturity. When a no-maturity NCA has been placed on notice, or a term account has a remaining maturity of less than five years, the corporate will reduce the amount of the account that can be considered as nonperpetual capital by a constant monthly amortization that ensures the 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 an NCA being amortized, not just the remaining non-amortized portion, is available to absorb

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losses in excess of the sum of retained earnings and perpetual contributed 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. Nonperpetual capital may not be released due solely to the merger, charter conversion, or liquidation of the account holder. In the event of a merger, the capital account transfers to the continuing entity. In the event of a charter conversion, the capital account transfers to the new institution. In the event of liquidation, the corporate may release a member capital account to facilitate the payout of shares, but only with the prior written approval of the NCUA.

(5) Redemption. A corporate credit union may redeem NCAs prior to maturity or prior to the end of the notice period only with the prior approval of the NCUA and, for state chartered corporate credit unions, the approval of the appropriate state regulator.

(6) Sale. A member may transfer its interest in a nonperpetual capital account to another member or to a nonmember (other than a natural person). At least 14 days before consummating such a transfer, the member must notify the corporate credit union of the pending transfer. The corporate credit union must, within 10 days of such notice, provide the member and the potential transferee all financial information about the corporate credit union that is available to the public or that the corporate credit union has provided to its members, including any call report data submitted by the corporate credit union to NCUA but not yet posted on NCUA's Web site.

(7) Merger. In the event of a merger of a corporate credit union, nonperpetual capital will transfer to the continuing corporate credit union. The minimum five-year notice period for withdrawal of no-maturity capital remains in effect.

(c) *Requirements for perpetual contributed capital (PCC)*—(1) Disclosure. The terms and conditions of any perpetual contributed 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. Perpetual contributed 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 perpetual contributed capital transfers to the continuing credit union. In the event of a charter conversion, the perpetual contributed capital transfers to the new institution. In the event of liquidation, the perpetual contributed capital may be released to facilitate the payout of shares with NCUA's prior written approval.

(3) Callability. A corporate credit union may call perpetual contributed capital in-

struments only with the prior approval of the NCUA and, for state chartered corporate credit unions, the applicable state regulator. Perpetual contributed capital accounts are callable on a pro-rata basis across an issuance class.

(4) Perpetual contributed capital. A corporate credit union may issue perpetual contributed capital to both members and nonmembers.

(5) The holder of a PCC instrument may transfer its interests in the instrument to another member or to a nonmember (other than a natural person). At least 14 days before consummating such a transfer, the member must notify the corporate credit union of the pending transfer. The corporate credit union must, within 10 days of such notice, provide the member and the potential transferee all financial information about the corporate credit union that is available to the public or that the corporate credit union has provided to its members, including any call report data submitted by the corporate credit union to NCUA but not yet posted on NCUA's Web site.

(6) A corporate credit union is permitted to condition membership, services, or prices for services on a member's ownership of PCC, provided the corporate credit union gives existing members at least six months written notice of:

(i) The requirement to purchase PCC, including specific amounts; and

(ii) The effects of a failure to purchase the requisite PCC on the pricing of services or on the member's access to membership or services.

(d) *Individual minimum capital requirements.*

(1) *General.* The rules and procedures specified in this paragraph apply to the establishment of an individual minimum capital requirement for a corporate credit union that varies from any of the risk-based capital requirement(s) or leverage ratio requirements that would otherwise apply to the corporate credit union under this part.

(2) *Appropriate considerations for establishing individual minimum capital requirements.* Minimum capital levels higher than the risk-based capital requirements or the leverage ratio requirement under this part may be appropriate for individual corporate credit unions. The NCUA may establish increased individual minimum capital requirements, including modification of the minimum capital requirements related to being either significantly and critically undercapitalized for purposes of § 704.4 of this part, upon a determination that the corporate credit union's capital is or may become inadequate in view of the credit union's circumstances. For example, higher capital levels may be appropriate when NCUA determines that:

(i) A corporate credit union is receiving special supervisory attention;

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(ii) A corporate credit union has or is expected to have losses resulting in capital inadequacy;

(iii) A corporate credit union has a high degree of exposure to interest rate risk, prepayment risk, credit risk, concentration risk, certain risks arising from nontraditional activities or similar risks, or a high proportion of off-balance sheet risk including standby letters of credit;

(iv) A corporate credit union has poor liquidity or cash flow;

(v) A corporate credit union is growing, either internally or through acquisitions, at such a rate that supervisory problems are presented that are not dealt with adequately by other NCUA regulations or other guidance;

(vi) A corporate credit union may be adversely affected by the activities or condition of its CUSOs or other persons or entities with which it has significant business relationships, including concentrations of credit;

(vii) A corporate credit union with a portfolio reflecting weak credit quality or a significant likelihood of financial loss, or has loans or securities in nonperforming status or on which borrowers fail to comply with repayment terms;

(viii) A corporate credit union has inadequate underwriting policies, standards, or procedures for its loans and investments;

(ix) A corporate credit union has failed to properly plan for, or execute, necessary retained earnings growth, or

(ix) A corporate credit union has a record of operational losses that exceeds the average of other, similarly situated corporate credit unions; has management deficiencies, including failure to adequately monitor and control financial and operating risks, particularly the risks presented by concentrations of credit and nontraditional activities; or has a poor record of supervisory compliance.

(3) *Standards for determination of appropriate individual minimum capital requirements.* The appropriate minimum capital levels for an individual corporate credit union cannot be determined solely through the application of a rigid mathematical formula or wholly objective criteria. The decision is necessarily based, in part, on subjective judgment grounded in agency expertise. The factors to be considered in NCUA's determination will vary in each case and may include, for example:

(i) The conditions or circumstances leading to the determination that a higher minimum capital requirement is appropriate or necessary for the corporate credit union;

(ii) The exigency of those circumstances or potential problems;

(iii) The overall condition, management strength, and future prospects of the corporate credit union and, if applicable, its

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subsidiaries, affiliates, and business partners;

(iv) The corporate credit union's liquidity, capital and other indicators of financial stability, particularly as compared with those of similarly situated corporate credit unions; and

(v) The policies and practices of the corporate credit union's directors, officers, and senior management as well as the internal control and internal audit systems for implementation of such adopted policies and practices.

(4) Procedures—(i) In the case of a state chartered corporate credit union, NCUA will consult with the appropriate state regulator when considering imposing a new minimum capital requirement.

(ii) When the NCUA determines that a minimum capital requirement is necessary or appropriate for a particular corporate credit union, it will notify the corporate credit union in writing of its proposed individual minimum capital requirement; the schedule for compliance with the new requirement; and the specific causes for determining that the higher individual minimum capital requirement is necessary or appropriate for the corporate credit union. The NCUA shall forward the notifying letter to the appropriate state supervisory authority (SSA) if a state-chartered corporate credit union would be subject to an individual minimum capital requirement.

(iii) The corporate credit union's response must include any information that the credit union wants the NCUA to consider in deciding whether to establish or to amend an individual minimum capital requirement for the corporate credit union, what the individual capital requirement should be, and, if applicable, what compliance schedule is appropriate for achieving the required capital level. The responses of the corporate credit union and SSA must be in writing and must be delivered to the NCUA within 30 days after the date on which the notification was received. The NCUA may extend the time period for good cause, and the time period for response by the insured corporate credit union may be shortened for good cause:

(A) When, in the opinion of the NCUA, the condition of the corporate credit union so requires, and the NCUA informs the corporate credit union of the shortened response period in the notice;

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

(C) When the corporate credit union already has advised the NCUA that it cannot or will not achieve its applicable minimum capital requirement.

(iv) Failure by the corporate credit union to respond within 30 days, or such other time period as may be specified by the NCUA, may constitute a waiver of any objections to the

proposed individual minimum capital requirement or to the schedule for complying with it, unless the NCUA has provided an extension of the response period for good cause.

(v) After expiration of the response period, the NCUA will decide whether or not the proposed individual minimum capital requirement should be established for the corporate credit union, or whether that proposed requirement should be adopted in modified form, based on a review of the corporate credit union's response and other relevant information. The NCUA's decision will address comments received within the response period from the corporate credit union and the appropriate state supervisory authority (SSA) (if a state-chartered corporate credit union is involved) and will state the level of capital required, the schedule for compliance with this requirement, and any specific remedial action the corporate credit union could take to eliminate the need for continued applicability of the individual minimum capital requirement. The NCUA will provide the corporate credit union and the appropriate SSA (if a state-chartered corporate credit union is involved) with a written decision on the individual minimum capital requirement, addressing the substantive comments made by the corporate credit union and setting forth the decision and the basis for that decision. Upon receipt of this decision by the corporate credit union, the individual minimum capital requirement becomes effective and binding upon the corporate credit union. This decision represents final agency action.

(vi) In lieu of the procedures established above, a corporate credit union may request an informal hearing. The corporate credit union must make the request for a hearing in writing, and NCUA must receive the request no later than 10 days following the date of the notice described in paragraph (d)(4)(ii) of this section. Upon receipt of the request for hearing, NCUA will conduct an informal hearing and render a decision using the procedures described in paragraphs (d), (e), and (f) of § 747.3003 of this chapter.

(5) *Failure to comply.* Failure to satisfy any individual minimum capital requirement, or to meet any required incremental additions to capital under a schedule for compliance with such an individual minimum capital requirement, will constitute a basis to take action as described in § 704.4.

(6) *Change in circumstances.* If, after a decision is made under paragraph (b)(3)(iv) of this section, there is a change in the circumstances affecting the corporate credit union's capital adequacy or its ability to reach its required minimum capital level by the specified date, the NCUA may amend the individual minimum capital requirement or the corporate credit union's schedule for such compliance. The NCUA may decline to consider a corporate credit union's request

for such changes that are not based on a significant change in circumstances or that are repetitive or frivolous. Pending the NCUA's reexamination of the original decision, that original decision and any compliance schedule established in that decision will continue in full force and effect.

(e) *Reservation of authority.*

(1) *Transactions for purposes of evasion.* The NCUA may disregard any transaction entered into primarily for the purpose of reducing the minimum required amount of regulatory capital or otherwise evading the requirements of this section.

(2) *Period-end versus average figures.* The NCUA reserves the right to require a corporate credit union to compute its capital ratios on the basis of period-end assets rather than average assets when the NCUA determines this requirement is appropriate to carry out the purposes of this part.

(3) *Reservation of authority.* (i) Notwithstanding the definitions of core and supplementary capital in paragraph (d) of this section, the NCUA may find that a particular asset or core or supplementary capital component has characteristics or terms that diminish its contribution to a corporate credit union's ability to absorb losses, and the NCUA may require the discounting or deduction of such asset or component from the computation of core, supplementary, or total capital.

(ii) Notwithstanding appendixC to this Part, the NCUA will look to the substance of a transaction and may find that the assigned risk-weight for any asset, or credit equivalent amount or credit conversion factor for any off-balance sheet item does not appropriately reflect the risks imposed on the corporate credit union. The NCUA may require the corporate credit union to apply another risk-weight, credit equivalent amount, or credit conversion factor that NCUA deems appropriate.

(iii) If appendixC to this part does not specifically assign a risk-weight, credit equivalent amount, or credit conversion factor to a particular asset or activity of the corporate credit union, the NCUA may assign any risk-weight, credit equivalent amount, or credit conversion factor that it deems appropriate. In making this determination, NCUA will consider the risks associated with the asset or off-balance sheet item as well as other relevant factors.

(4) Where practicable, the NCUA will consult with the appropriate state regulator before taking any action under this paragraph (e) that involves a state chartered corporate credit union.

(5) Before taking any action under this paragraph (e), NCUA will provide the corporate credit union with written notice of the intended action and the reasons for such action. The corporate credit union will have

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seven days to provide the NCUA with a written response, and the NCUA will consider the response before taking the action. Upon the timely request of the corporate credit union, and for good cause, NCUA may extend the seven day response period.

(f) *Former capital accounts.* This paragraph addresses membership capital accounts (MCAs) that qualified as corporate capital prior to October 20, 2011 but which no longer satisfy the definitions of capital because the accounts have not been converted by the member to nonperpetual capital accounts (NCAs) or to perpetual contributed capital (PCC).

(1) For MCAs structured as adjustable balance accounts, the corporate will immediately place the account on notice of withdrawal if the member has not already done so. The corporate will continue to adjust the balance of the MCA account in accordance with the original terms of the account until the entire notice period has run and then return the remaining balance, less any losses, to the member. Until the expiration of the notice period the entire adjusted balance will be available to cover losses at the corporate credit union that exceed retained earnings and PCC (excluding, if a corporate credit union exercises the capital prioritization option under part I of appendix A to this Part, any PCC with priority under that option).

(2) For term MCAs, the corporate credit union will return the balance of the MCA account to the member at the expiration of the term. Until the expiration of term, the entire account balance will be available to cover losses that exceed retained earnings and PCC (excluding, if a corporate credit union exercises the capital prioritization option under part I of appendix A to this part, any PCC with priority under that option).

(3) A corporate credit union may count a portion of unconverted MCAs as Tier 2 capital. Beginning on the date of issuance (for term MCAs) or the date of notice of withdrawal (for other MCAs), the corporate may count the entire account balance as Tier 2 capital, but will then reduce the amount of the account that can be considered as Tier 2 capital by a constant monthly amortization that ensures the capital is fully amortized one year before the date of maturity or one year before the end of the notice period. For adjustable balance account MCAs where the adjustment is determined based on some impermanent measure, such as shares on deposit with the corporate, the corporate credit union may not treat any part of the account as capital.

(4) A corporate credit union must, on or before December 20, 2011, provide any members that hold unconverted MCAs a one-time written disclosure about the status of their MCA accounts as described in this paragraph (f).

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§ 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]

EFFECTIVE DATE NOTES: 1. At 75 FR 64836, Oct. 20, 2010, § 704.4 was redesignated to 704.13, effective Jan. 18, 2011.

2. At 75 FR 64836, Oct. 20, 2010, § 704.4 was added, effective Oct. 20, 2011. For the convenience of the user, the added text is set forth as follows:

§ 704.4 Prompt corrective action.

(a) *Purpose.* The principal purpose of this section is to define, for corporate credit unions that are not adequately capitalized, the capital measures and capital levels that are used for determining appropriate supervisory actions. This section establishes procedures for submission and review of capital restoration plans and for issuance and review of capital directives, orders, and other supervisory directives.

(b) *Scope.* This section applies to corporate credit unions, including officers, directors, and employees.

(1) This section does not limit the authority of NCUA in any way to take supervisory actions to address unsafe or unsound practices, deficient capital levels, violations of law, unsafe or unsound conditions, or other practices. The NCUA may take action under this section independently of, in conjunction with, or in addition to any other enforcement action available to the NCUA, including issuance of cease and desist orders, approval or denial of applications or notices, assessment of civil money penalties, or any other actions authorized by law.

(2) Unless permitted by the NCUA or otherwise required by law, no corporate credit union may state in any advertisement or promotional material its capital category under this part or that the NCUA has assigned the corporate credit union to a particular category.

(3) Any group of credit unions applying for a new corporate credit union charter will submit, as part of the charter application, a detailed draft plan for soliciting contributed capital and building retained earnings. The draft plan will include specific levels of contributed capital and retained earnings and the anticipated timeframes for achieving those levels. The Board will review the draft plan and modify it as necessary. If the Board approves the plan, the Board will include any necessary waivers of this section or part.

(c) *Notice of capital category.* (1) Effective date of determination of capital category. A corporate credit union will be deemed to be within a given capital category as of the most recent date:

(i) A 5310 Financial Report is required to be filed with the NCUA;

(ii) A final NCUA report of examination is delivered to the corporate credit union; or

(iii) Written notice is provided by the NCUA to the corporate credit union that its capital category has changed as provided in paragraphs (c)(2) or (d)(3) of this section.

(2) Adjustments to reported capital levels and category—

(i) Notice of adjustment by corporate credit union. A corporate credit union must provide the NCUA with written notice that an adjustment to the corporate credit union's capital category may have occurred no later than 15 calendar days following the date that

any material event has occurred that would cause the corporate credit union to be placed in a lower capital category from the category assigned to the corporate credit union for purposes of this section on the basis of the corporate credit union's most recent call report or report of examination.

(ii) Determination by the NCUA to change capital category. After receiving notice pursuant to paragraph (c)(1) of this section, or on its own initiative, the NCUA will determine whether to change the capital category of the corporate credit union and will notify the corporate credit union of the NCUA's determination.

(d) *Capital measures and capital category definitions.* (1) Capital measures. For purposes of this section, the relevant capital measures are:

(i) The total risk-based capital ratio;

(ii) The Tier 1 risk-based capital ratio; and

(iii) The leverage ratio.

(2) Capital categories. For purposes of this section, a corporate credit union is:

(i) Well capitalized if the corporate credit union:

(A) Has a total risk-based capital ratio of 10.0 percent or greater; and

(B) Has a Tier 1 risk-based capital ratio of 6.0 percent or greater; and

(C) Has a leverage ratio of 5.0 percent or greater; and

(D) Is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by NCUA to meet and maintain a specific capital level for any capital measure.

(ii) Adequately capitalized if the corporate credit union:

(A) Has a total risk-based capital ratio of 8.0 percent or greater; and

(B) Has a Tier 1 risk-based capital ratio of 4.0 percent or greater; and

(C) Has:

(1) A leverage ratio of 4.0 percent or greater; and

(2) Does not meet the definition of a well capitalized corporate credit union.

(iii) Undercapitalized if the corporate credit union:

(A) Has a total risk-based capital ratio that is less than 8.0 percent; or

(B) Has a Tier 1 risk-based capital ratio that is less than 4.0 percent; or

(C) Has a leverage ratio that is less than 4.0 percent.

(iv) Significantly undercapitalized if the corporate credit union has:

(A) A total risk-based capital ratio that is less than 6.0 percent; or

(B) A Tier 1 risk-based capital ratio that is less than 3.0 percent; or

(C) A leverage ratio that is less than 3.0 percent.

(v) Critically undercapitalized if the corporate credit union has:

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(A) A total risk-based capital ratio that is less than 4.0 percent; or

(B) A Tier 1 risk-based capital ratio that is less than 2.0 percent; or

(C) A leverage ratio that is less than 2.0 percent.

(3) Reclassification based on supervisory criteria other than capital. Notwithstanding the elements of paragraph (d)(2) of this section, the NCUA may reclassify a well capitalized corporate credit union as adequately capitalized, and may require an adequately capitalized or undercapitalized corporate credit union to comply with certain mandatory or discretionary supervisory actions as if the corporate credit union were in the next lower capital category, in the following circumstances:

(i) Unsafe or unsound condition. The NCUA has determined, after notice and opportunity for hearing pursuant to paragraph (h)(1) of this section, that the corporate credit union is in an unsafe or unsound condition; or

(ii) Unsafe or unsound practice. The NCUA has determined, after notice and an opportunity for hearing pursuant to paragraph (h)(1) of this section, that the corporate credit union received a less-than-satisfactory rating (*i.e.*, three or lower) for any rating category (other than in a rating category specifically addressing capital adequacy) under the Corporate Risk Information System (CRIS) rating system and has not corrected the conditions that served as the basis for the less than satisfactory rating. Ratings under this paragraph (d)(3)(ii) refer to the most recent ratings (as determined either on-site or off-site by the most recent examination) of which the corporate credit union has been notified in writing.

(4) The NCUA may, for good cause, modify any of the percentages in paragraph (d)(2) of this section as described in § 704.3(d).

(e) *Capital restoration plans.* (1) Schedule for filing plan—

(i) In general. A corporate credit union must file a written capital restoration plan with the NCUA within 45 days of the date that the corporate credit union receives notice or is deemed to have notice that the corporate credit union is undercapitalized, significantly undercapitalized, or critically undercapitalized, unless the NCUA notifies the corporate credit union in writing that the plan is to be filed within a different period. An adequately capitalized corporate credit union that has been required pursuant to paragraph (d)(3) of this section to comply with supervisory actions as if the corporate credit union were undercapitalized is not required to submit a capital restoration plan solely by virtue of the reclassification.

(ii) Additional capital restoration plans. Notwithstanding paragraph (e)(1)(i) of this section, a corporate credit union that has already submitted and is operating under a capital restoration plan approved under this

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section is not required to submit an additional capital restoration plan based on a revised calculation of its capital measures or a reclassification of the institution under paragraph (d)(3) of this section unless the NCUA notifies the corporate credit union that it must submit a new or revised capital plan. A corporate credit union that is notified that it must submit a new or revised capital restoration plan must file the plan in writing with the NCUA within 45 days of receiving such notice, unless the NCUA notifies the corporate credit union in writing that the plan is to be filed within a different period.

(2) Contents of plan. All financial data submitted in connection with a capital restoration plan must be prepared in accordance with the instructions provided on the call report, unless the NCUA instructs otherwise. The capital restoration plan must include all of the information required to be filed under paragraph (k)(2)(ii) of this section. A corporate credit union required to submit a capital restoration plan as the result of a reclassification of the corporate credit union pursuant to paragraph (d)(3) of this section must include a description of the steps the corporate credit union will take to correct the unsafe or unsound condition or practice.

(3) Failure to submit a capital restoration plan. A corporate credit union that is undercapitalized and that fails to submit a written capital restoration plan within the period provided in this section will, upon the expiration of that period, be subject to all of the provisions of this section applicable to significantly undercapitalized credit unions.

(4) Review of capital restoration plans. Within 60 days after receiving a capital restoration plan under this section, the NCUA will provide written notice to the corporate credit union of whether it has approved the plan. The NCUA may extend this time period.

(5) Disapproval of capital plan. If the NCUA does not approve a capital restoration plan, the corporate credit union must submit a revised capital restoration plan, when directed to do so, within the time specified by the NCUA. An undercapitalized corporate credit union is subject to the provisions applicable to significantly undercapitalized credit unions until it has submitted, and NCUA has approved, a capital restoration plan. If the NCUA directs that the corporate credit union submit a revised plan, it must do so in time frame specified by the NCUA.

(6) Failure to implement a capital restoration plan. Any undercapitalized corporate credit union that fails in any material respect to implement a capital restoration plan will be subject to all of the provisions of this section applicable to significantly undercapitalized institutions.

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(7) Amendment of capital plan. A corporate credit union that has filed an approved capital restoration plan may, after prior written notice to and approval by the NCUA, amend the plan to reflect a change in circumstance. Until such time as NCUA has approved a proposed amendment, the corporate credit union must implement the capital restoration plan as approved prior to the proposed amendment.

(f) *Mandatory and discretionary supervisory actions.* (1) Mandatory supervisory actions.—

(i) Provisions applicable to all corporate credit unions. All corporate credit unions are subject to the restrictions contained in paragraph (k)(1) of this section on capital distributions.

(ii) Provisions applicable to undercapitalized, significantly undercapitalized, and critically undercapitalized corporate credit unions. Immediately upon receiving notice or being deemed to have notice, as provided in paragraph (c) or (e) of this section, that the corporate credit union is undercapitalized, significantly undercapitalized, or critically undercapitalized, the corporate credit union will be subject to the following provisions of paragraph (k) of this section:

(A) Restricting capital distributions (paragraph (k)(1));

(B) NCUA monitoring of the condition of the corporate credit union (paragraph (k)(2)(i));

(C) Requiring submission of a capital restoration plan (paragraph (k)(2)(ii));

(D) Restricting the growth of the corporate credit union's assets (paragraph (k)(2)(iii)); and

(E) Requiring prior approval of certain expansion proposals (paragraph (k)(2)(iv)).

(iii) Additional provisions applicable to significantly undercapitalized, and critically undercapitalized corporate credit unions. In addition to the mandatory requirements described in paragraph (f)(1) of this section, immediately upon receiving notice or being deemed to have notice that the corporate credit union is significantly undercapitalized, or critically undercapitalized, or that the corporate credit union is subject to the provisions applicable to corporate credit unions that are significantly undercapitalized because the credit union failed to submit or implement in any material respect an acceptable capital restoration plan, the corporate credit union will become subject to the provisions of paragraph (k)(3)(iii) of this section that restrict compensation paid to senior executive officers of the institution.

(iv) Additional provisions applicable to critically undercapitalized corporate credit unions. In addition to the provisions described in paragraphs (f)(1)(ii) and (f)(1)(iii) of this section, immediately upon receiving notice or being deemed to have notice that the corporate credit union is critically undercapitalized, the corporate credit union

will become subject to these additional provisions of paragraph (k) of this section:

(A) Restricting the activities of the corporate credit union ((k)(5)(i)); and

(B) Restricting payments on subordinated debt of the corporate credit union ((k)(5)(ii)).

(2) Discretionary supervisory actions.

(i) All PCA actions listed in paragraph (k) of this section that are not discussed in paragraph (f)(1) of this section are discretionary.

(ii) All discretionary actions available to NCUA in the case of an undercapitalized corporate credit union are available to NCUA in the case of a significantly undercapitalized credit union. All discretionary actions available to NCUA in the case of an undercapitalized corporate credit union or a significantly undercapitalized corporate credit union are available to NCUA in the case of a critically undercapitalized corporate credit union.

(iii) In taking any discretionary PCA actions with a corporate credit union that is deemed to be undercapitalized, significantly undercapitalized or critically undercapitalized, or has been reclassified as undercapitalized, or significantly undercapitalized; or an action in connection with an officer or director of such corporate credit union; the NCUA will follow the procedures for issuing directives under paragraphs (g) and (i) of this section.

(iv) NCUA will consult and seek to work cooperatively with the appropriate state supervisory authority (SSA) before taking any discretionary supervisory action with respect to a state-chartered corporate credit union; will provide notice of its decision to the SSA; and will allow the appropriate SSA an opportunity to take the proposed action independently or jointly with NCUA.

(g) *Directives to take prompt corrective action.* The NCUA will provide an undercapitalized, significantly undercapitalized, or critically undercapitalized corporate credit union prior written notice of the NCUA's intention to issue a directive requiring such corporate credit union to take actions or to follow prescriptions described in this part. Section 747.3002 of this chapter prescribes the notice content and associated process.

(h) *Procedures for reclassifying a corporate credit union based on criteria other than capital.* When the NCUA intends to reclassify a corporate credit union or subject it to the supervisory actions applicable to the next lower capitalization category based on an unsafe or unsound condition or practice, the NCUA will provide the credit union with prior written notice of such intent. Section 747.3003 of this chapter prescribes the notice content and associated process.

(i) *Order to dismiss a Director or senior executive officer.* When the NCUA issues and serves a directive on a corporate credit union requiring it to dismiss from office any director or senior executive officer under paragraphs (k)(3) of this section, the NCUA will also

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serve upon the person the corporate credit union is directed to dismiss (Respondent) a copy of the directive (or the relevant portions, where appropriate) and notice of the Respondent's right to seek reinstatement. Section 747.3004 of this chapter prescribes the content of the notice of right to seek reinstatement and the associated process.

(j) *Enforcement of directives.* Section 747.3005 of this chapter prescribes the process for enforcement of directives.

(k) *Remedial actions towards undercapitalized, significantly undercapitalized, and critically undercapitalized corporate credit unions.*

(1) Provision applicable to all corporate credit unions. A corporate credit union is prohibited from making any capital distribution, including payment of dividends on perpetual and nonperpetual capital accounts, if, after making the distribution, the credit union would be undercapitalized.

(2) Provisions applicable to undercapitalized corporate credit unions.

(i) Monitoring required. The NCUA will—

(A) Closely monitor the condition of any undercapitalized corporate credit union;

(B) Closely monitor compliance with capital restoration plans, restrictions, and requirements imposed under this section; and

(C) Periodically review the plan, restrictions, and requirements applicable to any undercapitalized corporate credit union to determine whether the plan, restrictions, and requirements are achieving the purpose of this section.

(ii) Capital restoration plan required.

(A) Any undercapitalized corporate credit union must submit an acceptable capital restoration plan to the NCUA.

(B) The capital restoration plan will—

(1) Specify—

(i) The steps the corporate credit union will take to become adequately capitalized;

(ii) The levels of capital to be attained during each year in which the plan will be in effect;

(iii) How the corporate credit union will comply with the restrictions or requirements then in effect under this section; and

(iv) The types and levels of activities in which the corporate credit union will engage; and

(2) Contain such other information as the NCUA may require.

(C) The NCUA will not accept a capital restoration plan unless the NCUA determines that the plan—

(1) Complies with paragraph (k)(2)(ii)(B) of this section;

(2) Is based on realistic assumptions, and is likely to succeed in restoring the corporate credit union's capital; and

(3) Would not appreciably increase the risk (including credit risk, interest-rate risk, and other types of risk) to which the corporate credit union is exposed.

(iii) Asset growth restricted. An undercapitalized corporate credit union must not permit its daily average net assets during any calendar month to exceed its moving daily average net assets unless—

(A) The NCUA has accepted the corporate credit union's capital restoration plan; and

(B) Any increase in total assets is consistent with the plan.

(iv) Prior approval required for acquisitions, branching, and new lines of business. An undercapitalized corporate credit union must not, directly or indirectly, acquire any interest in any entity, establish or acquire any additional branch office, or engage in any new line of business unless the NCUA has accepted the corporate credit union's capital restoration plan, the corporate credit union is implementing the plan, and the NCUA determines that the proposed action is consistent with and will further the achievement of the plan.

(3) Provisions applicable to significantly undercapitalized corporate credit unions and undercapitalized corporate credit unions that fail to submit and implement capital restoration plans.

(i) In general. This paragraph applies with respect to any corporate credit union that—

(A) Is significantly undercapitalized; or

(B) Is undercapitalized and—

(1) Fails to submit an acceptable capital restoration plan within the time allowed by the NCUA under paragraph (e)(1) of this section; or

(2) Fails in any material respect to implement a plan accepted by the NCUA.

(ii) Specific actions authorized. The NCUA may take one or more of the following actions:

(A) Requiring recapitalization.

(1) Requiring the corporate credit union to seek and obtain additional contributed capital.

(2) Requiring the corporate credit union to increase its rate of earnings retention.

(3) Requiring the corporate credit union to combine, in whole or part, with another insured depository institution, if one or more grounds exist under this section or the Federal Credit Union Act for appointing a conservator or liquidating agent.

(B) Restricting any ongoing or future transactions with affiliates.

(C) Restricting interest rates paid.

(1) In general. Restricting the rates of dividends and interest that the corporate credit union pays on shares and deposits to the prevailing rates on shares and deposits of comparable amounts and maturities in the region where the institution is located, as determined by the NCUA.

(2) Retroactive restrictions prohibited.

Paragraph (k)(3)(ii)(c) of this section does not authorize the NCUA to restrict interest rates paid on time deposits or shares made before (and not renewed or renegotiated

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after) the date the NCUA announced this restriction.

(D) Restricting asset growth. Restricting the corporate credit union's asset growth more stringently than in paragraph (k)(2)(iii) of this section, or requiring the corporate credit union to reduce its total assets.

(E) Restricting activities. Requiring the corporate credit union or any of its CUSOs to alter, reduce, or terminate any activity that the NCUA determines poses excessive risk to the corporate credit union.

(F) Improving management. Doing one or more of the following:

(1) New election of directors. Ordering a new election for the corporate credit union's board of directors.

(2) Dismissing directors or senior executive officers. Requiring the corporate credit union to dismiss from office any director or senior executive officer who had held office for more than 180 days immediately before the corporate credit union became undercapitalized.

(3) Employing qualified senior executive officers. Requiring the corporate credit union to employ qualified senior executive officers (who, if the NCUA so specifies, will be subject to approval by the NCUA).

(G) Requiring divestiture. Requiring the corporate credit union to divest itself of or liquidate any interest in any entity if the NCUA determines that the entity is in danger of becoming insolvent or otherwise poses a significant risk to the corporate credit union;

(H) Conserve or liquidate the corporate credit union if NCUA determines the credit union has no reasonable prospect of becoming adequately capitalized; and

(I) Requiring other action. Requiring the corporate credit union to take any other action that the NCUA determines will better carry out the purpose of this section than any of the actions described in this paragraph.

(iii) Senior executive officers' compensation restricted.

(A) In general. The corporate credit union is prohibited from doing any of the following without the prior written approval of the NCUA:

(1) Pay any bonus or profit-sharing to any senior executive officer.

(2) Provide compensation to any senior executive officer at a rate exceeding that officer's average rate of compensation (excluding bonuses and profit-sharing) during the 12 calendar months preceding the calendar month in which the corporate credit union became undercapitalized.

(B) Failing to submit plan. The NCUA will not grant approval with respect to a corporate credit union that has failed to submit an acceptable capital restoration plan.

(iv) Discretion to impose certain additional restrictions. The NCUA may impose

one or more of the restrictions prescribed by regulation under paragraph (k)(5) of this section if the NCUA determines that those restrictions are necessary to carry out the purpose of this section.

(4) More stringent treatment based on other supervisory criteria.

(i) In general. If the NCUA determines, after notice and an opportunity for hearing as described in subpart M of part 747 of this chapter, that a corporate credit union is in an unsafe or unsound condition or deems the corporate credit union to be engaging in an unsafe or unsound practice, the NCUA may—

(A) If the corporate credit union is well capitalized, reclassify the corporate credit union as adequately capitalized;

(B) If the corporate credit union is adequately capitalized (but not well capitalized), require the corporate credit union to comply with one or more provisions of paragraphs (k)(1) and (k)(2) of this section, as if the corporate credit union were undercapitalized; or

(C) If the corporate credit union is undercapitalized, take any one or more actions authorized under paragraph (k)(3)(ii) of this section as if the corporate credit union were significantly undercapitalized.

(ii) Contents of plan. Any plan required under paragraph (k)(4)(i) of this section will specify the steps that the corporate credit union will take to correct the unsafe or unsound condition or practice. Capital restoration plans, however, will not be required under paragraph (k)(4)(i)(B) of this section.

(5) Provisions applicable to critically undercapitalized corporate credit unions.

(i) Activities restricted. Any critically undercapitalized corporate credit union must comply with restrictions prescribed by the NCUA under paragraph (k)(6) of this section.

(ii) Payments on contributed capital and subordinated debt prohibited. A critically undercapitalized corporate credit union must not, beginning no later than 60 days after becoming critically undercapitalized, make any payment of dividends on contributed capital or any payment of principal or interest on the corporate credit union's subordinated debt unless the NCUA determines that an exception would further the purpose of this section. Interest, although not payable, may continue to accrue under the terms of any subordinated debt to the extent otherwise permitted by law. Dividends on contributed capital do not, however, continue to accrue.

(iii) Conservatorship, liquidation, or other action. The NCUA may, at any time, conserve or liquidate any critically undercapitalized corporate credit union or require the credit union to combine, in whole or part, with another institution. NCUA will consider, not later than 90 days after a corporate credit union becomes critically

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undercapitalized, whether NCUA should liquidate, conserve, or combine the institution.

(6) Restricting activities of critically undercapitalized corporate credit unions. To carry out the purpose of this section, the NCUA will, by order—

(i) Restrict the activities of any critically undercapitalized corporate credit union; and

(ii) At a minimum, prohibit any such corporate credit union from doing any of the following without the NCUA's prior written approval:

(A) Entering into any material transaction other than in the usual course of business, including any investment, expansion, acquisition, sale of assets, or other similar action.

(B) Extending credit for any transaction NCUA determines to be highly leveraged.

(C) Amending the corporate credit union's charter or bylaws, except to the extent necessary to carry out any other requirement of any law, regulation, or order.

(D) Making any material change in accounting methods.

(E) Paying compensation or bonuses NCUA determines to be excessive.

(F) Paying interest on new or renewed liabilities at a rate that would increase the corporate credit union's weighted average cost of funds to a level significantly exceeding the prevailing rates of interest on insured deposits in the corporate credit union's normal market areas.

§ 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;

(2) The repurchase securities are legal investments for that corporate credit union;

(3) The corporate credit union, directly or through its agent, receives daily assessment of the market value of the repurchase securities and maintains adequate margin that reflects a risk assessment of the repurchase securities and the term of the transaction; and

(4) The corporate credit union has entered into signed contracts with all approved counterparties and agents, and ensures compliance with the contracts. Such contracts must address any supplemental terms and conditions necessary to meet the specific requirements of this part. Third party arrangements must be supported by tri-party contracts in which the repurchase securities are priced and reported daily and the tri-party agent ensures compliance.

(e) *Securities lending.* A corporate credit union may enter into a securities lending transaction provided that:

(1) The corporate credit union, directly or through its agent, receives

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written confirmation of the loan, obtains a first priority security interest in the collateral by taking physical possession or control of the collateral, or is recorded as owner of the collateral through the Federal Reserve Book-Entry Securities Transfer System;

(2) The collateral is a legal investment for that corporate credit union;

(3) The corporate credit union, directly or through its agent, receives daily assessment of the market value of collateral and maintains adequate margin that reflects a risk assessment of the collateral and terms of the loan; and

(4) The corporate credit union has entered into signed contracts with all agents and, directly or through its agent, has executed a written loan and security agreement with the borrower. The corporate or its agent ensures compliance with the agreements.

(f) *Investment companies.* A corporate credit union may invest in an investment company registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a), provided that the prospectus of the company restricts the investment portfolio to investments and investment transactions that are permissible for that corporate credit union.

(g) *Forward settlement of transactions later than regular way.* A corporate credit union may enter into an agreement to purchase or sell an instrument, with settlement later than regular way, provided that:

(1) Delivery and acceptance are mandatory;

(2) The transaction is clearly disclosed in the appropriate risk reporting required under § 704.8(b);

(3) If the corporate credit union is the purchaser, it has adequate cash flow projections evidencing its ability to purchase the instrument;

(4) If the corporate credit union is the seller, it owns the instrument on the trade date; and

(5) The transaction is settled on a cash basis at the settlement date.

(h) *Prohibitions.* A corporate credit union is prohibited from:

(1) Purchasing or selling derivatives, except for embedded options not required under GAAP to be accounted for

separately from the host contract or forward sales commitments on loans to be purchased by the corporate credit union;

(2) Engaging in trading securities unless accounted for on a trade date basis;

(3) Engaging in adjusted trading or short sales; and

(4) Purchasing mortgage servicing rights, small business related securities, residual interests in collateralized mortgage obligations, residual interests in real estate mortgage investment conduits, or residual interests in asset-backed securities; and

(5) Purchasing stripped mortgage backed securities (SMBS), or securities that represent interests in SMBS, except as described in subparagraphs (i) and (iii) below.

(i) A corporate credit union may invest in exchangeable collateralized mortgage obligations (exchangeable CMOs) representing beneficial ownership interests in one or more interest-only classes of a CMO (IO CMOs) or principal-only classes of a CMO (PO CMOs), but only if:

(A) At the time of purchase, the ratio of the market price to the remaining principal balance is between .8 and 1.2, meaning that the discount or premium of the market price to par must be less than 20 points;

(B) The offering circular or other official information available at the time of purchase indicates that the notional principal on each underlying IO CMO should decline at the same rate as the principal on one or more of the underlying non-IO CMOs, and that the principal on each underlying PO CMO should decline at the same rate as the principal, or notional principal, on one or more of the underlying non-PO CMOs; and

(C) The credit union investment staff has the expertise dealing with exchangeable CMOs to apply the conditions in paragraphs (h)(5)(i)(A) and (B) of this section.

(ii) A corporate credit union that invests in an exchangeable CMO may exercise the exchange option only if all of the underlying CMOs are permissible investments for that credit union.

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(iii) A corporate credit union may accept an exchangeable CMO representing beneficial ownership interests in one or more IO CMOs or PO CMOs as an asset associated with an investment repurchase transaction or as collateral in a securities lending transaction. When the exchangeable CMO is associated with one of these two transactions, it need not conform to the conditions in paragraphs (h)(5)(i)(A) or (B) of this section.

(i) *Conflicts of interest.* A corporate credit union's officials, employees, and immediate family members of such individuals, may not receive pecuniary consideration in connection with the making of an investment or deposit by the corporate credit union. Employee compensation is exempt from this prohibition. All transactions not specifically prohibited by this paragraph must be conducted at arm's length and in the interest of the corporate credit union.

(j) *Grandfathering.* A corporate credit union's authority to hold an investment is governed by the regulation in effect at the time of purchase. However, all grandfathered investments are subject to the requirements of §§ 704.8 and 704.9.

[62 FR 12938, Mar. 19, 1997, as amended at 63 FR 24105, May 1, 1998; 67 FR 65654, Oct. 25, 2002; 69 FR 39832, July 1, 2004; 75 FR 34620, June 18, 2010]

EFFECTIVE DATE NOTE: At 75 FR 64839, Oct. 20, 2010, § 704.5 was revised, effective Jan. 18, 2011. For the convenience of the user, the revised text is set forth as follows:

§ 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:

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(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;

(2) The repurchase securities are legal investments for that corporate credit union;

(3) The corporate credit union, directly or through its agent, receives daily assessment of the market value of the repurchase securities and maintains adequate margin that reflects a risk assessment of the repurchase securities and the term of the transaction; and

(4) The corporate credit union has entered into signed contracts with all approved counterparties and agents, and ensures compliance with the contracts. Such contracts must address any supplemental terms and conditions necessary to meet the specific requirements of this part. Third party arrangements must be supported by tri-party contracts in which the repurchase securities are priced and reported daily and the tri-party agent ensures compliance; and

(e) *Securities Lending.* A corporate credit union may enter into a securities lending transaction provided that:

(1) The corporate credit union, directly or through its agent, receives written confirmation of the loan, obtains a first priority security interest in the collateral by taking physical possession or control of the collateral, or is recorded as owner of the collateral through the Federal Reserve Book-Entry Securities Transfer System;

(2) The collateral is a legal investment for that corporate credit union;

(3) The corporate credit union, directly or through its agent, receives daily assessment of the market value of collateral and maintains adequate margin that reflects a risk

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assessment of the collateral and terms of the loan; and

(4) The corporate credit union has entered into signed contracts with all agents and, directly or through its agent, has executed a written loan and security agreement with the borrower. The corporate or its agent ensures compliance with the agreements.

(f) *Investment companies.* A corporate credit union may invest in an investment company registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a), or a collective investment fund maintained by a national bank under 12 CFR 9.18 or a mutual savings bank under 12 CFR 550.260, provided that the company or fund prospectus restricts the investment portfolio to investments and investment transactions that are permissible for that corporate credit union.

(g) *Investment settlement.* A corporate credit union may only contract for the purchase or sale of an investment if the transaction is settled on a delivery versus payment basis within 60 days for mortgage-backed securities, within 30 days for new issues (other than mortgage-backed securities), and within three days for all other securities.

(h) *Prohibitions.* A corporate credit union is prohibited from:

(1) Purchasing or selling derivatives, except for embedded options not required under GAAP to be accounted for separately from the host contract or forward sales commitments on loans to be purchased by the corporate credit union;

(2) Engaging in trading securities unless accounted for on a trade date basis;

(3) Engaging in adjusted trading or short sales;

(4) Purchasing mortgage servicing rights, small business related securities, residual interests in collateralized mortgage obligations, residual interests in real estate mortgage investment conduits, or residual interests in asset-backed securities;

(5) Purchasing net interest margin securities;

(6) Purchasing collateralized debt obligations;

(7) Purchasing private label residential mortgage-backed securities;

(8) Purchasing subordinated securities; and

(9) Purchasing stripped mortgage-backed securities (SMBS), or securities that represent interests in SMBS, except as described in subparagraphs (i) and (iii) below.

(i) A corporate credit union may invest in exchangeable collateralized mortgage obligations (exchangeable CMOs) representing beneficial ownership interests in one or more interest-only classes of a CMO (IO CMOs) or principal-only classes of a CMO (PO CMOs), but only if:

(A) At the time of purchase, the ratio of the market price to the remaining principal balance is between .8 and 1.2, meaning that

the discount or premium of the market price to par must be less than 20 points;

(B) The offering circular or other official information available at the time of purchase indicates that the notional principal on each underlying IO CMO should decline at the same rate as the principal on one or more of the underlying non-IO CMOs, and that the principal on each underlying PO CMO should decline at the same rate as the principal, or notional principal, on one or more of the underlying non-PO CMOs; and

(C) The credit union investment staff has the expertise dealing with exchangeable CMOs to apply the conditions in paragraphs (h)(5)(i)(A) and (B) of this section.

(ii) A corporate credit union that invests in an exchangeable CMO may exercise the exchange option only if all of the underlying CMOs are permissible investments for that credit union.

(iii) A corporate credit union may accept an exchangeable CMO representing beneficial ownership interests in one or more IO CMOs or PO CMOs as an asset associated with an investment repurchase transaction or as collateral in a securities lending transaction. When the exchangeable CMO is associated with one of these two transactions, it need not conform to the conditions in paragraphs (h)(5)(i)(A) or (B) of this section.

(i) *Conflicts of interest.* A corporate credit union's officials, employees, and immediate family members of such individuals, may not receive pecuniary consideration in connection with the making of an investment or deposit by the corporate credit union. Employee compensation is exempt from this prohibition. All transactions not specifically prohibited by this paragraph must be conducted at arm's length and in the interest of the corporate credit union.

(j) *Grandfathering.* A corporate credit union's authority to hold an investment is governed by the regulation in effect at the time of purchase. However, all grandfathered investments are subject to the requirements of §§ 704.8 and 704.9.

§ 704.6 Credit risk management.

(a) *Policies.* A corporate credit union must operate according to a credit risk management policy that is commensurate with the investment risks and activities it undertakes. The policy must address at a minimum:

(1) The approval process associated with credit limits;

(2) Due diligence analysis requirements;

(3) Maximum credit limits with each obligor and transaction counterparty,

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set as a percentage of capital. In addition to addressing deposits and securities, limits with transaction counterparties must address aggregate exposures of all transactions including, but not limited to, repurchase agreements, securities lending, and forward settlement of purchases or sales of investments; and

(4) Concentrations of credit risk (*e.g.*, originator of receivables, insurer, industry type, sector type, and geographic).

(b) *Exemption.* The requirements of this section do not apply to investments that are issued or fully guaranteed as to principal and interest by the U.S. government or its agencies or enterprises (excluding subordinated debt) or are fully insured (including accumulated interest) by the NCUSIF or Federal Deposit Insurance Corporation.

(c) *Concentration limits*—(1) *General rule.* The aggregate of all investments in any single obligor is limited to 50 percent of capital or \$5 million, whichever is greater.

(2) *Exceptions.* Exceptions to the general rule are:

(i) Aggregate investments in repurchase and securities lending agreements with any one counterparty are limited to 200 percent of capital;

(ii) Investments in corporate CUSOs are subject to the limitations of § 704.11; and

(iii) Aggregate investments in corporate credit unions are not subject to the limitations of paragraph (c)(1) of this section.

(3) 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 nonconforming. 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 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.

(d) *Credit ratings.* (1) All investments, other than in a corporate credit union

or CUSO, must have an applicable credit rating from at least one nationally recognized statistical rating organization (NRSRO).

(2) At the time of purchase, investments with long-term ratings must be rated no lower than AA– (or equivalent) and investments with short-term ratings must be rated no lower than A–1 (or equivalent).

(3) Any rating(s) relied upon to meet the requirements of this part must be identified at the time of purchase and must be monitored for as long as the corporate owns the investment.

(4) When two or more ratings are relied upon to meet the requirements of this part at the time of purchase, the board or an appropriate committee must place on the § 704.6(e)(1) investment watch list any investment for which a rating is downgraded below the minimum rating requirements of this part.

(5) Investments are subject to the requirements of § 704.10 if:

(i) One rating was relied upon to meet the requirements of this part and that rating is downgraded below the minimum rating requirements of this part; or

(ii) Two or more ratings were relied upon to meet the requirements of this part and at least two of those ratings are downgraded below the minimum rating requirements of this part.

(e) *Reporting and documentation.* (1) At least annually, a written evaluation of each credit limit with each obligor or transaction counterparty must be prepared and formally approved by the board or an appropriate committee. At least monthly, the board or an appropriate committee must receive an investment watch list of existing and/or potential credit problems and summary credit exposure reports, which demonstrate compliance with the corporate credit union's risk management policies.

(2) At a minimum, the corporate credit union must maintain:

(i) A justification for each approved credit limit;

(ii) Disclosure documents, if any, for all instruments held in portfolio. Documents for an instrument that has been sold must be retained until completion of the next NCUA examination; and

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(iii) The latest available financial reports, industry analyses, internal and external analyst evaluations, and rating agency information sufficient to support each approved credit limit.

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

EFFECTIVE DATE NOTES: 1. At 75 FR 64841, Oct. 20, 2010, § 704.6 was revised, effective Jan. 18, 2011. For the convenience of the user, the revised text is set forth as follows:

§ 704.6. Credit risk management.

(a) *Policies.* A corporate credit union must operate according to a credit risk management policy that is commensurate with the investment risks and activities it undertakes. The policy must address at a minimum:

(1) The approval process associated with credit limits;

(2) Due diligence analysis requirements;

(3) Maximum credit limits with each obligor and transaction counterparty, set as a percentage of capital. In addition to addressing deposits and securities, limits with transaction counterparties must address aggregate exposures of all transactions including, but not limited to, repurchase agreements, securities lending, and forward settlement of purchases or sales of investments; and

(4) Concentrations of credit risk (*e.g.*, originator of receivables, servicer of receivables, insurer, industry type, sector type, geographic, collateral type, and tranche priority).

(b) *Exemption.* The limitations and requirements of this section do not apply to certain assets, whether or not considered investments under this part, including fixed assets, individual loans and loan participation interests, investments in CUSOs, investments that are issued or fully guaranteed as to principal and interest by the U.S. government or its agencies or its sponsored enterprises (other than mortgage backed securities), investments that are fully insured or guaranteed (including accumulated dividends and interest) by the NCUSIF or the Federal Deposit Insurance Corporation, and settlement funds in federally insured depository institutions.

(c) *Issuer concentration limits*—(1) General rule. The aggregate of all investments in any single obligor is limited to 25 percent of capital or \$5 million, whichever is greater.

(2) Exceptions.

(i) Investments in one obligor where the remaining maturity of all obligations is less than 30 days are limited to 50 percent of capital;

(ii) Investments in credit card master trust asset-backed securities are limited to 50 percent of capital in any single obligor;

(iii) Aggregate investments in repurchase and securities lending agreements with any one counterparty are limited to 200 percent of capital;

(iv) Investments in non-money market registered investment companies are limited to 50 percent of capital in any single obligor;

(v) Investments in money market registered investment companies are limited to 100 percent of capital in any single obligor; and

(vi) Investments in corporate CUSOs are subject to the limitations of § 704.11.

(3) 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 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.

(d) *Sector concentration limits.* (1) A corporate credit union must establish sector limits that do not exceed the following maximums:

(i) Mortgage-backed securities (Inclusive of commercial mortgage-backed securities)—the lower of 1000 percent of capital or 50 percent of assets;

(ii) Commercial mortgage-backed securities—the lower of 300 percent of capital or 15 percent of assets;

(iii) FFELP student loan asset-backed securities—the lower of 1000 percent of capital or 50 percent of assets;

(iv) Private student loan asset-backed securities—the lower of 500 percent of capital or 25 percent of assets;

(v) Auto loan/lease asset-backed securities—the lower of 500 percent of capital or 25 percent of assets;

(vi) Credit card asset-backed securities—the lower of 500 percent of capital or 25 percent of assets;

(vii) Other asset-backed securities not listed in paragraphs (ii) through (vi)—the lower of 500 percent of capital or 25 percent of assets;

(viii) Corporate debt obligations—the lower of 1000 percent of capital or 50 percent of assets; and

(ix) Municipal securities—the lower of 1000 percent of capital or 50 percent of assets.

(2) Registered investment companies—A corporate credit union must limit its investment in registered investment companies to the lower of 1000 percent of capital or 50 percent of assets. In addition to applying the limit in this paragraph (d)(2), a corporate

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credit union must also include the underlying assets in each registered investment company in the relevant sectors described in paragraph (d)(1) of this section when calculating those sector limits.

(3) A corporate credit union will limit its aggregate holdings in any investments not described in paragraphs (d)(1) or (d)(2) of this section to the lower of 100 percent of capital or 5 percent of assets. The NCUA may approve a higher percentage in appropriate cases.

(4) Investments in other federally insured credit unions, deposits and federal funds investments in other federally insured depository institutions, and investment repurchase agreements are excluded from the concentration limits in paragraphs (d)(1), (d)(2), and (d)(3) of this section.

(e) *Corporate debt obligation subsector limits.* In addition to the limitations in paragraph (d)(1)(viii) of this section, a corporate credit union must not exceed the lower of 200 percent of capital or 10 percent of assets in any single North American Industry Classification System (NAICS) industry sector. If the corporation does not have a readily ascertainable NAICS classification, a corporate credit union will use its reasonable judgment in assigning such a classification. NCUA may direct, however, that the corporate change the classification.

(f) *Credit ratings.*—(1) All investments, other than in another depository institution, must have an applicable credit rating from at least one NRSRO. At a minimum, 90 percent of all such investments, by book value, must have a rating by at least two NRSROs. Corporate credit unions may use either public or nonpublic NRSRO ratings to satisfy this requirement.

(2) At the time of purchase, investments with long-term ratings must be rated no lower than AA- (or equivalent) by every NRSRO that provides a publicly available long-term rating on that investment, and investments with short-term ratings must be rated no lower than A-1 (or equivalent) by every NRSRO that provides a publicly available short-term rating on that investment. If the corporate credit union obtains a nonpublic NRSRO rating, that rating must also be no lower than AA-, or A-1, for long-term and short-term ratings, respectively.

(3) All rating(s) relied upon to meet the requirements of this part must be identified at the time of purchase and must be monitored for as long as the corporate owns the investment. Corporate credit unions must identify and monitor any new post-purchase NRSRO ratings on investments they hold.

(4) Investments are subject to the requirements of § 704.10 if:

(i) An NRSRO that rates the investment downgrades that rating, after purchase, below the minimum rating requirements of this part; or

(ii) The investment is part of an asset class or group of investments that exceeds the sector or obligor concentration limits of this section.

(g) *Reporting and documentation.* (1) At least annually, a written evaluation of each credit limit with each obligor or transaction counterparty must be prepared and formally approved by the board or an appropriate committee. At least monthly, the board or an appropriate committee must receive an investment watch list of existing and/or potential credit problems and summary credit exposure reports, which demonstrate compliance with the corporate credit union's risk management policies.

(2) At a minimum, the corporate credit union must maintain:

(i) A justification for each approved credit limit;

(ii) Disclosure documents, if any, for all instruments held in portfolio. Documents for an instrument that has been sold must be retained until completion of the next NCUA examination; and

(iii) The latest available financial reports, industry analyses, internal and external analyst evaluations, and rating agency information sufficient to support each approved credit limit.

2. At 75 FR 71528, Nov. 24, 2010, § 704.6 was amended by revising paragraph (b), effective Jan. 18, 2011. For the convenience of the user, the revised text is set forth as follows:

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* * * * *

(b) *Exemption.* The limitations and requirements of this section do not apply to certain assets, whether or not considered investments under this part, including fixed assets, individual loans and loan participation interests, investments in CUSOs, investments that are issued or fully guaranteed as to principal and interest by the U.S. government or its agencies or its sponsored enterprises (but not exempting, for purposes of paragraph (d) of this section, mortgage backed securities), investments that are fully insured or guaranteed (including accumulated dividends and interest) by the NCUSIF or the Federal Deposit Insurance Corporation, and settlement funds in federally insured depository institutions.

* * * * *

§ 704.7 Lending.

(a) *Policies.* A corporate credit union must operate according to a lending policy which addresses, at a minimum:

(1) Loan types and limits;

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(2) Required documentation and collateral; and

(3) Analysis and monitoring standards.

(b) *General.* Each loan or line of credit limit will be determined after analyzing the financial and operational soundness of the borrower and the ability of the borrower to repay the loan.

(c) *Loans to members—(1) Credit unions.* (i) The maximum aggregate amount in unsecured loans and lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, must not exceed 50 percent of capital.

(ii) The maximum aggregate amount in secured loans and lines of credit to any one member credit union, excluding those secured by shares or marketable securities and member reverse repurchase transactions, must not exceed 100 percent of capital.

(2) *Corporate CUSOs.* Any loan or line of credit must comply with § 704.11.

(3) *Other members.* The maximum aggregate amount of loans and lines of credit to any other one member must not exceed 15 percent of the corporate credit union's capital plus pledged shares.

(d) *Loans to nonmembers—(1) Credit unions.* A loan to a nonmember credit union, other than through a loan participation with another corporate credit union, is only permissible if the loan is for an overdraft related to the providing of correspondent services pursuant to § 704.12. Generally, such a loan will have a maturity of one business day.

(2) *Corporate CUSOs.* Any loan or line of credit must comply with § 704.11.

(e) *Member business loan rule.* Loans, lines of credit and letters of credit to:

(1) Member credit unions are exempt from part 723 of this chapter;

(2) Corporate CUSOs are not subject to part 723 of this chapter.

(3) Other members not excluded under § 723.1(b) of this chapter must comply with part 723 of this chapter unless the loan or line of credit is fully guaranteed by a credit union or fully secured by U.S. Treasury or agency securities. Those guaranteed and secured loans must comply with the aggregate limits of § 723.16 but are exempt from the other requirements of part 723.

(f) *Participation loans with other corporate credit unions.* A corporate credit union is permitted to participate in a loan with another corporate credit union provided the corporate retains an interest of at least 5 percent of the face amount of the loan and a master participation loan agreement is in place before the purchase or the sale of a participation. A participating corporate credit union must exercise the same due diligence as if it were the originating corporate credit union.

(g) *Prepayment penalties.* If provided for in the loan contract, a corporate credit union is authorized to assess prepayment penalties on loans.

[62 FR 12938, Mar. 19, 1997, as amended at 64 FR 57365, Oct. 25, 1999; 67 FR 65655, Oct. 25, 2002; 68 FR 56550, Oct. 1, 2003; 75 FR 34621, June 18, 2010]

§ 704.8 Asset and liability management.

(a) *Policies.* A corporate credit union must operate according to a written asset and liability management policy which addresses, at a minimum:

(1) The purpose and objectives of the corporate credit union's asset and liability activities;

(2) The maximum allowable percentage decline in net economic value (NEV), compared to base case NEV;

(3) The minimum allowable NEV ratio;

(4) Policy limits and specific test parameters for the interest rate sensitivity analysis requirements set forth in paragraph (d) of this section;

(5) The modeling of indexes that serve as references in financial instrument coupon formulas; and

(6) The tests that will be used, prior to purchase, to estimate the impact of investments on the percentage decline in NEV, compared to base case NEV. The most recent NEV analysis, as determined under paragraph (d)(1)(i) of this section may be used as a basis of estimation.

(b) *Asset and liability management committee (ALCO).* A corporate credit union's ALCO must have at least one member who is also a member of the board of directors. The ALCO must review asset and liability management reports on at least a monthly basis. These reports must address compliance

with Federal Credit Union Act, NCUA Rules and Regulations (12 CFR chapter VII), and all related risk management policies.

(c) *Penalty for early withdrawals.* A corporate credit union that permits early certificate/share withdrawals must assess market-based penalties sufficient to cover the estimated replacement cost of the certificate/share redeemed. This means the minimum penalty must be reasonably related to the rate that the corporate credit union would be required to offer to attract funds for a similar term with similar characteristics.

(d) *Interest rate sensitivity analysis.* (1) A corporate credit union must:

(i) Evaluate the risk in its balance sheet by measuring, at least quarterly, the impact of an instantaneous, permanent, and parallel shock in the yield curve of plus and minus 100, 200, and 300 basis points on its NEV and NEV ratio. If the base case NEV ratio falls below 3 percent at the last testing date, these tests must be calculated at least monthly until the base case NEV ratio again exceeds 3 percent;

(ii) Limit its risk exposure to levels that do not result in a base case NEV ratio or any NEV ratio resulting from the tests set forth in paragraph (d)(1)(i) of this section below 2 percent; and

(iii) Limit its risk exposures to levels that do not result in a decline in NEV of more than 15 percent.

(2) A corporate credit union must assess annually if it should conduct periodic additional tests to address market factors that may materially impact that corporate credit union's NEV. These factors should include, but are not limited to, the following:

(i) Changes in the shape of the Treasury yield curve;

(ii) Adjustments to prepayment projections used for amortizing securities to consider the impact of significantly faster/slower prepayment speeds;

(iii) Adjustments to the market spread assumptions for non Treasury instruments to consider the impact of widening spreads; and

(iv) Adjustments to volatility assumptions to consider the impact that changing volatilities have on embedded option values.

(e) *Regulatory violations.* If a corporate credit union's decline in NEV, base case NEV ratio or any NEV ratio resulting from the tests set forth in paragraph (d)(1)(i) of this section violates the limits established by this rule and is not brought into compliance within 10 calendar days, operating management of the corporate credit union must immediately report the information to the board of directors, supervisory committee, and the OCCU Director. If any violation persists for 30 calendar days, the corporate credit union must submit a detailed, written action plan to the OCCU Director that sets forth the time needed and means by which it intends to correct the violation. If the OCCU Director determines that the plan is unacceptable, the corporate credit union must immediately restructure the balance sheet to bring the exposure back within compliance or adhere to an alternative course of action determined by the OCCU Director.

(f) *Policy violations.* If a corporate credit union's decline in NEV, base case NEV ratio, or any NEV ratio resulting from the tests set forth in paragraph (d)(1)(i) of this section violates the limits established by its board, it must determine how it will bring the exposure within policy limits. The disclosure to the board of the violation must occur no later than its next regularly scheduled board meeting.

[62 FR 12938, Mar. 19, 1997, as amended at 67 FR 65655, Oct. 25, 2002; 69 FR 39833, July 1, 2004; 73 FR 30477, May 28, 2008]

EFFECTIVE DATE NOTE: At 75 FR 64842, Oct. 20, 2010, §704.8 was revised, effective Jan. 18, 2011. For the convenience of the user, the revised text is set forth as follows:

§ 704.8. Asset and liability management.

(a) *Policies.* A corporate credit union must operate according to a written asset and liability management policy which addresses, at a minimum:

(1) The purpose and objectives of the corporate credit union's asset and liability activities;

(2) The maximum allowable percentage decline in net economic value (NEV), compared to base case NEV;

(3) The minimum allowable NEV ratio;

(4) Policy limits and specific test parameters for the NEV sensitivity analysis requirements set forth in paragraphs (d), (e), and (f) of this section;

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(5) The modeling of indexes that serve as references in financial instrument coupon formulas; and

(6) The tests that will be used, prior to purchase, to estimate the impact of investments on the percentage decline in NEV compared to base case NEV. The most recent NEV analysis, as determined under paragraph (d)(1)(i) of this section may be used as a basis of estimation.

(b) *Asset and liability management committee (ALCO)*. A corporate credit union's ALCO must have at least one member who is also a member of the board of directors. The ALCO must review asset and liability management reports on at least a monthly basis. These reports must address compliance with Federal Credit Union Act, NCUA Rules and Regulations (12 CFR chapter VII), and all related risk management policies.

(c) *Penalty for early withdrawals*. A corporate credit union that permits early certificate/share withdrawals must assess market-based penalties sufficient to cover the estimated replacement cost of the certificate redeemed. This means the minimum penalty must be reasonably related to the rate that the corporate credit union would be required to offer to attract funds for a similar term with similar characteristics.

(d) *Interest rate sensitivity analysis*. (1) A corporate credit union must:

(i) Evaluate the risk in its balance sheet by measuring, at least quarterly, including once on the last day of the calendar quarter, the impact of an instantaneous, permanent, and parallel shock in the yield curve of plus and minus 100, 200, and 300 BP on its NEV and NEV ratio. If the base case NEV ratio falls below 3 percent at the last testing date, these tests must be calculated at least monthly, including once on the last day of the month, until the base case NEV ratio again exceeds 3 percent;

(ii) Limit its risk exposure to levels that do not result in a base case NEV ratio or any NEV ratio resulting from the tests set forth in paragraph (d)(1)(i) of this section below 2 percent; and

(iii) Limit its risk exposures to levels that do not result in a decline in NEV of more than 15 percent.

(2) A corporate credit union must assess annually if it should conduct periodic additional tests to address market factors that may materially impact that corporate credit union's NEV. These factors should include, but are not limited to, the following:

(i) Changes in the shape of the Treasury yield curve;

(ii) Adjustments to prepayment projections used for amortizing securities to consider the impact of significantly faster/slower prepayment speeds; and

(iii) Adjustments to volatility assumptions to consider the impact that changing volatilities have on embedded option values.

(e) *Net interest income modeling*. A corporate credit union must perform net interest income (NII) modeling to project earnings in multiple interest rate environments for a period of no less than 2 years. NII modeling must, at minimum, be performed at least quarterly, including once on the last day of the calendar quarter.

(f) *Weighted average asset life*. The weighted average life (WAL) of a corporate credit union's loan and investment portfolio, excluding derivative contracts and equity investments, may not exceed 2 years. A corporate credit union must test its assets at least quarterly, including once on the last day of the calendar quarter, for compliance with this WAL limitation. When calculating its WAL, a corporate credit union must assume that no issuer or market options will be exercised. If the WAL of a corporate credit union's assets exceeds 2 years on the testing date, this test must be calculated at least monthly, including once on the last day of the month, until the WAL is below 2 years.

(g) *Weighted average asset life with 50 percent slowdown in prepayment speeds*. The weighted average life (WAL) of a corporate credit union's loan and investment portfolio, 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 investments at least quarterly, including once on the last day of the calendar quarter, for compliance with this WAL limitation. When calculating its WAL, a corporate credit union must assume that no issuer or market options will be exercised. If the WAL of a corporate credit union's assets exceeds 2.25 years, this test must be calculated at least monthly, including once on the last day of the month, until the WAL with the 50 slowdown in prepayment speeds is below 2.25 years.

(h) *Government issued or guaranteed securities*. The WAL of investments that are issued or fully guaranteed as to principal and interest by the U.S. government, its agencies or sponsored enterprises, including investments that are fully insured or guaranteed (including accumulated dividends and interest) by the NCUSIF or the Federal Deposit Insurance Corporation, will be multiplied by a factor of 0.50 for purposes of the WAL tests of paragraphs (f) and (g) of this section.

(i) *Effective and spread durations*. A corporate credit union must measure at least once a quarter, including once on the last day of the calendar quarter, the effective duration and spread durations of each of its assets and liabilities, where the values of these are affected by changes in interest rates or credit spreads.

(j) *Regulatory violations*. (1)(i) If a corporate credit union's decline in NEV, base case NEV ratio or any NEV ratio resulting from the

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test set forth in paragraph (d) of this section violates the limits established in that paragraph, or the corporate credit union is unable to satisfy the tests in paragraphs (f) or (g) of this section; and

(ii) The corporate cannot adjust its balance sheet so as to satisfy the requirements of paragraphs (d), (f), or (g) of this section within 10 calendar days after detecting the violation, then:

(iii) The operating management of the corporate credit union must immediately report this information to its board of directors, supervisory committee, and the NCUA.

(2) If any violation described in paragraph (j)(1)(i) persists for 30 or more calendar days, the corporate credit union:

(i) Must immediately submit a detailed, written action plan to the NCUA that sets forth the time needed and means by which it intends to correct the violation and, if the NCUA determines that the plan is unacceptable, the corporate credit union must immediately restructure its balance sheet to bring the exposure back within compliance or adhere to an alternative course of action determined by the NCUA; and

(ii) If presently categorized as adequately capitalized or well capitalized for PCA purposes, immediately be recategorized as undercapitalized until the violation is corrected, and

(iii) If presently less than adequately capitalized, immediately be downgraded one additional capital category.

(k) *Overall limit on business generated from individual credit unions.* On or after April 22, 2013, a corporate credit union is prohibited from accepting from any member, or any nonmember credit union, any investment, including shares, loans, PCC, or NCAs if, following that investment, the aggregate of all investments from that entity in the corporate would exceed 15 percent of the corporate credit union's moving daily average net assets.

§ 704.9 Liquidity management.

(a) *General.* In the management of liquidity, a corporate credit union must:

(1) Evaluate the potential liquidity needs of its membership in a variety of economic scenarios;

(2) Regularly monitor sources of internal and external liquidity;

(3) Demonstrate that the accounting classification of investment securities is consistent with its ability to meet potential liquidity demands; and

(4) Develop a contingency funding plan that addresses alternative funding strategies in successively deteriorating liquidity scenarios. The plan must:

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(i) List all sources of liquidity, by category and amount, that are available to service an immediate outflow of funds in various liquidity scenarios;

(ii) Analyze the impact that potential changes in fair value will have on the disposition of assets in a variety of interest rate scenarios; and

(iii) Be reviewed by the board or an appropriate committee no less frequently than annually or as market or business conditions dictate.

(b) *Borrowing.* A corporate credit union may borrow up to 10 times capital or 50 percent of shares (excluding shares created by the use of member reverse repurchase agreements) and capital, whichever is greater. CLF borrowings and borrowed funds created by the use of member reverse repurchase agreements are excluded from this limit. The corporate credit union must demonstrate that sufficient contingent sources of liquidity remain available.

EFFECTIVE DATE NOTE: At 75 FR 64843, Oct. 20, 2010, § 704.9 was revised, effective Jan. 18, 2011. For the convenience of the user, the revised text is set forth as follows:

§ 704.9. Liquidity management.

(a) *General.* In the management of liquidity, a corporate credit union must:

(1) Evaluate the potential liquidity needs of its membership in a variety of economic scenarios;

(2) Regularly monitor and demonstrate accessibility to sources of internal and external liquidity;

(3) Keep a sufficient amount of cash and cash equivalents on hand to support its payment system obligations;

(4) Demonstrate that the accounting classification of investment securities is consistent with its ability to meet potential liquidity demands; and

(5) Develop a contingency funding plan that addresses alternative funding strategies in successively deteriorating liquidity scenarios. The plan must:

(i) List all sources of liquidity, by category and amount, that are available to service an immediate outflow of funds in various liquidity scenarios;

(ii) Analyze the impact that potential changes in fair value will have on the disposition of assets in a variety of interest rate scenarios; and

(iii) Be reviewed by the board or an appropriate committee no less frequently than annually or as market or business conditions dictate.

(b) *Borrowing limits.* A corporate credit union may borrow up to the lower of 10 times

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capital or 50 percent of capital and shares (excluding shares created by the use of member reverse repurchase agreements).

(1) *Secured borrowings.* A corporate credit union may borrow on a secured basis for liquidity purposes, but the maturity of the borrowing may not exceed 30 days. Only a credit union with core capital in excess of five percent of its moving DANA may borrow on a secured basis for nonliquidity purposes, and the outstanding amount of secured borrowing for nonliquidity purposes may not exceed an amount equal to the difference between core capital and five percent of moving DANA.

(2) *Exclusions.* CLF borrowings and borrowed funds created by the use of member reverse repurchase agreements are excluded from this limit.

§ 704.10 Investment action plan.

(a) Any corporate credit union in possession of an investment, including a derivative, that fails to meet a requirement of this part must, within 30 calendar days of the failure, report the failed investment to its board of directors, supervisory committee and the OCCU Director. If the corporate credit union does not sell the failed investment, and the investment continues to fail to meet a requirement of this part, the corporate credit union must, within 30 calendar days of the failure, provide to the OCCU Director a written action plan that addresses:

(1) The investment's characteristics and risks;

(2) The process to obtain and adequately evaluate the investment's market pricing, cash flows, and risk;

(3) How the investment fits into the credit union's asset and liability management strategy;

(4) The impact that either holding or selling the investment will have on the corporate credit union's earnings, liquidity, and capital in different interest rate environments; and

(5) The likelihood that the investment may again pass the requirements of this part.

(b) The OCCU Director may require, for safety and soundness reasons, a shorter time period for plan development than that set forth in paragraph (a) of this section.

(c) If the plan described in paragraph (a) of this section is not approved by the OCCU Director, the credit union

must adhere to the OCCU Director's directed course of action.

[62 FR 12938, Mar. 19, 1997, as amended at 67 FR 65656, 65659, Oct. 25, 2002]

§ 704.11 Corporate Credit Union Service Organizations (Corporate CUSOs).

(a) A corporate CUSO is an entity that:

(1) Is at least partly owned by a corporate credit union;

(2) Primarily serves credit unions;

(3) Restricts its services to those related to the normal course of business of credit unions; and

(4) Is structured as a corporation, limited liability company, or limited partnership under state law.

(b) *Investment and loan limitations.* (1) The aggregate of all investments in member and nonmember corporate CUSOs must not exceed 15 percent of a corporate credit union's capital.

(2) The aggregate of all investments in and loans to member and nonmember corporate CUSOs must not exceed 30 percent of a corporate credit union's capital. A corporate credit union may lend to member and nonmember corporate CUSOs an additional 15 percent of capital if the loan is collateralized by assets in which the corporate has a perfected security interest under state law.

(3) If the limitations in paragraphs (b)(1) and (b)(2) of this section are reached or exceeded because of the profitability of the CUSO and the related GAAP valuation of the investment under the equity method without an additional cash outlay by the corporate, divestiture is not required. A corporate credit union may continue to invest up to the regulatory limit without regard to the increase in the GAAP valuation resulting from the corporate CUSO's profitability.

(c) *Due diligence.* A corporate credit union must comply with the due diligence requirements of §§ 723.5 and 723.6(f) through (j) of this chapter for all loans to corporate CUSOs. This requirement does not apply to loans excluded under § 723.1(b).

(d) *Separate entity.* (1) A corporate CUSO must be operated as an entity separate from a corporate credit union.

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(2) A corporate credit union investing in or lending to a corporate CUSO must obtain a written legal opinion that concludes the corporate CUSO is organized and operated in a manner that the corporate credit union will not reasonably be held liable for the obligations of the corporate CUSO. This opinion must address factors that have led courts to “pierce the corporate veil,” such as inadequate capitalization, lack of corporate identity, common boards of directors and employees, control of one entity over another, and lack of separate books and records.

(e) *Prohibited activities.* A corporate credit union may not use this authority to acquire control, directly or indirectly, of another depository financial institution or to invest in shares, stocks, or obligations of an insurance company, trade association, liquidity facility, or similar organization.

(f) An official of a corporate credit union which has invested in or loaned to a corporate CUSO may not receive, either directly or indirectly, any salary, commission, investment income, or other income, compensation, or consideration from the corporate CUSO. This prohibition also extends to immediate family members of officials.

(g) Prior to making an investment in or loan to a corporate CUSO, a corporate credit union must obtain a written agreement that the corporate CUSO will:

(1) Follow GAAP;

(2) Provide financial statements to the corporate credit union at least quarterly;

(3) Obtain an annual CPA opinion audit and provide a copy to the corporate credit union. A wholly owned or majority owned CUSO is not required to obtain a separate annual audit if it is included in the corporate credit union’s annual consolidated audit; and

(4) Allow the auditor, board of directors, and NCUA complete access to its books, records, and any other pertinent documentation.

(h) Corporate credit union authority to invest in or loan to a CUSO is limited to that provided in this section. A corporate credit union is not author-

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ized to invest in or loan to a CUSO under part 712 of this chapter.

[62 FR 12938, Mar. 19, 1997, as amended at 63 FR 10756, Mar. 5, 1998; 67 FR 65656, Oct. 25, 2002; 68 FR 56550, Oct. 1, 2003]

EFFECTIVE DATE NOTE: At 75 FR 64843, Oct. 20, 2010, § 704.11 was revised, effective Jan. 18, 2011. For the convenience of the user, the revised text is set forth as follows:

§ 704.11 Corporate Credit Union Service Organizations (Corporate CUSOs).

(a) A corporate CUSO is an entity that:

(1) Is at least partly owned by a corporate credit union;

(2) Primarily serves credit unions;

(3) Restricts its services to those related to the normal course of business of credit unions as specified in paragraph (e) of this section; and

(4) Is structured as a corporation, limited liability company, or limited partnership under state law.

(b) *Investment and loan limitations.* (1) The aggregate of all investments in member and non-member corporate CUSOs must not exceed 15 percent of a corporate credit union’s capital.

(2) The aggregate of all investments in and loans to member and nonmember corporate CUSOs must not exceed 30 percent of a corporate credit union’s capital. A corporate credit union may lend to member and non-member corporate CUSOs an additional 15 percent of capital if the loan is collateralized by assets in which the corporate has a perfected security interest under state law.

(3) If the limitations in paragraphs (b)(1) and (b)(2) of this section are reached or exceeded because of the profitability of the CUSO and the related GAAP valuation of the investment under the equity method without an additional cash outlay by the corporate, divestiture is not required. A corporate credit union may continue to invest up to the regulatory limit without regard to the increase in the GAAP valuation resulting from the corporate CUSO’s profitability.

(c) *Due diligence.* A corporate credit union must comply with the due diligence requirements of §§ 723.5 and 723.6(f) through (j) of this chapter for all loans to corporate CUSOs. This requirement does not apply to loans excluded under § 723.1(b).

(d) *Separate entity.* (1) A corporate CUSO must be operated as an entity separate from a corporate credit union.

(2) A corporate credit union investing in or lending to a corporate CUSO must obtain a written legal opinion that concludes the corporate CUSO is organized and operated in a manner that the corporate credit union will not reasonably be held liable for the obligations of the corporate CUSO. This opinion must address factors that have led courts to

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“pierce the corporate veil,” such as inadequate capitalization, lack of corporate identity, common boards of directors and employees, control of one entity over another, and lack of separate books and records.

(e). *Permissible activities.* (1) Beginning on April 18, 2011, a corporate CUSO must agree to limit its activities to:

- (i) Brokerage services,
- (ii) Investment advisory services, and
- (iii) Other categories of activities as approved in writing by NCUA and published on NCUA’s Web site.

(2) A corporate credit union must divest from any CUSO that is engaged in activities not approved by NCUA under paragraph (e)(1) of this section. A corporate credit union may take until October 20, 2011 to divest itself from a CUSO engaging in one or more unapproved activities, but only if the CUSO was engaging in those activities before October 20, 2010 and the corporate credit union can establish that those activities satisfied the requirements of this section as it existed before October 20, 2010.

(3) Once NCUA has approved an activity and published that activity on its Web site as provided for in paragraph (e)(1)(iii) of this section, NCUA will not remove that particular activity the approved list, or make substantial changes to the content or description of that approved activity, except through the formal rulemaking process.

(f) An official of a corporate credit union which has invested in or loaned to a corporate CUSO may not receive, either directly or indirectly, any salary, commission, investment income, or other income, compensation, or consideration from the corporate CUSO. This prohibition also extends to immediate family members of officials.

(g) Prior to making an investment in or loan to a corporate CUSO, a corporate credit union must obtain a written agreement that the CUSO:

- (1) Will follow GAAP;
- (2) Will provide financial statements to the corporate credit union at least quarterly;
- (3) Will obtain an annual CPA opinion audit and provide a copy to the corporate credit union. A wholly owned or majority owned CUSO is not required to obtain a separate annual audit if it is included in the corporate credit union’s annual consolidated audit;
- (4) Will not acquire control, directly or indirectly, of another depository financial institution or to invest in shares, stocks, or obligations of an insurance company, trade association, liquidity facility, or similar organization;
- (5) Will allow the auditor, board of directors, and NCUA complete access to its personnel, facilities, equipment, books, records, and any other documentation that the auditor, directors, or NCUA deem pertinent; and

(6) Will comply with all the requirements of this section.

(h) Corporate credit union authority to invest in or loan to a CUSO is limited to that provided in this section. A corporate credit union is not authorized to invest in or loan to a CUSO under part 712 of this chapter.

§ 704.12 Permissible services.

(a) *Preapproved services.* A corporate credit union may provide to members the preapproved services set out in this section. NCUA may at any time, based upon supervisory, legal, or safety and soundness reasons, limit or prohibit any preapproved service. The specific activities listed within each preapproved category are provided as illustrations of activities permissible under the particular category, not as an exclusive or exhaustive list.

(1) *Correspondent services agreement.* A corporate credit union may only provide financial services to nonmembers through a correspondent services agreement. A correspondent services agreement is an agreement between two corporate credit unions, whereby one of the corporate credit unions agrees to provide services to the other corporate credit union or its members.

(2) *Credit and investment services.* Credit and investment services are advisory and consulting activities that assist the member in lending or investment management. These services may include loan reviews, investment portfolio reviews and investment advisory services.

(3) *Electronic financial services.* Electronic financial services are any services, products, functions, or activities that a corporate credit union is otherwise authorized to perform, provide or deliver to its members but performed through electronic means. Electronic services may include automated teller machines, online transaction processing through a website, website hosting services, account aggregation services, and internet access services to perform or deliver products or services to members.

(4) *Excess capacity.* Excess capacity is the excess use or capacity remaining in facilities, equipment or services that: a corporate credit union properly invested in or established, in good faith, with the intent of serving its members; and it reasonably anticipates will be

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taken up by the future expansion of services to its members. A corporate credit union may sell or lease the excess capacity in facilities, equipment or services, such as office space, employees and data processing.

(5) *Liquidity and asset and liability management.* Liquidity and asset and liability management services are any services, functions or activities that assist the member in liquidity and balance sheet management. These services may include liquidity planning and balance sheet modeling and analysis.

(6) *Operational services.* Operational services are services established to deliver financial products and services that enhance member service and promote safe and sound operations. Operational services may include tax payment, electronic fund transfers and providing coin and currency service.

(7) *Payment systems.* Payment systems are any methods used to facilitate the movement of funds for transactional purposes. Payment systems may include Automated Clearing House, wire transfer, item processing and settlement services.

(8) *Trustee or custodial services.* Trustee services are services in which the corporate credit union is authorized to act under a written trust agreement to the extent permitted under part 724 of this chapter. Custodial and safekeeping services are services a corporate credit union performs on behalf of its member to act as custodian or safekeeper of investments.

(b) *Procedure for adding services that are not preapproved.* To provide a service to its members that is not preapproved by NCUA:

(1) A federal corporate credit union must request approval from NCUA. The request must include a full explanation and complete documentation of the service and how the service relates to a corporate credit union's authority to provide services to its members. The request must be submitted jointly to the OCCU Director and the Secretary of the Board. The request will be treated as a petition to amend § 704.12 and NCUA will request public comment or otherwise act on the petition within a reasonable period of time. Before engaging in the formal approval process, a corporate credit union should seek an

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advisory opinion from NCUA's Office of General Counsel as to whether a proposed service is already covered by one of the authorized categories without filing a petition to amend the regulation; and

(2) A state-chartered corporate credit union must submit a request for a waiver that complies with § 704.1(b) to the OCCU Director.

(c) *Prohibition.* A corporate credit union is prohibited from purchasing loan servicing rights.

[67 FR 65656, Oct. 25, 2002]

§ 704.13 [Reserved]

§ 704.14 Representation.

(a) *Board representation.* The board will be determined as stipulated in its bylaws governing election procedures, provided that:

(1) At least a majority of directors, including the chair of the board, must serve on the board as representatives of member credit unions;

(2) The chair of the board may not serve simultaneously as an officer, director, or employee of a credit union trade association;

(3) A majority of directors may not serve simultaneously as officers, directors, or employees of the same credit union trade association or its affiliates (not including chapters or other subunits of a state trade association);

(4) For purposes of meeting the requirements of paragraphs (a)(2) and (a)(3) of this section, an individual may not serve as a director or chair of the board if that individual holds a subordinate employment relationship to another employee who serves as an officer, director, or employee of a credit union trade association; and

(5) In the case of a corporate credit union whose membership is composed of more than 25 percent non credit unions, the majority of directors serving as representatives of member credit unions, including the chair, must be elected only by member credit unions.

(b) *Credit union trade association.* As used in this section, a credit union trade association includes but is not limited to, state credit union leagues and league service corporations and national credit union trade associations.

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(c) *Representatives of organizational members.* (1) An organizational member of a corporate credit union is a member that is not a natural person. An organizational member may appoint one of its members or officials as a representative to the corporate credit union. The representative shall be empowered to attend membership meetings, to vote, and to stand for election on behalf of the member. No individual may serve as the representative of more than one organizational member in the same corporate credit union.

(2) Any vacancy on the board of a corporate credit union caused by a representative being unable to complete his or her term shall be filled by the board of the corporate credit union according to its bylaws governing the filling of board vacancies.

(d) *Recusal provision.* (1) No director, committee member, officer, or employee of a corporate credit union shall in any manner, directly or indirectly, participate in the deliberation upon or the determination of any question affecting his or her pecuniary interest or the pecuniary interest of any entity (other than the corporate credit union) in which he or she is interested, except if the matter involves general policy applicable to all members, such as setting dividend or loan rates or fees for services.

(2) An individual is "interested" in an entity if he or she:

- (i) Serves as a director, officer, or employee of the entity;
- (ii) Has a business, ownership, or deposit relationship with the entity; or
- (iii) Has a business, financial, or familial relationship with an individual whom he or she knows has a pecuniary interest in the entity.

(3) In the event of the disqualification of any directors, by operation of paragraph (c)(1) of this section, the remaining qualified directors present at the meeting, if constituting a quorum with the disqualified directors, may exercise, by majority vote, all the powers of the board with respect to the matter under consideration. Where all of the directors are disqualified, the matter must be decided by the members of the corporate credit union.

(4) In the event of the disqualification of any committee member by op-

eration of paragraph (c)(1) of this section, the remaining qualified committee members, if constituting a quorum with the disqualified committee members, may exercise, by majority vote, all the powers of the committee with respect to the matter under consideration. Where all of the committee members are disqualified, the matter shall be decided by the board of directors.

(e) *Administration.* (1) A corporate credit union shall be under the direction and control of its board of directors. While the board may delegate the performance of administrative duties, the board is not relieved of its responsibility for their performance. The board may employ a chief executive officer who shall have such authority and such powers as delegated by the board to conduct business from day to day. Such chief executive officer must answer solely to the board of the corporate credit union, and may not be an employee of a credit union trade association.

(2) The provisions of §701.14 of this chapter apply to corporate credit unions, except that where "Regional Director" is used, read "NCUA Board."

[62 FR 12938, Mar. 19, 1997, as amended at 67 FR 65657, Oct. 25, 2002]

EFFECTIVE DATE NOTE: At 75 FR 64844, Oct. 20, 2010, §704.14 was amended by revising paragraph (a), effective Jan. 18, 2011. For the convenience of the user, the revised text is set forth as follows:

§ 704.14 Representation.

(a) *Board representation.* The board will be determined as stipulated in its bylaws governing election procedures, provided that:

(1) At least a majority of directors, including the chair of the board, must serve on the board as representatives of member credit unions;

(2) On or after February 17, 2011, only individuals who currently hold the position of chief executive officer, chief financial officer, chief operating officer, or treasurer/manager at a member may seek election or re-election to the board;

(3) No individual may be elected or appointed to serve on the board if, after such election or appointment, the individual would be a director at more than one corporate credit union;

(4) No individual may be elected or appointed to serve on the board if, after such election or appointment, any member of the corporate credit union would have more than

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one representative on the board of the corporate;

(5) The chair of the board may not serve simultaneously as an officer, director, or employee of a credit union trade association;

(6) A majority of directors may not serve simultaneously as officers, directors, or employees of the same credit union trade association or its affiliates (not including chapters or other subunits of a state trade association);

(7) For purposes of meeting the requirements of paragraphs (a)(5) and (a)(6) of this section, an individual may not serve as a director or chair of the board if that individual holds a subordinate employment relationship to another employee who serves as an officer, director, or employee of a credit union trade association;

(8) In the case of a corporate credit union whose membership is composed of more than 25 percent non credit unions, the majority of directors serving as representatives of member credit unions, including the chair, must be elected only by member credit unions, and

(9) After October 21, 2013, at least a majority of directors of every corporate credit union, including the chair of the board, must serve on the board as representatives of natural person credit union members.

* * * * *

§ 704.15 Audit requirements.

(a) *External audit.* The corporate credit union supervisory committee shall cause an annual opinion audit of the financial statements to be made. The audit must be performed in accordance with generally accepted auditing standards and the audited financial statements must be prepared consistent with GAAP, except where law or regulation has provided for a departure from GAAP. The supervisory committee shall submit the audit report to the board of directors. A copy of the audit report, and copies of all communications that are provided to the corporate credit union by the external auditor, shall be submitted to the OCCU Director within 30 calendar days after receipt by the board of directors. If requested by the OCCU Director, the external auditor's workpapers shall be made available, at the auditor's office or elsewhere, for the OCCU Director's review. The corporate credit union shall submit a summary of the audit report to the membership at the next annual meeting.

(b) *Internal audit.* A corporate credit union with average daily assets in excess of \$400 million for the preceding calendar year, or as ordered by the OCCU Director, must employ or contract, on a full- or part-time basis, the services of an internal auditor. The internal auditor's responsibilities will, at a minimum, comply with the Standards and Professional Practices of Internal Auditing, as established by the Institute of Internal Auditors. The internal auditor will report directly to the chair of the corporate credit union's supervisory committee, who may delegate supervision of the internal auditor's daily activities to the chief executive officer of the corporate credit union. The internal auditor's reports, findings, and recommendations will be in writing and presented to the supervisory committee no less than quarterly, and will be provided upon request to the external auditor and the OCCU Director.

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

§ 704.16 Contracts/written agreements.

Services, facilities, personnel, or equipment shared with any party shall be supported by a written contract, with the duties and responsibilities of each party specified and the allocation of service fee/expenses fully supported and documented.

§ 704.17 State-chartered corporate credit unions.

(a) This part does not expand the powers and authorities of any state-chartered corporate credit union, beyond those powers and authorities provided under the laws of the state in which it was chartered.

(b) A state-chartered corporate credit union that is not insured by the NCUSIF, but that receives funds from federally insured credit unions, is considered an "institution-affiliated party" within the meaning of Section 206(r) of the Federal Credit Union Act, 12 U.S.C. 1786(r).

(c) NCUA will notify, consult with, and provide explanation to the appropriate state supervisory authority before taking administrative action against a state-chartered corporate credit union.

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§ 704.18 Fidelity bond coverage.

(a) *Scope.* This section provides the fidelity bond requirements for employees and officials in corporate credit unions.

(b) *Review of coverage.* The board of directors of each corporate credit union shall, at least annually, carefully review the bond coverage in force to determine its adequacy in relation to risk exposure and to the minimum requirements in this section.

(c) *Minimum coverage; approved forms.* Every corporate credit union will maintain bond coverage with a company holding a certificate of authority from the Secretary of the Treasury. All bond forms, and any riders and endorsements which limit the coverage provided by approved bond forms, must receive the prior written approval of NCUA. Fidelity bonds must provide coverage for the fraud and dishonesty of all employees, directors, officers, and supervisory and credit committee members. Notwithstanding the foregoing, all bonds must include a provision, in a form approved by NCUA, requiring written notification by surety to NCUA:

(1) When the bond of a credit union is terminated in its entirety;

(2) When bond coverage is terminated, by issuance of a written notice, on an employee, director, officer, supervisory or credit committee member; or

| Core capital ratio | Maximum deductible |
|---------------------------------|---|
| Less than 1.0 percent | 7.5 percent of the sum of retained earnings and paid-in capital. |
| 1.0-1.74 percent | 10.0 percent of the sum of retained earnings and paid-in capital. |
| 1.75-2.24 percent | 12.0 percent of the sum of retained earnings and paid-in capital. |
| Greater than 2.25 percent | 15.0 percent of the sum of retained earnings and paid-in capital. |

(2) A deductible may be applied separately to one or more insuring clauses in a blanket bond. Deductibles in excess of those showing in this section must have the written approval of NCUA at least 30 calendar days prior to the effective date of the deductibles.

(f) *Additional coverage.* NCUA may require additional coverage for any corporate credit union when, in the opinion of NCUA, current coverage is insufficient. The board of directors of the corporate credit union must obtain ad-

(3) When a deductible is increased above permissible limits. Said notification shall be sent to NCUA and shall include a brief statement of cause for termination or increase.

(d) *Minimum coverage amounts.* (1) The minimum amount of bond coverage will be computed based on the corporate credit union's daily average net assets for the preceding calendar year. The following table lists the minimum requirements:

| Daily average net assets | Minimum bond (million) |
|-------------------------------|------------------------|
| Less than \$50 million | \$1.0 |
| \$50-\$99 million | 2.0 |
| \$100-\$499 million | 4.0 |
| \$500-\$999 million | 6.0 |
| \$1.0-\$1.999 billion | 8.0 |
| \$2.0-\$4.999 billion | 10.0 |
| \$5.0-\$9.999 billion | 15.0 |
| \$10.0-\$24.999 billion | 20.0 |
| \$25.0 billion plus | 25.0 |

(2) It is the duty of the board of directors of each corporate credit union to provide adequate protection to meet its unique circumstances by obtaining, when necessary, bond coverage in excess of the minimums in the table in paragraph (d)(1) of this section.

(e) *Deductibles.* (1) The maximum amount of deductibles allowed are based on the corporate credit union's core capital ratio. The following table sets out the maximum deductibles, except that in each category the maximum deductible shall be \$5 million:

ditional coverage within 30 calendar days after the date of written notice from NCUA.

[62 FR 12938, Mar. 19, 1997, as amended at 67 FR 65657, Oct. 25, 2002]

§ 704.19 Wholesale corporate credit unions.

(a) *General.* Wholesale corporate credit unions are subject to the preceding requirements of this part, except as set forth in this section.

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(b) *Earnings retention requirement.* A wholesale corporate credit union must increase retained earnings if the prior month-end retained earnings ratio is less than 1 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 1 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 1 percent and the core capital ratio is equal to or greater than 3 percent, the earnings retention factor is .075 percent per annum.

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

(5) Operating management of the wholesale corporate credit union must notify its board of directors, supervisory committee, OCCU Director and, if applicable, the state regulator within 10 calendar days of determining the retained earnings ratio has declined below 1 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 1 percent by the next month

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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

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

[62 FR 12938, Mar. 19, 1997, as amended at 67 FR 65657, Oct. 25, 2002]

EFFECTIVE DATE NOTE: At 75 FR 64844, Oct. 20, 2010, § 704.19 was revised, effective Jan. 18, 2011. For the convenience of the user, the revised text is set forth as follows:

§ 704.19 Disclosure of executive and director compensation.

(a) *Annual disclosure.* Corporate credit unions must annually prepare and maintain a disclosure of the compensation, in dollar terms, paid to its most highly compensated employees, in accordance with the following schedule:

(1) For corporate credit unions with forty-one or more full time employees, disclosure is required of the compensation paid to the five most highly compensated employees;

(2) For corporate credit unions with between thirty and forty-one full time employees, disclosure is required of the compensation paid to the four most highly compensated employees;

(3) For corporate credit unions with thirty or fewer full time employees, disclosure is required of the compensation paid to the three most highly compensated employees; and

(4) In all cases, compensation paid to the corporate credit union's chief executive officer must also be disclosed, if the chief executive officer is not already included among the most highly compensated employees described in paragraphs (a)(1) through (a)(3) of this section.

(b) *Availability of disclosure.* Any member may obtain a copy of the most current disclosure, and all disclosures for the previous three years, on request made in person or in writing. The corporate credit union must provide the disclosure(s), at no cost to the member, within five business days of receiving the request. In addition, the corporate must distribute the most current disclosure

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to all its members at least once a year, either in the annual report or in some other manner of the corporate's choosing.

(c) *Supplemental information.* In providing the disclosure required by this section, a corporate credit union may also provide supplementary information to put the disclosure in context, for example, salary surveys, a discussion of compensation in relation to other credit union expenses, or compensation information from similarly sized credit unions or financial institutions.

(d) *Special rule for mergers.* With respect to any merger involving a corporate credit union that would result in a material increase in compensation, *i.e.*, an increase of more than 15 percent or \$10,000, whichever is greater, for any senior executive officer or director of the merging corporate, the corporate must:

(1) Describe the compensation arrangement in the merger plan documents submitted to NCUA for approval of the merger, pursuant to §708b of this part; and

(2) In the case of any federally chartered corporate credit union, describe the compensation arrangement in the materials provided to the membership of the merging credit union before the member vote on approving the merger.

§ 704.20 Limitations on golden parachute and indemnification payments.

(a) *Definitions.* The following definitions apply for this section:

(1) *Board* means the National Credit Union Administration Board.

(2) *Benefit plan* means any plan, contract, agreement or other arrangement which is an "employee welfare benefit plan" as that term is defined in section 3(1) of the Employee Retirement Income Security Act of 1974, as amended (29 U.S.C. 1002(1)), or other usual and customary plans such as dependent care, tuition reimbursement, group legal services or cafeteria plans; provided however, that such term does not include any plan intended to be subject to paragraphs (a)(4)(iv)(C) and (E) of this section.

(3) *Bona fide deferred compensation plan or arrangement* means any plan, contract, agreement or other arrangement whereby:

(i) An institution-affiliated party (IAP) voluntarily elects to defer all or a portion of the reasonable compensation, wages or fees paid for services rendered which otherwise would have been paid to the IAP at the time the services were rendered (including a

plan that provides for the crediting of a reasonable investment return on such elective deferrals) and the corporate credit union either:

(A) Recognizes compensation expense and accrues a liability for the benefit payments according to Generally Accepted Accounting Principles (GAAP); or

(B) Segregates or otherwise sets aside assets in a trust which may only be used to pay plan and other benefits, except that the assets of such trust may be available to satisfy claims of the institution's or holding company's creditors in the case of insolvency; or

(ii) A corporate credit union establishes a nonqualified deferred compensation or supplemental retirement plan, other than an elective deferral plan described in paragraph (a)(3)(i) of this section:

(A) Primarily for the purpose of providing benefits for certain IAPs in excess of the limitations on contributions and benefits imposed by Sections 415, 401(a)(17), 402(g) or any other applicable provision of the Internal Revenue Code of 1986 (26 USC 415, 401(a)(17), 402(g)); or

(B) Primarily for the purpose of providing supplemental retirement benefits or other deferred compensation for a select group of directors, management or highly compensated employees (excluding severance payments described in paragraph (4)(ii)(E) of this section and permissible golden parachute payments described in §704.20(d); and

(iii) In the case of any nonqualified deferred compensation or supplemental retirement plans as described in paragraphs (a)(3)(i) and (ii) of this section, the following requirements will apply:

(A) The plan was in effect at least one year prior to any of the events described in paragraph (a)(4)(ii) of this section;

(B) Any payment made pursuant to such plan is made in accordance with the terms of the plan as in effect no later than one year prior to any of the events described in paragraph (a)(4)(ii) of this section and in accordance with any amendments to such plan during such one year period that do not increase the benefits payable thereunder;

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(C) The IAP has a vested right, as defined under the applicable plan document, at the time of termination of employment to payments under such plan;

(D) Benefits under such plan are accrued each period only for current or prior service rendered to the employer (except that an allowance may be made for service with a predecessor employer);

(E) Any payment made pursuant to such plan is not based on any discretionary acceleration of vesting or accrual of benefits which occurs at any time later than one year prior to any of the events described in paragraph (a)(4)(ii) of this section;

(F) The corporate credit union has previously recognized compensation expense and accrued a liability for the benefit payments according to GAAP or segregated or otherwise set aside assets in a trust which may only be used to pay plan benefits, except that the assets of such trust may be available to satisfy claims of the corporate credit union's creditors in the case of insolvency; and

(G) Payments pursuant to such plans must not be in excess of the accrued liability computed in accordance with GAAP.

(4) *Golden parachute payment* means any payment (or any agreement to make any payment) in the nature of compensation by any corporate credit union for the benefit of any current or former IAP pursuant to an obligation of such corporate credit union that:

(i) Is contingent on, or by its terms is payable on or after, the termination of such IAP's primary employment or affiliation with the corporate credit union; and

(ii) Is received on or after, or is made in contemplation of, any of the following events:

(A) The insolvency (or similar event) of the corporate that is making the payment; or

(B) The appointment of any conservator or liquidating agent for such corporate credit union; or

(C) A determination by the Board or the appropriate state supervisory authority (in the case of a state-chartered corporate credit union) respec-

tively, that the corporate credit union is in a troubled condition; or

(D) The corporate credit union is undercapitalized, as defined in § 704.4; or

(E) The corporate credit union is subject to a proceeding to terminate or suspend its share account insurance; and

(iii) Is payable to an IAP whose employment by or affiliation with the corporate is terminated at a time when the corporate credit union by which the IAP is employed or with which the IAP is affiliated satisfies any of the conditions enumerated in paragraphs (a)(4)(ii)(A) through (E) of this section, or in contemplation of any of these conditions.

(iv) *Exceptions.* The term *golden parachute payment* does not include:

(A) Any payment made pursuant to a pension or retirement plan which is qualified (or is intended within a reasonable period of time to be qualified) under Section 401 of the Internal Revenue Code of 1986 (26 U.S.C. 401); or

(B) Any payment made pursuant to a benefit plan as that term is defined in paragraph (a)(2) of this section; or

(C) Any payment made pursuant to a bona fide deferred compensation plan or arrangement as defined in paragraph (a)(3) of this section; or

(D) Any payment made by reason of death or by reason of termination caused by the disability of an IAP; or

(E) Any payment made pursuant to a nondiscriminatory severance pay plan or arrangement which provides for payment of severance benefits to all eligible employees upon involuntary termination other than for cause, voluntary resignation, or early retirement; *provided, however*, that no employee will receive any such payment which exceeds the base compensation paid to such employee during the twelve months (or such longer period or greater benefit as the Board will consent to) immediately preceding termination of employment, resignation or early retirement, and such severance pay plan or arrangement must not have been adopted or modified to increase the amount or scope of severance benefits at a time when the corporate credit union was in a condition specified in paragraph (a)(4)(ii) of this section or in

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contemplation of such a condition without the prior written consent of the Board; or

(F) Any severance or similar payment which is required to be made pursuant to a state statute which is applicable to all employers within the appropriate jurisdiction (with the exception of employers that may be exempt due to their small number of employees or other similar criteria); or

(G) Any other payment which the Board determines to be permissible in accordance with § 704.20(d).

(5) *Institution-affiliated party* (IAP) means any individual meeting the criteria specified in section 206(r) of the Act (12 U.S.C. 1786(r)).

(6) *Liability or legal expense* means:

(i) Any legal or other professional fees and expenses incurred in connection with any claim, proceeding, or action;

(ii) The amount of, and any cost incurred in connection with, any settlement of any claim, proceeding, or action; and

(iii) The amount of, and any cost incurred in connection with, any judgment or penalty imposed with respect to any claim, proceeding, or action.

(7) *Nondiscriminatory* means that the plan, contract or arrangement in question applies to all employees of a corporate credit union who meet reasonable and customary eligibility requirements applicable to all employees, such as minimum length of service requirements. A nondiscriminatory plan, contract or arrangement may provide different benefits based only on objective criteria such as salary, total compensation, length of service, job grade or classification, which are applied on a proportionate basis (with a variance in severance benefits relating to any criterion of plus or minus ten percent) to groups of employees consisting of not less than the lesser of 33 percent of employees or 1,000 employees.

(8) *Payment* means:

(i) Any direct or indirect transfer of any funds or any asset;

(ii) Any forgiveness of any debt or other obligation;

(iii) The conferring of any benefit, including but not limited to stock options and stock appreciation rights; or

(iv) Any segregation of any funds or assets, the establishment or funding of any trust or the purchase of or arrangement for any letter of credit or other instrument, for the purpose of making, or pursuant to any agreement to make, any payment on or after the date on which such funds or assets are segregated, or at the time of or after such trust is established or letter of credit or other instrument is made available, without regard to whether the obligation to make such payment is contingent on:

(A) The determination, after such date, of the liability for the payment of such amount; or

(B) The liquidation, after such date, of the amount of such payment.

(9) *Prohibited indemnification payment* means any payment (or any agreement or arrangement to make any payment) by any corporate credit union for the benefit of any person who is or was an IAP of such corporate credit union, to pay or reimburse such person for any civil money penalty, judgment or other liability or legal expense resulting from any administrative or civil action instituted by the Board or any appropriate state regulatory authority that results in a final order or settlement pursuant to which such person:

(i) Is assessed a civil money penalty;

(ii) Is removed from office or prohibited from participating in the conduct of the affairs of the corporate credit union; or

(iii) Is required to cease and desist from or take any affirmative action described in Section 206 of the Act with respect to such corporate credit union.

(iv) *Exceptions.* The term *prohibited indemnification payment* does not include any reasonable payment by a corporate credit union that:

(A) Is used to purchase any commercial insurance policy or fidelity bond, provided that such insurance policy or bond must not be used to pay or reimburse an IAP for the cost of any judgment or civil money penalty assessed against such person in an administrative proceeding or civil action commenced by NCUA or the appropriate state supervisory authority (in the case of a state chartered corporate), but may pay any legal or professional expenses incurred in connection with

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such proceeding or action or the amount of any restitution to the corporate credit union or its liquidating agent; or

(B) Represents partial indemnification for legal or professional expenses specifically attributable to particular charges for which there has been a formal and final adjudication or finding in connection with a settlement that the IAP has not violated certain laws or regulations or has not engaged in certain unsafe or unsound practices or breaches of fiduciary duty, unless the administrative action or civil proceeding has resulted in a final prohibitive order against the IAP.

(10) *Troubled Condition* means that the corporate credit union:

(i) *Has been assigned:*

(A) A 4 or 5 Corporate Risk Information System (CRIS) rating by NCUA in either the Financial Risk or Risk Management composites, in the case of a federal corporate credit union, or

(B) An equivalent 4 or 5 CRIS rating in either the Financial Risk or Risk Management composites by the state supervisory authority (SSA) in the case of a federally insured, state-chartered corporate credit union in a state that has adopted the CRIS system, or an equivalent 4 or 5 CAMEL composite rating by the SSA in the case of a federally insured, state-chartered corporate credit union in a state that uses the CAMEL system, or

(C) A 4 or 5 CRIS rating in either the Financial Risk or Risk Management composites by NCUA based on core work papers received from the SSA in the case of a federally insured, state-chartered credit union in a state that does not use either the CRIS or CAMEL system. In this case, the SSA will be notified in writing by the Director of the Office of Corporate Credit Unions that the corporate credit union has been designated by NCUA as a troubled institution; or

(ii) Has been granted assistance as outlined under Sections 208 or 216 of the Federal Credit Union Act.

(b) *Golden parachute payments prohibited.* No corporate credit union will make or agree to make any golden parachute payment, except as otherwise provided in this section.

(c) *Prohibited indemnification payments.* No corporate credit union will make or agree to make any prohibited indemnification payment, except as provided in this section.

(d) *Permissible golden parachute payments.* (1) A corporate credit union may agree to make or may make a golden parachute payment if and to the extent that:

(i) Such an agreement is made in order to hire a person to become an IAP either at a time when the corporate credit union satisfies or in an effort to prevent it from imminently satisfying any of the criteria set forth in paragraph (a)(4)(ii) of this section, and the Board, consents in writing to the amount and terms of the golden parachute payment. Such consent by the Board must not improve the IAP's position in the event of the insolvency of the corporate credit union since such consent can neither bind a liquidating agent nor affect the provability of claims in liquidation. In the event that the institution is placed into conservatorship or liquidation, the conservator or the liquidating agent, as the case may be, will not be obligated to pay the promised golden parachute and the IAP will not be accorded preferential treatment on the basis of such prior approval; or

(ii) Such a payment is made pursuant to an agreement which provides for a reasonable severance payment, not to exceed twelve months salary, to an IAP in the event of a merger with another corporate credit union; provided, however, that a corporate credit union must obtain the consent of the Board, before making such a payment and this paragraph (d)(1)(iii) does not apply to any merger between corporates that results from an assisted transaction as described in Section 208 of the Act (12 U.S.C. 1788) or the corporate credit union being placed into conservatorship or liquidation; or

(iii) The Board, with the written concurrence of the appropriate state supervisory authority (in the case of a state-chartered corporate), determines that such a payment or agreement is permissible.

(2) A corporate credit union making a request pursuant to paragraphs (d)(1)(i)

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through (iii) of this section must demonstrate that it does not possess and is not aware of any information, evidence, documents or other materials which would indicate that there is a reasonable basis to believe, at the time such payment is proposed to be made, that:

(i) The IAP has committed any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the corporate credit union that has had or is likely to have a material adverse effect on the corporate credit union;

(ii) The IAP is substantially responsible for the insolvency of, the appointment of a conservator or liquidating agent for, or the troubled condition, as defined by §701.14(b)(4), of the corporate credit union;

(iii) The IAP has materially violated any applicable federal or state banking law or regulation that has had or is likely to have a material effect on the corporate credit union; and

(iv) The IAP has violated or conspired to violate Section 215, 656, 657, 1005, 1006, 1007, 1014, 1032, or 1344 of Title 18 of the United States Code, or Section 1341 or 1343 of such title affecting a federally insured financial institution as defined in Title 18 of the United States Code.

(3) In making a determination under paragraphs (d)(1)(i) through (iii) of this section, the Board may consider:

(i) Whether, and to what degree, the IAP was in a position of managerial or fiduciary responsibility;

(ii) The length of time the IAP was affiliated with the corporate credit union, and the degree to which the proposed payment represents a reasonable payment for services rendered over the period of employment; and

(iii) Any other factors or circumstances which would indicate that the proposed payment would be contrary to the intent of Section 206(t) of the Act or this part.

(e) *Permissible indemnification payments.* (1) A corporate credit union may make or agree to make reasonable indemnification payments to an IAP with respect to an administrative proceeding or civil action initiated by NCUA or a state regulatory authority if:

(i) The corporate credit union's board of directors, in good faith, determines in writing after due investigation and consideration that the institution-affiliated party acted in good faith and in a manner he/she believed to be in the best interests of the membership;

(ii) The corporate credit union's board of directors, in good faith, determines in writing after due investigation and consideration that the payment of such expenses will not materially adversely affect the institution's or holding company's safety and soundness;

(iii) The indemnification payments do not constitute prohibited indemnification payments as that term is defined in §704.20(c); and

(iv) The IAP agrees in writing to reimburse the corporate credit union, to the extent not covered by payments from insurance or bonds purchased pursuant to §704.20(a)(9)(iv)(A), for that portion of the advanced indemnification payments which subsequently become prohibited indemnification payments, as defined in §704.20(a)(9).

(2) An IAP seeking indemnification payments must not participate in any way in the board's discussion and approval of such payments; provided, however, that such IAP may present his/her request to the board and respond to any inquiries from the board concerning his/her involvement in the circumstances giving rise to the administrative proceeding or civil action.

(3) In the event that a majority of the members of the board of directors are named as respondents in an administrative proceeding or civil action and request indemnification, the remaining members of the board may authorize independent legal counsel to review the indemnification request and provide the remaining members of the board with a written opinion of counsel as to whether the conditions delineated in paragraph (e)(1) of this section have been met. If independent legal counsel opines that said conditions have been met, the remaining members of the board of directors may rely on such opinion in authorizing the requested indemnification.

(4) In the event that all of the members of the board of directors are

named as respondents in an administrative proceeding or civil action and request indemnification, the board will authorize independent legal counsel to review the indemnification request and provide the board with a written opinion of counsel as to whether the conditions delineated in paragraph (e)(1) of this section have been met. If independent legal counsel opines that said conditions have been met, the board of directors may rely on such opinion in authorizing the requested indemnification.

(f) *Filing instructions.* Requests to make excess nondiscriminatory severance plan payments pursuant to §704.20(a)(4)(iv)(E) and golden parachute payments permitted by §704.20(d) must be submitted in writing to the Board. The request must be in letter form and must contain all relevant factual information as well as the reasons why such approval should be granted.

(g) *Applicability in the event of liquidation or conservatorship.* The provisions of this part, or any consent or approval granted under the provisions of this part by the Board, will not in any way bind any liquidating agent or conservator for a failed corporate credit union and will not in any way obligate the liquidating agent or conservator to pay any claim or obligation pursuant to any golden parachute, severance, indemnification or other agreement. Claims for employee welfare benefits or other benefits that are contingent, even if otherwise vested, when a liquidating agent or conservator is appointed for any corporate credit union, including any contingency for termination of employment, are not provable claims or actual, direct compensatory damage claims against such liquidating agent or conservator. Nothing in this part may be construed to permit the payment of salary or any liability or legal expense of any IAP contrary to 12 U.S.C. 1786(t)(3).

[75 FR 64845, Oct. 20, 2010]

EFFECTIVE DATE NOTE: At 75 FR 64845, Oct. 20, 2010, §704.20 was added, effective January 18, 2011.

APPENDIX A TO PART 704—MODEL FORMS

This appendix contains sample forms intended for use by corporate credit unions to aid in compliance with the membership capital account and paid-in capital disclosure requirements of §704.3.

Sample Form 1

Terms and Conditions of Membership Capital Account

(1) A membership capital account is not subject to share insurance coverage by the NCUSIF or other deposit insurer.

(2) A membership capital account is not releasable due solely to the merger, charter conversion or liquidation of the member credit union. In the event of a merger, the membership capital account transfers to the continuing credit union. In the event of a charter conversion, the membership capital account transfers to the new institution. In the event of liquidation, the membership capital account may be released to facilitate the payout of shares with the prior written approval of NCUA.

(3) A member credit union may withdraw membership capital with three years' notice.

(4) Membership capital cannot be used to pledge borrowings.

(5) Membership capital is available to cover losses that exceed retained earnings and paid-in capital.

(6) Where the corporate credit union is liquidated, membership capital accounts are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF.

(7) Where the corporate credit union is merged into another corporate credit union, the membership capital account will transfer to the continuing corporate credit union. The three-year notice period for withdrawal of the membership capital account will remain in effect.

(8) {If an adjusted balance account}: The membership capital balance will be adjusted (1 or 2) time(s) annually in relation to the member credit union's (assets or other measure) as of (date(s)) . {If a term certificate}: The membership capital account is a term certificate that will mature on (date) .

I have read the above terms and conditions and I understand them.

I further agree to maintain in the credit union's files the annual notice of terms and conditions of the membership capital account.

The notice form must be signed by either all of the directors of the member credit union or, if authorized by board resolution,

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the chair and secretary of the board of the credit union.

The annual disclosure notice form must be signed by the chair of the corporate credit union. The chair must then 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.

Sample Form 2

Terms and Conditions of Paid-In Capital

(1) A paid-in capital account is not subject to share insurance coverage by the NCUSIF or other deposit insurer.

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

(3) The funds are callable only at the option of the corporate credit union and only if the corporate credit union meets its minimum required capital and NEV ratios after the funds are called.

(4) Paid-in capital cannot be used to pledge borrowings.

(5) Paid-in capital is available to cover losses that exceed retained earnings.

(6) Where the corporate credit union is liquidated, paid-in capital accounts are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF, and membership capital holders.

(7) Where the corporate credit union is merged into another corporate credit union, the paid-in capital account will transfer to the continuing corporate credit union.

(8) Paid-in capital is perpetual maturity and noncumulative dividend.

I have read the above terms and conditions and I understand them. I further agree to maintain in the credit union's files the annual notice of terms and conditions of the paid-in capital instrument.

The notice form must be signed by either all of the directors of the credit union or, if authorized by board resolution, the chair and secretary of the board of the credit union.

[67 FR 65657, Oct. 25, 2002]

EFFECTIVE DATE NOTE: At 75 FR 64848, Oct. 20, 2010, appendix A of part 704 was revised, effective Jan. 18, 2011. For the convenience of the user, the revised text is set forth as follows:

APPENDIX A TO PART 704—CAPITAL PRIORITIZATION AND MODEL FORMS

PART I—OPTIONAL CAPITAL PRIORITIZATION

Notwithstanding any other provision in this chapter, a corporate credit union, at its option, may determine that capital contributed to the corporate on or after January 18, 2011 will have priority, for purposes of availability to absorb losses and payout in liquidation, over capital contributed to the corporate before that date. The board of directors at a corporate credit union that desires to make this determination must:

(a) On or before January 18, 2011, adopt a resolution implementing its determination.

(b) Inform the credit union's members and NCUA, in writing and as soon as practicable after adoption of the resolution, of the contents of the board resolution.

(c) Ensure the credit union uses the appropriate initial and periodic Model Form disclosures in Part II below.

PART II—MODEL FORMS

Part II contains model forms intended for use by corporate credit unions to aid in compliance with the capital disclosure requirements of § 704.3 and Part I of this Appendix.

Model Form A

Terms and Conditions of Membership Capital Account

NOTE: This form is for use before October 20, 2011 in the circumstances where the credit union has determined NOT to give newly issued capital priority over older capital as described in Part I of this Appendix.

(1) A membership capital account is not subject to share insurance coverage by the NCUSIF or other deposit insurer.

(2) A membership capital account is not releasable due solely to the merger, charter conversion or liquidation of the member credit union. In the event of a merger, the membership capital account transfers to the continuing credit union. In the event of a charter conversion, the membership capital account transfers to the new institution. In the event of liquidation, the membership capital account may be released to facilitate the payout of shares with the prior written approval of NCUA.

(3) A member credit union may withdraw membership capital with three years' notice.

(4) Membership capital cannot be used to pledge borrowings.

(5) Membership capital is available to cover losses that exceed retained earnings and paid-in capital.

(6) Where the corporate credit union is liquidated, membership capital accounts are

payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF.

(7) Where the corporate credit union is merged into another corporate credit union, the membership capital account will transfer to the continuing corporate credit union. The three-year notice period for withdrawal of the membership capital account will remain in effect.

(8) If an adjusted balance account—: The membership capital balance will be adjusted—(1 or 2)—time(s) annually in relation to the member credit union's—(assets or other measure)—as of—(date(s))—. If a term certificate—: The membership capital account is a term certificate that will mature on—(date)—.

I have read the above terms and conditions and I understand them.

I further agree to maintain in the credit union's files the annual notice of terms and conditions of the membership capital account.

The notice form 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 of the credit union.

The annual disclosure notice form must be signed by the chair of the corporate credit union. The chair must then 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.

Model Form B

Terms and Conditions of Membership Capital Account

NOTE: This form is for use before October 20, 2011 in the circumstances where the credit union has determined THAT IT WILL give newly issued capital priority over older capital as described in Part I of this Appendix.

(1) A membership capital account is not subject to share insurance coverage by the NCUSIF or other deposit insurer.

(2) A membership capital account is not releasable due solely to the merger, charter conversion or liquidation of the member credit union. In the event of a merger, the membership capital account transfers to the continuing credit union. In the event of a charter conversion, the membership capital account transfers to the new institution. In the event of liquidation, the membership capital account may be released to facilitate the payout of shares with the prior written approval of NCUA.

(3) A member credit union may withdraw membership capital with three years' notice.

(4) Membership capital cannot be used to pledge borrowings.

(5)(a) Membership capital that is issued on or after January 18, 2011, is available to cover losses that exceed retained earnings, contributed capital issued before January 18, 2011, and perpetual capital issued on or after January 18, 2011. Any such losses will be distributed *pro rata*, at the time the loss is realized, among membership capital account holders with accounts issued on or after January 18, 2011. To the extent that NCA funds are used to cover losses, the corporate credit union is prohibited from restoring or replenishing the affected accounts under any circumstances.

(b) Membership capital that is issued before January 18, 2011 is available to cover losses that exceed retained earnings and perpetual capital issued before January 18, 2011. Any such losses will be distributed *pro rata*, at the time the loss is realized, among membership capital account holders with accounts issued before January 18, 2011. To the extent that NCA funds are used to cover losses, the corporate credit union is prohibited from restoring or replenishing the affected accounts under any circumstances.

(c) Attached to this disclosure is a statement that describes the amount of NCA the credit union has with the corporate credit union in each of the categories described in paragraphs (5)(a) and (5)(b) above.

(6) If the corporate credit union is liquidated:

(a) Membership capital accounts issued on or after January 18, 2011 are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF, but not including contributed capital accounts issued before January 18, 2011 and perpetual capital accounts issued on or after January 18, 2011. However, membership capital that is used to cover losses in a calendar year previous to the year of liquidation has no claim against the liquidation estate.

(b) Membership capital accounts issued before January 18, 2011, are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF, but not including perpetual capital accounts issued before January 18, 2011. However, membership capital that is used to cover losses in a calendar year previous to the year of liquidation has no claim against the liquidation estate.

(7) Where the corporate credit union is merged into another corporate credit union, the membership capital account will transfer to the continuing corporate credit union. The three-year notice period for withdrawal of the membership capital account will remain in effect.

(8) If an adjusted balance account—: The membership capital balance will be adjusted—(1 or 2)—time(s) annually in relation to the member credit union's—(assets or

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other measure)—as of—(date(s))—. If a term certificate—: The membership capital account is a term certificate that will mature on—(date)—.

I have read the above terms and conditions and I understand them.

I further agree to maintain in the credit union's files the annual notice of terms and conditions of the membership capital account.

The notice form 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 of the credit union.

The annual disclosure notice form must be signed by the chair of the corporate credit union. The chair must then 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.

Model Form C

Terms and Conditions of Nonperpetual Capital

NOTE: This form is for use on and after October 20, 2011 in the circumstances where the credit union has determined NOT to give newly issued capital priority over older capital as described in Part I of this Appendix. Also, corporate credit unions should ensure that existing membership capital accounts that do not meet the qualifying conditions for nonperpetual capital are modified so as to meet those conditions.

Terms and Conditions of Nonperpetual Capital Account

(1) A nonperpetual capital account is not subject to share insurance coverage by the NCUSIF or other deposit insurer.

(2) A nonperpetual capital account is not releasable due solely to the merger, charter conversion or liquidation of the member credit union. In the event of a merger, the nonperpetual capital account transfers to the continuing credit union. In the event of a charter conversion, the nonperpetual capital account transfers to the new institution. In the event of liquidation, the nonperpetual capital account may be released to facilitate the payout of shares with the prior written approval of NCUA.

(3) If the nonperpetual capital account is a notice account, a member credit union may withdraw the nonperpetual capital with a minimum of five years' notice. If the nonperpetual capital account is a term instrument it may be redeemed only at maturity. The corporate credit union may not redeem any account prior to the expiration of the notice period, or maturity, without the prior written approval of the NCUA.

(4) Nonperpetual capital cannot be used to pledge borrowings.

(5) Nonperpetual capital is available to cover losses that exceed retained earnings and perpetual contributed capital. Any such losses will be distributed *pro rata* among nonperpetual capital account holders at the time the loss is realized. To the extent that NCA funds are used to cover losses, the corporate credit union is prohibited from restoring or replenishing the affected accounts under any circumstances.

(6) Where the corporate credit union is liquidated, nonperpetual capital accounts are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF. However, nonperpetual capital that is used to cover losses in a calendar year previous to the year of liquidation has no claim against the liquidation estate.

(7) Where the corporate credit union is merged into another corporate credit union, the nonperpetual capital account will transfer to the continuing corporate credit union. For notice accounts, the five-year notice period for withdrawal of the nonperpetual capital account will remain in effect. For term accounts, the original term will remain in effect.

(8) If a term certificate—: The nonperpetual capital account is a term certificate that will mature on—(date)—(insert date with a minimum five-year original maturity).

I have read the above terms and conditions and I understand them.

I further agree to maintain in the credit union's files the annual notice of terms and conditions of the nonperpetual capital account.

The notice form 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 of the credit union.

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

Model Form D

Terms and Conditions of Nonperpetual Capital

NOTE: This form is for use before October 20, 2011 in the circumstances where the credit union has determined THAT IT WILL give newly issued capital priority over older capital as described in Part I of this Appendix. Also, corporate credit unions should ensure that existing membership capital accounts that do not meet the qualifying conditions

for nonperpetual capital are modified so as to meet those conditions.

Terms and Conditions of Nonperpetual
Capital Account

(1) A nonperpetual capital account is not subject to share insurance coverage by the NCUSIF or other deposit insurer.

(2) A nonperpetual capital account is not releasable due solely to the merger, charter conversion or liquidation of the member credit union. In the event of a merger, the nonperpetual capital account transfers to the continuing credit union. In the event of a charter conversion, the nonperpetual capital account transfers to the new institution. In the event of liquidation, the nonperpetual capital account may be released to facilitate the payout of shares with the prior written approval of NCUA.

(3) If the nonperpetual capital account is a notice account, a member credit union may withdraw the nonperpetual capital with a minimum of five years' notice. If the nonperpetual capital account is a term instrument it may be redeemed only at maturity. The corporate credit union may not redeem any account prior to the expiration of the notice period, or maturity, without the prior written approval of the NCUA.

(4) Nonperpetual capital cannot be used to pledge borrowings.

(5)(a) Nonperpetual capital that is issued on or after January 18, 2011 is available to cover losses that exceed retained earnings, all contributed capital issued before January 18, 2011, and perpetual capital issued on or after January 18, 2011. Any such losses will be distributed *pro rata*, at the time the loss is realized, among nonperpetual capital account holders with accounts issued on or after January 18, 2011. To the extent that NCA funds are used to cover losses, the corporate credit union is prohibited from restoring or replenishing the affected accounts under any circumstances.

(b) Nonperpetual capital that is issued before January 18, 2011, is available to cover losses that exceed retained earnings and perpetual capital issued before January 18, 2011. Any such losses will be distributed *pro rata*, at the time the loss is realized, among nonperpetual capital account holders with accounts issued before January 18, 2011. To the extent that NCA funds are used to cover losses, the corporate credit union is prohibited from restoring or replenishing the affected accounts under any circumstances.

(c) Attached to this disclosure is a statement that describes the amount of NCA the credit union has with the corporate credit union in each of the categories described in paragraphs (5)(a) and (5)(b) above.

(6) If the corporate credit union is liquidated:

(a) Nonperpetual capital accounts issued on or after January 18, 2011 are payable only

after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF, but not including contributed capital accounts issued before January 18, 2011 or perpetual capital accounts issued on or after January 18, 2011. However, nonperpetual capital that is used to cover losses in a calendar year previous to the year of liquidation has no claim against the liquidation estate.

(b) Nonperpetual capital accounts issued before January 18, 2011 are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF, but not including perpetual capital accounts issued before January 18, 2011. However, nonperpetual capital that is used to cover losses in a calendar year previous to the year of liquidation has no claim against the liquidation estate.

(7) Where the corporate credit union is merged into another corporate credit union, the nonperpetual capital account will transfer to the continuing corporate credit union. For notice accounts, the five-year notice period for withdrawal of the nonperpetual capital account will remain in effect. For term accounts, the original term will remain in effect.

(8) If a term certificate—: The nonperpetual capital account is a term certificate that will mature on—(date)—(insert date with a minimum five-year original maturity).

I have read the above terms and conditions and I understand them.

I further agree to maintain in the credit union's files the annual notice of terms and conditions of the nonperpetual capital account.

The notice form 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 of the credit union.

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

Model Form E

Terms and Conditions of Paid-In Capital

NOTE: This form is for use before October 20, 2011 in the circumstances where the credit union has determined NOT to give newly issued capital priority over older capital as described in Part I of this Appendix.

National Credit Union Administration

Pt. 704, App. A, Nf.

Terms and Conditions of Paid-In Capital

(1) A paid-in capital account is not subject to share insurance coverage by the NCUSIF or other deposit insurer.

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

(3) The funds are callable only at the option of the corporate credit union and only if the corporate credit union meets its minimum required capital and NEV ratios after the funds are called. The corporate must also obtain NCUA's approval before the corporate calls any paid-in capital.

(4) Paid-in capital cannot be used to pledge borrowings.

(5) Paid-in capital is available to cover losses that exceed retained earnings.

(6) Where the corporate credit union is liquidated, paid-in capital accounts are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF, and membership capital holders.

(7) Where the corporate credit union is merged into another corporate credit union, the paid-in capital account will transfer to the continuing corporate credit union.

(8) Paid-in capital is perpetual maturity and noncumulative dividend.

I have read the above terms and conditions and I understand them. I further agree to maintain in the credit union's files the annual notice of terms and conditions of the paid-in capital instrument.

The notice form must be signed by either all of the directors of the credit union or, if authorized by board resolution, the chair and secretary of the board of the credit union.

Model Form F

Terms and Conditions of Paid-In Capital

NOTE: This form is for use before October 20, 2011 in the circumstances where the credit union has determined THAT IT WILL give newly issued capital priority over older capital as described in Part I of this Appendix.

Terms and Conditions of Paid-In Capital

(1) A paid-in capital account is not subject to share insurance coverage by the NCUSIF or other deposit insurer.

(2) A paid-in capital account is not releasable due solely to the merger, charter conversion or liquidation of the member credit union. In the event of a merger, the paid-in capital account transfers to the continuing

credit union. In the event of a charter conversion, the paid-in capital account transfers to the new institution. In the event of liquidation, the paid-in capital account may be released to facilitate the payout of shares with the prior written approval of NCUA.

(3) The funds are callable only at the option of the corporate credit union and only if the corporate credit union meets its minimum required capital and NEV ratios after the funds are called. The corporate must also obtain NCUA's approval before the corporate calls any paid-in capital.

(4) Paid-in capital cannot be used to pledge borrowings.

(5) Availability to cover losses.

(a) Paid-in capital issued before January 18, 2011 is available to cover losses that exceed retained earnings. Any such losses must be distributed *pro rata*, at the time the loss is realized, among holders of paid-in capital issued before January 18, 2011. To the extent that paid-in capital funds are used to cover losses, the corporate credit union is prohibited from restoring or replenishing the affected accounts under any circumstances.

(b) Paid-in capital issued on or after January 18, 2011 is available to cover losses that exceed retained earnings and any contributed capital issued before January 18, 2011. Any such losses must be distributed *pro rata*, at the time the loss is realized, among holders of paid-in capital issued on or after January 18, 2011. To the extent that paid-in capital funds are used to cover losses, the corporate credit union is prohibited from restoring or replenishing the affected accounts under any circumstances.

(c) Attached to this disclosure is a statement that describes the amount of perpetual capital the credit union has with the corporate credit union in each of the categories described in paragraphs (5)(a) and (5)(b) above.

(6) Where the corporate credit union is liquidated:

(a) Paid-in capital accounts issued on or after January 18, 2011 are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF, but not including contributed capital accounts issued before January 18, 2011. However, paid-in capital that is used to cover losses in a calendar year previous to the year of liquidation has no claim against the liquidation estate.

(b) Paid-in capital accounts issued before January 18, 2011 are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF, nonperpetual accounts issued before January 18, 2011 and contributed capital accounts issued on or after January 18, 2011. However, paid-in capital that is used to cover losses in a calendar

year previous to the year of liquidation has no claim against the liquidation estate.

(7) Where the corporate credit union is merged into another corporate credit union, the paid-in capital account will transfer to the continuing corporate credit union.

(8) Paid-in capital is perpetual maturity and noncumulative dividend.

I have read the above terms and conditions and I understand them. I further agree to maintain in the credit union's files the annual notice of terms and conditions of the paid-in capital instrument.

The notice form must be signed by either all of the directors of the credit union or, if authorized by board resolution, the chair and secretary of the board of the credit union.

Model Form G

Terms and Conditions of Perpetual
Contributed Capital

NOTE: This form is for use on and after October 20, 2011 in the circumstances where the credit union has determined NOT to give newly issued capital priority over older capital as described in Part I of this Appendix. Also, capital previously issued under the nomenclature "paid-in capital" is considered perpetual contributed capital.

(1) A perpetual contributed capital account is not subject to share insurance coverage by the NCUSIF or other deposit insurer.

(2) A perpetual contributed capital account is not releasable due solely to the merger, charter conversion or liquidation of the member credit union. In the event of a merger, the perpetual contributed capital account transfers to the continuing credit union. In the event of a charter conversion, the perpetual contributed capital account transfers to the new institution. In the event of liquidation, the perpetual contributed capital account may be released to facilitate the payout of shares with the prior written approval of NCUA.

(3) The funds are callable only at the option of the corporate credit union and only if the corporate credit union meets its minimum required capital and NEV ratios after the funds are called. The corporate must also obtain the prior, written approval of the NCUA before releasing any perpetual contributed capital funds.

(4) Perpetual contributed capital cannot be used to pledge borrowings.

(5) Perpetual contributed capital is perpetual maturity and noncumulative dividend.

(6) Perpetual contributed capital is available to cover losses that exceed retained earnings. Any such losses must be distributed *pro rata* among perpetual contributed capital holders at the time the loss is realized. To the extent that perpetual contributed capital funds are used to cover losses, the corporate credit union is prohibited from

restoring or replenishing the affected accounts under any circumstances.

(7) Where the corporate credit union is liquidated, perpetual contributed capital accounts are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF, and nonperpetual capital holders. However, perpetual contributed capital that is used to cover losses in a calendar year previous to the year of liquidation has no claim against the liquidation estate.

I have read the above terms and conditions and I understand them. I further agree to maintain in the credit union's files the annual notice of terms and conditions of the perpetual contributed capital instrument.

The notice form must be signed by either all of the directors of the credit union or, if authorized by board resolution, the chair and secretary of the board of the credit union.

Model Form H

Terms and Conditions of Perpetual
Contributed Capital

NOTE: This form is for use before October 20, 2011 in the circumstances where the credit union has determined THAT IT WILL give newly issued capital priority over older capital as described in Part I of this Appendix. Also, capital previously issued under the nomenclature "paid-in capital" is considered perpetual contributed capital.

(1) A perpetual contributed capital account is not subject to share insurance coverage by the NCUSIF or other deposit insurer.

(2) A perpetual contributed capital account is not releasable due solely to the merger, charter conversion or liquidation of the member credit union. In the event of a merger, the perpetual contributed capital account transfers to the continuing credit union. In the event of a charter conversion, the perpetual contributed capital account transfers to the new institution. In the event of liquidation, the perpetual contributed capital account may be released to facilitate the payout of shares with the prior written approval of NCUA.

(3) The funds are callable only at the option of the corporate credit union and only if the corporate credit union meets its minimum required capital and NEV ratios after the funds are called. The corporate must also obtain the prior, written approval of the NCUA before releasing any perpetual contributed capital funds.

(4) Perpetual contributed capital cannot be used to pledge borrowings.

(5) Perpetual contributed capital is perpetual maturity and noncumulative dividend.

(6) Availability to cover losses.

(a) Perpetual contributed capital issued before January 18, 2011 is available to cover

losses that exceed retained earnings. Any such losses must be distributed *pro rata*, at the time the loss is realized, among holders of perpetual contributed capital issued before January 18, 2011. To the extent that perpetual contributed capital funds are used to cover losses, the corporate credit union is prohibited from restoring or replenishing the affected accounts under any circumstances.

(b) Perpetual contributed capital issued on or after January 18, 2011 is available to cover losses that exceed retained earnings and any contributed capital issued before January 18, 2011. Any such losses must be distributed *pro rata*, at the time the loss is realized, among holders of perpetual contributed capital issued on or after January 18, 2011. To the extent that perpetual contributed capital funds are used to cover losses, the corporate credit union is prohibited from restoring or replenishing the affected accounts under any circumstances.

(c) Attached to this disclosure is a statement that describes the amount of perpetual capital the credit union has with the corporate credit union in each of the categories described in paragraphs (6)(a) and (6)(b) above.

(7) Where the corporate credit union is liquidated:

(a) Perpetual contributed capital accounts issued on or after January 18, 2011 are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF, but not including contributed capital accounts issued before January 18, 2011. However, perpetual contributed capital that is used to cover losses in a calendar year previous to the year of liquidation has no claim against the liquidation estate.

(b) Perpetual contributed capital accounts issued before January 18, 2011 are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF, nonperpetual capital accounts issued before January 18, 2011, and all contributed capital accounts issued on or after January 18, 2011. However, perpetual contributed capital that is used to cover losses in a calendar year previous to the year of liquidation has no claim against the liquidation estate.

I have read the above terms and conditions and I understand them. I further agree to maintain in the credit union's files the annual notice of terms and conditions of the perpetual contributed capital instrument.

The notice form must be signed by either all of the directors of the credit union or, if authorized by board resolution, the chair and secretary of the board of the credit union.

2. At 75 FR 71528, Nov. 24, 2010, appendix A to part 704 was amended by revising the introductory note in Model Form H, effective Jan. 18, 2011. For the convenience of the user, the revised text is set forth as follows:

APPENDIX A TO PART 704—CAPITAL
PRIORITIZATION AND MODEL FORMS

* * * * *

Model Form H

NOTE: This form is for use on or after October 20, 2011 in the circumstances where the credit union has determined that it will give newly issued capital priority over older capital as described in Part I of this Appendix. Also, capital previously issued under the nomenclature "paid-in capital" is considered perpetual contributed capital.

* * * * *

APPENDIX B TO PART 704—EXPANDED
AUTHORITIES AND REQUIREMENTS

A corporate credit union may obtain all or part of the expanded authorities contained in this appendix if it meets the applicable requirements of part 704 and appendix B, fulfills additional management, infrastructure, and asset and liability requirements, and receives NCUA's written approval. Additional guidance is set forth in the NCUA publication Guidelines for Submission of Requests for Expanded Authority.

A corporate credit union seeking expanded authorities must submit to NCUA a self-assessment plan supporting its request. A corporate credit union may adopt expanded authorities when NCUA has provided final approval. If NCUA denies a request for expanded authorities, it will advise the corporate credit union of the reason(s) for the denial and what it must do to resubmit its request. NCUA may revoke these expanded authorities at any time if an analysis indicates a significant deficiency. NCUA will notify the corporate credit union in writing of the identified deficiency. A corporate credit union may request, in writing, reinstatement of the revoked authorities by providing a self-assessment plan detailing how it has corrected the deficiency.

Minimum Requirement

In order to participate in any of the authorities set forth in Base-Plus, part I, part II, part III, part IV, and part V of this appendix, a corporate credit union must evaluate monthly the changes in NEV and the NEV ratio for the tests set forth in §704.8(d)(1)(i).

BASE-PLUS

A corporate that has met the requirements for this Base-plus authority may, in performing the rate stress tests set forth in §704.8(d)(1)(i), allow its NEV to decline as much as 20 percent.

PART I

(a) A corporate credit union that has met the requirements for this Part I may:

- (1) Purchase investments with long-term ratings no lower than A- (or equivalent);
- (2) Purchase investments with short-term ratings no lower than A-2 (or equivalent), provided that the issuer has a long-term rating no lower than A- (or equivalent) or the investment is a domestically-issued asset-backed security;
- (3) Engage in short sales of permissible investments to reduce interest rate risk;
- (4) Purchase principal only (PO) stripped mortgage-backed securities to reduce interest rate risk; and
- (5) Enter into a dollar roll transaction.

(b) Aggregate investments in repurchase and securities lending agreements with any one counterparty are limited to 300 percent of capital.

(c) In performing the rate stress tests set forth in §704.8(d)(1)(i), the NEV of a corporate credit union that has met the requirements of this Part I may decline as much as:

- (1) 20 percent;
- (2) 28 percent if the corporate credit union has a 5 percent minimum capital ratio and is specifically approved by NCUA; or
- (3) 35 percent if the corporate credit union has a 6 percent minimum capital ratio and is specifically approved by NCUA.

(d) The maximum aggregate amount in unsecured loans and lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, must not exceed 100 percent of the corporate credit union's capital. The board of directors must establish the limit, as a percent of the corporate credit union's capital plus pledged shares, for secured loans and lines of credit.

PART II

(a) A corporate credit union that has met the requirements for this part II may:

- (1) Purchase investments with long-term ratings no lower than BBB (flat) (or equivalent). The aggregate of all investments rated BBB+ (or equivalent) or lower in any single obligor is not to exceed 25 percent of capital;
 - (2) Purchase investments with short-term ratings no lower than A-2 (or equivalent), provided that the issuer has a long-term rating no lower than BBB (flat) (or equivalent) or the investment is a domestically issued asset-backed security;
 - (3) Engage in short sales of permissible investments to reduce interest rate risk;
 - (4) Purchase principal only (PO) stripped mortgage-backed securities to reduce interest rate risk; and
 - (5) Enter into a dollar roll transaction.
- (b) Aggregate investments in repurchase and securities lending agreements with any

one counterparty are limited to 400 percent of capital.

(c) In performing the rate stress tests set forth in §704.8(d)(1)(i), the NEV of a corporate credit union which has met the requirements of this part II may decline as much as:

- (1) 20 percent;
- (2) 28 percent if the corporate credit union has a 5 percent minimum capital ratio and is specifically approved by NCUA; or
- (3) 35 percent if the corporate credit union has a 6 percent minimum capital ratio and is specifically approved by NCUA.

(d) The maximum aggregate amount in unsecured loans and lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, must not exceed 100 percent of the corporate credit union's capital. The board of directors must establish the limit, as a percent of the corporate credit union's capital plus pledged shares, for secured loans and lines of credit.

PART III

(a) A corporate credit union that has met the requirements of either part I or part II of this appendix and the additional requirements for part III may invest in:

- (1) Debt obligations of a foreign country;
- (2) Deposits and debt obligations of foreign banks or obligations guaranteed by these banks;
- (3) Marketable debt obligations of foreign corporations. This authority does not apply to debt obligations that are convertible into the stock of the corporation; and
- (4) Foreign issued asset-backed securities.

(b) All foreign investments are subject to the following requirements:

- (1) Investments must be rated no lower than the minimum permissible domestic rating under the corporate credit union's part I or part II authority;
- (2) A sovereign issuer, and/or the country in which an obligor is organized, must have a long-term foreign currency (non-local currency) debt rating no lower than AA- (or equivalent);
- (3) For each approved foreign bank line, the corporate credit union must identify the specific banking centers and branches to which it will lend funds;
- (4) Obligations of any single foreign obligor may not exceed 50 percent of capital; and
- (5) Obligations in any single foreign country may not exceed 250 percent of capital.

PART IV

(a) A corporate credit union that has met the requirements for this part IV may enter into derivative transactions specifically approved by NCUA to:

- (1) Create structured products;
- (2) Manage its own balance sheet; and

(3) Hedge the balance sheets of its members.

(b) Credit Ratings:

(1) All derivative transactions are subject to the following requirements:

(i) If the counterparty is domestic, the counterparty rating must be no lower than the minimum permissible rating for comparable term permissible investments; and

(ii) If the counterparty is foreign, the corporate must have part III expanded authority and the counterparty rating must be no lower than the minimum permissible rating for a comparable term investment under part III Authority.

(iii) Any rating(s) relied upon to meet the requirements of this part must be identified at the time the transaction is entered into and must be monitored for as long as the contract remains open.

(iv) Section 704.10 of this part if:

(A) one rating was relied upon to meet the requirements of this part and that rating is downgraded below the minimum rating requirements of this part; or

(B) two or more ratings were relied upon to meet the requirements of this part and at least two of those ratings are downgraded below the minimum rating requirements of this part.

(2) Exceptions. Credit ratings are not required for derivative transactions with:

(i) Domestically chartered credit unions;

(ii) U.S. government sponsored enterprises; or

(iii) Counterparties if the transaction is fully guaranteed by an entity with a minimum permissible rating for comparable term investments.

PART V

A corporate credit union that has met the requirements for this part V may participate in loans with member natural person credit unions as approved by the OCCU Director and subject to the following:

(a) The maximum aggregate amount of participation loans with any one member credit union must not exceed 25 percent of capital; and

(b) The maximum aggregate amount of participation loans with all member credit unions will be determined on a case-by-case basis by the OCCU Director.

[67 FR 65658, Oct. 25, 2002]

EFFECTIVE DATE NOTE: At 75 FR 64851, Oct. 20, 2010, appendix B to part 704 was revised, effective Jan. 18, 2011. For the convenience of the user, the revised text is set forth as follows:

APPENDIX B TO PART 704—EXPANDED AUTHORITIES AND REQUIREMENTS

A corporate credit union may obtain all or part of the expanded authorities contained in

this Appendix if it meets the applicable requirements of Part 704 and Appendix B, fulfills additional management, infrastructure, and asset and liability requirements, and receives NCUA's written approval. Additional guidance is set forth in the NCUA publication Guidelines for Submission of Requests for Expanded Authority.

A corporate credit union seeking expanded authorities must submit to NCUA a self-assessment plan supporting its request. A corporate credit union may adopt expanded authorities when NCUA has provided final approval. If NCUA denies a request for expanded authorities, it will advise the corporate credit union of the reason(s) for the denial and what it must do to resubmit its request. NCUA may revoke these expanded authorities at any time if an analysis indicates a significant deficiency. NCUA will notify the corporate credit union in writing of the identified deficiency. A corporate credit union may request, in writing, reinstatement of the revoked authorities by providing a self-assessment plan detailing how it has corrected the deficiency.

A state chartered corporate credit union may not exercise any expanded authority that exceeds the powers and authorities provided for under its state laws. Accordingly, requests by state chartered corporate credit unions for expansions under this part must be approved by the state regulator before being submitted to NCUA.

Minimum Requirement

In order to participate in any of the authorities set forth in Base-Plus, Part I, Part II, Part III, or Part IV of this Appendix, a corporate credit union must evaluate monthly, including once on the last day of the month, the changes in NEV, NEV ratio, NII, WAL, and duration as required by paragraphs (d)(1)(i), (e), (f), (g), and (i) of §704.8.

Base-Plus

A corporate that has met the requirements for this Base-plus authority may, in performing the rate stress tests set forth in 704.8(d)(1)(i), allow its NEV to decline as much as 20 percent.

Part I

(a) A corporate credit union that has met all the requirements established by NCUA for this Part I, including a minimum capital ratio of at least six percent, may:

(1) Purchase investments with long-term ratings no lower than A- (or equivalent);

(2) Purchase investments with short-term ratings no lower than A-2 (or equivalent), provided that the issuer has a long-term rating no lower than A- (or equivalent) or the investment is a domestically-issued asset-backed security;

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(3) Engage in short sales of permissible investments to reduce interest rate risk;

(4) Purchase principal only (PO) stripped mortgage-backed securities to reduce interest rate risk; and

(5) Enter into a dollar roll transaction.

(b) In performing the rate stress tests set forth in §704.8(d), the NEV of a corporate credit union that has met the requirements of this Part I may decline as much as:

(1) 20 percent;

(2) 28 percent if the corporate credit union has a seven percent minimum capital ratio and is specifically approved by NCUA; or

(3) 35 percent if the corporate credit union has an eight percent minimum capital ratio and is specifically approved by NCUA.

(c) The maximum aggregate amount in unsecured loans and lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, must not exceed 100 percent of the corporate credit union's capital. The board of directors must establish the limit, as a percent of the corporate credit union's capital plus pledged shares, for secured loans and lines of credit.

(d) The aggregate total of investments purchased under the authority of Part I (a)(1) and Part I (a)(2) may not exceed the lower of 500 percent of the corporate credit union's capital or 25 percent of assets.

(e) On or after October 20, 2011, corporate credit unions will substitute "leverage ratio" for "capital ratio" wherever it appears in Part I.

Part II

(a) A corporate credit union that has met the requirements of Part I of this Appendix and the additional requirements established by NCUA for Part II may invest in:

(1) Debt obligations of a foreign country;

(2) Deposits and debt obligations of foreign banks or obligations guaranteed by these banks;

(3) Marketable debt obligations of foreign corporations. This authority does not apply to debt obligations that are convertible into the stock of the corporation; and

(4) Foreign issued asset-backed securities.

(b) All foreign investments are subject to the following requirements:

(1) Investments must be rated no lower than the minimum permissible domestic rating under the corporate credit union's Part I authority;

(2) A sovereign issuer, and/or the country in which an obligor is organized, must have a long-term foreign currency (non-local currency) debt rating no lower than AA- (or equivalent);

(3) For each approved foreign bank line, the corporate credit union must identify the specific banking centers and branches to which it will lend funds;

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(4) Obligations of any single foreign obligor may not exceed 25 percent of capital or \$5 million, whichever is greater; and

(5) Obligations in any single foreign country may not exceed 250 percent of capital.

Part III

(a) A corporate credit union that has met the requirements established by NCUA for this Part III may enter into derivative transactions specifically approved by NCUA to:

(1) Create structured products;

(2) Mitigate interest rate risk and credit risk on its own balance sheet; and

(3) Hedge the balance sheets of its members.

(b) Credit Ratings:

(1) All derivative transactions are subject to the following requirements:

(i) If the intended counterparty is domestic, the counterparty rating must be no lower than A- (or equivalent) by every NRSRO that provides a publicly available long-term rating on the counterparty;

(ii) If the intended counterparty is foreign, the corporate must have Part II expanded authority and the counterparty rating must be no lower than the minimum permissible rating for a comparable term investment under Part II Authority;

(iii) The corporate must identify the rating(s) relied upon to meet the requirements of this part at the time the transaction is entered into and monitor those ratings for as long as the contract remains open; and

(iv) The corporate credit unions must comply with §704.10 of this part if any rating relied upon to meet the requirements of paragraphs (b)(1)(i) or (ii) of this part is downgraded below the minimum rating requirements.

(2) Exceptions. Credit ratings are not required for derivative transactions with:

(i) Domestically chartered credit unions;

(ii) U.S. government sponsored enterprises; or

(iii) Counterparties where the transaction is fully guaranteed by an entity with a minimum permissible rating for comparable term investments.

Part IV

A corporate credit union that has met all the requirements established by NCUA for this Part IV may participate in loans with member natural person credit unions as approved by the NCUA and subject to the following:

(a) The maximum aggregate amount of participation loans with any one member credit union must not exceed 25 percent of capital; and

(b) The maximum aggregate amount of participation loans with all member credit unions will be determined on a case-by-case basis by the NCUA.

APPENDIX C TO PART 704—RISK-BASED
CAPITAL CREDIT RISK-WEIGHT CAT-
EGORIES

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PART I: INTRODUCTION

(a) Scope

(1) This Appendix explains how a corporate credit union must compute its risk-weighted assets for purposes of determining its capital ratios.

(2) Risk-weighted assets equal risk-weighted on-balance sheet assets (computed under Section II(a) of this Appendix), plus risk-weighted off-balance sheet activities (computed under Section II(b) of this Appendix), plus risk-weighted recourse obligations, direct credit substitutes, and certain other positions (computed under Section II(c) of this Appendix).

(3) Assets not included (*i.e.*, deducted from capital) for purposes of calculating capital under part 704 are not included in calculating risk-weighted assets.

(4) Although this Appendix describes risk-weightings for various assets and activities, this Appendix does not provide authority for corporate credit unions to invest in or purchase any particular type of asset or to engage in any particular type of activity. A corporate credit union *must have other identifiable authority* for any investment it makes or activity it engages in. So, for example, this Appendix describes risk weightings for subordinated securities. Section 704.5, however, prohibits corporate credit unions from investing in subordinated securities, and so a corporate credit union cannot invest in subordinated securities.

(b) Definitions

The following definitions apply to this Appendix. Additional definitions, applicable to this entire Part, are located in §704.2 of this Part.

Cash items in the process of collection means checks or drafts in the process of collection that are drawn on another depository institution, including a central bank, and that are payable immediately upon presentation; U.S. Government checks that are drawn on the United States Treasury or any other U.S. Government or Government-sponsored agency and that are payable immediately upon presentation; broker's security drafts and commodity or bill-of-lading drafts payable immediately upon presentation; and unposted debits.

Commitment means any arrangement that obligates a corporate credit union to:

- (1) Purchase loans or securities;
- (2) Extend credit in the form of loans or leases, participations in loans or leases, overdraft facilities, revolving credit facilities, home equity lines of credit, eligible ABCP liquidity facilities, or similar transactions.

Depository institution means a financial institution that engages in the business of providing financial services; that is recognized as a bank or a credit union by the supervisory or monetary authorities of the country of its incorporation and the country of its principal banking operations; that receives deposits to a substantial extent in the regular course of business; and that has the power to accept demand deposits. In the United States, this definition encompasses all federally insured offices of commercial banks, mutual and stock savings banks, savings or building and loan associations (stock and mutual), cooperative banks, credit unions, and international banking facilities of domestic depository institutions.

Bank holding companies and savings and loan holding companies are excluded from this definition. For the purposes of assigning risk-weights, the differentiation between OECD depository institutions and non-OECD depository institutions is based on the country of incorporation. Claims on branches and agencies of foreign banks

located in the United States are to be categorized on the basis of the parent bank's country of incorporation.

Direct credit substitute means an arrangement in which a corporate credit union assumes, in form or in substance, credit risk associated with an on-balance sheet or off-balance sheet asset or exposure that was not previously owned by the corporate credit union (third-party asset) and the risk assumed by the corporate credit union exceeds the *pro rata* share of the corporate credit union's interest in the third-party asset. If a corporate credit union has no claim on the third-party asset, then the corporate credit union's assumption of any credit risk is a direct credit substitute. Direct credit substitutes include:

(1) Financial standby letters of credit that support financial claims on a third party that exceed a corporate credit union's *pro rata* share in the financial claim;

(2) Guarantees, surety arrangements, credit derivatives, and similar instruments backing financial claims that exceed a corporate credit union's *pro rata* share in the financial claim;

(3) Purchased subordinated interests that absorb more than their *pro rata* share of losses from the underlying assets, including any tranche of asset-backed securities that is not the most senior tranche;

(4) Credit derivative contracts under which the corporate credit union assumes more than its *pro rata* share of credit risk on a third-party asset or exposure;

(5) Loans or lines of credit that provide credit enhancement for the financial obligations of a third party;

(6) Purchased loan servicing assets if the servicer is responsible for credit losses or if the servicer makes or assumes credit-enhancing representations and warranties with respect to the loans serviced. Servicer cash advances as defined in this section are not direct credit substitutes;

(7) Clean-up calls on third-party assets. However, clean-up calls that are 10 percent or less of the original pool balance and that are exercisable at the option of the corporate credit union are not direct credit substitutes; and

(8) Liquidity facilities that provide support to asset-backed commercial paper (other than eligible ABCP liquidity facilities).

Exchange rate contracts means cross-currency interest rate swaps; forward foreign exchange rate contracts; currency options purchased; and any similar instrument that, in the opinion of the NCUA, may give rise to similar risks.

Face amount means the notational principal, or face value, amount of an off-balance sheet item or the amortized cost of an on-balance sheet asset.

Financial asset means cash or other monetary instrument, evidence of debt, evidence of an ownership interest in an entity, or a contract that conveys a right to receive or exchange cash or another financial instrument from another party.

Financial standby letter of credit means a letter of credit or similar arrangement that represents an irrevocable obligation to a third-party beneficiary:

(1) To repay money borrowed by, or advanced to, or for the account of, a second party (the account party); or

(2) To make payment on behalf of the account party, in the event that the account party fails to fulfill its obligation to the beneficiary.

OECD-based country means a member of that grouping of countries that are full members of the Organization for Economic Cooperation and Development (OECD) plus countries that have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the IMF's General Arrangements To Borrow. This term excludes any country that has rescheduled its external sovereign debt within the previous five years. A rescheduling of external sovereign debt generally would include any renegotiation of terms arising from a country's inability or unwillingness to meet its external debt service obligations, but generally would not include renegotiations of debt in the normal course of business, such as a renegotiation to allow the borrower to take advantage of a decline in interest rates or other change in market conditions.

Original maturity means, with respect to a commitment, the earliest date

after a commitment is made on which the commitment is scheduled to expire (*i.e.*, it will reach its stated maturity and cease to be binding on either party), provided that either:

(1) The commitment is not subject to extension or renewal and will actually expire on its stated expiration date; or

(2) If the commitment is subject to extension or renewal beyond its stated expiration date, the stated expiration date will be deemed the original maturity only if the extension or renewal must be based upon terms and conditions independently negotiated in good faith with the member at the time of the extension or renewal and upon a new, bona fide credit analysis utilizing current information on financial condition and trends.

Performance-based standby letter of credit means any letter of credit, or similar arrangement, however named or described, which represents an irrevocable obligation to the beneficiary on the part of the issuer to make payment on account of any default by a third party in the performance of a non-financial or commercial obligation. Such letters of credit include arrangements backing subcontractors' and suppliers' performance, labor and materials contracts, and construction bids.

Prorated assets means the total assets (as determined in the most recently available GAAP report but in no event more than one year old) of a consolidated CUSO multiplied by the corporate credit union's percentage of ownership of that consolidated CUSO.

Qualifying mortgage loan means a loan that:

(1) Is fully secured by a first lien on a one-to four-family residential property;

(2) Is underwritten in accordance with prudent underwriting standards, including standards relating the ratio of the loan amount to the value of the property (LTV ratio), as presented in the *Interagency Guidelines for Real Estate Lending Policies*, 57 FR 62890 (December 31, 1992). A nonqualifying mortgage loan that is paid down to an appropriate LTV ratio (calculated using value at origination, appraisal obtained within the prior six months, or updated value using an automated

valuation model) may become a qualifying loan if it meets all other requirements of this definition;

(3) Maintains an appropriate LTV ratio based on the amortized principal balance of the loan; and

(4) Is performing and is not more than 90 days past due.

If a corporate credit union holds the first and junior lien(s) on a residential property and no other party holds an intervening lien, the transaction is treated as a single loan secured by a first lien for the purposes of determining the LTV ratio and the appropriate risk-weight under Appendix C. Also, a loan to an individual borrower for the construction of the borrower's home may be included as a qualifying mortgage loan.

Qualifying multifamily mortgage loan.

(1) *Qualifying multifamily mortgage loan* means a loan secured by a first lien on multifamily residential properties consisting of 5 or more dwelling units, provided that:

(i) The amortization of principal and interest occurs over a period of not more than 30 years;

(ii) The original minimum maturity for repayment of principal on the loan is not less than seven years;

(iii) When considering the loan for placement in a lower risk-weight category, all principal and interest payments have been made on a timely basis in accordance with its terms for the preceding year;

(iv) The loan is performing and not 90 days or more past due;

(v) The loan is made in accordance with prudent underwriting standards; and

(vi) If the interest rate on the loan does not change over the term of the loan, the current loan balance amount does not exceed 80 percent of the value of the property securing the loan, and for the property's most recent calendar year, the ratio of annual net operating income generated by the property (before payment of any debt service on the loan) to annual debt service on the loan is not less than 120 percent, or in the case of cooperative or other not-for-profit housing projects, the property generates sufficient cash flows to provide comparable protection to the institution; or

(vii) If the interest rate on the loan changes over the term of the loan, the current loan balance amount does not exceed 75 percent of the value of the property securing the loan, and for the property's most recent calendar year, the ratio of annual net operating income generated by the property (before payment of any debt service on the loan) to annual debt service on the loan is not less than 115 percent, or in the case of cooperative or other not-for-profit housing projects, the property generates sufficient cash flows to provide comparable protection to the institution.

(2) For purposes of paragraphs (1)(vi) and (1)(vii) of this definition, the term value of the property means, at origination of a loan to purchase a multifamily property, the lower of the purchase price or the amount of the initial appraisal, or if appropriate, the initial evaluation. In cases not involving purchase of a multifamily loan, the value of the property is determined by the most current appraisal, or if appropriate, the most current evaluation. In cases where a borrower refinances a loan on an existing property, as an alternative to paragraphs (1)(iii), (1)(vi), and (1)(vii) of this definition:

(i) All principal and interest payments on the loan being refinanced have been made on a timely basis in accordance with the terms of that loan for the preceding year; and

(ii) The net income on the property for the preceding year would support timely principal and interest payments on the new loan in accordance with the applicable debt service requirement.

Qualifying residential construction loan, also referred to as a residential bridge loan, means a loan made in accordance with sound lending principles satisfying the following criteria:

(1) The builder must have substantial project equity in the home construction project;

(2) The residence being constructed must be a 1-4 family residence sold to a home purchaser;

(3) The lending entity must obtain sufficient documentation from a permanent lender (which may be the construction lender) demonstrating that the home buyer intends to purchase the residence and has the ability to ob-

tain a permanent qualifying mortgage loan sufficient to purchase the residence;

(4) The home purchaser must have made a substantial earnest money deposit;

(5) The construction loan must not exceed 80 percent of the sales price of the residence;

(6) The construction loan must be secured by a first lien on the lot, residence under construction, and other improvements;

(7) The lending credit union must retain sufficient undisbursed loan funds throughout the construction period to ensure project completion;

(8) The builder must incur a significant percentage of direct costs (*i.e.*, the actual costs of land, labor, and material) before any drawdown on the loan;

(9) If at any time during the life of the construction loan any of the criteria of this rule are no longer satisfied, the corporate must immediately recategorize the loan at a 100 percent risk-weight and must accurately report the loan in the corporate's next quarterly call report;

(10) The home purchaser must intend that the home will be owner-occupied;

(11) The home purchaser(s) must be an individual(s), not a partnership, joint venture, trust corporation, or any other entity (including an entity acting as a sole proprietorship) that is purchasing the home(s) for speculative purposes; and

(12) The loan must be performing and not more than 90 days past due.

The NCUA retains the discretion to determine that any loans not meeting sound lending principles must be placed in a higher risk-weight category. The NCUA also reserves the discretion to modify these criteria on a case-by-case basis provided that any such modifications are not inconsistent with the safety and soundness objectives of this definition.

Qualifying securities firm means:

(1) A securities firm incorporated in the United States that is a broker-dealer that is registered with the Securities and Exchange Commission (SEC) and that complies with the SEC's net capital regulations (17 CFR 240.15c3(1)); and

(2) A securities firm incorporated in any other OECD-based country, if the corporate credit union is able to demonstrate that the securities firm is subject to consolidated supervision and regulation (covering its subsidiaries, but not necessarily its parent organizations) comparable to that imposed on depository institutions in OECD countries. Such regulation must include risk-based capital requirements comparable to those imposed on depository institutions under the Accord on International Convergence of Capital Measurement and Capital Standards (1988, as amended in 1998).

Recourse means a corporate credit union's retention, in form or in substance, of any credit risk directly or indirectly associated with an asset it has sold (in accordance with Generally Accepted Accounting Principles) that exceeds a *pro rata* share of that corporate credit union's claim on the asset. If a corporate credit union has no claim on an asset it has sold, then the retention of any credit risk is recourse. A recourse obligation typically arises when a corporate credit union transfers assets in a sale and retains an explicit obligation to repurchase assets or to absorb losses due to a default on the payment of principal or interest or any other deficiency in the performance of the underlying obligor or some other party. Recourse may also exist implicitly if a corporate credit union provides credit enhancement beyond any contractual obligation to support assets it has sold. Recourse obligations include:

(1) Credit-enhancing representations and warranties made on transferred assets;

(2) Loan servicing assets retained pursuant to an agreement under which the corporate credit union will be responsible for losses associated with the loans serviced. Servicer cash advances as defined in this section are not recourse obligations;

(3) Retained subordinated interests that absorb more than their *pro rata* share of losses from the underlying assets;

(4) Assets sold under an agreement to repurchase, if the assets are not already included on the balance sheet;

(5) Loan strips sold without contractual recourse where the maturity of the transferred portion of the loan is shorter than the maturity of the commitment under which the loan is drawn;

(6) Credit derivatives that absorb more than the corporate credit union's *pro rata* share of losses from the transferred assets;

(7) Clean-up calls on assets the corporate credit union has sold. However, clean-up calls that are 10 percent or less of the original pool balance and that are exercisable at the option of the corporate credit union are not recourse arrangements; and

(8) Liquidity facilities that provide support to asset-backed commercial paper (other than eligible ABCP liquidity facilities).

Replacement cost means, with respect to interest rate and exchange-rate contracts, the loss that would be incurred in the event of a counterparty default, as measured by the net cost of replacing the contract at the current market value. If default would result in a theoretical profit, the replacement value is considered to be zero. This mark-to-market process must incorporate changes in both interest rates and counterparty credit quality.

Residential properties means houses, condominiums, cooperative units, and manufactured homes. This definition does not include boats or motor homes, even if used as a primary residence, or timeshare properties.

Residual interest. (1) *Residual interest* means any on-balance sheet asset that:

(i) Represents an interest (including a beneficial interest) created by a transfer that qualifies as a sale (in accordance with Generally Accepted Accounting Principles) of financial assets, whether through a securitization or otherwise; and

(ii) Exposes a corporate credit union to credit risk directly or indirectly associated with the transferred asset that exceeds a *pro rata* share of that corporate credit union's claim on the asset, whether through subordination provisions or other credit enhancement techniques.

(2) Residual interests generally include credit-enhancing interest-only strips, spread accounts, cash collateral

accounts, retained subordinated interests (and other forms of overcollateralization), and similar assets that function as a credit enhancement. Residual interests further include those exposures that, in substance, cause the corporate credit union to retain the credit risk of an asset or exposure that had qualified as a residual interest before it was sold. Residual interests generally do not include assets purchased from a third party, but a credit-enhancing interest-only strip that is acquired in any asset transfer is a residual interest.

(3) Corporate credit unions will use this definition of the term “residual interests,” and not the definition in §704.2, for purposes of applying this Appendix.

Risk participation means a participation in which the originating party remains liable to the beneficiary for the full amount of an obligation (e.g., a direct credit substitute), notwithstanding that another party has acquired a participation in that obligation.

Risk-weighted assets means the sum total of risk-weighted on-balance sheet assets, as calculated under Section II(a) of this Appendix, and the total of risk-weighted off-balance sheet credit equivalent amounts. The total of risk-weighted off-balance sheet credit equivalent amounts equals the risk-weighted off-balance sheet activities as calculated under Section II(b) of this Appendix plus the risk-weighted recourse obligations, risk-weighted direct credit substitutes, and certain other risk-weighted positions as calculated under Section II(c) of this Appendix.

Servicer cash advance means funds that a residential mortgage servicer advances to ensure an uninterrupted flow of payments, including advances made to cover foreclosure costs or other expenses to facilitate the timely collection of the loan. A servicer cash advance is not a recourse obligation or a direct credit substitute if:

(1) The servicer is entitled to full reimbursement and this right is not subordinated to other claims on the cash flows from the underlying asset pool; or

(2) For any one loan, the servicer’s obligation to make nonreimbursable advances is contractually limited to an insignificant amount of the outstanding principal amount on that loan.

Structured financing program means a program where receivable interests and asset-or mortgage-backed securities issued by multiple participants are purchased by a special purpose entity that repackages those exposures into securities that can be sold to investors. Structured financing programs allocate credit risk, generally, between the participants and credit enhancement provided to the program.

Traded position means a position retained, assumed, or issued in connection with a securitization that is rated by a NRSRO, where there is a reasonable expectation that, in the near future, the rating will be relied upon by:

(1) Unaffiliated investors to purchase the security; or

(2) An unaffiliated third party to enter into a transaction involving the position, such as a purchase, loan, or repurchase agreement.

Unconditionally cancelable means, with respect to a commitment-type lending arrangement, that the corporate credit union may, at any time, with or without cause, refuse to advance funds or extend credit under the facility.

United States Government or its agencies means an instrumentality of the U.S. Government whose debt obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the United States Government.

United States Government-sponsored agency or corporation means an agency or corporation originally established or chartered to serve public purposes specified by the United States Congress but whose obligations are not explicitly guaranteed by the full faith and credit of the United States Government.

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PART II: RISK-WEIGHTINGS

(a) *On-Balance Sheet Assets*

Except as provided in Section II(b) of this Appendix, risk-weighted on-balance sheet assets are computed by multiplying the on-balance sheet asset amounts times the appropriate risk-weight categories. The risk-weight categories are:

(1) Zero percent Risk-Weight (Category 1).

(i) Cash, including domestic and foreign currency owned and held in all offices of a corporate credit union or in transit. Any foreign currency held by a corporate credit union must be converted into U.S. dollar equivalents;

(ii) Securities issued by and other direct claims on the U.S. Government or its agencies (to the extent such securities or claims are unconditionally backed by the full faith and credit of the United States Government) or the central government of an OECD country;

(iii) Notes and obligations issued or guaranteed by the Federal Deposit Insurance Corporation or the National Credit Union Share Insurance Fund and backed by the full faith and credit of the United States Government;

(iv) Deposit reserves at, claims on, and balances due from Federal Reserve Banks;

(v) The book value of paid-in Federal Reserve Bank stock;

(vi) That portion of assets directly and unconditionally guaranteed by the United States Government or its agencies, or the central government of an OECD country.

(viii) Claims on, and claims guaranteed by, a qualifying securities firm that are collateralized by cash on deposit in the corporate credit union or by securities issued or guaranteed by the United States Government or its agencies, or the central government of an OECD country. To be eligible for this risk-weight, the corporate credit union must maintain a positive margin of collateral on the claim on a daily basis, taking into account any change in a corporate credit union's exposure to the obligor or counterparty under the claim in relation to the market value of the collateral held in support of the claim.

(2) 20 percent Risk-Weight (Category 2).

(i) Cash items in the process of collection;

(ii) That portion of assets conditionally guaranteed by the United States Government or its agencies, or the central government of an OECD country;

(iii) That portion of assets collateralized by the current market value of securities issued or guaranteed by the United States government or its agencies, or the central government of an OECD country;

(iv) Securities (not including equity securities) issued by and other claims on the U.S. Government or its agencies which are not backed by the full faith and credit of the United States Government;

(v) Securities (not including equity securities) issued by, or other direct claims on, United States Government-sponsored agencies;

(vi) That portion of assets guaranteed by United States Government-sponsored agencies;

(vii) That portion of assets collateralized by the current market value of securities issued or guaranteed by United States Government-sponsored agencies;

(viii) Claims on, and claims guaranteed by, a qualifying securities firm, subject to the following conditions:

(A) A qualifying securities firm must have a long-term issuer credit rating, or a rating on at least one issue of long-term unsecured debt, from a NRSRO. The rating must be in one of the three highest investment grade categories used by the NRSRO. If two or more NRSROs assign ratings to the qualifying securities firm, the corporate credit union must use the lowest rating to determine whether the rating requirement of this paragraph is met. A qualifying securities firm may rely on the rating of its parent consolidated company, if the parent consolidated company guarantees the claim.

(B) A collateralized claim on a qualifying securities firm does not have to comply with the rating requirements under paragraph (a) if the claim arises under a contract that:

(1) Is a reverse repurchase/repurchase agreement or securities lending/borrowing transaction executed using standard industry documentation;

(2) Is collateralized by debt or equity securities that are liquid and readily marketable;

(3) Is marked-to-market daily;

(4) Is subject to a daily margin maintenance requirement under the standard industry documentation; and

(5) Can be liquidated, terminated or accelerated immediately in bankruptcy or similar proceeding, and the security or collateral agreement will not be stayed or avoided under applicable law of the relevant jurisdiction. For example, a claim is exempt from the automatic stay in bankruptcy in the United States if it arises under a securities contract or a repurchase agreement subject to Section 555 or 559 of the Bankruptcy Code (11 U.S.C. 555 or 559), a qualified financial contract under Section 207(c)(8) of the Federal Credit Union Act (12 U.S.C. 1787(c)(8)) or Section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or a netting contract between or among financial institutions under Sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401-4407), or Regulation EE (12 CFR part 231).

(C) If the securities firm uses the claim to satisfy its applicable capital requirements, the claim is not eligible for a risk-weight under this paragraph II(a)(2)(viii);

(ix) Claims representing general obligations of any public-sector entity in an OECD country, and that portion of any claims guaranteed by any such public-sector entity;

(x) Balances due from and all claims on domestic depository institutions. This includes demand deposits and other transaction accounts, savings deposits and time certificates of deposit, federal funds sold, loans to other depository institutions, including overdrafts and term federal funds, holdings of the corporate credit union's own discounted acceptances for which the account party is a depository institution, holdings of bankers acceptances of other institutions and securities issued by depository institutions, except those that qualify as capital;

(xi) The book value of paid-in Federal Home Loan Bank stock;

(xii) Deposit reserves at, claims on and balances due from the Federal Home Loan Banks;

(xiii) Assets collateralized by cash held in a segregated deposit account by the reporting corporate credit union;

(xiv) Claims on, or guaranteed by, official multilateral lending institutions or regional development institutions in which the United States Government is a shareholder or contributing member;¹

(xv) That portion of assets collateralized by the current market value of securities issued by official multilateral lending institutions or regional development institutions in which the United States Government is a shareholder or contributing member.

(xvi) All claims on depository institutions incorporated in an OECD country, and all assets backed by the full faith and credit of depository institutions incorporated in an OECD country. This includes the credit equivalent amount of participations in commitments and standby letters of credit sold to other depository institutions incorporated in an OECD country, but only if the originating bank remains liable to the member or beneficiary for the full amount of the commitment or standby letter of credit. Also included in this category are the credit equivalent amounts of risk participations in bankers' acceptances conveyed to other depository institutions incorporated in an OECD country. However, bank-issued securities that qualify as capital of the issuing bank are not included in this risk category;

(xvii) Claims on, or guaranteed by depository institutions other than the central bank, incorporated in a non-OECD country, with a remaining maturity of one year or less;

(xviii) That portion of local currency claims conditionally guaranteed by central governments of non-OECD

¹These institutions include, but are not limited to, the International Bank for Reconstruction and Development (World Bank), the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Investment Bank, the International Monetary Fund and the Bank for International Settlements.

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countries, to the extent the corporate credit union has local currency liabilities in that country.

(3) 50 percent Risk-Weight (Category 3).

(i) Revenue bonds issued by any public-sector entity in an OECD country for which the underlying obligor is a public-sector entity, but which are repayable solely from the revenues generated from the project financed through the issuance of the obligations;

(ii) Qualifying mortgage loans and qualifying multifamily mortgage loans;

(iii) Privately-issued mortgage-backed securities (*i.e.*, those that do not carry the guarantee of the U.S. Government, a U.S. government agency, or a U.S. government sponsored enterprise) representing an interest in qualifying mortgage loans or qualifying multifamily mortgage loans. If the security is backed by qualifying multifamily mortgage loans, the corporate credit union must receive timely payments of principal and interest in accordance with the terms of the security. Payments will generally be considered timely if they are not 30 days past due; and

(iv) Qualifying residential construction loans.

(4) 100 percent Risk-Weight (Category 4).

All assets not specified above or deducted from calculations of capital pursuant to §704.2 and §704.3 of this part, including, but not limited to:

- (i) Consumer loans;
- (ii) Commercial loans;
- (iii) Home equity loans;
- (iv) Non-qualifying mortgage loans;
- (v) Non-qualifying multifamily mortgage loans;
- (vi) Residential construction loans;
- (vii) Land loans;
- (viii) Nonresidential construction loans;

(ix) Obligations issued by any state or any political subdivision thereof for the benefit of a private party or enterprise where that party or enterprise, rather than the issuing state or political subdivision, is responsible for the timely payment of principal and interest on the obligations, *e.g.*, industrial development bonds;

(x) Debt securities not specifically risk-weighted in another category;

(xi) Investments in fixed assets and premises;

(xii) Servicing assets;

(xiii) Interest-only strips receivable, other than credit-enhancing interest-only strips;

(xiv) Equity investments;

(xv) The prorated assets of subsidiaries (except for the assets of consolidated CUSOs) to the extent such assets are included in adjusted total assets;

(xvi) All repossessed assets or assets that are more than 90 days past due; and

(xvii) Intangible assets not specifically weighted in some other category.

(5) Indirect ownership interests in pools of assets. Assets representing an indirect holding of a pool of assets, *e.g.*, mutual funds, are assigned to risk-weight categories under this section based upon the risk-weight that would be assigned to the assets in the portfolio of the pool. An investment in shares of a mutual fund whose portfolio consists primarily of various securities or money market instruments that, if held separately, would be assigned to different risk-weight categories, generally is assigned to the risk-weight category appropriate to the highest risk-weighted asset that the fund is permitted to hold in accordance with the investment objectives set forth in its prospectus. The corporate credit union may, at its option, assign the investment on a *pro rata* basis to different risk-weight categories according to the investment limits in its prospectus. In no case will an investment in shares in any such fund be assigned to a total risk-weight less than 20 percent. If the corporate credit union chooses to assign investments on a *pro rata* basis, and the sum of the investment limits of assets in the fund's prospectus exceeds 100 percent, the corporate credit union must assign the highest *pro rata* amounts of its total investment to the higher risk categories. If, in order to maintain a necessary degree of short-term liquidity, a fund is permitted to hold an insignificant amount of its assets in short-term, highly liquid securities of superior credit quality that do not qualify for a

preferential risk-weight, such securities will generally be disregarded in determining the risk-weight category into which the corporate credit union's holding in the overall fund should be assigned. The prudent use of hedging instruments by a mutual fund to reduce the risk of its assets will not increase the risk-weighting of the mutual fund investment. For example, the use of hedging instruments by a mutual fund to reduce the interest rate risk of its government bond portfolio will not increase the risk-weight of that fund above the 20 percent category. Nonetheless, if the fund engages in any activities that appear speculative in nature or has any other characteristics that are inconsistent with the preferential risk-weighting assigned to the fund's assets, holdings in the fund will be assigned to the 100 percent risk-weight category.

(6) Derivatives. Certain transactions or activities, such as derivatives transactions, may appear on a corporate's balance sheet but are not specifically described in the Section II(a) on-balance sheet risk-weight categories. These items will be assigned risk-weights as described in Section II(b) or II(c) below.

(b) Off-Balance Sheet Items

Except as provided in Section II(c) of this Appendix, risk-weighted off-balance sheet items are determined by the following two-step process. First, the face amount of the off-balance sheet item must be multiplied by the appropriate credit conversion factor listed in this Section II(b). This calculation translates the face amount of an off-balance sheet exposure into an on-balance sheet credit-equivalent amount. Second, the credit-equivalent amount must be assigned to the appropriate risk-weight category using the criteria regarding obligors, guarantors, and collateral listed in Section II(a) of this Appendix.² The following are the credit

²The sufficiency of collateral and guarantees for off-balance sheet items is determined by the market value of the collateral or the amount of the guarantee in relation to the face amount of the item, except for derivative contracts, for which this determination is generally made in relation to the credit equivalent amount. Collateral and

conversion factors and the off-balance sheet items to which they apply.

(1) 100 percent credit conversion factor (Group A).

(i) Risk participations purchased in bankers' acceptances;

(ii) Forward agreements and other contingent obligations with a certain draw down, *e.g.*, legally binding agreements to purchase assets at a specified future date. On the date a corporate credit union enters into a forward agreement or similar obligation, it should convert the principal amount of the assets to be purchased at 100 percent as of that date and then assign this amount to the risk-weight category appropriate to the obligor or guarantor of the item, or the nature of the collateral;

(iii) Indemnification of members whose securities the corporate credit union has lent as agent. If the member is not indemnified against loss by the corporate credit union, the transaction is excluded from the risk-based capital calculation. When a corporate credit union lends its own securities, the transaction is treated as a loan. When a corporate credit union lends its own securities or is acting as agent, agrees to indemnify a member, the transaction is assigned to the risk-weight appropriate to the obligor or collateral that is delivered to the lending or indemnifying institution or to an independent custodian acting on their behalf; and

(iv) Unused portions of ABCP liquidity facilities that do not meet the definition of an eligible ABCP liquidity facility. The resulting credit equivalent amount is assigned to the risk category appropriate to the assets to be funded by the liquidity facility based on the assets or the obligor, after considering any collateral or guarantees, or external credit ratings under paragraph II(c)(3) of this Appendix, if applicable.

(2) 50 percent credit conversion factor (Group B).

(i) Transaction-related contingencies, including, among other things, performance bonds and performance-

guarantees are subject to the same provisions noted under paragraph II(d) of this Appendix C.

based standby letters of credit related to a particular transaction;

(ii) Unused portions of commitments (including home equity lines of credit and eligible ABCP liquidity facilities) with an original maturity exceeding one year except those listed in paragraph II(b)(5) of this Appendix. For eligible ABCP liquidity facilities, the resulting credit equivalent amount is assigned to the risk category appropriate to the assets to be funded by the liquidity facility based on the assets or the obligor, after considering any collateral or guarantees, or external credit ratings under paragraph II(c)(3) of this Appendix, if applicable; and

(iii) Revolving underwriting facilities, note issuance facilities, and similar arrangements pursuant to which the corporate credit union's CUSO or member can issue short-term debt obligations in its own name, but for which the corporate credit union has a legally binding commitment to either:

(A) Purchase the obligations the member is unable to sell by a stated date; or

(B) Advance funds to its member, if the obligations cannot be sold.

(3) 20 percent credit conversion factor (Group C). Trade-related contingencies, *i.e.*, short-term, self-liquidating instruments used to finance the movement of goods and collateralized by the underlying shipment. A commercial letter of credit is an example of such an instrument.

(4) 10 percent credit conversion factor (Group D). Unused portions of eligible ABCP liquidity facilities with an original maturity of one year or less. The resulting credit equivalent amount is assigned to the risk category appropriate to the assets to be funded by the liquidity facility based on the assets or the obligor, after considering any collateral or guarantees, or external credit ratings under paragraph II(c)(3) of this Appendix, if applicable;

(5) Zero percent credit conversion factor (Group E). (i) Unused portions of commitments with an original maturity of one year or less, except for eligible ABCP liquidity facilities;

(ii) Unused commitments with an original maturity greater than one year, if they are unconditionally cancelable at any time at the option of

the corporate credit union and the corporate credit union has the contractual right to make, and in fact does make, either:

(A) A separate credit decision based upon the borrower's current financial condition before each drawing under the lending facility; or

(B) An annual (or more frequent) credit review based upon the borrower's current financial condition to determine whether or not the lending facility should be continued; and

(iii) The unused portion of retail credit card lines or other related plans that are unconditionally cancelable by the corporate credit union in accordance with applicable law.

(6) Off-balance sheet derivative contracts; interest rate and foreign exchange rate contracts (Group F).

(i) Calculation of credit equivalent amounts. The credit equivalent amount of an off-balance sheet derivative contract that is not subject to a qualifying bilateral netting contract in accordance with paragraph II(b)(6)(ii) of this Appendix is equal to the sum of the current credit exposure, *i.e.*, the replacement cost of the contract, and the potential future credit exposure of the contract. The calculation of credit equivalent amounts is measured in U.S. dollars, regardless of the currency or currencies specified in the contract.

(A) Current credit exposure. The current credit exposure of an off-balance sheet derivative contract is determined by the mark-to-market value of the contract. If the mark-to-market value is positive, then the current credit exposure equals that mark-to-market value. If the mark-to-market value is zero or negative, then the current exposure is zero. In determining its current credit exposure for multiple off-balance sheet derivative contracts executed with a single counterparty, a corporate credit union may net positive and negative mark-to-market values of off-balance sheet derivative contracts if subject to a bilateral netting contract as provided in paragraph II(b)(6)(ii) of this Appendix.

(B) Potential future credit exposure. The potential future credit exposure of

an off-balance sheet derivative contract, including a contract with a negative mark-to-market value, is estimated by multiplying the notional principal by a credit conversion fac-

tor.³ Corporate credit unions, subject to examiner review, should use the effective rather than the apparent or stated notional amount in this calculation. The conversion factors are:⁴

| Remaining maturity | Interest rate contracts (percent) | Foreign exchange rate contracts (percent) | Other derivative contracts (percent) |
|--|-----------------------------------|---|--------------------------------------|
| One year or less | 0.0 | 1.0 | 10.0 |
| Over one year but less than five years | 0.50 | 5.0 | 12.0 |
| Over five years | 0.50 | 5.0 | 15.0 |

(ii) Off-balance sheet derivative contracts subject to bilateral netting contracts. In determining its current credit exposure for multiple off-balance sheet derivative contracts executed with a single counterparty, a corporate credit union may net off-balance sheet derivative contracts subject to a bilateral netting contract by offsetting positive and negative mark-to-market values, provided that:

(A) The bilateral netting contract is in writing;

(B) The bilateral netting contract creates a single legal obligation for all individual off-balance sheet derivative contracts covered by the bilateral netting contract. In effect, the bilateral netting contract provides that the corporate credit union has a single claim or obligation either to receive or pay only the net amount of the sum of the positive and negative mark-to-market values on the individual off-balance sheet derivative contracts covered by the bilateral netting contract. The single legal obligation for the net amount is operative in the event that a counterparty, or a counterparty to whom the bilateral netting contract has been validly assigned, fails to perform due to any of the following events: Default, insolvency, bankruptcy, or other similar circumstances;

(C) The corporate credit union obtains a written and reasoned legal opinion(s) representing, with a high degree of certainty, that in the event of a legal challenge, including one resulting from default, insolvency, bankruptcy or similar circumstances, the relevant court and administrative authorities would find the corporate credit union's exposure to be the net amount under:

(1) The law of the jurisdiction in which the counterparty is chartered or the equivalent location in the case of noncorporate entities, and if a branch of the counterparty is involved, then also under the law of the jurisdiction in which the branch is located;

(2) The law that governs the individual off-balance sheet derivative contracts covered by the bilateral netting contract; and

(3) The law that governs the bilateral netting contract;

(D) The corporate credit union establishes and maintains procedures to monitor possible changes in relevant law and to ensure that the bilateral netting contract continues to satisfy the requirements of this section; and

(E) The corporate credit union maintains in its files documentation adequate to support the netting of an off-balance sheet derivative contract.⁵

³For purposes of calculating potential future credit exposure for foreign exchange contracts and other similar contracts, in which notional principal is equivalent to cash flows, total notional principal is defined as the net receipts to each party falling due on each value date in each currency.

⁴No potential future credit exposure is calculated for single currency interest rate swaps in which payments are made based upon two floating rate indices, so-called

floating/floating or basis swaps; the credit equivalent amount is measured solely on the basis of the current credit exposure.

⁵By netting individual off-balance sheet derivative contracts for the purpose of calculating its credit equivalent amount, a corporate credit union represents that documentation adequate to support the netting of an off-balance sheet derivative contract is in the corporate credit union's files and

(iii) Walkaway clause. A bilateral netting contract that contains a walkaway clause is not eligible for netting for purposes of calculating the current credit exposure amount. The term "walkaway clause" means a provision in a bilateral netting contract that permits a nondefaulting counterparty to make a lower payment than it would make otherwise under the bilateral netting contract, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the bilateral netting contract.

(iv) Risk-weighting. Once the corporate credit union determines the credit equivalent amount for an off-balance sheet derivative contract, that amount is assigned to the risk-weight category appropriate to the counterparty, or, if relevant, to the nature of any collateral or guarantee. Collateral held against a netting contract is not recognized for capital purposes unless it is legally available for all contracts included in the netting contract. However, the maximum risk-weight for the credit equivalent amount of such off-balance sheet derivative contracts is 50 percent.

(v) Exceptions. The following off-balance sheet derivative contracts are not subject to the above calculation, and therefore, are not part of the denominator of a corporate credit union's risk-based capital ratio:

(A) A foreign exchange rate contract with an original maturity of 14 calendar days or less; and

(B) Any interest rate or foreign exchange rate contract that is traded on an exchange requiring the daily payment of any variations in the market value of the contract.

(C) Asset-backed commercial paper programs.

(1) A corporate credit union that qualifies as a primary beneficiary and

available for inspection by the NCUA. Upon determination by the NCUA that a corporate credit union's files are inadequate or that a bilateral netting contract may not be legally enforceable under any one of the bodies of law described in paragraphs II(b)(5)(ii) of this Appendix, the underlying individual off-balance sheet derivative contracts may not be netted for the purposes of this section.

must consolidate an ABCP program that is a variable interest entity under Generally Accepted Accounting Principles may exclude the consolidated ABCP program assets from risk-weighted assets if the corporate credit union is the sponsor of the ABCP program.

(2) If a corporate credit union excludes such consolidated ABCP program assets from risk-weighted assets, the corporate credit union must assess the appropriate risk-based capital requirement against any exposures of the corporate credit union arising in connection with such ABCP programs, including direct credit substitutes, recourse obligations, residual interests, liquidity facilities, and loans, in accordance with Sections II(a), II(b), and II(c) of this Appendix.

(3) If a corporate credit union has multiple overlapping exposures (such as a program-wide credit enhancement and a liquidity facility) to an ABCP program that is not consolidated for risk-based capital purposes, the corporate credit union is not required to hold duplicative risk-based capital under this part against the overlapping position. Instead, the corporate credit union should apply to the overlapping position the applicable risk-based capital treatment that results in the highest capital charge.

(c) Recourse Obligations, Direct Credit Substitutes, and Certain Other Positions

(1) In general. Except as otherwise permitted in this Section II(c), to determine the risk-weighted asset amount for a recourse obligation or a direct credit substitute (but not a residual interest):

(i) Multiply the full amount of the credit-enhanced assets for which the corporate credit union directly or indirectly retains or assumes credit risk by a 100 percent conversion factor (For a direct credit substitute that is an on-balance sheet asset (e.g., a purchased subordinated security), a corporate credit union must use the amount of the direct credit substitute and the full amount of the asset it supports, i.e., all the more senior positions in the structure); and

(ii) Assign this credit equivalent amount to the risk-weight category appropriate to the obligor in the underlying transaction, after considering any associated guarantees or collateral. Section II(a) lists the risk-weight categories.

(2) Residual interests. Except as otherwise permitted under this Section II(c), a corporate credit union must maintain risk-based capital for residual interests as follows:

(i) Credit-enhancing interest-only strips. A corporate credit union must maintain risk-based capital for a credit-enhancing interest-only strip equal to the remaining amount of the strip even if the amount of risk-based capital that must be maintained exceeds the full risk-based capital requirement for the assets transferred.

(ii) Other residual interests. A corporate credit union must maintain risk-based capital for a residual interest (excluding a credit-enhancing interest-only strip) equal to the face amount of the residual interest, even if the amount of risk-based capital that must be maintained exceeds the full risk-based capital requirement for the assets transferred.

(iii) Residual interests and other recourse obligations. Where a corporate credit union holds a residual interest (including a credit-enhancing interest-only strip) and another recourse obligation in connection with the same transfer of assets, the corporate credit union must maintain risk-based capital equal to the greater of:

(A) The risk-based capital requirement for the residual interest as calculated under Section II(c)(2)(i) through (ii) of this Appendix; or

(B) The full risk-based capital requirement for the assets transferred, subject to the low-level recourse rules under Section II(c)(5) of this Appendix.

(3) Ratings-based approach—(i) Calculation. A corporate credit union may calculate the risk-weighted asset amount for an eligible position described in Section II(c)(3)(ii) of this section by multiplying the face amount of the position by the appropriate risk-weight determined in accordance with Table A or B of this section.

TABLE A

| Long term rating category | Risk-weight (in percent) |
|--|--------------------------|
| Highest or second highest investment grade | 20 |
| Third highest investment grade | 50 |
| Lowest investment grade | 100 |
| One category below investment grade | 200 |

TABLE B

| Short term rating category | Risk-weight (in percent) |
|---------------------------------------|--------------------------|
| Highest investment grade | 20 |
| Second highest investment grade | 50 |
| Lowest investment grade | 100 |

(ii) Eligibility.

(A) Traded positions. A position is eligible for the treatment described in paragraph II(c)(3)(i) of this Appendix if:

(1) The position is a corporate debt obligation with a remaining maturity of 120 days or less, a recourse obligation, a direct credit substitute, a residual interest, or an asset- or mortgage-backed security and is not a credit-enhancing interest-only strip;

(2) The position is a traded position; and

(3) The NRSRO has rated a long term position as one grade below investment grade or better or a short term position as investment grade. If two or more NRSROs assign ratings to a traded position, the corporate credit union must use the lowest rating to determine the appropriate risk-weight category under paragraph (3)(i).

(B) Non-traded positions. A position that is not traded is eligible for the treatment described in paragraph(3)(i) if:

(1) The position is a recourse obligation, a direct credit substitute, a residual interest, or an asset- or mortgage-backed security extended in connection with a securitization and is not a credit-enhancing interest-only strip;

(2) More than one NRSRO rate the position;

(3) All of the NRSROs that rate the position rate it as no lower than one grade below investment grade (for long term position) or no lower than investment grade (for short term investments). If the NRSROs assign different ratings to the position, the corporate credit union must use the lowest rating to determine the appropriate risk-weight category under paragraph (3)(i);

(4) The NRSROs base their ratings on the same criteria that they use to rate securities that are traded positions; and

(5) The ratings are publicly available.

(C) Unrated senior positions. If a recourse obligation, direct credit substitute, residual interest, or asset- or mortgage-backed security is not rated by an NRSRO, but is senior or preferred in all features to a traded position (including collateralization and maturity), the corporate credit union may risk-weight the face amount of the senior position under paragraph (3)(i) of this section, based on the rating of the traded position, subject to supervisory guidance. The corporate credit union must satisfy NCUA that this treatment is appropriate. This paragraph (3)(i)(c) applies only if the traded position provides substantive credit support to the unrated position until the unrated position matures.

(iii) Consistent use of Ratings Based Approach. A corporate credit union that determines to use the ratings based approach must do so in a consistent manner. For example, if the corporate credit union employs the ratings based approach on at least one security or position on a given call report, the credit union must use the ratings based approach on that call report for every security and position that is eligible for the ratings based approach.

(4) Certain positions that are not rated by NRSROs. (i) Calculation. A corporate credit union may calculate the risk-weighted asset amount for eligible position described in paragraph II(c)(4)(ii) of this section based on the corporate credit union's determination of the credit rating of the position. To risk-weight the asset, the corporate credit union must multiply the face amount of the position by the appropriate risk-weight determined in accordance with Table C of this section.

TABLE C

| Rating category | Risk-weight (in percent) |
|---|--------------------------|
| Investment grade | 100 |
| One category below investment grade | 200 |

(ii) Eligibility. A position extended in connection with a securitization is eligible for the treatment described in

paragraph II(c)(4)(i) of this section if it is not rated by an NRSRO, is not a residual interest, and meets the one of the three alternative standards described in paragraphs (A), (B), or (C) below:

(A) Position rated internally. A direct credit substitute, but not a purchased credit-enhancing interest-only strip, is eligible for the treatment described under paragraph II(c)(4)(i) of this Appendix, if the position is assumed in connection with an asset-backed commercial paper program sponsored by the corporate credit union. Before it may rely on an internal credit risk rating system, the corporate must demonstrate to NCUA's satisfaction that the system is adequate. Acceptable internal credit risk rating systems typically:

(1) Are an integral part of the corporate credit union's risk management system that explicitly incorporates the full range of risks arising from the corporate credit union's participation in securitization activities;

(2) Link internal credit ratings to measurable outcomes, such as the probability that the position will experience any loss, the expected loss on the position in the event of default, and the degree of variance in losses in the event of default on that position;

(3) Separately consider the risk associated with the underlying loans or borrowers, and the risk associated with the structure of the particular securitization transaction;

(4) Identify gradations of risk among "pass" assets and other risk positions;

(5) Use clear, explicit criteria to classify assets into each internal rating grade, including subjective factors;

(6) Employ independent credit risk management or loan review personnel to assign or review the credit risk ratings;

(7) Include an internal audit procedure to periodically verify that internal risk ratings are assigned in accordance with the corporate credit union's established criteria;

(8) Monitor the performance of the assigned internal credit risk ratings over time to determine the appropriateness of the initial credit risk rating assignment, and adjust individual

credit risk ratings or the overall internal credit risk rating system, as needed; and

(9) Make credit risk rating assumptions that are consistent with, or more conservative than, the credit risk rating assumptions and methodologies of NRSROs.

(B) Program ratings.

(1) A recourse obligation or direct credit substitute, but not a residual interest, is eligible for the treatment described in paragraph II(c)(4)(i) of this Appendix, if the position is retained or assumed in connection with a structured finance program and an NRSRO has reviewed the terms of the program and stated a rating for positions associated with the program. If the program has options for different combinations of assets, standards, internal or external credit enhancements and other relevant factors, and the NRSRO specifies ranges of rating categories to them, the corporate credit union may apply the rating category applicable to the option that corresponds to the corporate credit union's position.

(2) To rely on a program rating, the corporate credit union must demonstrate to NCUA's satisfaction that the credit risk rating assigned to the program meets the same standards generally used by NRSROs for rating traded positions. The corporate credit union must also demonstrate to NCUA's satisfaction that the criteria underlying the assignments for the program are satisfied by the particular position.

(3) If a corporate credit union participates in a securitization sponsored by another party, NCUA may authorize the corporate credit union to use this approach based on a program rating obtained by the sponsor of the program.

(C) Computer program. A recourse obligation or direct credit substitute, but not a residual interest, is eligible for the treatment described in paragraph II(c)(4)(i) of this Appendix, if the position is extended in connection with a structured financing program and the corporate credit union uses an acceptable credit assessment computer program to determine the rating of the position. An NRSRO must have developed the computer program and the corporate credit union must demonstrate

to NCUA's satisfaction that the ratings under the program correspond credibly and reliably with the rating of traded positions.

(5) Limitations on risk-based capital requirements—

(i) Low-level exposure rule. If the maximum contractual exposure to loss retained or assumed by a corporate credit union is less than the effective risk-based capital requirement, as determined in accordance with this Section II(c), for the assets supported by the corporate credit union's position, the risk-based capital requirement is limited to the corporate credit union's contractual exposure less any recourse liability account established in accordance with Generally Accepted Accounting Principles. This limitation does not apply when a corporate credit union provides credit enhancement beyond any contractual obligation to support assets it has sold.

(ii) Mortgage-related securities or participation certificates retained in a mortgage loan swap. If a corporate credit union holds a mortgage-related security or a participation certificate as a result of a mortgage loan swap with recourse, it must hold risk-based capital to support the recourse obligation and that percentage of the mortgage-related security or participation certificate that is not covered by the recourse obligation. The total amount of risk-based capital required for the security (or certificate) and the recourse obligation is limited to the risk-based capital requirement for the underlying loans, calculated as if the corporate credit union continued to hold these loans as an on-balance sheet asset.

(iii) Related on-balance sheet assets. If an asset is included in the calculation of the risk-based capital requirement under this Section II(c) and also appears as an asset on the corporate credit union's balance sheet, the corporate credit union must risk-weight the asset only under this Section II(c), except in the case of loan servicing assets and similar arrangements with embedded recourse obligations or direct credit substitutes. In that case, the corporate credit union must separately risk-weight the on-balance sheet servicing asset and the related recourse

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obligations and direct credit substitutes under this section, and incorporate these amounts into the risk-based capital calculation.

(6) Obligations of CUSOs. All recourse obligations and direct credit substitutes retained or assumed by a corporate credit union on the obligations of CUSOs in which the corporate credit union has an equity investment are risk-weighted in accordance with this Section II(c), unless the corporate credit union's equity investment is deducted from the credit union's capital and assets under § 704.2 and § 704.3.

(d) *Collateral*. The only forms of collateral that are recognized for risk-weighting purposes are cash on deposit in the corporate credit union; Treasuries, U.S. Government agency securities, and U.S. Government-sponsored enterprise securities; and securities issued by multilateral lending institutions or regional development banks. Claims secured by cash on deposit are assigned to the zero percent risk-weight category (to the extent of the cash amount). Claims secured by securities are assigned to the twenty percent risk-weight category (to the extent of the fair market value of the securities).

[75 FR 64852, Oct. 20, 2010]

EFFECTIVE DATE NOTE: At 75 FR 64852, Oct. 20, 2010, appendix C of part 704 was added, effective Jan. 18, 2011.

PART 705—COMMUNITY DEVELOPMENT REVOLVING LOAN PROGRAM FOR CREDIT UNIONS

Sec.

- 705.0 Applicability.
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- 705.9 Application period.
- 705.10 Technical assistance.

AUTHORITY: 12 U.S.C. 1772c-1; 42 U.S.C. 9822 and 9822 note.

SOURCE: 58 FR 21646, Apr. 23, 1993, unless otherwise noted.

§ 705.0 Applicability.

Monies from the Community Development Revolving Loan Fund for Credit Unions are governed by this part.

§ 705.1 Scope.

(a) This part implements the Community Developments Revolving Loan Program for Credit Unions (Program) under the sole administration of the National Credit Union Administration.

(b) This part establishes the following:

- (1) Definitions;
- (2) The application process and requirements for qualifying for a loan under the program;
- (3) How loan funds are to be made available and their repayment; and
- (4) Technical assistance to be provided to participating credit unions.

§ 705.2 Purpose of the program.

(a) The Community Development Revolving Loan Program for Credit Unions is intended to support the efforts of participating credit unions through loans and technical assistance to those credit unions in:

- (1) Providing basic financial and related services to residents in their communities; and
- (2) Stimulating economic activities in the communities they service which will result in increased income, ownership and employment opportunities for low-income residents, and other community growth efforts.

(b) The policy of NCUA is to revolve loan funds to qualifying credit unions as often as practical in order to gain maximum economic impact on as many participating credit unions as possible.

§ 705.3 Definitions.

(a) The term "low-income members" means those members defined in § 701.34 of this chapter.

(b) For purposes of this part, a *participating credit union* means a state- or federally-chartered credit union that is specifically involved in the stimulation of economic development activities and community revitalization efforts aimed at benefiting the community it serves; whose membership consists of predominantly low-income members as defined in paragraph (a) of this section