NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 702 and 747

Prompt Corrective Action

AGENCY: National Credit Union Administration (NCUA).

ACTION: Proposed Rule.

SUMMARY: In 1998, Congress amended the Federal Credit Union Act to require the NCUA Board to adopt, by regulation, a system of ''prompt corrective action'' to be taken by NCUA and by federally-insured credit unions if they become undercapitalized. The new FCUA provision imposes a series of progressively more stringent restrictions and requirements indexed to five capital categories which it establishes for federally-insured credit unions. It also mandates a separate system of prompt corrective action for ''new'' credit unions and an additional risk-based net worth requirement for ''complex'' credit unions. The proposed rule combines the components of prompt corrective action which are expressly prescribed by statute (except the risk-based net worth requirement for ''complex'' credit unions) with those NCUA is responsible for developing to suit credit unions. The rule also establishes conforming reserve and dividend payment requirements, and procedures for reviewing and enforcing directives imposing prompt corrective action.

DATES: Comments must be received on or before August 16, 1999.

ADDRESSES: Direct comments to Becky Baker, Secretary of the Board. Mail or hand-deliver comments to: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428. Fax comments to (703) 518–6319. Please send comments by one method only.

FOR FURTHER INFORMATION CONTACT: Herbert S. Yolles, Deputy Director, Office of Examination and Insurance, at the above address or telephone (703) 518–6362; or Steven W. Widerman, Trial Attorney, Office of General Counsel, at the above address or telephone (703) 518–6557.

SUPPLEMENTARY INFORMATION:

A. Background

1. The Credit Union Membership Access Act

On August 7, 1998, Congress enacted the Credit Union Membership Access Act, Public Law No. 105–219, 112 Stat. 913 (1998). Section 103 of the statute added a new section 216 to the Federal Credit Union Act (FCUA), 12 U.S.C. 1790d (hereinafter referred to as ''CUMAA'' or ''the statute'' and cited as ''§ 1790d''). Section 1790d requires the NCUA Board to adopt by regulation a system of ''prompt corrective action'' (sometimes referred to as ''PCA'') to be taken by NCUA when a federally-insured ''natural person'' credit union becomes undercapitalized. The stated purpose of § 1790d is to ''resolve the problems of insured credit unions at the least possible long-term loss to the [National Credit Union Share Insurance Fund (NCUSIF)].'' § 1790d(a)(1). The system of PCA for credit unions must take into account the distinguishing features of credit unions: that they are cooperatives that do not issue capital stock, must rely on retained earnings to build net worth, and have primarily volunteer boards of directors. § 1790d(b)(1)(B).

Much of the system of PCA for credit unions is expressly prescribed by § 1790d. This includes the five net worth categories and the net worth measures for each, the requirement to submit a Net Worth Restoration Plan, the requirement to annually transfer a portion of earnings to net worth, restrictions on increasing assets and on increasing member business loans, and conditions triggering mandatory conservatorship and liquidation. §§ 1790d(c), (e), (f), (g), (i); 12 U.S.C. 1786(h)(1)(F) and (G), 1787(a)(3)(A). The implementing regulations adhere to the substance of the statutory components of PCA.

To complete the framework of PCA for credit unions, CUMAA authorizes NCUA to develop, by regulation, a comprehensive series of discretionary supervisory actions to complement the mandatory supervisory actions prescribed by statute. The statutory criteria for these discretionary actions are that they must be consistent with the purpose of § 1790d, and must be ''comparable'' [1] to the ''discretionary safeguards'' which the Federal banking agencies [2] are permitted to impose under section 38 of the Federal Deposit Insurance Act, 12 U.S.C. 1831o (FDIA § 38) [3]—the statute which established prompt corrective action for federally-insured depository institutions. § 1790d(b)(1)(A); S. Rep. No. 193, 105th Cong., 2d Sess. 12 (1998) (S. Rep.); H.R. Rep. No. 472, 105th Cong., 2d Sess. 23 (1998) (H.R. Rep. at 23). Accordingly, the proposed implementing regulations establish a series of discretionary supervisory actions indexed to the ''undercapitalized'' and lower net worth categories. NCUA has the discretion to impose these restrictions and requirements to further the purpose of prompt corrective action. Although comparable to FDIA § 38, these discretionary supervisory actions are tailored to suit the distinctive characteristics of credit unions.

For credit unions which CUMAA defines as ''new''—those in operation less than ten years and which have $10 million or less in assets—the statute requires NCUA to develop an alternative system of prompt corrective action to apply in lieu of the system prescribed by CUMAA for all other federally-insured credit unions. § 1790d(b)(2)(A); see U.S. Dept. of Treasury, *Credit Unions* (Washington, D.C. 1997) at 79. The alternative system of PCA must recognize that ''new'' credit unions initially have no net worth, need reasonable time to accumulate net worth, and need incentives to become ''adequately capitalized'' by the time they are no longer ''new.'' § 1790d(b)(2)(B). Accordingly, although it follows the ''net worth category'' model, the system of PCA for new credit unions has relaxed net worth ratios, allows regulatory forbearance, and offers incentives to build net worth.

CUMAA requires NCUA to formulate the definition of a ''complex'' credit union according to the risk level of its portfolio of assets and liabilities. § 1790d(d)(1). ''Well capitalized'' and ''adequately capitalized'' credit unions which meet that definition will be subject to an additional ''risk-based net worth requirement'' to compensate for ''any material risks against which the [statutory net worth ratio for ''adequately capitalized''] may not provide adequate protection.'' § 1790d(d)(2). The ''risk-based net worth requirement'' for ''complex'' credit unions will be the subject of a separate proposed rule to be issued by the NCUA Board in late 1999.

CUMAA requires NCUA to implement an independent appeal process by which affected credit unions and certain officials can appeal to the NCUA Board decisions by NCUA staff to impose discretionary restrictions or requirements. § 1790d(k). To fulfill this mandate, the proposed rule adds a new subpart L to part 747 of NCUA's

[1] ''Comparable'' is defined as ''parallel in substance (though not necessarily identical in detail) and equivalent in rigor.'' S. Rep. at 12.

[2] The Federal banking agencies consist of the Federal Reserve Board, the Office of Comptroller of the Currency, the Federal Deposit Insurance Corporation (FDIC) and the Office of Thrift Supervision. § 1790d(o)(1) incorporating 12 U.S.C. 1813(z). Their Joint Final Rule establishing a system of prompt corrective action pursuant to 12 U.S.C. 1831o is published at 57 FR 44886 (Sept. 29, 1992).

[3] Section 38 of the Federal Deposit Insurance Act, 12 U.S.C. 1831o, was added by section 131 of the Federal Deposit Insurance Corporation Improvement Act, Pub. L 102–242, 105 Stat. 2236 (1991).

regulations, 12 CFR 747.2001, establishing procedures for issuance, review and enforcement of directives requiring prompt corrective action. Subpart L generally provides a right of notice of the decision to impose a discretionary restriction or requirement, and an opportunity to respond to the notice, an informal hearing if requested in certain cases, and NCUA Board review of the decision.

Although not required by CUMAA, the proposed rule retains in substance certain of NCUA's current reserve and dividend payment requirements. In subpart C, these requirements have been modified to reflect repeal of FCUA § 116, 12 U.S.C. 1762, and to conform to CUMAA's earnings retention requirement. § 1790d(e).

Finally, in formulating regulations to implement a system of PCA for credit unions, CUMAA required NCUA to consult with the Secretary of the Treasury, the Federal banking agencies, and State officials having jurisdiction over federally-insured, State-chartered credit unions. CUMAA § 301(c). To that end, the proposed rule is a product of consultation with representatives of the Department of the Treasury, solicitation of comments from the Federal banking agencies, and collaboration with a committee of representative State credit union supervisors.

2. Statutory Timetable

CUMAA set deadlines for NCUA to issue proposed rules and final rules on PCA, and dates for those rules to take effect. Congress directed NCUA to commence rulemaking by issuing an Advance Notice of Proposed Rulemaking (ANPR) addressing only the ''risk-based net worth requirement'' for ''complex'' credit unions, no later than February 3, 1999. CUMAA § 301(d)(2)(A). To fulfill that requirement, NCUA issued an ANPR soliciting public comment not only on the ''risk-based net worth requirement'' for ''complex'' credit unions, but also regarding PCA for ''new'' credit unions and the contents, criteria, and deadlines for a Net Worth Restoration Plan. 63 FR 57938 (October 29, 1998). The great majority of the 34 comments NCUA received by the January 27, 1999, deadline addressed the risk-based net worth requirement for ''complex'' credit unions, which is not the subject of this rule.

CUMAA directs NCUA to propose rules for PCA (other than the ''risk-based net worth requirement'' for ''complex'' credit unions) no later than May 4, 1999, and to adopt final rules no later than February 7, 2000, to take effect August 7, 2000. CUMAA § 301(d)(1) and (e)(1). While no date is prescribed for a proposed rule on the ''risk-based net worth requirement'' for ''complex'' credit unions, NCUA is required to issue the final no later than August 7, 2000, to take effect January 1, 2001. CUMAA § 301(d)(2)(B) and (e)(2). NCUA plans to issue a proposed rule on the ''risk-based net worth requirement'' for ''complex'' credit unions in late 1999.

3. Report to Congress

CUMAA requires NCUA to report to Congress twice in the rulemaking process for prompt corrective action—-first when proposed rules are published, and again when final rules are adopted (February 7, 2000). CUMAA § 301(f); S. Rep. at 19; H.R. Rep. at 23. The report must explain how NCUA's implementing regulations establish a system of PCA which is consistent with the cooperative character of credit unions. CUMAA § 301(f)(1); see § 1790d(b)(1)(B). Further, the report must identify how NCUA's implementing regulations differ from FDIA § 38 and the reasons for those differences. CUMAA § 301(f)(2). NCUA expects to report that the proposed rule is comparable in nearly all respects to FDIA § 38, i.e., that it is parallel in substance and equivalent in rigor.

4. Notice of Proposed Rulemaking

Through this notice, NCUA invites public comment on all aspects of its proposed rule. Broad public input addressing the proposed rule will assist the NCUA Board in tailoring a system of prompt corrective action that is workable, fair and effective in light of the cooperative character of credit unions. See S. Rep. at 14. Although NCUA lacks discretion to modify the substance of components of prompt corrective action prescribed by statute, the proposed rule establishes a comprehensive array of discretionary restrictions and requirements adapted, with modifications, from FDIA § 38. Comments addressing these and other non-statutory components of the proposed rule—such as the contents and criteria for approval of a net worth restoration plan, and the alternative system of PCA for new credit unions-will be most helpful.

B. Framework of Proposed Rule

The proposed rule consists of four parts. Subpart A is the system of PCA for all federally-insured credit unions except those which meet the statutory definition of ''new.'' Subpart B is the alternative system of PCA which the statute required NCUA to develop exclusively for ''new'' credit unions. For ease of access, in subparts A and B, all of the supervisory actions which apply to a credit union in a particular net worth category are combined in a single section devoted exclusively to that category. The supervisory actions and corresponding net worth categories are depicted in Appendices A and B to the preamble of this rule. Subpart C restates certain reserve, dividend payment and other requirements, modified to facilitate the earnings retention requirement in subparts A and B. Finally, subpart L of part 747 provides for notice, review and enforcement of certain supervisory actions imposed under subparts A and B.

1. Net Worth Classification

Statutory net worth categories. Section 702.101(a) sets forth the five net worth categories which CUMAA establishes for all federally-insured credit unions, other than those which are ''new,'' and the corresponding net worth ratio of each. § 1790d(c). The range of net worth ratios for each net worth category (assuming no risk-based net worth requirement) and the percentage and number of federally-insured credit unions that fall within each category as of December 1998, are depicted as follows:

Net worth category	Net worth ratio	Percent of all FICUs	Number of all FICUs
''Well Capitalized''	7% or above	94.03	10,339
''Adequately Capitalized''	6% to 6.99%	2.80	308
''Undercapitalized''	4% to 5.99%	2.06	227
''Significantly Undercapitalized''	2% to 3.99%	0.59	65
''Critically Undercapitalized''	Less than 2%	0.51	56

Adjustment of Net Worth Category. Part 702 incorporates the two statutory criteria for requiring a downward adjustment of a credit union's original net worth category to a lower one.[4] §§ 702.101(a)(4)(B) and (a)(1)–(2). First, a credit union classified as ''undercapitalized,'' and which has a net worth ratio of less than 5%, must be downgraded to ''significantly undercapitalized'' if it fails to timely file or implement a Net Worth Restoration Plan.[5] § 1790d(c)(1)(D)(ii). See also § 702.109(g). Second, credit unions otherwise categorized as either ''well capitalized'' or ''adequately capitalized,'' and which meet the definition of ''complex,'' will be subject to a risk-based net worth requirement. § 1790d(c)(1)(A)(ii) and (c)(1)(B)(2). Credit unions which do not meet the risk-based requirement in either category are required to be reclassified ''undercapitalized.'' § 1790d(c)(1)(C)(ii).

Reclassification of Net Worth Category. Apart from statutory adjustment, CUMAA authorizes reclassification of a credit union on safety and soundness grounds, consistent with FDIA § 38(g). § 1790d(h). The proposed rule thus provides that the NCUA Board may reclassify to the next lower net worth category a credit union originally classified above ''significantly undercapitalized'' if that credit union is either in an unsafe or unsound condition or has failed to correct an unsafe or unsound practice. §§ 702.101(b) and 702.202(d). The authority to make a final decision to reclassify on these grounds cannot be delegated, § 1790d(h)(2), and when exercised, requires notice to the credit union and an opportunity to respond and to request an informal hearing. § 747.2003.

The statutory criteria for mandatory adjustment of a net worth category and for discretionary reclassification on safety and soundness grounds under part 702 are summarized as follows:

Original category	Additional criterion	Grounds to reclassify or adjust category	Adjusted or reclassified to . . .
''Well Capitalized''	Must be ''complex''.		
''Adequately Capitalized''	Must be ''complex''	Fails to meet risk-based net worth Requirement.	Adjusted to ''Undercapitalized''.
''Undercapitalized''	Net worth ratio less than 5%	Fails to timely file or implement Net Worth Restoration Plan.	''Significantly Undercapitalized''.
''Well Capitalized'' or ''Adequately Capitalized''.	None		Discretion to reclassify to next lower category.
''Undercapitalized'' or ''significantly undercapitalized''.	None	Unsafe or unsound	Discretion to treat as if in next lower category.
''Well Capitalized'' or ''Adequately Capitalized'' new credit union.	must be ''new''	condition or practice	Discretion to reclassify to next lower category.
''Moderately Capitalized'' or ''Marginally Capitalized'' new credit union.	Must be ''new''		Discretion to treat as if in next lower category.

Notice and effective date of net worth classification. Section 1790d is silent about how and when a credit union has notice of its net worth ratio and corresponding classification. Part 702 generally deems a credit union to have notice of its net worth ratio and to have become classified within the corresponding net worth category on a quarterly basis, coinciding with the end of the credit union's quarterly dividend period or every monthly dividend period, as the case may be. § 702.3(b)(1). This imposes no additional burden on credit unions because the net worth ratio is derived from their financial statements, which federally- and State-chartered credit unions already prepare monthly.[6] *See* Standard By-Law Art. VIII, § 5(d). Once a credit union has notice that a change in its net worth places it in a lower net worth category, the credit union must notify NCUA in writing within 15 days. § 702.3(c). A credit union may rely on NCUA or the appropriate State official for notice of its net worth category only when it is given in an examination report, notice of reclassification on safety and soundness grounds, or notice of adjustment to its net worth ratio to reflect an accounting adjustment. §§ 702.3(b)(2)–(3), 747.2003(a)(1)(ii).

2. Prompt Corrective Action by Net Worth Category

The following is a summary of the mandatory and discretionary supervisory actions that apply under part 702 to each statutory net worth category. These are also depicted in Appendix A and B to the preamble of this rule. Each supervisory action is explained in greater detail beginning in subsequent sections:

''Well Capitalized''. A credit union classified ''well capitalized'' under part 702 is subject to no prompt corrective action.

''Adequately Capitalized''. A credit union classified ''adequately capitalized'' must comply with a single mandatory supervisory action—an ''earnings retention requirement'' under which the credit union transfers to its regular reserve an amount of earnings equal to a proportion of the credit union's total assets. § 702.104. It is not subject to any discretionary supervisory actions.

''Undercapitalized''. A credit union classified ''undercapitalized'' must comply with four mandatory supervisory actions—

- Transfer of earnings to its regular reserve an amount of earnings equal to no less than 4/10ths percent of the credit union's average total assets;
- Restrict total assets to the average of the credit union's assets over the preceding 12 calendar months (unless

[4] Apart from adjustments to net worth category classification, the proposed rule gives NCUA the authority to adjust a credit union's net worth net worth ratio to reflect the impact of certain accounting adjustments. § 702.3(d).

[5] 5% falls mid-way between the 4% floor of the ''undercapitalized'' category and its 5.99% ceiling. See § 702.101(a)(3). An ''undercapitalized'' credit union having a new worth ratio of between 5% and 5.99% is not subject to a downward adjustment for failure to timely file or implement at New Worth Restoration Plan, although it would be subject to other means of enforcement.

[6] Federal depository institutions rely on quarterly Call Reports to determine the ''leverage ratio'' (the equivalent of a net worth ratio) on a quarterly basis. Part 702 does not rely on Call Reports to determine credit union's net worth because only credit unions having $50 million or more in assets file them quarterly, 12 CFR 741.6(a); other credit unions file Call Reports semi-annually.

an approved Net Worth Restoration Plan provides for increasing assets);

• Submit and implement a Net Worth Restoration Plan; and

• Restrict the making of member business loans (unless primarily in the business of making such loans.

§ 702.105(a). An ''undercapitalized'' credit union also is subject to one or more of the following discretionary supervisory actions which NCUA is authorized to impose to further the purpose of part 702: Prior approval by NCUA for acquisitions, branching, new lines of business.

• Restrict CUSO transactions and ownership.

• Restrict dividends paid on shares.

• Prohibit asset growth or reduce it (below the preceding year's average.

• Alter, terminate or reduce any activity.

• Prohibit nonmember deposits.

• Other actions no more severe than the preceding discretionary actions.

• Order new election of board of directors.

• Dismiss directors or senior executive officers.

• Require employment of qualified senior executive officers.

§ 702.105(b).

''Significantly Undercapitalized''. Credit unions classified ''significantly undercapitalized'' are subject to all of the same mandatory and discretionary supervisory actions as an ''undercapitalized'' credit union, except for the ''no more severe'' limitation on ''other actions'' taken in addition to those enumerated for that category. § 702.106(a)-(b). A ''significantly undercapitalized'' credit union also is subject to the following additional discretionary supervisory actions:

• Restrict senior executive officers' compensation and bonus.

• Require merger with another financial institution if grounds exist for conservatorship or liquidation.

§ 702.106(b)(7) and (9).

Apart from these mandatory and discretionary supervisory actions, the NCUA Board may place a ''significantly undercapitalized'' credit union into conservatorship or liquidation if it ''has no reasonable prospect of becoming 'adequately capitalized'.'' § 702.106(c); 12 U.S.C. 1786(h)(1)(f), 1787(a)(3)(A)(i).

''Critically Undercapitalized''. A credit union classified ''critically undercapitalized'' is subject to all of the same mandatory and discretionary supervisory actions as a ''significantly undercapitalized'' credit union. § 702.107(a)–(b). A ''critically undercapitalized'' credit union also is subject to the following additional discretionary supervisory actions:

• Restrict payments on uninsured secondary capital.

• Require NCUA prior approval for certain actions.

§ 702.107(b)(9)-(10).

Apart from these mandatory and discretionary supervisory actions, the NCUA Board must place a ''critically undercapitalized'' credit union into conservatorship or liquidation within 90 days, unless the NCUA Board determines that other corrective action in lieu of conservatorship or liquidation would better achieve the purposes of prompt corrective action. § 702.107(c)(1). That determination expires at the end of a period of no more than 180 days, § 702.107(c)(1)(C), and if not affirmed within that period, the credit union must be conserved or liquidated. § 702.107(c)(2). Even if that determination is renewed for another period of up to 180 days, the NCUA Board must conserve or liquidate a ''critically undercapitalized'' credit union which remains in that category on average for a full calendar quarter following a period of 18 months from the date it initially became ''critically undercapitalized, § 702.107(c)(3)(i), unless certain statutory requirements for an exception are met. § 702.07(c)(3)(ii).

3. Proposed Rule Provisions Applicable to All Credit Unions

The following provisions of part 702 form the framework of prompt corrective action under both subparts A and B, and apply to all net worth categories:

Definitions. Section 702.2 adopts the statutory definitions set forth in § 1790d(o), with four additions. First, the term ''appropriate State official'' is defined so as to abbreviate references throughout part 702. § 702.2(a). Second, the definition of ''Credit Union Service Organization'' (CUSO) is expanded beyond the existing definition, 12 C.F.R. 712.3(a), which is limited to federally-chartered credit unions. § 702.2(c). This will ensure that CUSOs of federally-insured State-chartered credit unions are within the scope of discretionary restrictions on CUSO transactions and ownership. E.g., § 702.105(b)(2). Third, the terms ''credit union'' and ''shares'' are defined to ensure that part 702 encompasses State-chartered credit unions and analogous terms for shares under applicable State law. § 702.2(b) and (h). Finally, the term ''total assets' is defined as the average of total assets reported by a credit union on its most recent four quarterly Call Reports, or for semiannual filers, on its two most recent semi-annual Call Reports. § 702.2(i).

The statutory definition of ''net worth''—''retained earnings balance of the credit union, as determined under generally accepted accounting principles [GAAP]''—will in some cases distort the ''net worth ratio'' as a true measure of actual capital strength. § 702.2(e); § 1790d(o)(2)(A). The GAAP definition of ''retained earnings'' does not include items of ''other comprehensive income'' such as unrealized gains or losses on available-for-sale (AFS) securities (Call Report account 945).[7] As a result, when the fair value of AFS securities falls, that reduction is not reflected in net worth, artificially overstating the credit union's ''net worth ratio'' and possibly forestalling appropriate prompt corrective action.[8] In response to this dilemma, the proposed rule authorizes the NCUA Board to adjust a credit union's net worth ratio to reflect accounting adjustments such as gains and losses in the fair value of AFS securities. § 702.203(d).

Consultation With State Officials. Part 702 tracks the statutory requirement that NCUA consult with the appropriate State credit union official when taking prompt corrective action against a federally-insured State-chartered credit union (FISCU). § 1790d(l). Before placing a FISCU into conservatorship or liquidation to facilitate prompt corrective action, NCUA must consult with the appropriate State official, provide reasons for the proposed action, give the official an opportunity to respond, and allow the official to place the FISCU into conservatorship or liquidation. § 702.108(a). If the State official does not concur in the conservatorship or liquidation decision, the NCUA Board cannot proceed unless it makes certain findings of risk of loss to the NCUSIF. § 702.108(a)(3); see also 12 U.S.C. 1786(h)(2)(C), 1787(b).

[7] Under GAAP, ''retained earnings'' consists of undivided earnings, statutory reserves, and other appropriations as defined by management or regulatory authorities. AICPA, *Audit & Accounting Guide: Audits of Credit Unions* at § 11.01 (1998).

[8] For example, assume a credit union has retained earnings under GAAP of $6500 and total assets of $100,000; it would have a net worth ratio of 6.5% and would be classified ''adequately capitalized.'' Assume that during the next quarter, the credit union experiences an $8,000 decrease in the fair value of its available-for-sale (AFS) securities. This unrealized loss would be reflected in total assets (the denominator of the net worth ratio), reducing them to $92,000. However, under the statutory definition of ''net worth,'' the unrealized loss would not be reflected at all in retained earnings (the numerator of the net worth ratio), and would still be $6500. As result, the credit union would have a net worth ratio of 7.06% and be classified ''well capitalized'' despite having sustained a decline in the fair value of its AFS securities. Conversely, an understated net worth ratio results when the credit union experiences an unrealized gain in the fair value of its AFS securities.

To satisfy the requirement that NCUA ''consult and seek to work cooperatively with State officials'' when implementing prompt corrective action, § 1790d(I)(1), part 702 generally provides throughout for participation by the appropriate State official in decisions about a FISCU on which prompt corrective action is predicated. Specifically, part 702 provides that NCUA ''shall notify the appropriate State official before taking any discretionary action'' concerning a FISCU and ''shall allow the appropriate State official to take the proposed action independently or jointly with NCUA.'' § 702.108(c). When evaluating a FISCU's Net Worth Restoration Plan, NCUA must consult with State officials. § 702.109(d)(2). To facilitate consultation, a FISCU which submits a Net Worth Restoration Plan to NCUA must submit a duplicate to the appropriate State official. § 702.109(a)(1). When a FISCU, or an official who it has been ordered to dismiss, seeks review of a decision to impose a discretionary supervisory action, the appropriate State official must be served with a copy of all notices and decisions issued by NCUA, and responses and requests filed by the FISCU or its official. § 747.2001(b).

C. Mandatory and Discretionary Supervisory Actions

1. Mandatory Actions Prescribed by Statute

Under the proposed rule, each of the following mandatory supervisory actions is a self-executing legal obligation of a credit union once it is classified within a net worth category requires that action. The legal obligation is not triggered by notification from NCUA.

Earnings transfer to regular reserve. The proposed rule adopts the mandatory ''earnings retention requirement'' under which credit unions classified ''adequately capitalized'' or lower must ''annually set aside as net worth an amount equal to not less than 0.4% of its total assets.'' § 1790d(e)(1). However, CUMAA does not answer how or when a credit union's total assets should be measured for this purpose, or where the earnings set aside should be held. To measure ''total assets,'' part 702 uses the average of the credit union's total assets as set forth in its most recent four quarterly Call Reports or most recent two semi-annual Call Reports, as the case may be. § 702.2(i). Measuring total assets on a single day, such as the last day the prior quarter or prior year, would not take into account seasonal fluctuations in asset size. The rule also directs that the resulting amount of earnings to be set aside over the ensuing year is to be transferred in installments to the credit union's regular reserve. A credit union having a monthly dividend period for regular shares must make monthly transfers of at least 8.334%, or 1/12th , of the annual sum. § 702.104(a)(1). A credit union having a quarterly or less frequent dividend period for regular shares must make a quarterly transfer of at least 25%, or ¼ of the annual sum. § 702.104(a)(2).

Part 702 also amplifies the terms of the statutory exception to the 0.4% minimum set aside. § 1790d(e)(2). First, the NCUA Board interprets the phrase ''by order'' to indicate that exceptions to 0.4% statutory minimum are to be granted on a case-by-case basis. § 702.104(b). Second, the proposed rule implements the mandate to ''periodically review any order'' decreasing the 0.4% statutory minimum by requiring ''review and revocation no less frequently than quarterly,'' to coincide with the dividend period for regular shares which is common among credit unions. *Id.*

Net Worth Restoration Plan. The requirement to implement a Net Worth Restoration Plan (NWRP) emerges as the hallmark of prompt corrective action. To restore a credit union's net worth to the ''adequately capitalized'' level, CUMAA provides that credit unions classified ''undercapitalized'' or lower must timely submit to the NCUA Board and implement a NWRP. § 1790d(f)(1). The statute requires NCUA to establish ''reasonable'' deadlines for submission of NWRPs; set ''expeditious'' deadlines for NCUA to act on them; allow credit unions which fail to timely submit an NWRP a further opportunity to do so; and allow a credit union whose NWRP is not approved an opportunity to submit a revised NWRP. § 1790d(f)(3)–(4). Further, credit unions having less than $10 million in assets are entitled to receive assistance in preparing an NWRP. § 1790d(f)(2).

To fulfill this mandate, the proposed rule sets a 45-day period for submitting an NWRP, and if that deadline is not met, allows an additional 15 days to submit an NWRP. § 702.109(a)(1). The NCUA Board is required to act on an initial NWRP within 60 days, and to provide reasons in the event of disapproval. § 702.109(e)(1). When an initial NWRP is not approved, the credit union is given 30 days to file a revised NWRP, on which the NCUA Board is required to act within 30 days of receipt. § 702.109(f). The periods for submission and review of an initial NWRP parallel those which FDIA § 38(e)(2)(D)(ii) sets for ''capital restoration plans''—the federally-insured depository institutions' analog to an NWRP—and are consistent with comments on the topic received in response to the ANPR. The NCUA Board has declined to set a deadline by which a credit union having less than $10 million in assets must request assistance in preparing an NWRP; under the proposed rule, NCUA will provide assistance simply ''upon timely request.'' § 702.109(b).

CUMAA is silent as to the contents of an NWRP, and sets just a single standard for approving one. § 1790d(f)(5). As comments received in response to the ANPR suggested, the NCUA Board has examined the contents and criteria that FDIA § 38 prescribes for a ''capital restoration plan.'' With certain additions and adjustments to distinguish between credit unions and other depository institutions, the NCUA Board proposes to require for an NWRP much of the content information that FDIA § 38(e)(2)(B) demands of a ''capital restoration plan.'' Accordingly, section 702.109(c) requires a proposed NWRP to specify—

- The steps the credit union will take to become ''adequately capitalized'';
- A specific timetable for increasing net worth during each year in which the NWRP will be in effect;
- How the credit union will comply with the mandatory and discretionary restrictions or requirements imposed on it under this part;
- The types and levels of activities in which the credit union will engage;
- The amount of earnings the credit union will transfer to its regular reserve account pursuant to the earnings retention requirement in section 702.104; and
- In the case of a plan submitted by a credit union which has been reclassified under § 702.101(b) on safety and soundness grounds, the steps the credit union will take to correct the unsafe or unsound practice(s) or condition(s).

§ 702.109(c)(1) (i)–(vi).

Finally, an NWRP must be accompanied by pro-forma financial statements covering the next two years, and financial data submitted in connection with an NWRP must generally conform to GAAP. § 702.109 (c)(2) and (c)(4).

Similarly, to supplement the single statutory criterion for approval of a NWRP—that it be ''based on realistic assumptions'' and be ''likely to succeed in restoring * * * net worth''—the NCUA Board proposes to adopt as appropriate for approving an NWRP the additional criteria which FDIA

§ 38(e)(2)(c) establishes for accepting a ''capital restoration plan,'' with significant modifications addressed below. To be approved, section 702.109(d) requires an NWRP to—

- Be based on realistic assumptions and likely to succeed in restoring net worth;
- Comply with content requirements in section 702.109(c);
- Not unreasonably increase the credit union's exposure to risk (including credit risk, interest-rate risk, and other types of risk); and be supported by appropriate assurances from the credit union that it will comply with the plan until it has remained ''adequately capitalized'' for four (4) consecutive calendar quarters.

Whereas a ''capital restoration plan'' cannot ''appreciably increase'' risk exposure, an NWRP must ''not unreasonably increase the credit union's exposure to risk.'' (emphasis added.) Compare FDIA § 38(e)(2)(C)(I)(III) with § 702.109(d)(3). This permits a credit union with little or no risk exposure to incur reasonable exposure to improve net worth. Approval of a ''capital plan'' requires a financial ''guarantee'' of compliance until ''the institution becomes adequately capitalized on average during each of 4 consecutive calendar quarters,'' and ''appropriate assurances'' of performance. FDIA § 38(e)(2)(c)(ii). Section 702.109(d)(4) combines and condenses this pair of requirements into a single, criterion appropriate for credit unions—requiring ''appropriate assurances'' of compliance with the NWRP until the credit union ''has remained 'adequately capitalized' for four (4) consecutive calendar quarters'' on an absolute basis rather than just on average. The NCUA Board may delegate to its Regional Directors the authority to evaluate an NWRP according to the proposed criteria.

Restriction on increase in assets. Part 702 adopts CUMAA's limitation on increasing assets, which provides that a credit union classified ''undercapitalized'' or lower shall ''not generally permit its average total assets to increase'' unless doing so is consistent with the credit union's approved NWRP and the credit union increases assets and net worth at the rate the Plan prescribes. § 1790d(g)(1); § 702.105(a)(3). However, the statute does not specify the period over which ''average total assets'' should be calculated for purposes of limiting asset growth. Therefore, to avoid seasonal fluctuations in asset size, section 702.105(a)(3) relies on the definition of total assets in section 702.2(i).

In many cases, at the time a credit union becomes subject to the limit on increasing assets, its total assets already will exceed the average for the preceding twelve months, raising the question whether it should be required to reduce assets to that level. Section 702.105(b)(4) gives the NCUA Board discretionary authority to prohibit a credit union classified ''undercapitalized'' or lower from increasing its total assets or an individual category of assets beyond an absolute level, or even to require the credit union to reduce total assets or a category of assets. Due to the availability of this complementary restriction, the NCUA Board declines to interpret the statutory asset limitation as requiring a reduction in assets to the level of average total assets over the preceding 12 months.

Restriction on increase in member business loans. CUMAA prohibits credit unions classified ''undercapitalized'' or lower from ''mak[ing] any increase in the total amount of member business loans * * * outstanding at that credit union at any one time * * *'' 1790d(g)(2). This imposes a freeze on member business lending, rather than confining it to an average. Part 702 incorporates within this restriction the exemptions Title II of CUMAA prescribes for ''a credit union chartered for the purpose of making, or that has a history of primarily making, member business loans to its members,'' or which is designated low income, or which participates in the Community Development Financial Institutions program. 12 U.S.C. 1757a(b). Applying these exemptions to the proposed rule's member business loan restriction will ensure that prompt corrective action does not defeat the net worth restoration efforts of credit unions which rely heavily on member business lending.

Part 702's member business loan restriction is imposed ''[n]otwithstanding'' the Title II maximum on member business loans—1.75 times net worth for less than ''well capitalized'' credit unions; 12.25% of assets for those which are ''well capitalized'' (but not ''complex''). 12 U.S.C. 1757a(a)(1). This makes it clear that the part 702 restriction is overriding. Thus, a credit union cannot claim to be entitled to increase member business loans to the Title II maximum before the part 702 restriction can take effect.

Conservatorship and Liquidation. CUMAA prescribes criteria for allowing and for mandating conservatorship and liquidation of a credit union classified ''significantly undercapitalized'' or ''critically undercapitalized,'' § 1790d(i)(1)–(2), and amends the FCUA accordingly. CUMAA § 301(b). Section 702.106(b) faithfully reflects the statutory authority to place a ''significantly undercapitalized'' credit union into conservatorship or liquidation to facilitate prompt corrective action upon finding that the credit union ''has no reasonable prospect of becoming adequately capitalized.'' 12 U.S.C. 1786(h)(1)(F), 1787(a)(3)(A)(i).

In the case of a ''critically undercapitalized'' credit union, regardless of its prospect of becoming ''adequately capitalized,'' the NCUA Board must—

> not later than 90 days after the date on which an insured credit union becomes critically undercapitalized—
>
> (A) appoint a conservator or liquidating agent for the credit union; or (B) take such other action as the Board determines would better achieve the purpose of [§ 1790d], after documenting why the action would better achieve that purpose.

§ 1790d(i)(1). Section 702.107(c) restates this mandate.

The statute provides that the determination to take other corrective action shall ''cease to be effective not later than the end of the 180-day period beginning on the date on which the determination is made,'' and the credit union shall be placed into conservatorship or liquidation ''unless the Board makes a new determination * * * before the end of the effective period of the prior determination'' that continuing other corrective action will further the purpose of § 1790d. § 1790d(d)(2). Section 702.107(c)(2) implements this procedure for renewing other corrective action in lieu of conservatorship and liquidation. The NCUA Board interprets the ''documenting'' prerequisite for initially taking other corrective action as setting a standard for renewing that determination.

Regardless whether other corrective action restores net worth, the NCUA Board is required by statute to place the credit union into liquidation ''if [it] is critically undercapitalized on average during the calendar quarter beginning 18 months after the date on which the credit union became critically undercapitalized.'' § 1790d(i)(3)(A). An exception to mandatory liquidation is allowed, however, and other corrective action may continue, if the NCUA Board makes three findings:

- That the credit union has substantially complied with a Net Worth Restoration Plan requiring improvement in net worth since the date the plan was approved;

• That the credit union has positive net income or a sustainable upward trend in earnings; and

• That the credit union is viable and not expected to fail.

§ 1790d(i)(3)(B).

The mandate for liquidation of a ''critically undercapitalized'' credit union after 18 months, and the grounds for an exception to it, are incorporated in section 702.107(c)(3).[9]

Although faithful to the statutory language, section 702.107(c) is phrased to reveal flexibility that may not be apparent. First, the effective period of a determination to take ''other corrective action'' need not extend for the maximum duration of 180 days. The NCUA Board has the discretion to establish a shorter effective period. Further, the NCUA Board may reconsider any determination periodically, and reverse and discontinue the ''other corrective action'' altogether. To continue the action beyond an effective period, the NCUA Board must make a new finding prior to the end of the effective period that its ''other corrective action'' still furthers the purpose of prompt corrective action. If the new finding is made, the ''other corrective action'' can continue for a new effective period that is appropriate to achieve the ''other corrective action,'' which the NCUA Board may specify as any period of up to 180 days from the date of the determination. The new determination still can be reconsidered periodically, and renewed for an additional effective period or discontinued.

Second, if the credit union first became ''critically undercapitalized'' at the end of a calendar quarter, the last possible day for ''other corrective action'' may be as soon as 18 months plus 3 months of the next calendar quarter, for a total of 21 months. If the date the credit union first became ''critically undercapitalized'' was other than the end of a calendar quarter, the last possible day for ''other corrective action'' would extend to the end of the calendar quarter following the 21 months, for a total of up to 23 months.[10]

2. Discretionary Actions Under Statutory Authority

CUMAA requires NCUA to develop discretionary supervisory actions to complement the mandatory ones it prescribes, provided they are consistent with the purpose of prompt corrective action, and are ''comparable'' to the ''discretionary safeguards'' in FDIA § 38. § 1790d(b)(1)(A). The discretionary supervisory actions NCUA proposes are generally allocated among the five statutory net worth categories in part 702 by corresponding capital category in FDIA § 38.[11] Throughout the proposed rule, the use of discretionary actions is conditioned upon furthering the purpose of part 702. However, NCUA is not required to give mandatory supervisory actions an opportunity to improve net worth before resorting to discretionary actions. Except as noted, there is no limit to the number or sequence in which the NCUA Board imposes one or more discretionary actions. Each discretionary requirement and restriction is adapted as follows from FDIA § 38 with appropriate modifications to suit the distinct features of credit unions in the net worth categories established by statute and those developed for ''new'' credit unions:

PART 702—DISCRETIONARY SUPERVISORY ACTIONS

Discretionary supervisory action	Applies in which statutory and ''new'' net worth categories	Comparison with FDIA § 38 and appropriateness of discretionary actions for credit unions.
1. Requiring NCUA prior approval for acquisitions, branching, new lines of business.	*Statutory:* ''Undercapitalized'' and lower. *New:* ''Moderately Capitalized'' and lower.	NCUA may prohibit a credit union ''from, directly or indirectly, acquiring any interest in any CUSO or credit union, establishing or acquiring any additional branch office, or engaging in any new line of business unless the NCUA Board has approved the credit union's net worth restoration plan, the credit union is implementing its plan, and the NCUA Board determines that the proposed action is consistent with and will further the objectives of that plan.'' § 702.105(b)(1). This authority extends to ownership interests in a CUSO and is a discretionary supervisory action in part 702, whereas in FDIA § 38 the approval plan is a mandatory supervisory action.
2. Restricting transactions with and ownership of CUSOs.	*Statutory:* ''Undercapitalized'' and lower. *New:* ''Moderately Capitalized'' and lower.	NCUA may restrict transactions between a credit union and its wholly- or partially-owned CUSO(s), and require that credit union to reduce or divest its ownership interest in a CUSO. § 702.105(b)(2). This is an analog to FDIA § 38(f)(2)(B), which restricts a depository institution from transactions with its affiliate institutions. The authority to require a credit union to reduce or divest it ownership interest in a CUSO is appropriate because CUSO ownership can be a drain on the credit union's financial resources and attention at a time when both need to be devoted to improving net worth.
3. Restricting dividends paid.	*Statutory:* ''Undercapitalized'' and lower. *New:* ''Moderately Capitalized'' and lower.	NCUA may restrict the dividend rates a credit union pays on shares to the prevailing rates paid on comparable accounts and maturities in the region where the credit union is located, but may not apply this restriction retroactively to dividends on shares already issued. § 702.105(b)(3). This is an analog to the FDIA § 38(f)(2)(c), which imposes the same restriction on interest rates. In order not to undermine the ability of a credit union to attract new members, the rate reduction is limited to ''prevailing rates paid on comparable accounts'' in the region, thus permitting a credit union to remain competitive in the rates it pays.

[9] The authority to elect among conservatorship, liquidation, or other action concerning a ''critically undercapitalized'' credit union cannot be delegated unless the credit union has less than $5,000,000 in assets. § 1790d(l)(4)(A). If made by delegation, the decision is directly appealable to the NCUA Board. § 1790d(i)(4)(B); § 702.107(c)(4). Finally, a ''significantly undercapitalized'' or ''critically undercapitalized'' credit union which is placed into conservatorship or liquidation under part 702 retains the right to challenge NCUA Board's decision in court within 10 days. 12 U.S.C. 1786(h)(3), 1787(a)(1)(b).

[10] In any event, a credit union's net worth ratio need only average 2% or more over the full calendar quarter following 18 months from the date the credit union was first classified ''critically undercapitalized.''

[11] The Federal banking agencies' Joint Final Rule does not restate or establish by regulation the ''discretionary safeguards'' prescribed in FDIA § 38; it merely incorporates them by general reference to the statute. See, e.g., 12 CFR 325.105(a)(2). However, FDIA § 38(b)(1)'s five capital categories and corresponding range of ''leverage ratios'' (the equivalent of a net worth ratio) are the same as part 702's five net worth categories and corresponding range of net worth ratios. Compare FDIA § 38(b)(1) with § 1790d(c); see e.g., 12 CFR 325.103(b).

PART 702—DISCRETIONARY SUPERVISORY ACTIONS—Continued

Discretionary supervisory action	Applies in which statutory and ''new'' net worth categories	Comparison with FDIA § 38 and appropriateness of discretionary actions for credit unions.
4. Prohibiting or reducing asset growth.	*Statutory:* ''Undercapitalized'' and lower. *New:* ''Moderately Capitalized'' and lower.	NCUA may place an absolute limit on increases in assets generally or on increases in a particular asset category, or may compel the credit union to reduce its total assets or a certain category of assets. § 702.105(b)(4). This is a modified version of the FDIA provision ''restricting the institution's asset growth more stringently'' than limiting increases in total average assets. FDIA § 38(f)(2)(D). This authority is appropriate for credit unions because it can be targeted to limit growth in one or more specific asset categories and complements the mandatory action limiting assets to total average assets. See § 702.105(a)(3).
5. Alter, reduce or terminate any activity by credit union or its CUSO.	*Statutory:* ''Undercapitalized'' and lower. *New:* ''Moderately Capitalized'' and lower.	NCUA may compel a credit union to alter, reduce or terminate any activity in which it or its CUSO engages. §§ 702.105(b)(5), 702.106(b)(5), 702.107(b)(5). This is adapted from FDIA's similar restriction, but is extended to CUSOs and is without the prerequisite that the subject activity poses ''excessive risk to the institution. '' FDIA § 38(f)(2)(E). This is appropriate for credit unions because activities which may not be excessively risky still may distract the attention of management, compromise a CUSOs internal controls, or pose cost efficiency or conflict of interest problems—all of which can impact on net worth.
6. Prohibiting nonmember deposits.	*Statutory:* ''Undercapitalized'' and lower. *New:* ''Moderately Capitalized'' and lower.	NCUA may prohibit a credit union from accepting all or certain nonmember deposits as otherwise permitted under 12 U.S.C. 1757(6) and 12 CFR 701.32. § 702.105(b)(6). This is an analog to the FDIA § 38 provision prohibiting deposits from correspondent banks. FDIA § 38(f)(2)(G). This restriction may serve a critical purpose for credit unions when large nonmember depositors are unduly influential in credit union affairs affecting its net worth.
7. Other actions to further the purpose of part 702.	*Statutory:* ''Undercapitalized'' and lower. *New:* ''Moderately Capitalized'' and lower.	NCUA may ''restrict or require such other action as [it] determines will carry out the purpose of [part 702] better than any of the [discretionary] actions prescribed [for that category.]'' §§ 702.106(b)(10), 702.107(b)(11). For the ''undercapitalized'' category only, however, ''such other restriction or requirement [must be] no more severe than the [other discretionary] actions prescribed'' for that category. § 702.105(b)(7). FDIA § 38(f)(2)(J) is analogous, but without the ''no more severe'' limitation. NCUA has added the ''no more severe'' limitation to ensure that in the case of an ''undercapitalized'' credit union—whose net worth ratio may, for example, be just tens of basis points short of ''adequately capitalized''—that the least intrusive means is used to further the purpose of part 702. This is not the case with ''significantly undercapitalized'' and ''critically undercapitalized'' credit unions, who, by definition, are not near to being ''adequately capitalized.''
8. Ordering new election of board of directors.	*Statutory:* ''Undercapitalized'' and lower. *New:* ''Moderately Capitalized'' and lower.	As one means of improving management, NCUA may compel a credit union to hold a new election of its board of directors. § 702.105(c)(1). FDIA § 38(f)(2)(F)(i) is identical. This action is an appropriate means of improving management where the board of directors is determined to be responsible for a net worth deficiency and is either unwilling or not capable of taking action needed to correct the deficiency. NCUA intervention is minimal because a new election gives the credit union membership an opportunity to change member representation on the board of directors, possibly eliminating the need for further action by NCUA. For ''undercapitalized'' credit unions only, this and other means of ''improving management'' may be imposed only after NCUA takes one or more of the discretionary prescribed for that category (i.e., § 702.105(b)(1)–(7)) or determines that none of those actions would further the purpose of part 702.[12] § 702.105(c). Similarly to ''other actions'' in paragraph 7 above, this is to ensure that the least extreme discretionary action is used in the case of a credit union whose net worth ratio may fall just short of being ''adequately capitalized.''
9. Dismissing directors or senior executive officers.	*Statutory:* ''Undercapitalized'' and lower. *New:* ''Moderately Capitalized'' and lower.	As a second means of improving management, NCUA may require a credit union to dismiss one or more directors or senior executive officers. § 702.105(c)(2). This action is appropriate when a surgical approach to replacing management is warranted. FDIA § 38(f)(2)(F)(ii) is identical, except that it provides a period of protection from dismissal for persons who have held office 180 or fewer days prior to the date the institution was classified ''undercapitalized'' or lower. The theory behind this period of protection from dismissal is that such persons have not held office long enough to be responsible for net worth problems causing the institution to be classified ''undercapitalized'' or lower. NCUA proposes to eliminate this period of protection so that no official who is responsible for a credit union's rapidly declining net worth, or who is incapable reversing the decline, can have a ''safe harbor'' from dismissal. This action is subject to the prerequisite only in the ''undercapitalized'' category that other discretionary actions in that category be used first or be determined not to further the purpose of part 702. Subpart L of part 747 provides a specific review procedure for dismissals pursuant to this action. 12 CFR 747.2004.
10. Employing qualified senior executive officers.	*Statutory:* ''Undercapitalized'' and lower. *New:* ''Moderately Capitalized'' and lower.	As a third means of improving management, NCUA may require the credit union to employ qualified senior executive officers, who may be subject to the NCUA Board's approval. § 702.105(c)(3). FDIA § 38(f)(2)(F)(iii) is identical. This action can be a means of supplementing existing management, or replacing a dismissed officer, with persons who are competent to deal with and to correct the causes of declining net worth. NCUA can authorize the credit union to identify and to hire a sufficiently qualified person, or NCUA may condition hiring upon its approval of the credit union's candidate. This action is subject to the prerequisite in the ''undercapitalized'' category only that other discretionary actions in that category be used first or be determined not to further the purpose of part 702.

PART 702—DISCRETIONARY SUPERVISORY ACTIONS—Continued

Discretionary supervisory action	Applies in which statutory and ''new'' net worth categories	Comparison with FDIA § 38 and appropriateness of discretionary actions for credit unions.
11. Restricting senior executive officers' compensation and bonus.	*Statutory:* ''Significantly Undercapitalized'' and lower. *New:* ''Marginally Capitalized'' and lower.	NCUA may limit or reduce the compensation a credit union pays to its senior executive officers; limit, reduce, or prohibit bonuses paid to such officers; or condition payment of either compensation or a bonus upon NCUA approval. §§ 702.106(b)(7), 702.107(b)(7). FDIA § 38(f)(4)(A) is similar except that it does not authorize unilaterally limiting, reducing or prohibiting compensation or bonuses. Instead, it provides for approval by the appropriate Federal banking agency for compensation in excess of the officer's average compensation over the 12 calendar months preceding classification of the credit union as ''significantly undercapitalized'' or lower, and for a bonus in any amount. Such approval for either is prohibited if an institution has failed to submit an acceptable ''capital restoration plan.'' FDIA § 38(f)(4)(B).
12. Requiring merger if grounds exist for conser-vatorship or liquidation.	*Statutory:* ''Significantly Undercapitalized'' and lower. *New:* ''Marginally Capitalized'' and lower.	NCUA may require a credit union to merge with another financial institution, but only if grounds exist to place the credit union into conservatorship or liquidation. § 702.106(b)(9), 702.107(b)(9). The statutory grounds for conserving or liquidating a ''significantly undercapitalized'' or ''critically undercapitalized'' credit union to facilitate prompt corrective action is whether the credit union has a reasonable prospect of becoming ''adequately capitalized.'' 12 U.S.C. 1786(h)(1)(F), 1787(a)(3)(A)(i). FDIA § 38(f)(2)(A)(iii) is analogous, requiring an institution to be acquired by a depository institution holding company, or to combine with another depository institution if grounds exist for conservatorship or receivership. This action is appropriate for credit unions because NCUA's insistence on merger with another financial institution gives credit union management the opportunity to consummate a merger to avoid inevitable conservatorship or liquidation, thereby permitting the credit union to survive in merged form.
13. Restrict payments on uninsured secondary capital.	*Statutory:* ''Critically Undercapitalized''. *New:* ''Minimally Capitalized'' and ''Uncapitalized''.	NCUA may prohibit a credit union, beginning 60 days after it becomes ''critically undercapitalized'', from making payments of principal or interest on uninsured secondary capital.'' § 702.107(b)(9). This is analogous to FDIA § 38(h)(2)'s restriction on payment of principal and interest on subordinated debt. However, for Federal banking agencies that restriction is a mandatory supervisory action, whereas in part 702 it is discretionary. This restriction will have limited effect because only low-income credit unions are permitted by law to accept uninsured secondary capital. 12 U.S.C. 1757(6).
14. Require NCUA prior approval for certain actions.	*Statutory:* ''Critically Undercapitalized''. *New:* ''Minimally Capitalized'' and ''Uncapitalized''.	NCUA may require a credit union to obtain its approval before engaging in certain activities on the operational level, such as entering into a material transaction outside the normal course of business, amending by-laws, or changing accounting methods. § 702.107(b)(10). FDIA § 38(i) imposes a similar ''prior approval'' requirement which addresses the same actions and a few others not relevant to credit unions.

[12] The ''prerequisite'' provisions in the proposed rule—§§ 702.104(b)(7) and (c), 702.105(b)(10), 702.106(b)(10), 702.107(b)(11)—requiring certain discretionary actions to be taken before other more stringent or intrusive discretionary actions, are modeled conversely to FDIA § 38(f)(3), which establishes a ''presumption in favor of certain actions'' (requiring merger, restricting transactions with affiliates, and restricting interest rates) which are relatively more stringent than other available discretionary actions.

D. Alternative Prompt Corrective Action for New Credit Unions

CUMAA charged NCUA with the responsibility of developing ''a system of prompt corrective action that shall apply to new credit unions'' in lieu of the system of statutory PCA applicable to all other federally-insured credit unions. § 1790d(b)(2)(A). The statute defines a ''new'' credit union as having been in operation for less than 10 years and having $10 million or less in assets, § 1790d(o)(4). In addition, it requires the alternative system of PCA for new credit unions to:

- Recognize that new credit unions initially have no net worth, and must be given reasonable time to accumulate net worth;
- Create adequate incentives for new credit unions to become ''adequately capitalized'' by the time they either are in operation for more than 10 years or reach $10 million in total assets;
- Impose appropriate restrictions and requirements on new credit unions that do not make sufficient progress toward becoming ''adequately capitalized''; and
- Prevent evasion of the purpose of part 702.

§ 1790d(b)(2)(B).

In carrying out this mandate, the NCUA Board has relied upon two resources—comments on the topic in response to the ANPR and the advice of a ''new'' credit union committee assembled by NCUA for the purpose of studying field staff experience in dealing with new credit unions over the last decade. Among the members of the committee is a combined 81 years of field experience with credit unions and 10 years of private sector credit union experience.

A consensus of ANPR comments recommended that NCUA create a system of PCA for new credit unions which—

- Follows a modified ''net worth category'' model;
- Allows for gradual capital accumulation;
- Allows new credit unions to have no net worth in the early years;
- Sets no minimum on earnings transfers to the regular reserve; and
- Allows regulatory forbearance in imposing supervisory actions.

Based on field experience with new credit unions over the last 10 years, the ''new'' credit union committee made the following findings:

- The ability to accumulate capital through earnings is limited during a new credit union's early years of operation due to small asset size, the low ratio of loans to assets, and high fixed expenses;
- Historical data and field experience indicate that it takes between 3 and 5 years for a new credit union to accumulate a net worth of 2%;
- A business plan which establishes a strategy for achieving operational and financial objectives, and which is revised on an ongoing basis to reflect changing business conditions, is essential;

• A credit union which is unable to meet even modest net worth goals (established in its business plan) in its early years is unlikely to become ''adequately capitalized'' by the end of 10 years;

• Member business lending, although permitted for new credit unions, involves significant risks and requires a level of expertise not normally present in newly-chartered credit unions;

• Net worth categories for new credit unions should allow for gradual accumulation of net worth over 10 years; and

• Discretionary supervisory actions should be imposed commensurately with a new credit union's failure to meet net worth goals and the consequent increase in risk of loss to the NCUSIF.

The NCUA Board believes that the system of prompt corrective action for new credit unions which it proposes in subpart B reflects the intent of CUMAA, while incorporating the recommendations of commenters and the findings of the ''new'' credit union committee.

1. Provisions Applicable to All New Credit Unions

Section 702.2(f) adopts the statutory definition of a ''new'' credit union—in operation for less than 10 years and having $10 million or less in assets—which determines which credit unions will be subject to the alternative system of prompt corrective action under subpart B. For purposes of subpart B, a new credit union begins ''operation'' when it engages in a transaction that is required by GAAP to be reflected in the credit union's financial statement. The statutory definition significantly expands the definition in section 116 of the FCUA, which CUMAA repeals. CUMAA § 301(g)(3). The repealed provision defined a ''new'' credit union as having been in operation less than 4 years or having assets of less than $500,000. 12 U.S.C. 1762(a)(2).

Subpart B augments the new statutory definition. First, it makes clear that ''[a] credit union which exceeds $10 million in total assets may become ''new'', or may regain that status, ''if its total assets fall below $10 million while it is still in operation for less than 10 years.'' § 702.201(b). Second, it addresses the impact of a ''spin-off'' of a group in determining whether the newly-formed or surviving credit union has been in operation less than 10 years. § 702.201(c). Third, it allows the NCUA Board to deny ''new'' status under subpart B to any credit union formed primarily to qualify as ''new'' for purposes of subpart A. § 702.201(d).

Subpart B incorporates by reference the general provisions of part 702 concerning measurement of net worth, notice to a new credit union of its net worth ratio and the effective date of classification in the corresponding net worth category, notice to NCUA of a change in net worth category, and adjustments to a credit union's net worth ratio to reflect accounting adjustments. § 702.202(b) incorporating 702.3. Similarly to subpart A, subpart B provides for reclassification of new credit unions in certain net worth categories due to the existence of an unsafe or unsound condition or practice. § 702.202(d).

2. Net Worth Categories for New Credit Unions

Following the ''net worth category'' model of subpart A, subpart B establishes six net worth categories for new credit unions, denominated to indicate that they are building net worth anew, rather than restoring it from decline. § 702.202(c). The net worth categories, corresponding net worth ratio range for each (assuming no risk-based net worth requirement), and corresponding number of years in which a new credit union is reasonably expected, but not required, to attain each category, are depicted below:

New credit union net worth category	Net worth ratio (percent)	Expected by year-end of operation
''Well Capitalized''	7 or above	n/a
''Adequately Capitalized''	6 to 6.99	10th
''Moderately Capitalized''	3.5 to 5.99	7th
''Marginally Capitalized''	2 to 3.49	5th
''Minimally Capitalized''	0 to 1.99	3rd
''Uncapitalized''	Less than 0	n/a

In general, the net worth categories for new credit unions are designed to allow gradual accumulation of net worth over a ten year period. The ''minimally capitalized'' and ''marginally capitalized'' categories reflect the finding that it generally takes up to 3 years for a newly-chartered credit union to develop positive net worth and may take up to 5 years to attain a 2% net worth. The time frame in which a new credit union is ''reasonably expected'' to reach a given net worth category is a guide only, based on NCUA field experience; it does not establish a mandatory deadline nor trigger any supervisory action. Unlike subpart A, subpart B establishes an ''uncapitalized'' category which permits credit unions having no net worth to continue operating under limited time constrains before mandatory supervisory action must be taken. As commenters and the ''new'' credit union committee have emphasized, new credit unions which eventually succeed in becoming ''adequately capitalized'' may suffer periods of negative net worth while striving toward that goal, particularly in the early years of operation.

Unlike subpart A, there is no downward adjustment of a new credit union's net worth category if fails to comply with any particular supervisory action. Compare § 702.101(a)(4)(ii) with § 702.202(c)(3). However, new credit unions categorized as either ''well capitalized'' or ''adequately capitalized,'' and which meet the definition of ''complex,'' will be subject to a risk-based net worth requirement. § 1790d(c)(1)(A)(ii) and (c)(1)(B)(2). Like credit unions subject to subpart A, new credit unions which do not meet the risk-based requirement in either category will be reclassified ''moderately capitalized.''

3. Prompt Corrective Action for New Credit Unions by Net Worth Category

''Well Capitalized'' and ''Adequately Capitalized''. New credit unions classified ''well capitalized'' and ''adequately capitalized'' under subpart B are treated the same as their counterparts in subpart A. Thus, a ''well capitalized'' new credit union is subject to no prompt corrective action at all. An ''adequately capitalized'' credit union is subject to a single mandatory supervisory action—the requirement to transfer to the credit union's regular reserve earnings equal to not less than 4/10th percent of its average total assets. § 702.203. The alternative system of

prompt corrective action subjects an ''adequately capitalized'' new credit union to the same supervisory action as its counterpart in subpart A in order to facilitate a smooth transition to subpart A at the end of 10 years or by the time the credit union accumulates assets of $10 million or more.

''Moderately Capitalized,'' ''Minimally Capitalized'' and ''Marginally Capitalized''. Credit unions in these categories are subject to three mandatory supervisory actions which are similar to those which apply to credit unions categorized ''undercapitalized'' or lower in subpart A. The first is the requirement to annually transfer earnings to its regular reserve; however, for new credit unions there is no required minimum percentage of average total assets to determine the amount to be transferred. § 702.204(a)(1). The second is the restriction on increasing the credit union's total amount of member business loans until the credit union becomes ''adequately capitalized'' unless it qualifies under 12 U.S.C. 1757a(b) for any of the exemptions from the statutory maximum on member business loans.[13] § 702.204(a)(3). Third, each time a credit union fails to timely meet the net worth goals prescribed in its current approved business plan, it must submit a revised business plan to the NCUA Board for approval and implementation. § 702.204(a)(2). Because new credit unions in these categories are not restoring net worth, but are building it, they are not required to submit Net Worth Restoration Plans.

In both subparts A and B, a credit union is subject to mandatory and discretionary supervisory actions when it becomes classified ''undercapitalized'' or lower under subpart A or ''moderately capitalized'' or lower under subpart B. Under subpart A, a credit union also becomes subject to discretionary supervisory actions according to its classification among those net worth categories. Under subpart B, however, NCUA's authority to impose discretionary supervisory actions upon a new credit union is triggered by the failure to meet a net worth goal prescribed in the credit union's then-current business plan. § 702.204(b). In that event, the credit union becomes obligated to comply with the mandatory supervisory action requiring it to submit a revised business plan to NCUA for approval (which will set new net worth goals and timetables). NCUA then is authorized to impose one or more of discretionary supervisory actions according to the new credit union's net worth category, which incorporates as follows the discretionary actions in its corresponding statutory net worth category:

If a new credit union is classified	It is subject to the same discretionary actions as a credit union in subpart A classified as	Subpart A section No. incorporated by reference
''Moderately Capitalized''	''Undercapitalized''	702.105(b)–(c)
''Marginally Capitalized''	''Significantly Undercapitalized''	702.106(b)
''Minimally Capitalized''	''Critically Undercapitalized''	702.107(b)
''Uncapitalized''	''Critically Undercapitalized''	702.107(b)

Whereas a net worth restoration plan under subpart A is designed to restore net worth, the NCUA Board has developed the revised business plan (RBP) under subpart B to build net worth. While an RBP shares similar submission and decision deadlines and criteria for approval with an NWRP, the required contents of an RBP is broader in scope. First, the RBP calls for the credit union to progressively update the business plan elements originally required for charter approval, and to revise them as warranted by circumstances and experience since the date of charter. § 702.208(b)(1). Second, among other information, the RBP must specify the amount of earnings the credit union will transfer to its regular reserve (in view of the fact that subpart B sets no minimum) and establish at least quarterly targets for increasing net worth in each year in which the RBP is in effect. § 702.208(b)(2). Approval of RBP is effectively a charter to operate for the period covered by the plan.

Finally, as with a ''significantly undercapitalized'' credit union under subpart A, subpart B gives the NCUA Board discretion to place the credit union into conservatorship or liquidation pursuant to 12 U.S.C. §§ 1786(h)(1)(F), 1787(a)(3)(A)(i), if there is no reasonable prospect that the credit union will become ''adequately capitalized.'' § 702.204(c). Providing conservatorship and liquidation as an option is consistent with the purpose of prompt corrective action. Regardless of a new credit union's inadequate net worth at present, it should be allowed to survive under prompt corrective action if there is a reasonable prospect that it will be ''adequately capitalized'' by the time it is in operation for 10 years. Conversely, when a new credit union has no prospect of eventually becoming ''adequately capitalized,'' it is consistent with the purpose of prompt corrective action to prevent that credit union from exposing the NCUSIF to greater risk of loss.

''Uncapitalized''. The net worth classification of ''uncapitalized'' is designed to permit a new credit union to periodically and temporarily operate while having negative net worth. As commenters and NCUA's ''new'' credit union committee suggested, new credit unions which eventually become ''adequately capitalized'' may, while striving toward that goal, suffer periods when they have no net worth, particularly in the early years of operation. In view of this reality, the proposed rule treats a new credit union which is ''uncapitalized'' when it commences operating differently than one which subsequently declines from a higher net worth category to ''uncapitalized.''

A new credit union which is classified ''uncapitalized'' when it commences operating need only adhere to the requirements and net worth goals set forth in its initial business plan, approved at the time its charter was granted. That business plan (in the required pro-forma financial statement) may set quite modest net worth goals, allowing the credit union to remain ''uncapitalized'' for a substantial period. The authority to impose discretionary supervisory actions under section 702.207(b) is triggered only when the credit union fails to meet those net worth goals (as is the mandatory

[13] The NCUA Board will consider, for ''new'' credit unions only, whether to narrow the restriction on increasing members business loans to the *origination* of such loans. In that even, a ''new'' credit union would be prohibited from increasing member business loans which it originates, but would not necessarily be prohibited from participating in member business loans originated by another credit union which has expertise in originating such loans.

supervisory action requiring the credit union to file a revised business plan).

A new credit union classified in a net worth category above ''uncapitalized,'' which declines to that category from a higher one may continue operating, but is required (like other less than ''adequately capitalized'' credit unions) both to transfer earnings to its regular reserve and to not increase the total amount of member business loans. § 702.207(a)(1) and (3). However, within a period of time set by the NCUA Board, but not to exceed 90 days from the date the credit union declined to ''uncapitalized,'' the credit union must submit an RBP which provides for alternative means of funding the credit union's earnings deficit. § 702.207(a)(2). If the credit union fails to submit an RBP within the time prescribed by the NCUA Board, the credit union may be liquidated. § 702.207(c)(1). If the credit union remains ''uncapitalized'' 90 calendar days following approval of that RBP, the proposed rule requires the NCUA Board to liquidate the credit union. § 702.207(c)(2). The credit union can avoid mandatory liquidation at this point, however, only if it documents to the NCUA Board's satisfaction that it still is viable and has a reasonable prospect of becoming ''adequately capitalized.'' *Id.*

4. Incentives for New Credit Unions

Apart from regulatory forbearance in imposing discretionary supervisory actions, the NCUA Board proposes three types of incentives for new credit unions to become ''adequately capitalized'' before they are either in operation for more than 10 years or reach $10 million in total assets. § 1790d(b)(2)(B).[14] The first two of these incentives can be funded under 12 U.S.C. 1766(f)(2)(A) and (i)(3). First, NCUA will offer training in management, lending and product development for directors, officers and employees of new credit unions. § 702.209(a). This is envisioned as classroom training to generally educate officials in matters of importance to a new credit union's long-term survival. This training may commence before a new credit union begins operating and should continue as needed.

Second, NCUA will offer individualized guidance and training to directors, officers and employees of new credit unions in the preparation and revision of business plans. § 702.209(b). The purpose of this incentive is to build the skills within the credit union that are needed to revise business plans as required under subpart B, so that credit union management eventually is able to do so without assistance. Therefore, this incentive will consist neither of classroom training on the one hand, nor of engaging an outside consultant perform the service of revising the business plan for the credit union, on the other hand. Instead, an expert on business plans will be engaged to work on-site with credit union management to revise the credit union's individual business plan. This experience should build the skills of credit union management in addressing, through the credit union's business plan, the causes of its inability to improve net worth.

Third, a new credit union will be eligible to join and receive the benefits of NCUA's Small Credit Union Program. § 702.209(c). Under this program, an economic development specialist will be assigned at the Regional level to train and serve as a mentor to officials and management, and to advise and assist in areas such as—

- Arranging to receive mentoring by another credit union or trade association;
- Interacting with community organizations, trade associations, and other government agencies that may impact the credit union;
- Expanding fields of membership, where appropriate;
- Developing requests for financial assistance; and
- Developing and preparing business plans, capitalization plans, and marketing plans, Call Reports, financial statements and other reports.

NCUA Instruction no. 6052.00 (March 24, 1999) at 3–4.

E. Reserve Requirements To Conform to Prompt Corrective Action

Subpart C retains much of the substance of the current reserve transfer and dividend payment, modified to reflect the repeal of FCUA § 116, 12 U.S.C. 1762, and to conform with the requirements imposed by CUMAA. The ''statutory reserve'' requirement has been eliminated as inconsistent with CUMAA. The allowance for loan losses will no longer be combined with the regular reserve, and the subsequent reversing of the current period provision will no longer be allowed. The segregated regular reserve is retained in a form that comports with the earnings retention requirement in subparts A and B, and without noted adjustments. § 702.301(b). Reserve transfers continue to be reflected in the regular reserve account. § 702.301(c).

Provisions of full and fair disclosure are retained in a revised form. § 702.302. Subpart C addresses implementation of full and fair disclosure but excludes references to NCUA's Accounting Manual for Federal Credit Unions. § 702.301(b). Further, subpart C omits terms which may have suggested that proper full and fair disclosure implementation requires audited financial statements. *Id.*

The requirement to maintain an allowance for loan losses was retained for credit unions regardless of asset size. § 702.302(d). The allowance must provide for estimates of existing probable loses inherent in the loan portfolio. § 702.302(d)(2). The descriptive language was revised to reflect current guidance under Generally Accepted Accounting Principles.

The restriction on the payment of dividends was retained in substance. Amended language was added to address instances in which dividend payments cannot be made because credit union operations, allowance estimates, and/or reserve transfer requirements create a deficit condition in undivided earnings. § 702.303(a). In that event, subpart C provides that only a credit union classified ''well capitalized'' may transfer of funds from its regular reserve to undivided earnings to pay dividends, provided that doing so will not cause the credit union to decline from ''well capitalized.'' § 702.303(b)(1). Credit unions which can not meet these conditions may pay dividends from funds transferred from the regular reserve only with the permission of the appropriate Regional Director. § 702.303(b).

Finally, as with current section 702, subpart C will apply to State-as well as federally-chartered credit unions as provided under 12 CFR 741.3(a)(2).

F. Issuance, Review and Enforcement of Directives Imposing Prompt Corrective Action

Subpart L of part 747 establishes the means to challenge discretionary supervisory actions imposed by NCUA under authority of part 702. 12 C.F.R. 747.2001 *et seq.* CUMAA provides that ''material supervisory determinations, including decisions to require prompt corrective action, made * * * by [NCUA] officials other than the [NCUA] Board may be appealed to the [NCUA] Board'' through an independent appellate process required under 12 U.S.C. 4806(a)–(b), or ''pursuant to separate procedures prescribed by regulation.'' § 1790d(k). The NCUA Board established a Supervisory Review Committee to fulfill the requirements of

[14] Once chartered and in operation, a new credit union is eligible to receive special assistance under FCUA § 208, 12 U.S.C. 1788, ''to prevent the closing of an insured credit union which the Board has determined is in danger of closing.''

§ 4806,[15] but has concluded that a more expeditious process is needed to facilitate prompt corrective action. Therefore, the proposed rule incorporates, by regulation, the substance of the Federal banking agencies' procedure for giving notice and an opportunity to respond before issuing a directive imposing prompt corrective action. See, e.g., 12 C.F.R. 308.201. For purposes of section 747.2002, NCUA staff decisions to impose discretionary supervisory actions under subpart A or B of part 702 are considered material supervisory decisions. § 747.2001(a).

Notice, opportunity to respond, and review of directive. Under section 747.2002, the NCUA Board must generally give advance notice to a credit union when it intends to issue a directive imposing a discretionary supervisory action. § 747.2002(a)(1). Such a directive may take effect immediately only when necessary to further the purpose of prompt corrective action. § 747.2002(a)(2). The credit union may then respond, explaining why the proposed action is not appropriate and requesting that the directive not be issued or be modified. § 747.2002(c). However, the credit union is not entitled to a hearing, nor does § 4806 require the opportunity to have one. The NCUA Board may then decide not to issue the directive or to issue it as proposed or as modified. § 747.2002(d). The NCUA Board's decision is final. Under this procedure, a credit union which already is subject to a discretionary supervisory action may request reconsideration of a directive due to changed circumstances. § 747.2002(f).

Review of reclassification to lower category. CUMAA requires the NCUA Board to exercise its authority to reclassify a credit union on safety and soundness grounds ''under regulations comparable to [FDIA § 38(g)].'' § 1790d(h)(1). That provision requires that an institution may be reclassified on safety and soundness grounds only after ''notice and an opportunity for hearing.'' FDIA § 38(g)(1). To that end, the NCUA Board has adopted in section 747.2003 a version of the Federal banking agencies' procedure for notice of proposed reclassification and an opportunity to respond and to request a hearing. See, e.g., 12 C.F.R. 308.202. This procedure applies to reclassification pursuant to section 702.101(b) or 702.202(d) of part 702.

Under section 747.2003, the NCUA Board must give notice of its intention to reclassify a credit union, or to treat it as if it were the next lower net worth category, on safety and soundness grounds. § 747.2003(a). The notice must include reasons for the reclassification. § 747.2003(a)(2)(ii). The credit union may then respond, explaining why it is not in an unsafe or unsound condition or has not corrected an unsafe or unsound practice and providing evidence to support its position. § 747.2003(a)(3). The credit union also may request a hearing and the opportunity to present witnesses at the hearing. § 747.2003(a)(4).

If requested, a hearing shall be held before a presiding officer designated by the NCUA Board, but shall not be a formal adjudication subject to the Administrative Procedure Act, 5 U.S.C. 554–557, nor to the Uniform Rules of Practice and Procedure, 12 C.F.R. 747.1. § 747.2003(a)(5) and (6)(A). At the hearing, the credit union may introduce relevant documents, present oral argument, and if authorized, present witnesses. § 747.2003(a)(6)(i). At the close of the hearing the presiding officer shall make a recommended decision to the NCUA Board, § 747.2003(a)(7), and the NCUA Board shall then decide whether to reclassify the credit union. § 747.2003(a)(8). The decision of the NCUA Board is final. Apart from appointing a presiding officer to conduct a hearing and to recommend a decision, the NCUA Board may not delegate its authority to reclassify a credit union. § 747.2003(c); § 1790d(h)(2). Under this procedure, a credit union which has been reclassified may seek reconsideration. § 747.2003(b).

Review of dismissal of director or officer. FDIA § 38 requires that a director or senior executive officer dismissed pursuant to a discretionary supervisory action ''may obtain review of that order by filing a written petition for reinstatement. * * *'' FDIA § 38(n). In order to give directors and senior officers dismissed under part 702 a comparable opportunity for review, the NCUA Board has adopted in section 747.2004 of this subpart a procedure similar to that developed by the Federal banking agencies. *See, e.g.,* 12 C.F.R. § 308.203.

Under section 747.2004, when the NCUA Board directs the credit union to dismiss a director or senior executive officer, it must also serve that person with a copy of the directive. § 747.2004(a). The affected person may then file a written request for reinstatement,[16] which may include a request for an informal hearing before the NCUA Board and the opportunity to present witness testimony at the hearing. § 747.2004(b). The dismissal shall remain in effect while the request for reinstatement is pending. § 747.2004(b)(3).

Under section 747.2004, the procedure for conducting an informal hearing before a presiding officer designated by the NCUA Board is identical to that which section 747.2003 provides in cases of reclassification, except as follows. First, the affected person may appear at the hearing through counsel if he or she wishes. § 747.2004(d)(1). Second, the affected person bears the burden of proving that his or her continued employment would materially strengthen the credit union's ability to become ''adequately capitalized'' or to correct an unsafe or unsound condition, as the case may be. § 747.2004(e). Third, if the NCUA Board, after hearing, denies reinstatement, it must provide reasons for its action. § 747.2004(g). The NCUA Board's decision is final.

Enforcement of supervisory actions. CUMAA amended the FCUA to ensure that supervisory actions imposed under part 702 to facilitate prompt corrective action are enforceable. 12 U.S.C. §§ 1786(k)(1) and (2)(A). When a credit union fails to comply with a directive imposing a discretionary requirement or restriction, the NCUA Board may apply to the appropriate U.S. District Court to enforce that directive. § 747.2005(a). Alternatively, the NCUA Board may assess a civil money penalty against a credit union (and any institution affiliated party acting in concert with it) which violates or fails to comply with a directive, or fails to implement an approved net worth restoration plan under subpart A or revised business plan under subpart B. § 747.2005(b). Finally, subpart L allows the NCUA Board to enforce a directive under part 702 ''through any other judicial or administrative proceeding authorized by law.'' § 747.2005(c).

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[15] See Interpretive Ruling and Policy Statement 95–1, 60 FR 14795 (March 20, 1995).

[16] The credit union which was directed to dismiss a director or officer may not seek reinstatement of the dismissed director or officer under section 747.2004, but that credit union may challenge the directive under § 747.2002.

Appendix A: Statutory Prompt Corrective Action

		"Well Capitalized" NWR: 7% or greater	"Adequately Capitalized" NWR: 6% to 6.99%	"Undercapitalized" NWR:45% to 5.99%	"Significantly Undercapitalized" NWR: 2% to 3.99%	"Critically Undercapitalized" NWR: 0% to 1.99%
1	*Subject to risk-based net worth requirement for "complex" credit unions*					
2	*If NWR is less than 5%, reclassify to next lower category if no NWRP filed*					
3	*Reclassify to next lower category on safety and soundness grounds**					
	Mandatory Actions by Credit Unions					
4	*Earnings transfer to regular reserve no less than 4/10ths% of assets*					
5	*Submit New Worth Restoration Plan (NWRP)*					
6	*NCUA assistance in preparing NWRP if assets less than $10 million*					
7	*Restrict assets to average total assets over preceeding 12 months*					
8	*Restrict member business loans unless primarily making such loans*					
	Discretionary Actions By NCUA					
9	*NCUA approval for acquisitions, branching, new lines of business*					
10	*Restrict transactions with and ownership of CUSOs*					
11	*Restrict dividends paid on shares*					
12	*Prohibit or reduce asset growth*					
13	*Alter, reduce, or terminate any activity*					
14	*Prohibit nonmember deposits*					
15	*Other action no more severe than rows 9 through 14*					
16	*Other actions to further purpose of PCA*					
17	*New election of board of directors*					
18	*Dismiss directors or senior executive officers **					
19	*Employ qualified officers*					
20	*Restrict senior executive officers pay and benefits*					
21	*NCUA approval for certain actions*					

* = Subject to notice and hearing under subpart L of 747.

Appendix A: Statutory Prompt Corrective Action

		"Well Capitalized" NWR: 7% or greater	"Adequately Capitalized" NWR: 6% to 6.99%	"Undercapitalized" NWR:45% to 5.99%	"Significantly Undercapitalized" NWR: 2% to 3.99%	"Critically Undercapitalized" NWR: 0% to 1.99%
22	*Restrict payments on uninsured secondary capital*					
23	*Require merger if grounds for conservatorship or liquidation*					
	Conservatorship and Liquidation					
24	*Discretionary conservatorship or liquidation if no prospect of becoming "adequately capitalized"*					
25	*Mandatory conservatorship, liquidation or corrective action in lieu within 90 days*					
26	*Mandatory liquidation after 18 months (if exceptions not met)*					

* = Subject to notice and hearing under subpart L of 747.

Appendix B: Prompt Corrective Action for "New" Credit Unions

		"Well Capitalized" NWR: 7% or greater	"Adequately Capitalized" NWR: 6% to 6.99%	"Moderately Capitalized" NWR: 3.5% to 5.99%	"Marginally Capitalized" NWR: 2% to 3.49%	"Minimally Capitalized" NWR: 0% to 1.99%	"Uncapitalized" NWR: Less than 0%
1	Subject to risk-based net worth requirement for "complex" credit unions						
2	Reclassify to next lower category for lack of safety and soundness *						
	Mandatory Actions by Credit Unions						
3	Earnings transfer to regular reserves no less than 4/10ths% of assets						
4	Earnings transfer to regular reserves - no minimum						
5	Restrict member business loans unless primarily making such loans						
	Discretionary Actions By NCUA						
6	NCUA approval for acquisitions, branching, new lines of business						
7	Restrict transactions with and ownership of CUSOs						
8	Restrict dividends paid on shares						
9	Prohibit or reduce asset growth						
10	Alter, reduce, or terminate any activity						
11	Prohibit nonmember deposits						
12	Other action no more severe than rows 6 through 11						
13	Other actions to further purpose of PCA						
14	New election of board of directors						
15	Dismiss directors or senior executive officers *						
16	Employ qualified officers						
17	Restrict senior executive officers pay and benefits						
18	NCUA approval for certain actions						
19	Restrict payments on uninsured secondary capital						

* = Subject to notice and hearing under subpart L of 747.

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Appendix B: Prompt Corrective Action for "New" Credit Unions

		"Well Capitalized" NWR: 7% or greater	*"Adequately Capitalized"* NWR: 6% to 6.99%	*"Moderately Capitalized"* NWR: 3.5% to 5.99%	*"Marginally Capitalized"* NWR: 2% to 3.49%	*"Minimally Capitalized"* NWR: 0% to 1.99%	*"Uncapitalized"* NWR: Less than 0%
20	*Require merger if grounds for conservatorship or liquidation*						
	Conservatorship and Liquidation						
21	*Discretionary conservatorship or liquidation if no prospect of becoming "adequately capitalized"*						
	"New" Credit Unions Only						
23	*Submit revised business plan (RBP) when net worth goals not met or CU declines to "critically undercapitalized"*						
23	*Mandatory liquidation within 90 days of approval of RBP unless viable and has prospect of becoming "adequately" capitalized*						
24	*Eligible for NCUA-provided management training*						
25	*Eligible for NCUA-provided individualized guidance in preparing RBP*						
26	*Eligible to receive benefits of Small Credit Union Program*						

* = Subject to notice and hearing under subpart L of 747.

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Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis describing any significant economic impact a proposed regulation may have on a substantial number of small credit unions (primarily those under $1 million in assets). The NCUA Board has determined and certifies that the proposed rule, if adopted, will not have a significant economic impact on a substantial number of small credit unions. Thus, a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

NCUA has determined that five requirements of the proposed rule constitute collections of information under the Paperwork Reduction Act. The requirements are: (1) To provide written notice to the regional director and state supervisory authority, if appropriate, of a change to the credit union's net worth ratio that places the credit union in a lower net worth category; (2) To submit a net worth restoration plan if the credit union is undercapitalized, significantly undercapitalized, or critically undercapitalized; (3) To submit a revised net worth restoration plan when the initial plan is not approved; (4) For new credit unions, to submit a revised business plan; and (5) For new credit unions, to submit a new revised business plan when the revised business plan is not approved. NCUA is submitting a copy of the proposed regulation to the Office of Management and Budget (OMB) for its review.

NCUA estimates that 500 federally insured credit unions would have to prepare a notice to the regional director and state supervisory authority of a change to the credit union's net worth ratio. It is expected that this would take 1 hour per year, resulting in a total burden of 500 hours. NCUA estimates that 300 federally insured credit unions would be required to submit a net worth restoration plan, and each plan would require an average of 60 hours to prepare, resulting in 18,000 burden hours. NCUA further estimates that 30 federally insured credit unions' initial plans would not be approved, requiring an additional burden of 30 hours each and a total of 900 burden hours. NCUA estimates 50 new federally insured credit unions would be required to submit a revised business plan, and each plan would require an average of 80 hours to prepare, for a total burden of 4,000 hours. NCUA further estimates that 10 new federally insured credit unions' plans would not be approved, requiring an additional burden of 40 hours each, for a total of 400 hours. In total, the burden created by the proposed rule is 23,800 hours. It is NCUA's view that the additional requirements are necessary for affected federally insured credit unions to adequately address the net worth requirements of the proposed rule.

The Paperwork Reduction Act of 1995 and OMB regulations require that the public be provided an opportunity to comment on information collection requirements, including an agency's estimate of the burden of the collection of information. The NCUA Board invites comment on: (1) whether the collection of information is necessary; (2) the accuracy of NCUA's estimate of the burden of collecting the information; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) ways to minimize the burden of collection of information. Comments should be sent to: OMB Reports Management Branch, New Executive Office Building, Room 10202, Washington, D.C. 20503; Attention: Alex T. Hunt, Desk Officer for NCUA. Please send NCUA a copy of any comments you submit to OMB.

Executive Order 12612

Executive Order 12612 requires NCUA to consider the effect of its actions on state interests. As prescribed by CUMAA, part 702 applies to all federally-insured credit unions, including federally-insured, State-chartered credit unions. Accordingly, it may have a direct effect on the States, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. This impact is an unavoidable consequence of carrying out the statutory mandate to adopt a system of prompt corrective action for federally-insured credit unions.

Agency Regulatory Goal

NCUA's goal is clear, understandable regulations that impose a minimal regulatory burden. Although much of the language of this rule is mandated by Congress, we request your comments on whether the proposed rule is understandable and minimally intrusive if implemented as proposed.

List of Subjects

12 CFR Part 702

Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 747

Administrative practices and procedures, Credit unions.

By the National Credit Union Administration Board on May 3, 1999.

Becky Baker,

Secretary of the Board.

Accordingly, it is proposed that 12 CFR, parts 702 and 747 be amended as set forth below:

Part 702 is revised to read as follows:

PART 702—PROMPT CORRECTIVE ACTION

Sec.
702.1 Authority, purpose, scope, and other supervisory authority.
702.2 Definitions.
702.3 Measure, notice and effective date of net worth classification.

Subpart A—Statutory Prompt Corrective Action

702.101 Statutory net worth categories.
702.102 Complex credit unions defined [Reserved].
702.103 Risk-based net worth requirements for complex credit unions [Reserved].
702.104 Prompt corrective action for ''adequately capitalized'' credit unions.
702.105 Prompt corrective action for ''undercapitalized'' credit unions.
702.106 Prompt corrective action for ''significantly undercapitalized'' credit unions.
702.107 Prompt corrective action for ''critically undercapitalized'' credit unions.
702.108 Consultation with State officials on proposed prompt corrective action.
702.109 Net worth restoration plans.

Subpart B—Alternative Prompt Corrective Action for New Credit Unions

702.201 Scope and definition.
702.202 Net worth categories for new credit unions.
702.203 Prompt corrective action for ''adequately capitalized'' new credit unions.
702.204 Prompt corrective action for ''moderately capitalized'' new credit unions.
702.205 Prompt corrective action for ''marginally capitalized'' new credit unions.
702.206 Prompt corrective action for ''minimally capitalized'' new credit unions.
702.207 Prompt corrective action for ''uncapitalized'' new credit unions.
702.208 Revised business plans for new credit unions.
702.209 Incentives for new credit unions.

Subpart C—Reserves

702.301 Reserves
702.302 Full and fair disclosure of financial condition.
702.303 Payment of dividends.

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

§ 702.1 Authority, purpose, scope, and other supervisory authority.

(a) *Authority.* This part (except for subpart C) and subpart L of part 747 of this chapter are issued by the National

Credit Union Administration pursuant to section 216 of the Federal Credit Union Act (FCUA), 12 U.S.C. 1790d (section 1790d), as added by section 301 of the Credit Union Membership Access Act, Public Law 105–219, 112 Stat. 913 (1998). Subpart C of this part is issued pursuant to FCUA section 120, 12 U.S.C. 1766.

(b) *Purpose.* The express purpose of prompt corrective action under section 1790d is to resolve the problems of federally-insured credit unions at the least possible long-term loss to the National Credit Union Share Insurance Fund. This part carries out the purpose of prompt corrective action by establishing a framework of supervisory requirements and restrictions designed to restore and improve the capital levels of federally-insured credit unions according to a credit union's net worth ratio.

(c) *Scope.* This part implements the provisions of section 1790d as they apply to federally-insured credit unions, whether federally- or state-chartered; to such credit unions defined as ''new'' pursuant to 12 U.S.C. 1790d(b)(2); and to such credit unions defined as ''complex'' pursuant to 12 U.S.C. 1790d(d). Certain of these provisions also apply to officers and directors of federally-insured credit unions. This Part does not apply to corporate credit unions. Procedures for issuing, reviewing and enforcing orders and directives issued under this part are set forth in subpart L of Part 747 of this chapter, 12 CFR 747.2001.

(d) *Other supervisory authority.* Neither FCUA section 1790d nor this Part in any way limits the authority of the NCUA Board under any other provision of law to take additional supervisory actions to address unsafe or unsound practices or conditions, or violations of applicable law or regulations. Action taken under this part may be taken independently of, in conjunction with, or in addition to any other enforcement action available to the NCUA Board, including issuance of cease and desist orders, orders of prohibition, suspension and removal, or assessment of civil money penalties, or any other actions authorized by law.

§ 702.2 Definitions.

Except as provided below, the terms used in this part have the same meanings as set forth in FCUA sections 101 and 216, 12 U.S.C. 1752, 1790d.

(a) *Appropriate State official* means the commission, board or other supervisory authority having jurisdiction over credit unions chartered by the State which chartered the affected credit union.

(b) *Credit union* means a federally-insured, federally-chartered or State-chartered, unless otherwise indicated.

(c) *CUSO* means a credit union service organization defined for purposes of this part as a legal entity established under state law, which is owned in whole or in part by one of more federally-insured credit unions (including a state-chartered credit union) and which—

(1) Provides services associated with the routine operations of credit unions; or

(2) Engages in activities incidental to the conduct of a credit union; or

(3) Engages in activities that further or facilitate the purposes of a credit union; or

(4) Furnishes services to a credit union.

(d) *NCUSIF* means the National Credit Union Share Insurance Fund as defined by 12 U.S.C. 1783.

(e) *Net worth* means the retained earnings balance of the credit union as determined under generally accepted accounting principles. With respect to a credit union designated low-income (as defined in 12 U.S.C. 1757(6)), net worth includes secondary capital accounts that are uninsured and subordinate to all other claims against the low-income credit union, including the claims of creditors, shareholders and the NCUSIF.

(f) *Net worth ratio* means, with respect to a credit union, the ratio of the net worth of the credit union to the total assets of the credit union.

(g) *New credit union* means a federally-insured credit union which both has been in operation for less than ten (10) years and has $10,000,000 or less in total assets.

(h) *Shares* means insured shares as defined in 12 CFR 741.4(b)(2).

(i) *Total assets* means the average of the total assets reported (including those that reasonably should be reported) by the credit union on the line entitled ''TOTAL ASSETS'' on its most recent four (4) quarterly Call Reports, or for a semi-annual filer, on its most recent two (2) semi-annual Call Reports.

§ 702.3 Measures, notice and effective date of net worth classification.

(a) *Net worth measures.* For purposes of this part, a credit union's net worth category classification will be determined by two measures:

(1) The net worth ratio as defined in § 702.2(f); and

(2) The risk-based net worth requirement applicable to a credit union defined as ''complex'' under § 702.102.

(b) *Notice and effective date of net worth classification.* For purposes of this part, a federally-insured credit union shall have notice of its net worth ratio (including any applicable risk-based net worth requirement) and shall be classified within the corresponding net worth category as of the earliest to occur of:

(1) The last day of the credit union's most recent dividend period for regular shares, but no less frequently than quarterly; or

(2) The date the credit union received its most recent final report of examination; or

(3) The date the credit union received written notice from the NCUA Board or, if State-chartered, the appropriate State official of reclassification based on safety and soundness grounds as provided under §§ 702.101(b) and 702.202(d) of this part, or of an adjustment to its net worth ratio as provided under paragraph (d) of this section.

(c) *Notice by credit union of change in net worth category.* A federally-insured credit union shall provide written notice to the NCUA Board and, if State-chartered, to the appropriate State official, of a change in its net worth ratio that places the credit union in a lower net worth category no later than 15 calendar days after the effective date of the change as determined under paragraphs (b) (1) and (2) of this section. Written notice to the NCUA Board shall be deemed effective if it is delivered to the appropriate Regional Director and, if State-chartered, to the appropriate State official. Failure to provide such notice to the NCUA Board within 15 calendar days, or failure to provide such notice altogether, in no way alters the effective date of a change of net worth classification under this subparagraph, nor the affected credit union's legal obligations under this part.

(d) *Adjustment of net worth ratio.* To effectuate and further the purpose of this part, the NCUA Board and, in the case of a State-chartered credit union, the NCUA Board or appropriate State official, may adjust a credit union's net worth ratio to reflect the impact of accounting adjustments made for items of ''other comprehensive income'' such as accumulated unrealized gains and losses on available-for-sale securities when the failure to do so would overstate or understate the credit union's net worth ratio, thereby either permitting it to evade appropriate prompt corrective action or subjecting it to unwarranted prompt corrective action.

Subpart A—Statutory Prompt Corrective Action

§ 702.101 Statutory net worth categories.

(a) *Net worth categories.* Except for credit unions defined as ''new'' under subpart B of this part, a federally-insured credit union shall be classified—

(1) *Well capitalized* if it has a net worth ratio of seven percent (7%) or greater and also meets any applicable risk-based net worth requirement under § 702.102;

(2) *Adequately capitalized* if it has a net worth ratio of six percent (6%) or more but less than seven percent (7%), and also meets any applicable risk-based net worth requirement under § 702.102;

(3) *Undercapitalized* if it has a net worth ratio of four percent (4%) or more but less than six percent (6%), or fails to meet any applicable risk-based net worth requirement under § 702.102;

(4) *Significantly undercapitalized* if it:

(i) Has a net worth ratio of two percent (2%) or more but less than four percent (4%); or

(ii) Has a net worth ratio of two percent (2%) or more but less than five percent (5%), and either—

(A) Fails to submit an acceptable net worth restoration plan within the time prescribed in section 702.109; or

(B) Materially fails to implement a net worth restoration plan accepted by the NCUA Board;

(5) *Critically undercapitalized* if it has a net worth ratio of less than two percent (2%).

(b) *Reclassification based on supervisory criteria other than net worth.* The NCUA Board may reclassify a ''well capitalized'' credit union as ''adequately capitalized'' and may require an ''adequately capitalized'' or ''undercapitalized'' credit union to comply with certain mandatory or discretionary supervisory actions as if it were in the next lower net worth category (each of such actions hereinafter referred to generally as ''reclassification'') in the following circumstances:

(1) *Unsafe or unsound condition.* The NCUA Board has determined, after notice and opportunity for hearing pursuant to § 747.2003 of this chapter, that the credit union is in an unsafe or unsound condition; or

(2) *Unsafe or unsound practice.* The NCUA Board has determined, after notice and opportunity for hearing pursuant to § 747.2003 of this chapter, that the credit union had notice of, but has not corrected an unsafe or unsound practice.

(c) *Non-delegation.* The NCUA Board may not delegate its authority to reclassify a credit union under paragraph (b) of this section.

(d) *Consultation with State officials.* The NCUA Board shall seek and consider the views of the appropriate State official before reclassifying a credit union under paragraph (b) of this section.

§ 702.102 Complex credit unions defined [Reserved].

§ 702.103 Risk-based net worth requirements for complex credit unions [Reserved].

§ 702.104 Prompt corrective action for ''adequately capitalized'' credit unions.

(a) *Earnings transfer.* If a federally-insured credit union becomes ''adequately capitalized,'' it must annually transfer to its regular reserve account earnings equivalent to not less than 4/10ths percent (0.4%) of its total assets as defined by § 702.2(i), at the following rates:

(1) In the case of a credit union having a monthly dividend period for regular shares, at a rate of at least eight and one-third percent (8.334%) per month of the annual amount; and

(2) In the case of a credit union having a quarterly, semi-annual or annual dividend period for regular shares, at a rate of at least twenty five percent (25%) per quarter of the annual amount.

(b) *Reduction in earnings transfer.* On a case-by-case basis and subject to review and revocation no less frequently than quarterly, the NCUA Board may permit the credit union to transfer an amount that is less than the equivalent of 4/10ths percent (0.4%) of its total assets, to the extent the credit union demonstrates to the NCUA Board that such lesser amount—

(1) Is necessary to avoid a significant redemption of shares; and

(2) Would further the purpose of this part.

§ 702.105 Prompt corrective action for ''undercapitalized'' credit unions.

(a) *Mandatory action by credit union.* If a federally-insured credit union becomes ''undercapitalized,'' it must immediately—

(1) *Earnings transfer.* Transfer earnings to its regular reserve account as provided in § 702.104;

(2) *Submit net worth restoration plan.* Submit a net worth restoration plan pursuant to § 702.109;

(3) *Restrict increase in assets.* Not permit the credit union's assets to increase beyond its total assets as defined by § 702.2(i), unless—

(i) The NCUA Board has approved a net worth restoration plan which provides for an increase in total assets; and

(ii) The assets of the credit union are increasing consistent with the approved plan; and

(iii) The credit union's net worth ratio is increasing at a rate that is consistent with the approved plan;

(4) *Restrict member business loans.* Not increase the total amount of member business loans until the credit union becomes ''adequately capitalized'' unless it qualifies for an exception under 12 U.S.C. 1757a(b).

(b) *Discretionary action by NCUA.* Subject to the applicable procedures for issuing, reviewing and enforcing directives set forth in subpart L of part 747 of this chapter, the NCUA Board may, with respect to any ''undercapitalized'' credit union, or a director, officer or employee of such credit union, take one or more of the following actions, if it determines that those actions are necessary to carry out the purpose of this part:

(1) *Requiring prior approval for acquisitions, branching, new lines of business.* Prohibit a credit union from, directly or indirectly, acquiring any interest in any CUSO or credit union, establishing or acquiring any additional branch office, or engaging in any new line of business, unless the NCUA Board has approved the credit union's net worth restoration plan, the credit union is implementing its plan, and the NCUA Board determines that the proposed action is consistent with and will further the objectives of that plan;

(2) *Restricting transactions with and ownership of CUSO.* Restrict the credit union's transactions with a CUSO, or require the credit union to reduce or divest its ownership interest in a CUSO;

(3) *Restricting dividend paid.* Restrict the dividend rates the credit union pays on shares to the prevailing rates paid on comparable accounts and maturities in the region where the credit union is located, as determined by the NCUA Board, except that dividend rates already paid on shares acquired before imposing a restriction under this paragraph may not be retroactively restricted;

(4) *Prohibiting or reducing asset growth.* Prohibit any growth whatsoever in the credit union's assets or in a category of assets, or require the credit union to reduce its assets or a category of assets;

(5) *Alter, reduce or terminate activity.* Require the credit union or its CUSO to alter, reduce, or terminate any activity;

(6) *Prohibiting nonmember deposits.* Prohibit the credit union from accepting all or certain nonmember deposits as

otherwise permitted under 12 U.S.C. 1757(6) and § 701.32 of this chapter, or under applicable State law;

(7) *Other action no more severe.* Restrict or require such other action by the credit union as the NCUA Board determines will carry out the purpose of this part better than any of the actions prescribed in paragraphs (b) (1) through (6) of this section, provided that such other restriction or requirement is no more severe than the actions prescribed in paragraphs (b) (1) through (6).

(c) *Prerequisite for improving management.* The NCUA Board may take any of the following actions provided that it first takes one or more of the actions prescribed in paragraphs (b) (1) through (7) of this section or determines that none of those actions would further the purpose of this part:

(1) *New election of directors.* Order a new election of the credit union's board of directors;

(2) *Dismissing directors or senior executive officers.* Require the credit union to dismiss from office any director or senior executive officer, provided however, that a dismissal under this clause shall not be construed to be a formal administrative action for removal under 12 U.S.C. 1786(g);

(3) *Employing qualified senior executive officers.* Require the credit union to employ qualified senior executive officers (who, if the NCUA Board so specifies, shall be subject to its approval).

§ 702.106 Prompt corrective action for ''significantly undercapitalized'' credit unions.

(a) *Mandatory action by credit union.* Immediately upon becoming ''significantly undercapitalized,'' a federally-insured credit union must—

(1) *Earnings transfer.* Transfer earnings to its regular reserve account as provided in § 702.104;

(2) *Submit net worth restoration plan.* Submit a net worth restoration plan pursuant to § 702.109;

(3) *Restrict increase in assets.* Not permit the credit union's assets to increase beyond its total assets as defined by section 702.2(i), except as provided in § 702.105(a)(3);

(4) *Restrict member business loans.* Not increase the total amount of member business loans except as provided in § 702.105(a)(4).

(b) *Discretionary actions by NCUA.* Subject to the applicable procedures for issuing, reviewing and enforcing directives set forth in subpart L of part 747 of this chapter, the NCUA Board may, with respect to any ''significantly undercapitalized'' credit union, or a director, officer or employee of such credit union, take one or more of the following actions if it determines that those actions are necessary to carry out the purpose of this part:

(1) *Requiring prior approval for acquisitions, branching, new lines of business.* Prohibit a credit union from, directly or indirectly, acquiring any interest in any CUSO or credit union, establishing or acquiring any additional branch office, or engaging in any new line of business, except as provided in § 702.105(b)(1);

(2) *Restricting transactions with and ownership of CUSO.* Restrict the credit union's transactions with a CUSO, or require the credit union to divest or reduce its ownership interest in a CUSO;

(3) *Restricting dividend paid.* Restrict the dividend rates that the credit union pays on shares as provided in § 702.105(b)(3);

(4) *Prohibiting or reducing asset growth.* Prohibit any growth whatsoever in the credit union's assets or in a category of assets, or require the credit union to reduce assets or a category of assets;

(5) *Alter, reduce or terminate activity.* Require the credit union or its CUSO(s) to alter, reduce, or terminate any activity;

(6) *Prohibiting nonmember deposits.* Prohibit the credit union from accepting all or certain nonmember deposits as otherwise permitted under 12 U.S.C. 1757(6) and § 701.32 of this chapter, or under applicable State law;

(7) *Restricting senior executive officers' compensation.* Limit or reduce payment of compensation to any senior executive officer, limit or prohibit payment of a bonus to such officer, or condition payment of compensation or a bonus to such officer upon the NCUA Board's prior approval;

(8) *Improving management.* Order a new election of board of directors; dismiss directors or senior executive officers; or employ qualified senior executives, all as provided in § 702.105(c), without the prerequisite that applies to that section;

(9) *Requiring merger.* Require the credit union to merge with another financial institution if one or more grounds exist for placing the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i);

(10) *Other actions.* Restrict or require such other action by the credit union as the NCUA Board determines will carry out the purpose of this part better than any of the actions prescribed in paragraphs (b)(1) through (9) of this section.

(c) *Discretionary conservatorship or liquidation if no prospect of becoming ''adequately capitalized.''* Notwithstanding any other actions required or permitted to be taken under this section, when a credit union becomes ''significantly undercapitalized'' (including by reclassification under § 702.101(b)), the NCUA Board may place the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i), provided that the credit union has no reasonable prospect of becoming ''adequately capitalized.''

§ 702.107 Prompt corrective action for ''critically undercapitalized'' credit unions.

(a) *Mandatory action by credit union.* Immediately upon becoming ''critically undercapitalized,'' a federally-insured credit union must—

(1) *Earnings transfer.* Transfer earnings to its regular reserve account as provided in § 702.104;

(2) *Submit net worth restoration plan.* Submit a net worth restoration plan pursuant to § 702.109;

(3) *Restrict increase in assets.* Not permit the credit union's assets to increase beyond its total assets as defined by § 702.2(i), except as provided in § 702.105(a)(3);

(4) *Restrict member business loans.* Not increase the total amount of member business loans except as provided in § 702.105(a)(4).

(b) *Discretionary actions by NCUA.* Subject to the applicable procedures for issuing, reviewing and enforcing directives set forth in subpart L of part 747 of this chapter, the NCUA Board may, with respect to any ''critically undercapitalized'' credit union, or a director, officer or employee of such credit union, take one or more of the following actions if it determines that those actions are necessary to carry out the purpose of this part:

(1) *Requiring prior approval for acquisitions, branching, new lines of business.* Prohibit a credit union from, directly or indirectly, acquiring any interest in any CUSO or credit union, establishing or acquiring any additional branch office, or engaging in any new line of business, except as provided by § 702.105(b)(1);

(2) *Restricting transactions with and ownership of CUSO.* Restrict the credit union's transactions with a CUSO, or require the credit union to divest or reduce its ownership interest in a CUSO;

(3) *Restricting dividend paid.* Restrict the dividend rates that the credit union pays on shares as provided in § 702.105(b)(3);

(4) *Prohibiting or reducing asset growth.* Prohibit any growth whatsoever in the credit union's assets or in a category of assets, or require the credit union to reduce assets or a category of assets;

(5) *Alter, reduce or terminate activity.* Require the credit union or its CUSO(s) to alter, reduce, or terminate any activity;

(6) *Prohibiting nonmember deposits.* Prohibit the credit union from accepting all or certain nonmember deposits as otherwise permitted under 12 U.S.C. 1757(6) and § 701.32 of this chapter, or under applicable State law;

(7) *Restricting senior executive officers' compensation.* Limit or reduce payment of compensation to any senior executive officer, limit or prohibit payment of a bonus to such officer, or condition payment of compensation or a bonus to such officer upon the NCUA Board's approval;

(8) *Improving management.* Order a new election of board of directors; dismiss directors or senior executive officers; or employ qualified senior executive officers, all as provided in § 702.105(c), but without the prerequisite required in that section;

(9) *Restrictions on payments on uninsured secondary capital.* Beginning 60 days after a credit union becomes ''critically undercapitalized,'' prohibit payments of principal or dividends on the credit union's uninsured secondary capital accounts, except that unpaid dividends shall continue to accrue under the terms of the account to the extent permitted by law;

(10) *Requiring prior approval.* Require a ''critically undercapitalized'' credit union to obtain the NCUA Board's prior written approval before doing any of the following:

(i) 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 with respect to which the credit union is required to provide notice to the NCUA Board;

(ii) Extending credit for transactions deemed highly leveraged by the NCUA Board or, if State-chartered, by the appropriate State official;

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

(iv) Making any material change in accounting methods;

(v) Paying dividends on new share accounts at a rate that would increase the credit union's weighted average cost of funds to a level significantly exceeding the prevailing rates of interest on insured deposits in its normal market areas;

(11) *Other action.* Restrict or require such other action by the credit union as the NCUA Board determines will carry out the purpose of this part better than any of the actions prescribed in paragraphs (b)(1) through (10) of this section;

(12) *Requiring merger.* Require the credit union to merge with another financial institution if one or more grounds exist for placing the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i).

(c) *Mandatory conservatorship, liquidation or action in lieu thereof.* (1) *Action within 90 days.* Notwithstanding any other actions required or permitted to be taken under this section (and regardless of a credit union's prospect of becoming ''adequately capitalized''), the NCUA Board must, within 90 calendar days after a credit union becomes ''critically undercapitalized''—

(i) *Conservatorship.* Place the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(G); or

(ii) *Liquidation.* Liquidate the credit union pursuant to 12 U.S.C. 1787(a)(3)(A)(ii); or

(iii) *Other corrective action.* Take other corrective action in lieu of conservatorship or liquidation to better achieve the purpose of this part, provided that the NCUA Board documents why such action in lieu of conservatorship or liquidation would do so.

(2) *Renewal of other corrective action.* A determination by the NCUA Board to take other corrective action in lieu of conservatorship or liquidation under paragraph (c)(1)(iii) of this section shall expire after an effective period ending no later than 180 calendar days after the determination is made, and the credit union shall be immediately placed into conservatorship or liquidation under paragraphs (c)(1)(i) and (ii) of this section, unless the NCUA Board makes a new determination under paragraph (c)(1)(ii) of this section before the end of the effective period of the prior determination;

(3) *Mandatory liquidation after 18 months.* (i) *Generally.* Notwithstanding paragraphs (c)(1) and (2) of this section, the NCUA Board must place a credit union into conservatorship or liquidation if it remains ''critically undercapitalized'' on average for a full calendar quarter following a period of 18 months from the date on which the credit union first became ''critically undercapitalized'';

(ii) *Exception.* Notwithstanding paragraph (c)(3)(i) of this section section, the NCUA Board may continue to take other corrective action in lieu of conservatorship or liquidation if it certifies that the credit union—

(A) Has been in substantial compliance with an approved net worth restoration plan requiring consistent improvement in net worth since the date the net worth restoration plan was approved;

(B) Has positive net income or has an upward trend in earnings that the NCUA Board projects as sustainable; and

(C) is viable and not expected to fail.

(4) *Nondelegation.* The NCUA Board may not delegate its authority under paragraphs (c)(1) through (3) of this section unless the credit union has less than $5,000,000 in total assets. A credit union shall have a right of direct appeal to the NCUA Board of any decision made under this section by delegated authority.

§ 702.108 Consultation with State officials on proposed prompt corrective action.

(a) *Consultation on proposed conservatorship or liquidation.* Before placing a federally-insured State-chartered credit union into conservatorship (pursuant to 12 U.S.C. 1786(h)(1)(F) or (G)) or liquidation (pursuant to 12 U.S.C. 1787(a)(3)) as permitted or required under this part to facilitate prompt corrective action—

(1) The NCUA Board shall seek the views of the appropriate State official (as defined in § 702.2(a)), and give him or her an opportunity to place the credit union into conservatorship or liquidation;

(2) The NCUA Board shall, upon timely request of the appropriate State official, promptly provide him or her with a written statement of the reasons for the proposed conservatorship or liquidation, and reasonable time to respond to that statement;

(3) If the appropriate State official makes a timely written response that disagrees with the proposed conservatorship or liquidation and gives reasons for that disagreement, the NCUA Board shall not place the credit union into conservatorship or liquidation unless it first considers the views of the appropriate State official and determines that—

(i) The NCUSIF faces a significant risk of loss if the credit union is not

placed into conservatorship or liquidation; and

(ii) Conservatorship or liquidation is necessary to reduce any loss that the NCUSIF either is expected to incur or risks incurring with respect to the credit union.

(b) *Nondelegation.* The NCUA Board may not delegate any determination under paragraph (a)(3) of this section.

(c) *Notification when taking discretionary action.* The NCUA Board shall seek the views of the appropriate State official before taking any discretionary action with respect to a federally-insured State-chartered credit union, and shall allow the appropriate State official to take the proposed action independently or jointly with NCUA.

§ 702.109 Net worth restoration plans

(a) *Schedule for filing.* (1) *Generally.* A federally-insured credit union shall file a written net worth restoration plan (Plan) with the appropriate Regional Director and, if State-chartered, the appropriate State official within 45 calendar days of becoming either ''undercapitalized,'' ''significantly undercapitalized'' or ''critically undercapitalized,'' unless the NCUA Board notifies the credit union in writing that its Plan is to be filed within a different period.

(2) *Exception.* An ''adequately capitalized'' credit union that is required, on safety and soundness grounds under § 702.101(b), to comply with supervisory actions as if it were ''undercapitalized'' is not required to submit a Plan solely due to the reclassification.

(3) *Filing of additional plan.* Notwithstanding paragraph (a)(1) of this section, a credit union that has already submitted and is operating under a Plan approved under this section is not required to submit an additional Plan due to a change in net worth ratio or reclassification under § 702.101(b), unless the NCUA Board notifies the credit union that it must submit a new Plan. A credit union that is notified to submit a new or revised Plan shall file the Plan in writing with the appropriate Regional Director within 45 calendar days of receiving such notice, unless the NCUA Board notifies the credit union in writing that the Plan is to be filed within a different period.

(4) *Failure to timely file plan.* When a credit union fails to timely file a Plan pursuant to paragraph (a)(1) or (3) of this section, the NCUA Board shall promptly notify the credit union that it has failed to file a Plan and that it has 15 calendar days from receipt of that notice within which to file a Plan.

(b) *Assistance in preparing plan.* Upon timely request by a credit union having total assets of less than $10 million (regardless how many years it has been in operation), the NCUA Board shall provide assistance in preparing a plan required to be filed under paragraph (a) of this section.

(c) *Contents of plan.* A net worth restoration plan must—

(1) Specify—

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

(ii) A specific timetable for increasing net worth during each year in which the Plan will be in effect;

(iii) The amount of earnings equivalent to not less than 4/10ths percent (0.4%) of its total assets that the credit union will transfer to its regular reserve account under section 702.104(a), or such lesser amount as the credit union justifies to the NCUA Board under section 702.104(b);

(iv) How the credit union will comply with the mandatory and discretionary restrictions or requirements imposed on it under this part;

(v) the types and levels of activities in which the credit union will engage; and

(vi) if required to submit a plan due to reclassification under section § 702.101(b), the steps the credit union will take to correct the unsafe or unsound practice(s) or condition(s);

(2) Include pro forma financial statements covering the next two years;

(3) Contain such other information as the NCUA Board has required; and

(4) With respect to a credit union having assets of $10 million or more, financial data submitted in connection with its net worth restoration plan must be prepared in accordance with generally accepted accounting principles (GAAP) unless the NCUA Board instructs otherwise.

(d) *Criteria for approval of plan.* The NCUA Board shall not accept a net worth restoration plan unless the plan—

(1) Complies with paragraph (c) of this section;

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

(3) Would not unreasonably increase the credit union's exposure to risk (including credit risk, interest-rate risk, and other types of risk); and

(4) Is supported by appropriate assurances from the credit union that it will comply with the plan until it has remained ''adequately capitalized'' for four (4) consecutive calendar quarters.

(e) *Review of plan.* (1) *Notice of decision.* Within 60 calendar days after receiving a Plan under this part, the NCUA Board will notify the credit union in writing whether the Plan has been approved, and shall provide reasons for its decision in the event of disapproval.

(2) *Consultation with state officials.* In the case of a Plan submitted by a federally-insured State-chartered credit union, the NCUA Board shall, when evaluating the Plan, seek and consider the views of the appropriate State official.

(f) *Plan not approved. (1) Submission of revised plan.* If a Plan is not approved by the NCUA Board, the credit union shall submit a revised Plan within 30 calendar days of receiving notice of disapproval, unless it is notified in writing by the NCUA Board that the revised Plan is to be filed within a different period. Upon receipt of notice of disapproval of a Plan, an ''undercapitalized'' credit union having a net worth ratio of less than five percent (5%) shall remain subject to all of the provisions of this part applicable to ''significantly undercapitalized'' credit unions until a new or revised Plan submitted by the credit union is approved by the NCUA Board.

(2) *Notice of decision on revised plan.* Within 30 calendar days after receiving a revised Plan under paragraph (f)(1) of this section, the NCUA Board shall notify the credit union in writing whether the revised Plan is approved. The Board may extend the time within which notice of its decision shall be provided.

(g) *Failure to submit or implement plan.* Any ''undercapitalized'' credit union having a net worth ratio of less than five percent (5%) which fails to submit a written Plan within the applicable period provided in this section, or which fails in any material respect to timely implement an approved Plan, shall be remain subject to all of the provisions of this part applicable to ''significantly undercapitalized'' credit unions.

(h) *Amendment of plan.* A credit union that has filed an approved Plan may, after prior written notice to and approval by the NCUA Board, amend its Plan to reflect a change in circumstance. Until such time as a proposed amendment has been approved, the credit union shall implement the Plan as approved prior to the proposed amendment.

Subpart B—Alternative Prompt Corrective Action for New Credit Unions

§ 702.201 Scope and definition

(a) *Scope.* This subpart B applies exclusively to credit unions defined in paragraph (b) of this section as ''new'' pursuant to 12 U.S.C. 1790d(b)(2) in lieu of subpart A of this part.

(b) *New credit union defined.* A ''new'' credit union for purposes of this section is a federally-insured credit union that has both been in operation for less than ten (10) years and has total assets of not more than $10 million. A credit union which exceeds $10 million in total assets may become ''new'' if its total assets subsequently fall below $10 million while it is still in operation for less than 10 years.

(c) *Effect of spin-offs.* A credit union formed as the result of a ''spin-off'' of a group from the field of membership of an existing credit union is deemed to be in operation since the effective date of the ''spin-off.'' A credit union whose total assets decline below $10 million because a group within its field of membership has been ''spun-off'' is eligible to become ''new'' if it has been in operation less than 10 years.

(d) *Actions to evade statutory prompt corrective action.* If the NCUA Board determines that a credit union was formed as a result of a ''spin-off,'' or was expanded by merger or by the addition of a group to its field of membership, primarily to qualify as ''new'' under this subpart, the credit union shall be deemed subject to prompt corrective action under subpart A of this part.

§ 702.202 Net worth categories for new credit unions.

(a) *Net worth measures.* For purposes of this part, a new credit union's net worth category classification will be determined by its net worth ratio as defined in § 702.2(f), and any risk-based net worth requirement applicable to a new credit union defined as ''complex'' under § 702.102.

(b) *Notice and effective date of net worth classification of new credit union.* A new federally-insured credit union shall have notice of its net worth ratio (including any applicable risk-based net worth requirement), and shall be classified within the corresponding net worth category under this subpart, effective as provided in § 702.3(b).

(c) *Net worth categories.* A federally-insured credit union defined as ''new'' under this section shall be classified—

(1) *Well capitalized* if it has a net worth ratio of seven percent (7%) or greater and also meets any applicable risk-based net worth requirement under § 702.102;

(2) *Adequately capitalized* if it has a net worth ratio of six percent (6%) or more but less than seven percent (7%), and also meets any applicable risk-based net worth requirement under § 702.102;

(3) *Moderately capitalized* if it has a net worth ratio of three and one-half percent (3.5%) or more but less than six percent (6%), or fails to meet any applicable risk-based net worth requirement under § 702.102;

(4) *Marginally capitalized* if it has a net worth ratio of two percent (2%) or more but less than three and one-half percent (3.5%);

(5) *Minimally capitalized* if it has a net worth ratio of zero percent (0%) or greater but less than two percent (2%);

(6) *Uncapitalized* if it has a net worth ratio of less than zero percent (0%) (e.g., a deficit in retained earnings).

(d) *Reclassification based on supervisory criteria other than net worth.* Subject to § 702.101(c) and (d), the NCUA Board may reclassify a ''well capitalized'' new credit union as ''adequately capitalized'' and may require an ''adequately capitalized,'' ''moderately capitalized'' or marginally capitalized'' new credit union to comply with certain statutory or discretionary supervisory actions as if it were in the next lower net worth category (each of such actions is hereinafter referred to generally as ''reclassification'') in either of the circumstances prescribed in § 702.101(b).

§ 702.203 Prompt corrective action for ''adequately capitalized'' new credit unions.

Until an ''adequately capitalized'' new credit union becomes ''well capitalized,'' it must annually transfer earnings to its regular reserve account as provided in § 702.104.

§ 702.204 Prompt corrective action for ''moderately capitalized'' new credit unions.

(a) *Mandatory action by new credit union.* If a new credit union becomes ''moderately capitalized'' (including by reclassification under § 702.202(d)), it must immediately—

(1) *Earnings transfer.* Annually transfer earnings to its regular reserve account in an amount and at a rate reflected in the credit union's initial or revised business plan;

(2) *Submit revised business plan.* Submit a revised business plan pursuant to § 702.208 if its net worth ratio has not increased consistent with its then-present business plan;

(3) *Restrict member business loans.* Not increase the total amount of member business loans until the credit union becomes ''adequately capitalized'' unless it qualifies for an exception under 12 U.S.C. 1757a(b).

(b) *Discretionary actions by NCUA.* Subject to the applicable procedures set forth in subpart L of part 747 of this chapter for issuing, reviewing and enforcing directives, the NCUA Board may take one or more of the actions prescribed in § 702.105(b) and (c) if the credit union's net worth has not increased consistent with its then-present business plan.

(c) *Discretionary conservatorship or liquidation.* Notwithstanding any other actions required or permitted to be taken under this section, when a new credit union becomes ''moderately capitalized'' (including by reclassification under § 702.202(d)), the NCUA Board may place the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i), provided that the credit union has no reasonable prospect of becoming ''adequately capitalized.''

§ 702.205 Prompt corrective action for ''marginally capitalized'' new credit unions.

(a) *Mandatory actions by new credit union.* If a new credit union becomes ''marginally capitalized'' (including by reclassification under § 702.202(d)), it must immediately—

(1) *Earnings transfer.* Annually transfer earnings to its regular reserve account in an amount and at a rate reflected in the credit union's initial or revised business plan;

(2) *Submit revised business plan.* Submit a revised business plan pursuant to § 702.208 if its net worth ratio has not increased consistent with its then-present business plan; and

(3) *Restrict member business loans.* Not increase the total amount of member business loans except as provided in § 702.204(a)(3).

(b) *Discretionary actions by NCUA.* Subject to the applicable procedures set forth in subpart L of part 747 of this chapter for issuing, reviewing and enforcing directives, the NCUA Board may take one or more of the actions prescribed in § 702.106(b) if the credit union's net worth has not increased consistent with its then-present business plan.

(c) *Discretionary conservatorship or liquidation.* Notwithstanding any other actions required or permitted to be taken under this section, when a new credit union becomes ''marginally capitalized'' (including by reclassification under § 702.202(d)), the NCUA Board may place the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation

pursuant to 12 U.S.C. 1787(a)(3)(A)(i), provided that the credit union has no reasonable prospect of becoming ''adequately capitalized.''

§ 702.206 Prompt corrective action for ''minimally capitalized'' new credit unions.

(a) *Mandatory action by new credit union.* If a new credit union becomes ''minimally capitalized,'' it must immediately—

(1) *Earnings transfer.* Annually transfer earnings to its regular reserve account in an amount and at a rate reflected in the credit union's initial or revised business plan;

(2) *Submit revised business plan.* Submit a revised business plan pursuant to § 702.208 if its net worth ratio has not increased consistent with its then-present business plan; and

(3) *Restrict member business loans.* Not increase the total amount of member business loans except as provided in § 702.204(a)(3).

(b) *Discretionary actions by NCUA.* Subject to the procedures set forth in subpart L of part 747 of this chapter for issuing, reviewing and enforcing directives, the NCUA Board may take one or more of the actions prescribed in § 702.107(b) if the credit union's net worth has not increased consistent with its then-present business plan.

(c) *Discretionary conservatorship or liquidation.* Notwithstanding any other actions required or permitted to be taken under this section, when a new credit union becomes ''minimally capitalized'' (including by reclassification under § 702.202(d)), the NCUA Board may place the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i), provided that the credit union has no reasonable prospect of becoming ''adequately capitalized.''

§ 702.207 Prompt corrective action for ''uncapitalized'' new credit unions.

(a) *Mandatory action by new credit union.* If a federally-insured new credit union either remains ''uncapitalized'' beyond the time period provided in its initial business plan (approved at the time the credit union's charter was granted), or subsequently declines to that category, it must—

(1) *Earnings transfer.* Annually transfer earnings to its regular reserve account in an amount and at a rate determined reflected in the credit union's initial or revised business plan;

(2) *Submit revised business plan.* Within the period specified by the NCUA Board, but not to exceed 90 days from the date the credit union became ''uncapitalized,'' submit a revised business plan pursuant to § 702.208 providing for alternative means of funding the credit union's earnings deficit; and

(3) *Restrict member business loans.* Not increase the total amount of member business loans except as provided in § 702.204(a)(3).

(b) *Discretionary actions by NCUA.* Subject to the procedures set forth in subpart L of part 747 of this chapter for issuing, reviewing and enforcing directives, the NCUA Board may take one or more of the actions prescribed in § 702.107(b) if the credit union's net worth has not increased consistent with its then-present business plan.

(c) *Mandatory liquidation.* Notwithstanding any other actions required or permitted to be taken under this section, the NCUA Board—

(1) May place into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(ii) an ''uncapitalized'' new credit union which fails to submit a revised business plan within the time provided under paragraph (a)(2) of this section; or

(2) Must place into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(ii) an ''uncapitalized'' new credit union which still is ''uncapitalized'' ninety (90) calendar days after the date the NCUA Board approved the revised business plan submitted by the credit union pursuant to paragraph (a)(2) of this section, unless the credit union documents to the NCUA Board why it is viable and has a reasonable prospect of becoming ''adequately capitalized.''

§ 702.208 Revised business plans for new credit unions.

(a) *Schedule for filing.* (1) *Generally.* A ''moderately capitalized,'' ''marginally capitalized'' or ''minimally capitalized'' new credit union must file a written revised business plan (RBP) with the appropriate Regional Director and, if State-chartered, with the appropriate State official within 30 calendar days of the date the credit union has notice (as provided under § 702.3(b)) that its net worth ratio has failed to increase consistent with its then-present business plan, unless the NCUA Board notifies the credit union in writing that its RBP is to be filed within a different period, or that the NCUA Board is waiving the requirement that the credit union file an RBP. An ''uncapitalized'' new credit union must file an RBP within the time provided under § 702.207(a)(2).

(2) *Failure to timely file plan.* When a new credit union fails to file an RBP as provided under paragraph (a)(1) of this section, the NCUA Board shall promptly notify the credit union that it has failed to file an RBP and that it has 15 calendar days from receipt of that notice within which to do so.

(b) *Contents of revised business plan.* A new credit union's RBP must, at a minimum—

(1) Address changes, since the new credit union's current business plan was approved, in any of the business plan elements required for charter approval under section IV.D. of NCUA's *Chartering and Field of Membership Manual* (IRPS 99–1), 63 FR 71998, 72019 (Dec. 30, 1998), or for State-chartered credit unions under applicable State law;

(2) Specify the steps the new credit union will take to become ''adequately capitalized'';

(3) Establish at least quarterly targets for increasing net worth during each year in which the RBP will be in effect;

(4) Specify the amount of earnings that it will annually transfer to its regular reserve as provided under § 702.204(a)(1);

(5) Explain how the new credit union will comply with the restrictions or requirements then in effect under this subpart;

(6) Specify the types and levels of activities in which the new credit union will engage;

(7) In the case of an RBP submitted due to reclassification under § 702.202(d), specify the steps the credit union will take to correct the unsafe or unsound condition or practice; and

(8) Include such other information as the NCUA Board may require.

(c) *Review of revised business plan.* (1) *Consultation with State officials.* In the case of an RBP submitted by a federally-insured State-chartered new credit union, the NCUA Board shall, when evaluating the RBP, seek and consider the views of the appropriate State official.

(2) *Criteria for approval.* The NCUA Board shall not approve a new credit union's RBP unless it—

(i) addresses the items enumerated in paragraph (b) of this section;

(ii) is based on realistic assumptions, and is likely to succeed in restoring the credit union's net worth;

(iii) would not unreasonably increase the credit union's exposure to risk (including credit risk, interest-rate risk, and other types of risk); and

(iv) is supported by appropriate assurances from the credit union that it will comply with the approved plan until it has been ''adequately capitalized'' for four (4) consecutive calendar quarters.

(3) *Notice of decision.* Within 30 calendar days after receiving an RBP under this section, the NCUA Board shall notify the credit union in writing

whether its RBP is approved, and shall provide reasons for its decision in the event of disapproval. The NCUA Board may extend the time within which notice of its decision shall be provided.

(d) *Plan not approved.* (1) *Submission of new revised plan.* If an RBP is not approved by the NCUA Board, the new credit union shall submit a new RBP within 30 calendar days of receiving notice of disapproval of its initial RBP, unless it is notified in writing by the NCUA Board that the new RBP is to be filed within a different period.

(2) *Notice of decision on revised plan.* Within 30 calendar days after receiving an RBP under paragraph (d)(1) of this section, the NCUA Board shall notify the credit union in writing whether the new RBP is approved. The Board may extend the time within which notice of its decision shall be provided.

(e) *Amendment of plan.* A credit union that has filed an approved RBP may, after prior written notice to and approval by the NCUA Board, amend it to reflect a change in circumstance. Until such time as a proposed amendment has been approved, the new credit union shall implement its existing RBP as approved prior to the proposed amendment.

§ 702.209 Incentives for new credit unions.

(a) *Management training for officers and employees.* At the discretion of the NCUA Board, NCUA (or non-profit organizations funded through grants or contracts under 12 U.S.C. 1766(f)(2)(A) and (i)(3)) will provide training in management, lending, product development and other areas for directors, officers and employees of new credit unions.

(b) *Assistance in preparing business plans.* At the discretion of the NCUA Board, NCUA (or non-profit organizations funded through grants or contracts under 12 U.S.C. 1766(f)(2)(A) and (i)(3)) will provide individualized guidance and training to directors, officers and employees of new credit unions in the preparation of business plans required for charter approval and RBPs required under § 702.208.

(c) *Small credit union program.* A new credit union is eligible to join and receive comprehensive benefits and assistance under NCUA's Small Credit Union Program.

Subpart C—Reserves

§ 702.301 Reserves.

(a) *Special reserve.* Each federally-chartered credit union shall establish and maintain such reserves as may be required by the FCUA, or by regulation, or in special cases by the NCUA Board.

(b) *Regular reserve.* Each federally-chartered credit union shall establish and maintain a regular reserve account. Earnings required to be transferred annually to a credit union's regular reserve under subparts A or B of this part shall be held in this account.

(c) *Transfers to regular reserve.* The transfer of earnings to a federally-chartered credit union's regular reserve when required under subparts A or B of this part must occur after charges for loan or other losses are addressed as provided in § 702.302(d), but before the declaration or payment of any dividends to members.

§ 702.302 Full and fair disclosure of financial condition.

(a) *Full and fair disclosure defined.* ''Full and fair disclosure'' is the level of disclosure which a prudent person would provide to a member of a federally-chartered credit union, to NCUA, or, at the discretion of the board of directors, to creditors to fairly inform them of the financial condition and the results of operations of the credit union.

(b) *Full and fair disclosure implemented.* The financial statements of a federally-insured credit union shall provide for full and fair disclosure of all assets, liabilities, and members' equity, including such valuation (allowance) accounts as may be necessary to present fairly the financial condition; and all income and expenses necessary to present fairly the statement of income for the reporting period.

(c) *Declaration of officials.* The Statement of Financial Condition, when presented to members, creditors or to the NCUA, shall contain a dual declaration by the treasurer and by the president, or in the absence of the president, by any other officer designated by the board of directors of the reporting credit union to make such declaration, that the report and related financial statements are true and correct to the best of their knowledge and belief and present fairly the financial condition and the statement of income for the period covered.

(d) *Charges for loan and other losses.* Full and fair disclosure demands that a credit union properly address charges for loan and other losses as follows:

(1) Charges for loan and other losses shall be made in accordance with generally accepted accounting principles (GAAP);

(2) The allowance for loan losses established for loans must fairly present the probable losses for all categories of loans and the proper valuation of loans. The valuation allowance must encompass specifically identified loans, as well as estimated losses inherent in the loan portfolio, such as loans and pools of loans for which losses have been incurred but are not identifiable on a specific loan-by-loan basis;

(3) Adjustments to the valuation allowance for loan losses will be recorded in the expense account ''Provision for Loan Losses'';

(4) The maintenance of an allowance for loan losses shall not affect the requirement to transfer earnings to a credit union's regular reserve when required under subpart A or B of this part;

(5) At a minimum, adjustments to the allowance for loan losses shall be made prior to the distribution or posting of any dividend to the accounts of members.

§ 702.303 Payment of dividends.

(a) *Restriction on dividends.* Dividends shall be available only from post-closing, post-transfer, unappropriated, undivided earnings, if any.

(b) *Payment of dividends if undivided earnings depleted.* The board of directors of a federally-chartered credit union which has depleted the post-closing, post-transfer balance of its undivided earnings account may authorize a transfer of funds from the credit union's regular reserve to undivided earnings to pay dividends, provided that the credit union is classified ''well capitalized'' under subpart A or B of this part and either—

(1) The transfer of funds to undivided earnings will not cause the credit union's net worth classification to fall below ''well capitalized''; or

(2) The appropriate Regional Director gives written approval for the transfer.

PART 747—ADMINISTRATIVE ACTIONS, ADJUDICATIVE HEARINGS, RULES OF PRACTICE AND PROCEDURE, AND INVESTIGATIONS

1. The authority citation for part 747 is revised to read as follows:

Authority: 12 U.S.C. 1766, 1786, 1784, 1787, 1790d and 4806(a); and 42 U.S.C. 4012a.

2. Part 747 is amended by adding a new subpart L to read as follows:

Subpart L—Issuance, Review and Enforcement of Orders Imposing Prompt Corrective Action

Sec.

747.2001 Scope.
747.2002 Review of order imposing prompt corrective action.
747.2003 Review of order reclassifying a credit union based on safety and soundness criteria.
747.2004 Review of order to dismiss a director or senior executive officer.
747.2005 Enforcement of orders.

Subpart L—Issuance, Review and Enforcement of Orders Imposing Prompt Corrective Action

§ 747.2001 Scope.

(a) *Independent review process.* The rules and procedures set forth in this subpart apply to federally-insured credit unions, whether federally- or state-chartered (other than corporate credit unions), who are subject to discretionary supervisory actions and to reclassification under part 702 of this chapter to facilitate prompt corrective action under section 216 of the Federal Credit Union Act, 12 U.S.C. § 1790d; and senior executive officers and directors of such credit unions who are dismissed pursuant to a discretionary supervisory action imposed under part 702. NCUA staff decisions to impose discretionary supervisory restrictions or requirements under part 702 shall be considered material supervisory determinations for purposes of 12 U.S.C. 1790d(k). Section 747.2002 of this subpart provides an independent appellate process to challenge such decisions.

(b) *Notice to State officials.* With respect to a federally-insured State-chartered credit union under sections 747.2002, 747.2003 and 747.2004 of this subpart, notices, directives and decisions on appeal served upon a credit union, or a dismissed director or officer thereof, by the NCUA Board shall also be served upon the appropriate State official. Responses, requests for a hearing and to present witnesses, and requests for reinstatement served upon the NCUA Board by a credit union, or dismissed director or officer thereof, shall also be served upon the appropriate State official.

§ 747.2002 Review of orders imposing prompt corrective action.

(a) *Notice of intent to issue directive.*—(1) *Generally.* Whenever the NCUA Board intends to issue a directive imposing a discretionary requirement or restriction on a credit union classified ''undercapitalized'' or lower under §§ 702.105 (b) and (c), 702.106(b) and 702.107(b) of this chapter, or on a new credit union classified ''moderately capitalized'' or lower under §§ 702.204(b), 702.205(b), 702.206(b) and 702.207(b) of this chapter, it must give the credit union prior notice of the proposed action. The credit union shall have such time to respond to a proposed directive as the NCUA Board provides under paragraph (c)(1) of this section.

(2) *Immediate issuance of directive without notice.* The NCUA Board may issue a directive to take effect immediately under paragraph (a)(1) of this section without notice to the credit union if the NCUA Board finds it necessary in order to carry out the purposes of part 702 of this chapter. A credit union that is subject to a directive which takes effect immediately may appeal the directive in writing to the NCUA Board. Such an appeal must be received by the NCUA Board within 14 calendar days after the directive was issued, unless the NCUA Board permits a longer period. The NCUA Board shall consider any such appeal, if timely filed, within 60 calendar days of receiving it. Unless ordered by the NCUA Board, the directive shall remain in effect pending a decision on the appeal.

(b) *Contents of notice.* The NCUA Board's notice to a credit union of its intention to issue a directive imposing a discretionary restriction or requirement must state:

(1) The credit union's net worth ratio and net worth classification;

(2) The specific restrictions or requirements that the NCUA Board intends to impose, and the reasons therefor;

(3) The proposed date when the restriction or requirement would take effect and the proposed date for completing the required action or terminating the restriction; and

(4) The date by which the credit union must file its written response, if any, to the notice as required by paragraph (c)(1) of this section.

(c) *Response to notice.*—(1) *Time for response.* A credit union must file a written response, if any, to a notice of intent to issue a directive within 14 calendar days from the date of the notice, unless the NCUA Board determines that a shorter period is appropriate in light of the financial condition of the credit union or other relevant circumstances.

(2) *Content of response.* A credit union's response to a notice of the NCUA Board's intention to issue a directive imposing a discretionary restriction or requirement must:

(i) Explain why the proposed restriction or requirement is not an appropriate exercise of discretion under this part;

(ii) Request that the NCUA Board not issue or modify the proposed directive; and

(iii) Include other relevant information, mitigating circumstances, documentation, or other evidence in support of the credit union's position regarding the proposed directive.

(d) *NCUA Board consideration of response.* After considering a credit union's response to a notice of the NCUA Board's intention to issue a directive imposing a discretionary restriction or requirement, the NCUA Board may:

(1) Issue the directive as originally proposed or as modified;

(2) Determine not to issue the directive and so notify the credit union; or

(3) Seek additional information or clarification from the credit union or any other relevant source.

(e) *Failure to file response.* A credit union which fails to file a written response to a notice of the NCUA Board's intention to issue a directive imposing a discretionary restriction or requirement, within the specified time period, shall be deemed to have waived the opportunity to respond and to have consented to the issuance of the directive.

(f) *Request to modify or rescind directive.* A credit union that is subject to a directive imposing a discretionary restriction or requirement may request in writing that the NCUA Board reconsider the terms of the directive, or rescind or modify it, due to changed circumstances. Unless otherwise ordered by the NCUA Board, the directive shall remain in effect while such request is pending.

§ 747.2003 Review of order reclassifying a credit union based on safety and soundness criteria.

(a) *Reclassification based on unsafe or unsound condition or practice.* (1) *Issuance of notice of proposed reclassification.* (i) *Grounds for reclassification.* The NCUA Board may reclassify a credit union or subject it to the supervisory actions applicable to the next lower net worth category (each such action hereinafter referred to as ''reclassification'') pursuant to §§ 702.101(b) and 702.202(d) of this chapter;

(ii) *Prior notice to credit union.* Prior to reclassification, the NCUA Board shall issue and serve on the credit union a written notice of the NCUA Board's intention to reclassify it to a lower net worth category.

(2) *Contents of notice.* A notice of intention to reclassify a credit union based on unsafe or unsound condition or practice shall state:

(i) The credit union's net worth ratio, net worth category classification, and the net worth category to which the credit union would be reclassified;

(ii) The reasons for reclassification of the credit union;

(iii) The date by which the credit union must file with the NCUA Board a

written response to the proposed reclassification (and a request for a hearing), which date shall be no less than 14 calendar days from the date of service of the notice unless the NCUA Board determines that a shorter period is appropriate in light of the financial condition of the credit union or other relevant circumstances; and

(iv) That failure to—

(A) File a written response to the notice of proposed reclassification, within the specified time period, shall be deemed a waiver of the opportunity to respond and to have consented to the reclassification;

(B) That failure to request a hearing shall be deemed a waiver of any right to a hearing; and

(C) That failure to request the opportunity to present witness testimony shall be deemed a waiver of any right to present such testimony.

(3) *Response to notice of proposed reclassification.* A credit union may file a written response to a notice of proposed reclassification within the time period set by the NCUA Board. The response should explain why the credit union is not in an unsafe or unsound condition or has not corrected an unsafe or unsound practice, or otherwise should not be reclassified, and include any relevant information, mitigating circumstances, documentation, or other evidence in support of the credit union's position. A credit union which fails to file a written response to a notice of proposed reclassification, within the specified time period, shall be deemed to have waived the opportunity to respond and to have consented to the reclassification.

(4) *Request for informal hearing and presentation of witness testimony.* A credit union's response to a notice of proposed reclassification may include a request for an informal hearing before the NCUA Board under this section. If the credit union wishes to present witness testimony at the hearing, the credit union shall include a request to do so which specifies the names of the witnesses and the general nature of their expected testimony. Failure to request an informal hearing shall be deemed a waiver of any right to a hearing, and failure to request the opportunity to present witness testimony shall be deemed a waiver of any right to present such testimony.

(5) *Order for informal hearing.* Upon timely receipt of a written response that includes a request for a hearing, the NCUA Board shall issue an order commencing an informal hearing no later than 30 days after receipt of the request, unless the credit union requests a later date. The hearing shall be held in Alexandria, Virginia, or at such other place as may be designated by the NCUA Board, before a presiding officer designated by the NCUA Board to conduct the hearing and to recommend a decision.

(6) *Procedures for informal hearing.*

(i) The credit union shall have the right to introduce relevant documents and to present oral argument at the hearing. The credit union may introduce witness testimony only if expressly authorized by the NCUA Board or the presiding officer. Neither the provisions of the Administrative Procedure Act (5 U.S.C. 554–557) governing adjudications required by statute to be determined on the record nor the Uniform Rules of Practice and Procedure (12 CFR 747.1) shall apply to an informal hearing under this section unless the NCUA Board orders otherwise.

(ii) The informal hearing shall be recorded, and a transcript shall be furnished to the credit union upon request and payment of the cost thereof. Witnesses need not be sworn, unless specifically requested by a party or by the presiding officer. The presiding officer may ask questions of any witness.

(iii) The presiding officer may order that the hearing be continued for a reasonable period following completion of witness testimony or oral argument to allow additional written submissions to the hearing record.

(7) *Recommendation of presiding officer.* Within 20 calendar days following the closing of the hearing and the record, the presiding officer shall make a recommendation to the NCUA Board on the proposed reclassification.

(8) *Time for decision.* Not later than 60 calendar days after the date the record is closed or the date of receipt of the credit union's response in a case where no hearing was requested, the NCUA Board will decide whether to reclassify the credit union, and will notify the credit union of its decision. The decision of the NCUA Board shall be final.

(b) *Request to rescind reclassification.* Any credit union that has been reclassified under this section may file a written request to the NCUA Board to reconsider or rescind the reclassification, or to modify, rescind or remove any directives issued as a result of the reclassification. Unless otherwise ordered by the NCUA Board, the credit union shall remain reclassified, and subject to any directives issued as a result, while such request is pending.

(c) *Non-delegation.* The NCUA Board may not delegate its authority to reclassify a credit union into a lower net worth category or to treat a credit union as if it were in a lower net worth category pursuant to §§ 702.101(b) or 702.202(d) of this chapter.

§ 747.2004 Review of order to dismiss a director or senior executive officer.

(a) *Service of notice.* When the NCUA Board issues and serves a directive on a credit union pursuant to § 747.2002 requiring it to dismiss from office any director or senior executive officer under § 702.105(c)(2), 702.106(b)(8), 702.107(b)(8), 702.204(b), 702.205(b), 702.206(b) or 702.207(b) of this chapter, the NCUA Board shall also serve a copy of the directive (or the relevant portions, where appropriate) upon the person to be dismissed, and shall advise that person in writing that failure to—

(1) Request reinstatement shall be deemed a waiver of any right to seek reinstatement;

(2) Request a hearing shall be deemed a waiver of any right to a hearing; and

(3) Request the opportunity to present witness testimony shall be deemed a waiver of the right to present such testimony.

(b) *Response to directive.* (1) *Request for reinstatement.* A director or senior executive officer who has been served with a directive under paragraph (a) of this section (Respondent) may file a written request for reinstatement. The request for reinstatement shall be filed with the NCUA Board within 10 business days after the Respondent received the directive, unless further time is allowed by the NCUA Board at the request of the Respondent.

(2) *Contents of request for informal hearing.* The request for reinstatement shall include reasons why the Respondent should be reinstated, and may include a request for an informal hearing before the NCUA Board under this section. If the Respondent wishes to present witness testimony at the hearing, the Respondent shall include a request to do so which specifies the names of the witnesses and the general nature of their expected testimony. Failure to request a hearing shall be deemed a waiver of any right to a hearing and failure to request the opportunity to present witness testimony shall be deemed a waiver of any right to present such testimony.

(3) *Effective date.* Unless otherwise ordered by the NCUA Board, the dismissal shall remain in effect while a request for reinstatement is pending.

(c) *Order for informal hearing.* Upon receipt of a timely written request from a Respondent for an informal hearing on the portion of a directive requiring a credit union to dismiss from office any director or senior executive officer, the NCUA Board shall issue an order commencing an informal hearing to commence no later than 30 days after receipt of the request, unless the Respondent requests a later date. The hearing shall be held in Alexandria, Virginia, or at such other place as may be designated by the NCUA Board, before a presiding officer designated by the NCUA Board to conduct the hearing and recommend a decision.

(d) *Procedures for informal hearing*—(1) A Respondent may appear at the hearing personally or through counsel. A Respondent shall have the right to introduce relevant documents and to present oral argument. A Respondent may introduce witness testimony only if expressly authorized by the NCUA Board or by the presiding officer. Neither the provisions of the Administrative Procedure Act (5 U.S.C. 554–557) governing adjudications required by statute to be determined on the record nor the Uniform Rules of Practice and Procedure (12 CFR 741.1) apply to an informal hearing under this section unless the NCUA Board orders otherwise.

(2) The informal hearing shall be recorded, and a transcript shall be furnished to the Respondent upon request and payment of the cost thereof. Witnesses need not be sworn, unless specifically requested by a party or the presiding officer. The presiding officer may ask questions of any witness.

(3) The presiding officer may order that the hearing be continued for a reasonable period (normally five business days) following completion of witness testimony or oral argument to allow additional written submissions to the hearing record.

(e) *Standard for review.* A Respondent shall bear the burden of demonstrating that his or her continued employment by or service with the credit union would materially strengthen the credit union's ability to—

(1) Become ''adequately capitalized,'' to the extent that the directive was issued as a result of the credit union's net worth ratio or failure to submit or implement a net worth restoration plan or revised business plan; and

(2) Correct the unsafe or unsound condition or unsafe or unsound practice, to the extent that the directive was issued as a result of reclassification of the credit union pursuant to §§ 702.101(d) and 702.202(d) of this chapter.

(f) *Recommendation of presiding officer.* Within 20 calendar days following the date the hearing and the record are closed, the presiding officer shall make a recommendation to the NCUA Board concerning the Respondent's request for reinstatement with the credit union.

(g) *Time for decision.* Not later than 60 calendar days after the date the record is closed or the date of the response in a case where no hearing was requested, the NCUA Board shall grant or deny the request for reinstatement and shall notify the Respondent of its decision. If the NCUA Board denies the request for reinstatement, it shall set forth in the notification the reasons for the its action. The decision of the NCUA Board shall be final.

§ 747.2005 Enforcement of orders.

(a) *Judicial remedies.* Whenever a credit union fails to comply with a directive imposing a discretionary supervisory action or enforcing a mandatory supervisory action under part 702 of this chapter, the NCUA Board may seek enforcement of the directive in the appropriate United States District Court pursuant to 12 U.S.C. 1786(k)(1).

(b) *Administrative remedies*—(1) *Failure to comply with directive.* Pursuant to 12 U.S.C. 1786(k)(2)(A), the NCUA Board may assess a civil money penalty against any credit union that violates or otherwise fails to comply with any final directive issued under part 702 of this chapter against any institution-affiliated party of a credit union who participates in such violation or noncompliance;

(2) *Failure to implement plan.* Pursuant to 12 U.S.C. 1786(k)(2)(A), the NCUA Board may assess a civil money penalty against a credit union which fails to implement a net worth restoration plan under subpart A of part 702 or a revised business plan under subpart B of part 702.

(c) *Other enforcement action.* In addition to the actions described in paragraphs (a) and (b) of this section, the NCUA Board may seek enforcement of the directives issued under part 702 of this chapter through any other judicial or administrative proceeding authorized by law.

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