

in paragraphs (a) through (d) of this section by:

(2) The Olympic average of estimated pounds of cottonseed per pound of ginned cotton lint, as determined by CCC, for the five years preceding the 2004 crop year.

■ 10. Revise § 1427.1108 to read as follows:

**§ 1427.1108 Total payment quantity.**

The total quantity of 2004-crop cottonseed eligible under this subpart shall be based on the total payment quantity of cottonseed as determined under this subpart for which timely applications are filed. Eligible cottonseed for which no application is received according to announced application instructions shall not be included in the total payment quantity of cottonseed. The total payment quantity of cottonseed (ton-basis) shall be calculated by multiplying:

(a) The total weight of cotton lint, converted to tons, for which payment is requested by all applicants, as approved by CCC, by

(b) The Olympic average of estimated pounds of cottonseed per pound of ginned cotton lint, as determined by CCC for the five years preceding the 2004 crop year.

■ 11. Revise § 1427.1109 to read as follows:

**§ 1427.1109 Payment rate.**

The payment rate (dollars per ton) shall be determined by CCC by dividing the total available program funds by the total eligible payment quantity of cottonseed. However, in no event may the total payment to an eligible applicant exceed \$114 per ton of cottonseed multiplied by the applicant's total eligible payment quantity.

■ 12. Amend § 1427.1111 by revising paragraph (d) to read as follows:

**§ 1427.1111 Liability of first handler.**

\* \* \* \* \*

(d) For 3 years after the date of the application for 2004-crop payments, the applicant shall keep records, including records supporting the quantity of cottonseed for which payment was requested, and furnish such information and reports relating to the application to CCC as requested. Such records shall be available at all reasonable times for an audit or inspection by authorized representatives of CCC, United States Department of Agriculture, or the Comptroller General of the United States. Failure to keep, or make available, such records may result in refund to CCC of all payments received, plus interest thereon, as determined by CCC. In the event of a controversy

concerning payments, records must be kept for such longer period as may be specified by CCC until such controversy is resolved. Destruction of records at any time is at the risk of the applicant.

Signed in Washington, DC, on January 12, 2006.

**Teresa C. Lasseter,**

*Executive Vice President, Commodity Credit Corporation.*

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**NATIONAL CREDIT UNION ADMINISTRATION**

**12 CFR Parts 701 and 741**

**Uninsured Secondary Capital**

**AGENCY:** National Credit Union Administration (NCUA).

**ACTION:** Final rule.

**SUMMARY:** The National Credit Union Administration (NCUA) is adopting modifications to its rules on uninsured secondary capital accounts to allow low-income designated credit unions to begin redeeming the funds in those accounts when they are within five years of maturity, and to require prior approval of a plan for the use of uninsured secondary capital before a credit union can begin accepting the funds.

**DATES:** This rule is effective February 27, 2006.

**FOR FURTHER INFORMATION CONTACT:** Steven W. Widerman, Trial Attorney, Office of General Counsel, at 703/518-6557; or Margaret Miller, Program Officer, Office of Examination and Insurance, at 703/518-6375.

**SUPPLEMENTARY INFORMATION:**

**A. Background**

1. *Uninsured secondary capital accounts.* Under conditions prescribed by the NCUA Board, credit unions serving predominantly low-income members are permitted by law to receive payments on shares from non-natural persons. 12 U.S.C. 1757(6). In 1996, the NCUA Board authorized low-income designated credit unions ("LICUs"),<sup>1</sup> including State-chartered credit unions

<sup>1</sup> The NCUA Board is authorized by law to define "credit unions serving predominantly low-income members." 12 U.S.C. 1757(6). To be so designated by the appropriate Regional Director, the NCUA Board generally requires the majority of a credit union's members to earn less than 80 percent of the average national wage as determined by the Bureau of Labor Statistics, or to have annual household incomes below 80 percent of the national median as determined by the Census Bureau. 12 CFR 701.34(a)(2)-(3).

to the extent permitted by State law, to accept uninsured secondary capital ("USC") from non-natural person members and nonmembers. 12 CFR 701.34(b) (2005). The purpose of USC is to provide a further means—beyond setting aside a portion of earnings—for LICUs to build capital to support greater lending and financial services in their communities, and to absorb losses and thus protect LICUs from failing. 61 FR 3788 (Feb. 2, 1996); 61 FR 50696 (Sept 27, 1996).

To ensure the safety and soundness of LICUs that accept USC, the existing rule imposed multiple restrictions that also apply to State-chartered LICUs. 12 CFR 741.204. Before accepting USC, a LICU must submit a written plan for the use and repayment of USC. § 701.34(b)(1). USC accounts must have a minimum maturity of five years and may not be redeemable prior to maturity. § 701.34(b)(3)-(4). The accounts must be established as uninsured, non-share instruments. § 701.34(b)(2) and (5). And most importantly, USC funds on deposit (including interest paid into the account) must be available to cover operating losses in excess of the LICU's net available reserves and undivided earnings. § 701.34(b)(7). Funds used to cover such losses may not be replenished or restored to the USC accounts. *Id.*

2. *Impact of Prompt Corrective Action.* Since the inception of USC, existing § 701.34(c)(1) has required LICUs to discount a USC account's original capital value (now called "net worth value")—essentially recategorizing the discounted portion as subordinated debt—in 20 percent annual increments beginning at five years remaining maturity. Even as its capital value is discounted, however, the full amount of USC must remain on deposit to cover losses. § 701.34(c)(2) (2005).

In 2000, pursuant to Congressional mandate, NCUA adopted a system of "prompt corrective action" ("PCA") consisting of mandatory minimum capital standards indexed by a credit union's "net worth ratio" to five statutory net worth categories.<sup>2</sup> 12 U.S.C. 1790d; 12 CFR part 702; 65 FR 8560 (Feb. 18, 2000). As a credit union's net worth ratio falls, its classification among the net worth categories declines below "well capitalized," thus exposing it to an expanding range of mandatory and discretionary supervisory actions

<sup>2</sup> The "net worth" of a LICU is defined by law as its retained earnings under GAAP plus any USC on deposit. 12 U.S.C. 1790d(o)(2); 12 CFR 702.2(f). The "net worth ratio" of a credit union is the ratio of its net worth to its total assets. 12 U.S.C. 1790d(o)(3); 12 CFR 702.2(g) and (k).

designed to restore net worth. *E.g.*, 12 CFR 702.201(a), 702.202(a), 702.204(b).

Because of PCA, discounting the net worth value of USC beginning at five years remaining maturity reduces a LICU's net worth ratio. While the "net worth" numerator of the ratio is reduced at the rate of 20 percent annually, the "assets" denominator must remain the same because of the existing rule's restriction on redeeming USC accounts prior to maturity. § 701.34(b)(4) (2005). The result is that discounting the net worth value of USC dilutes a LICU's net worth ratio, threatening to lower its classification among the PCA net worth categories.

3. *2005 Proposed Rule.* December 2004 Call Report data indicated that a significant number of LICUs are exposed to the risk that discounting the value of their USC will dilute their net worth ratio. 70 FR 43789 (July 29, 2005).<sup>3</sup> For this reason, the NCUA Board issued a proposed rule allowing low-income designated credit unions that have USC accounts to begin redeeming the funds in those accounts when they are within five years of maturity. 70 FR 43789. To discourage the misuse of USC, the proposed rule also requires prior approval, not just submission, of a plan for the use and repayment of the aggregate USC before a LICU can accept USC accounts. *Id.*

NCUA received four comments in response to the proposed rule, all from credit union industry trade associations representing different segments of the industry. One commenter supported without reservation the proposal to allow redemption of USC accounts prior to maturity; the other three supported the proposal subject to their comments discussed below. One commenter supported without reservation the proposal to require prior approval of a plan for the use and repayment of USC; the other three opposed the requirement altogether for reasons given in their comments discussed below. Suggested revisions to the existing regulation beyond those introduced in the proposed rule also are addressed below.

## B. Analysis of Comments on Proposed Rule

### 1. Redemption of Secondary Capital Prior to Maturity

To protect a LICU's net worth ratio from being diluted by discounting the net worth value of its USC, the proposed

<sup>3</sup> June 2005 data shows that 55 LICUs have USC accounts. These accounts have an aggregate balance of \$30 million in USC. Of these LICUs, 46 are classified "well capitalized" and 4 are classified "adequately capitalized," indicating that 89 percent currently have net worth ratios that subject them to little or no PCA.

rule introduced new subsection (d) eliminating the existing bar against redemption and, instead, prescribing conditions under which LICU's may redeem discounted USC prior to maturity.

*Prepayment Risk.* Two commenters noted that the proposed rule fails to address the "prepayment risk" for account investors created by permitting LICUs to redeem USC prior to maturity, and also does not disclose that risk in the "Disclosure & Acknowledgement" form in the Appendix to § 701.34. "Prepayment risk" is the risk that, to the extent USC is repaid earlier than the final maturity date, the account investor may be deprived of expected interest income because it will be unable to reinvest the repaid funds at the same rate of interest for the balance of the period remaining until the original maturity date. This risk represents a legitimate concern. USC investors can protect themselves from prepayment risk to the extent they contract with the LICU to limit or bar redemption prior to maturity of the investor's account. To the extent the parties are silent about redemption prior to maturity, the "Disclosure and Acknowledgement" in Appendix A to § 701.34 is amended to put the investor on notice as follows:

4. *Prepayment and other risks.* Redemption of USC prior to the account's original maturity date may expose the account investor to the risk of being unable to reinvest the repaid funds at the same rate of interest for the balance of the period remaining until the original maturity date. The investor acknowledges that it understands and assumes responsibility for prepayment risk associated with [name of credit union]'s redemption of the investor's USC account prior to the original maturity date."

*Redemption in Final Year Prior to Maturity.* The new schedule for redeeming USC does not provide for redemption of the last twenty percent increment of discounted USC during the final year prior to maturity. § 701.34(d)(3). As the proposed rule explained, this last increment of discounted USC will be redeemed at the account's final maturity date. 70 FR at 43790. Two commenters asked why LICUs are not allowed to redeem the last increment of discounted USC during the final year, *i.e.*, before the account's final maturity date. The reason is that, to fulfill its most important purpose, the final twenty percent increment must remain available to cover operating losses until the final maturity date, even as its net worth value is discounted to zero. § 701.34(c)(2). If LICUs were permitted to redeem the last twenty percent increment before the account's

maturity, there would be no USC on deposit to cover post-redemption operating losses arising prior to the final maturity date. Thus, the final rule retains the new schedule for redemption as proposed. § 701.34(d)(3).

*Minimum post-redemption net worth classification.* To redeem discounted USC, the proposed rule required a LICU to have a post-redemption net worth classification of "well capitalized." 70 FR at 43790. However, a credit union that would be "adequately capitalized" after redeeming discounted USC could apply on a case-by-case basis for Regional Director approval to redeem. *Id.* It is apparent upon reconsideration that this requirement for "adequately capitalized" credit unions is redundant because each credit union's request to redeem, regardless of post-redemption net worth, already receives subjective, case-by-case evaluation and approval. Moreover, the post-redemption difference between a "well capitalized" and an "adequately capitalized" credit union is that PCA subjects the latter to a single "mandatory supervisory action": The requirement to make quarterly contributions of earnings to build net worth.

One commenter asked why the proposed rule did not allow a LICU to redeem discounted USC if its post-redemption net worth classification would be *less than* "adequately capitalized" (*i.e.*, a net worth ratio of 5.99 percent or less). There are three reasons for setting a minimum post-redemption net worth "floor" at "adequately capitalized." First, very few LICUs would be affected because typically only a handful (five or less as of June 2005) would have a net worth classification of less than "adequately capitalized" after redeeming their discounted USC. Second, among all LICUs that accept USC, redeeming discounted USC would rarely increase one's net worth ratio significantly enough to raise a LICU to a higher net worth category. And third, on rare occasions when redemption would raise a LICU to a higher category, as long as it still is below "adequately capitalized," the LICU would remain burdened with the full range of "mandatory supervisory actions" that PCA imposes on the bottom three net worth categories.<sup>4</sup> Prohibiting

<sup>4</sup> In addition to making quarterly transfers of earnings to build net worth, credit unions in the "undercapitalized," "significantly undercapitalized" and "critically undercapitalized" net worth categories must comply with three further "mandatory supervisory actions": (1) A freeze on total assets; (2) a freeze on the balance of MBLs; and (3) the requirement to submit a net worth

redemption by credit unions that remain in these categories furthers the goal of maximizing their cushion against operating losses that otherwise would be borne by the Share Insurance Fund.

For these reasons, the final rule retains “adequately capitalized” as the minimum post-redemption net worth “floor” for redeeming discounted USC.

**Resolution Authorizing Redemption.** The proposed rule requires that a LICU’s request to redeem USC be authorized by a resolution of the credit union’s board of directors. 70 FR at 43790. The rule explained that the purpose of a board resolution is to “document[] that a majority of the board participated in a board decision. Maximum board member participation in deciding to redeem SC helps to overcome possible conflicts of interest between LICU officials and officials of the SC account holder.” *Id.* A commenter asks either that this rationale be further explained, or that the resolution requirement be eliminated from the final rule.

The final rule retains the resolution requirement as proposed, but further explains its purpose as follows. In many instances, a LICU in search of USC and potential USC investors are identified and brought together by one or more individual officials of each party to the transaction. These individuals sometimes have pre-existing familial or business relationships that may impair their independence and fidelity to the interests of the party they represent. On the assumption that the credit union official who was the “finder” of the USC investor is singularly able to consummate the transaction, the natural tendency of credit union officials is to defer to that person’s knowledge and judgment. Excessive reliance on knowledge and judgment concentrated in one or a few individuals allows them to be unduly influential in the making of decisions relating to the transaction.

In the case of USC investments, the dominant influence of the “finder(s)” may extend to deciding whether to accommodate an investor’s wish to redeem its USC account at the earliest opportunity, thus realizing a prepayment award (through reinvestment at more favorable interest rate), or to forestall redemption to avoid prepayment risk (requiring reinvestment at a less favorable interest rate). A resolution of a credit union’s board of directors would ensure that such a decision is made by the board as a whole, is consistent with the credit union’s best interests, and is transparent. For these reasons, the final

restoration plan for approval. 12 U.S.C. 1790d(f)–(g); 12 CFR 702.202(a).

rule requires that a LICU’s request to redeem discounted USC be embodied in a duly authorized resolution of its board of directors.

**Timing and scope of request to redeem.** The proposed rule provided that “a request to redeem discounted secondary capital must be submitted in writing on an annual basis.” § 701.34(d)(1). The preamble explained that a request “must be submitted for each year preceding maturity (unless the Regional Director indicates in writing that the approval is for more than one year).” 70 FR at 43790. A commenter asks if this means that a redemption request may be submitted *only* once a year, thus precluding more than one request per year. The answer is no.

To ensure that redemption requests may be submitted at any time and may be broadly framed, the final rule is revised to allow a request to be submitted “at any time” so long as it “specif[ies] the increment(s) to be redeemed and the schedule for redeeming all or any part of each eligible increment.” As a result, LICUs will have the option to, for example, seek approval extending beyond the current year, thus allowing future years’ increments of discounted USC to be redeemed as they become eligible; or to redeem a year’s increment in installments timed to correspond with the availability of liquidity from maturing instruments and availability of sources of lower cost funds. Finally, to give Regional Directors maximum flexibility in addressing redemption requests that may be ambitious in scope, the final rule has been revised to provide that: “A request to redeem discounted secondary capital may be granted in whole or in part.”

## 2. Pre-Approval of Plan for Use of Uninsured Secondary Capital

Existing § 701.34(b) requires a LICU that is planning to accept USC accounts to forward to the appropriate Regional Director (and to the appropriate State Supervisory Authority (“SSA”) in the case of State-chartered LICU) a written plan for the use of the aggregate funds in those accounts and “subsequent liquidity needs” to repay them upon maturity (“Plan”). § 701.34(b)(1); 12 CFR 741.204(c). No Regional Director or SSA approval is required. In contrast, the proposed rule requires prior regulatory approval of a USC Plan, subject to certain matters the Plan must address, before USC accounts can be accepted.<sup>5</sup> § 701.34(b). As proposed, a

<sup>5</sup> Approval will be required only for USC Plans submitted on or after the effective date of this final rule; Plans submitted before that date will not be

USC Plan need not be submitted for each account individually; rather it may address the maximum aggregate USC that a LICU expects to receive.

**Misuse of Secondary Capital.** A principal reason for requiring approval—not just submission—of a LICU’s USC Plan is to ensure that USC is used to achieve the goals for which it was conceived, *i.e.* building capital to support expansion of lending and financial services in LICUs’ communities, and to serve as a cushion against losses. 61 FR 3788 (Feb. 2, 1996). Emphasizing that USC is disclosed in a LICU’s quarterly Call Report, three commenters questioned the proposed rule’s conclusion that “SC played a role in masking the magnitude of other problems” that caused LICUs to fail. 70 FR at 43791. One assumed that those cases “undoubtedly involved fraud and/or major recordkeeping deficiencies” and thus were atypical. Two commenters contended that requiring prior approval of USC Plans would not improve safety and soundness enough to justify the additional burden on credit unions. And the third objected that that burden creates an additional step that could discourage potential investors from entering the USC market.

Net worth is a reliable—if sometimes lagging—indicator of operational problems and poor financial performance that threaten a credit union’s solvency. Full disclosure of a LICU’s USC balance distinguishes the portion of net worth derived from earnings generated by routine credit union operations, in contrast to the portion derived from subordinated debt that ultimately must be repaid. However, this quantitative distinction tells us nothing about a LICU’s qualitative use of USC, which in terms of risk to credit union safety and soundness, can range from negligible to perilous.

Contrary to a commenter’s assumption, the problems that the final rule addresses generally are not solely the result of fraud and deficient recordkeeping. Rather, they reflect an emerging pattern of lenient practices that frustrate LICUs’ good faith use of USC. These practices include: (1) Poor due diligence and strategic planning in connection with establishing and expanding member service programs such as ATMs, share drafts and lending (*e.g.*, member business loans (“MBLs”) real estate and subprime); (2) Failure to

affected. However, no USC Plan is necessary for funds received after the effective date pursuant to a Plan adopted and submitted before the effective date.

adequately perform a prospective cost/benefit analysis of these programs to assess such factors as market demand and economies of scale; (3) Premature and excessively ambitious concentrations of USC to support unproven or poorly performing programs; and (4) Failure to realistically assess and timely curtail programs that, in the face of mounting losses, are not meeting expectations. When they occur, these lenient practices contribute to excessive net operating costs, high losses from loan defaults, and a shortfall in revenues (due to non-performing loans and poorly performing programs)—all of which, in turn, produce lower than expected returns.

Promoting diligent practices in place of lenient ones cannot help but improve the safety and soundness of LICUs. Requiring prior approval of a USC Plan will strengthen supervisory oversight and detection of lenient practices in several ways. First, it will prevent LICUs from accepting and using USC for purposes and in amounts that are improper or unsound. Second, the approval requirement will ensure that USC Plans are evaluated and critiqued by the Region before being implemented. Third, for both NCUA and the LICU, an approved USC Plan will document parameters to guide the proper implementation of USC, and to measure the LICU's progress and performance. For these reasons, the final rule requires prior Regional Director approval of a USC Plan.

Finally, to the extent that obtaining prior approval adds a step that might cause undue delay, possibly discouraging potential investors from entering the USC market, the final rule provides a backstop. A Regional Director has 45 days from the date a USC Plan is submitted to approve or disapprove it. However, the final rule provides that if a Regional director fails to act on a USC Plan within that period, the Plan is approved by default and "the LICU may proceed to accept secondary capital accounts pursuant to the plan." § 701.34(b)(2).

*Regional Director discretion to approve Plan.* Before accepting USC accounts, the proposed rule required a LICU to forward its USC Plan to the appropriate NCUA Regional Director for approval. § 701.34(b)(1). One commenter objected that this approval authority "places excessive discretion in the hands of the agency's regional directors." The NCUA Board believes the degree of Regional Director discretion is appropriate for two reasons. First, because the final rule establishes four criteria on which a decision to approve or disapprove must

be based: how the LICU will use the aggregate; how it will provide for subsequent liquidity to repay the accounts; whether the use of USC conforms to the LICU's strategic plan, business plan and budget; and whether the Plan is supported by two years of pro forma financial statements. And second, in assessing those criteria, the Regional Director will be relying on input from the examiner who regularly oversees the credit union and, thus, is well-suited to judge its capabilities. For these reasons, the NCUA Board is content to give its Regional Directors the authority to take final agency action on USC Plans. Accordingly, the final rule retains as proposed the requirement for Regional Director prior approval of USC Plans.

*Pro forma financial statements.* To the existing criteria for approval of a Plan, the proposed rule adds the requirement to demonstrate that the intended use of USC conforms to the accepting LICU's strategic plan, business plan and budget; and is supported by accompanying pro forma financial statements, including any off-balance sheet items, covering a minimum of the next two years. § 701.34(b)(1)(iv). As the proposed rule noted, the purpose of this criterion "is to project and document the future financial performance of the LICU in relation to the risks associated with accepting USC accounts." 70 FR at 43791. Nonetheless, the single commenter who addressed this requirement objected, without explanation, that it is "unnecessary" for a USC Plan to be supported and accompanied by pro forma financial statements. NCUA maintains that pro forma financial statements are a routine, yet essential, tool for documenting and testing the soundness of the assumptions a credit union relies on to project future performance. Pro forma financial statements benefit credit union management by measuring differences between planned and actual performance. And pro forma financial statements facilitate regulatory evaluation and supervisory oversight of USC Plans.

### 3. Other Comments

The commenters suggested several revisions to the existing § 701.34(b) beyond those introduced in the proposed rule.

*Use of Secondary Capital to Pay Dividends.* In both the existing and the proposed rule, the essential feature of USC is that it "must be available to cover operating losses realized by the credit union" in excess of its net worth. § 701.34(b)(7). Two commenters advocate revising the final rule to clarify

whether the payment of dividends is within or beyond the scope of "operating losses realized by the credit union." Most contend that it is beyond the scope and thus should not be subsidized by USC.

The Federal Credit Union Act addresses this issue by allowing a credit union's board of directors to declare a dividend only "after provision for required reserves." 12 U.S.C. 1763; see also 12 U.S.C. 1761b(18). The prerequisite to have reserves from which to fund dividends means that USC cannot be used to create reserves for that purpose where none exists. Thus, a credit union may declare dividends only to the extent it has reserves available. After fully posting and measuring net income, including completing provisioning for Allowance for Loan and Lease Losses and measuring it against net income, a credit union may declare and pay dividends only to the extent that it has reserves and undivided earnings *exclusive of USC*. The final rule revises the "Disclosure and Acknowledgement" form in the Appendix to § 701.34 to clearly establish that "Dividends are not considered operating losses and thus are not eligible to be paid out of secondary capital."

*Replenishment of Secondary Capital Account.* Both the existing and the proposed rule state that, to the extent an USC account is used to cover "operating losses," the LICU "shall under no circumstances restore or replenish the account." § 701.34(b)(7) (2005). Two commenters believe that this restriction should be withdrawn so that a LICU could replenish USC accounts should it subsequently regain financial health. To do so would be inconsistent with the purpose of USC accounts, as explained in the final rule that first established the accounts: "Permitting LICUs to replenish SC once financial health has been regained would defeat the purpose for establishing secondary capital. The goal of secondary capital is to enhance capital positions. The potential growth of primary capital could be slowed by allowing LICUs to replenish investor funds in the event those funds are depleted. Additionally, permitting replenishment could be interpreted as "guaranteed return of principal" by the investor which was not the Board's original intent." 61 FR at 50696. For these reasons, the final rule retains the restriction against restoring or replenishing USC accounts. § 701.34(b)(7).

*Suspension of Dividend and Interest Payments.* The proposed rule combines two subsections of the existing rule into a single, abbreviated section explaining

NCUA's authority to suspend "critically undercapitalized" LICUs from paying principal, interest and dividends on USC accounts established after August 7, 2000, the date PCA became effective. § 701.34(12). The sole commenter on this section advocated repealing this authority. Because it is indirectly prescribed by law for "critically undercapitalized" credit unions,<sup>6</sup> the authority to suspend payments of principal, interest and dividends on USC accounts is not subject to repeal through the rulemaking process. Like the existing rule, the proposed subsection simply puts USC investors on notice of the possibility of a suspension of such payments in the event the LICU becomes "critically undercapitalized." It is therefore retained as proposed. § 701.34(b)(12).

## Regulatory Procedures

### Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires NCUA to prepare an analysis describing any significant economic impact a proposed regulation may have on a substantial number of small credit unions. NCUA considers credit unions having less than ten million dollars (\$10,000,000) to be small for purposes of the RFA. The final rule allows credit unions to begin redeeming USC accounts when they are within five years of maturity, and requires them to obtain prior approval of a plan for the use and repayment of USC, without imposing any additional regulatory burden. The final rule will not have a significant economic impact on a substantial number of small credit unions. Thus, a Regulatory Flexibility Analysis is not required.

<sup>6</sup> Congress directed NCUA to make the system of PCA developed for insured credit unions "comparable" with the 1991 law (12 U.S.C. 1831o) that mandated PCA for all other federally-insured depository institutions. 12 U.S.C. 1790d(b)(1)(A)(ii). That law authorized the Federal banking agencies to prohibit payments of principal or interest on a "critically undercapitalized" institution's subordinated debt. 12 U.S.C. 1831o(h)(2)(A). The Federal Deposit Insurance Corporation rule implementing that authority, for example, makes the prohibition *mandatory*. 12 CFR 325.105(a)(4)(H). To be comparable with § 1831o(h)(2)(A) as Congress instructed, part 702 established a "discretionary supervisory action" allowing, *but not requiring*, NCUA to "prohibit payments of principal, dividends or interest on the credit union's uninsured secondary capital accounts \* \* \* except that unpaid dividends or interest shall continue to accrue under the terms of the account \* \* \*." 12 CFR 702.204(b)(11). See 64 FR 27090, 27098 (May 18, 1999); 65 FR 8560, 8674 (Feb. 18, 2000). Section 701.34(b) was amended in 2000 to reflect the addition of this "discretionary supervisory authority." 65 FR 21129 (April 20, 2000).

### Paperwork Reduction Act

NCUA has determined that the final rule would not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget. NCUA currently has OMB clearance for the collection requirements in § 701.34 and part 741 (OMB Nos. 3133-0140, 3133-0099, 3133-142 and 3133-163).

### Executive Order 13132

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

### Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104-121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedures Act. 5 U.S.C. 551. NCUA submitted the rule to the Office of Management and Budget, which has determined that it is not major for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

### Treasury and General Government Appropriations Act, 1999

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

### List of Subjects in 12 CFR Parts 701 and 741

Bank deposit insurance, Credit Unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on January 19, 2006.

**Mary F. Rupp,**  
*Secretary of the Board.*

■ For the reasons set forth above, 12 CFR parts 701 and 741 are amended as follows:

## PART 701—ORGANIZATION AND OPERATIONS OF FEDERAL CREDIT UNIONS

■ 1. The authority citation for part 701 continues to read as follows:

**Authority:** 12 U.S.C. 1752(5), 1755, 1756, 1757, 1759, 1761a, 1761b, 1766, 1767, 1782, 1784, 1787, 1789 and Public Law 101-73. Section 701.6 is also authorized by 31 U.S.C. 3717. Section 701.31 is also authorized by 12 U.S.C. 1601 *et seq.*, 42 U.S.C. 1981 and 42 U.S.C. 3601-3610. Section 701.35 is also authorized by 12 U.S.C. 4311-4312.

■ 2. Amend § 701.34 as follows:

- a. Revise the section heading to read as set forth below;
- b. Revise paragraphs (b) and (c) to read as set forth below;
- c. Add new paragraph (d) before the Appendix to § 701.34 to read as set forth below; and
- d. Revise the Appendix to § 701.34 following new paragraph (d) to read as follows:

### § 701.34 Designation of low income status; Acceptance of secondary capital accounts by low-income designated credit unions.

\* \* \* \* \*

(b) *Acceptance of secondary capital accounts by low-income designated credit unions.* A federal credit union having a designation of low-income status pursuant to paragraph (a) of this section may accept secondary capital accounts from nonnatural person members and nonnatural person nonmembers subject to the following conditions:

(1) *Secondary capital plan.* Before accepting secondary capital, a low-income credit union ("LICU") shall adopt, and forward to the appropriate NCUA Regional Director for approval, a written "Secondary Capital Plan" that, at a minimum:

- (i) States the maximum aggregate amount of uninsured secondary capital the LICU plans to accept;
- (ii) Identifies the purpose for which the aggregate secondary capital will be used, and how it will be repaid;
- (iii) Explains how the LICU will provide for liquidity to repay secondary capital upon maturity of the accounts;
- (iv) Demonstrates that the planned uses of secondary capital conform to the LICU's strategic plan, business plan and budget; and
- (v) Includes supporting pro forma financial statements, including any off-

balance sheet items, covering a minimum of the next two years.

(2) *Decision on plan.* If a LICU is not notified within 45 days of receipt of a Secondary Capital Plan that the plan is approved or disapproved, the LICU may proceed to accept secondary capital accounts pursuant to the plan.

(3) *Nonshare account.* The secondary capital account must be established as an uninsured secondary capital account or other form of non-share account.

(4) *Minimum maturity.* The maturity of the secondary capital account must be a minimum of five years.

(5) *Uninsured account.* The secondary capital account will not be insured by the National Credit Union Share Insurance Fund or any governmental or private entity.

(6) *Subordination of claim.* The secondary capital account investor's claim against the LICU must be subordinate to all other claims including those of shareholders, creditors and the National Credit Union Share Insurance Fund.

(7) *Availability to cover losses.* Funds deposited into a secondary capital account, including interest accrued and paid into the secondary capital account, must be available to cover operating losses realized by the LICU that exceed its net available reserves (exclusive of secondary capital and allowance accounts for loan and lease losses), and to the extent funds are so used, the LICU must not restore or replenish the account under any circumstances. The LICU may, in lieu of paying interest into the secondary capital account, pay accrued interest directly to the investor or into a separate account from which the secondary capital investor may make withdrawals. Losses must be distributed pro-rata among all secondary capital accounts held by the LICU at the time the losses are realized.

(8) *Security.* The secondary capital account may not be pledged or provided by the account investor as security on a loan or other obligation with the LICU or any other party.

(9) *Merger or dissolution.* In the event of merger or other voluntary dissolution of the LICU, other than merger into another LICU, the secondary capital accounts will be closed and paid out to the account investor to the extent they are not needed to cover losses at the time of merger or dissolution.

(10) *Contract agreement.* A secondary capital account contract agreement must be executed by an authorized representative of the account investor and of the LICU reflecting the terms and conditions mandated by this section and any other terms and conditions not inconsistent with this section.

(11) *Disclosure and acknowledgement.* An authorized representative of the LICU and of the secondary capital account investor each must execute a "Disclosure and Acknowledgment" as set forth in the Appendix to this section at the time of entering into the account agreement. The LICU must retain an original of the account agreement and the "Disclosure and Acknowledgment" for the term of the agreement, and a copy must be provided to the account investor.

(12) *Prompt corrective action.* As provided in §§ 702.204(b)(11), 702.304(b) and 702.305(b) of this chapter, the NCUA Board may prohibit a LICU classified "critically undercapitalized" or, if "new," as "moderately capitalized", "marginally capitalized", "minimally capitalized" or "uncapitalized", as the case may be, from paying principal, dividends or interest on its uninsured secondary capital accounts established after August 7, 2000, except that unpaid dividends or interest will continue to accrue under the terms of the account to the extent permitted by law.

(c) *Accounting treatment; Recognition of net worth value of accounts.* (1) *Equity account.* A LICU that issues secondary capital accounts pursuant to paragraph (b) of this section must record the funds on its balance sheet in an equity account entitled "uninsured secondary capital account."

(2) *Schedule for recognizing net worth value.* For accounts with remaining maturities of less than five years, the LICU must reflect the net worth value of the accounts in its financial statement in accordance with the following schedule:

Remaining maturity	Net worth value of original balance (percent)
Four to less than five years .....	80
Three to less than four years ...	60
Two to less than three years ....	40
One to less than two years .....	20
Less than one year .....	0

(3) *Financial statement.* The LICU must reflect the full amount of the secondary capital on deposit in a footnote to its financial statement.

(d) *Redemption of secondary capital.* With the written approval of the appropriate Regional Director, secondary capital that is not recognized as net worth under paragraph (c)(2) of this section ("discounted secondary capital" recategorized as subordinated debt) may be redeemed according to the remaining maturity schedule in paragraph (d)(3) of this section.

(1) *Request to redeem secondary capital.* A request for approval to redeem discounted secondary capital may be submitted in writing at any time, must specify the increment(s) to be redeemed and the schedule for redeeming all any part of each eligible increment, and must demonstrate to the satisfaction of the appropriate Regional Director that:

(i) The LICU will have a post-redemption net worth classification of "adequately capitalized" under part 702 of this chapter;

(ii) The discounted secondary capital has been on deposit at least two years;

(iii) The discounted secondary capital will not be needed to cover losses prior to final maturity of the account;

(iv) The LICU's books and records are current and reconciled;

(v) The proposed redemption will not jeopardize other current sources of funding, if any, to the LICU; and

(vi) The request to redeem is authorized by resolution of the LICU's board of directors.

(2) *Decision on request.* A request to redeem discounted secondary capital may be granted in whole or in part. If a LICU is not notified within 45 days of receipt of a request for approval to redeem secondary capital that its request is either granted or denied, the LICU may proceed to redeem secondary capital accounts as proposed.

(3) *Schedule for redeeming secondary capital.*

Remaining maturity	Redemption limit as percent of original balance
Four to less than five years .....	20
Three to less than four years ...	40
Two to less than three years ....	60
One to less than two years .....	80

**Appendix to § 701.34**

A LICU that is authorized to accept uninsured secondary capital accounts and each investor in such an account shall execute and date the following "Disclosure and Acknowledgment" form, a signed original of which must be retained by the credit union:

**Disclosure and Acknowledgment**

[Name of CU] and [Name of investor] hereby acknowledge and agree that [Name of investor] has committed [amount of funds] to a secondary capital account with [name of credit union] under the following terms and conditions:

1. *Term.* The funds committed to the secondary capital account are committed for a period of \_\_\_ years.

2. *Redemption prior to maturity.* Subject to the conditions set forth in 12 CFR 701.34, the funds committed to the secondary capital account are redeemable prior to maturity

only at the option of the LICU and only with the prior approval of the appropriate regional director.

3. *Uninsured, non-share account.* The secondary capital account is not a share account and the funds committed to the secondary capital account are not insured by the National Credit Union Share Insurance Fund or any other governmental or private entity.

4. *Prepayment risk.* Redemption of U.S.C. prior to the account's original maturity date may expose the account investor to the risk of being unable to reinvest the repaid funds at the same rate of interest for the balance of the period remaining until the original maturity date. The investor acknowledges that it understands and assumes responsibility for prepayment risk associated with the [name of credit union]'s redemption of the investor's U.S.C. account prior to the original maturity date.

5. *Availability to cover losses.* The funds committed to the secondary capital account and any interest paid into the account may be used by [name of credit union] to cover any and all operating losses that exceed the credit union's net worth exclusive of allowance accounts for loan losses, and in the event the funds are so used, (name of credit union) will under no circumstances restore or replenish those funds to [name of institutional investor]. Dividends are not considered operating losses and are not eligible to be paid out of secondary capital.

6. *Accrued interest.* By initialing below, [name of credit union] and [name of institutional investor] agree that accrued interest will be:

- Paid into and become part of the secondary capital account;
- Paid directly to the investor;
- Paid into a separate account from which the investor may make withdrawals; or
- Any combination of the above provided the details are specified and agreed to in writing.

7. *Subordination of claims.* In the event of liquidation of [name of credit union], the funds committed to the secondary capital account will be subordinate to all other claims on the assets of the credit union, including claims of member shareholders, creditors and the National Credit Union Share Insurance Fund.

8. *Prompt Corrective Action.* Under certain net worth classifications (see 12 CFR 702.204(b)(11), 702.304(b) and 702.305(b), as the case may be), the NCUA Board may prohibit [name of credit union] from paying principal, dividends or interest on its uninsured secondary capital accounts established after August 7, 2000, except that unpaid dividends or interest will continue to accrue under the terms of the account to the extent permitted by law.

ACKNOWLEDGED AND AGREED TO this \_\_\_ day of [month and year] by:

\_\_\_\_\_  
 [name of investor's official]  
 [title of official]  
 [name of investor]  
 [address and phone number of investor]  
 [investor's tax identification number]

\_\_\_\_\_  
 [name of credit union official]  
 [title of official]

**PART 741—REQUIREMENTS FOR INSURANCE**

■ 1. The authority citation for part 741 continues to read as follows:

**Authority:** 12 U.S.C. 1757, 1766, 1781—1790, and 1790d. Section 741.4 is also authorized by 31 U.S.C. 3717.

■ 2. Amend § 741.204 as follows:

■ a. Remove from paragraph (c) the citation “§ 701.34” wherever it appears and add in its place the citation “§ 701.34(b)(1)”;

■ b. Revise the second sentence of paragraph (c) and add a new third sentence to read as set forth below; and

■ c. Add new paragraph (d) to read as set forth below:

**§ 741.204 Maximum public unit and nonmember accounts, and low income designation.**

\* \* \* \* \*

(c) \* \* \* State chartered federally insured credit unions offering secondary capital accounts must submit the plan required by § 701.34(B)(1) to both the state supervisory authority and the NCUA Regional Director for approval. The state supervisory authority must approve or disapprove the plan with the concurrence of the appropriate NCUA Regional Director.

(d) Redeem secondary capital accounts only in accordance with the terms and conditions authorized for federal credit unions pursuant to § 701.34(d) of this chapter and to the extent not inconsistent with applicable state law and regulation. State chartered federally insured credit unions seeking to redeem secondary capital accounts must submit the request required by § 701.34(d)(1) to both the state supervisory authority and the NCUA Regional Director. The state supervisory authority must grant or deny the request with the concurrence of the appropriate NCUA Regional Director.

[FR Doc. 06-686 Filed 1-25-06; 8:45 am]

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**DEPARTMENT OF TRANSPORTATION**

**Federal Aviation Administration**

**14 CFR Part 71**

[Docket No. FAA-2005-20643; Airspace Docket No. 05-AAL-13]

**Establishment of Class D Airspace; and Revision of Class E Airspace; Big Delta, Allen Army Airfield, Fort Greely, AK**

**AGENCY:** Federal Aviation Administration (FAA), DOT.

**ACTION:** Final rule; correction.

**SUMMARY:** This action corrects an error in the airspace description contained in a Final Rule that was published in the **Federal Register** on Thursday, September 22, 2005 (70 FR 55531). Airspace Docket No. 05-AAL-13.

**EFFECTIVE DATE:** February 27, 2006.

**FOR FURTHER INFORMATION CONTACT:**

Derril Bergt, AFSAO, Federal Aviation Administration, 222 West 7th Avenue, Box 14, Anchorage, AK 99513-7587; telephone number (907) 271-2796; fax: (907) 271-2850; e-mail: [derril.bergt@faa.gov](mailto:derril.bergt@faa.gov). Internet address: <http://www.alaska.faa.gov/at>.

**SUPPLEMENTARY INFORMATION:**

**History**

**Federal Register** Document FAA-2005-20643, FR Doc. 05-18931, published on Thursday, September 22, 2005 (70 FR 55531), established Class D airspace at Big Delta, Allen Army Airfield, AK. An error was discovered in the airspace description that misidentified a highway name in the description of an area excluded from the Class D Airspace. This action corrects that error.

**Correction to Final Rule**

Accordingly, pursuant to the authority delegated to me, the airspace description of the Class D airspace published in the **Federal Register**, Thursday, September 22, 2005 (70 FR 55531), (FR Doc 05-18931), page 55533, column 1) is corrected as follows:

**§ 71.1 [Corrected]**

\* \* \* \* \*

**AAL AK D Big Delta, AK [Corrected]**

Big Delta, Allen AAF, AK  
(Lat. 63°59'40" N., long. 145°43'18" W.)  
Big Delta VORTAC  
(Lat. 64°00'16" N., long. 145°43'02" W.)  
Delta Junction Airport  
(Lat. 64°03'02" N., long. 145°43'02" W.)

That airspace extending upward from the surface to and including 3,800 feet MSL within a 6.3-mile radius of the Allen AAF; excluding the portion within the boundary of