NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 702

RIN 3133–AD81

Prompt Corrective Action; Amended Definition of Low-Risk Assets

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: In 2010, NCUA issued an Interim Final Rule expanding the definition of "low-risk assets" to include debt instruments on which the payment of principal and interest is unconditionally guaranteed by NCUA. Assets in this category receive a risk-weighting of zero for regulatory capital purposes to reflect the absence of credit risk. Having considered the public comments addressing the Interim Final Rule, NCUA is issuing this Final Rule permanently adopting the expanded definition of "low risk assets" without alteration.

DATES: This rule is effective March 23, 2011.

FOR FURTHER INFORMATION CONTACT: Steven W. Widerman, Trial Attorney, at the above address, or *telephone:* (703) 518–6557.

SUPPLEMENTARY INFORMATION:

Background

1. *Prompt Corrective Action.* In 1998, the Credit Union Membership Access Act, Public Law 105–219, 112 Stat. 913, mandated a system of regulatory capital standards for "natural person" credit unions entitled "Prompt Corrective Action" ("PCA"), 12 U.S.C. 1790d *et seq.* The NCUA Board adopted a comprehensive system of PCA, primarily in Part 702,[1] that imposes minimum capital standards and corresponding remedies to improve a credit union's net worth. 12 CFR 702 *et seq.*

Under PCA, a "natural person" credit union's "net worth ratio" determines its classification among five statutory net worth categories. 12 U.S.C. 1790d(c); 12 CFR 702.102. As a credit union's "net worth ratio" declines, so does its classification among the five net worth categories, thus subjecting it to an expanding range of mandatory and discretionary supervisory actions. 12 U.S.C. 1790d(e), (f) and (g); 12 CFR 702.204(a)–(b). For a credit union that is subject to an additional Risk-Based Net Worth Requirement, *id.* § 702.103, its minimum required "net worth ratio" depends upon a risk-weighting applied to each of eight different portfolios of credit union assets.[2] *Id.* § 702.104.

2. *NCUA Guaranteed Notes.* Chief among the problems experienced by corporate credit unions ("CCUs") during the Nation's recent economic downturn is the substantial devaluation of the mortgage-backed and asset-backed securities ("the distressed assets") held in their investment portfolios. In five such cases, the realization of losses on these distressed assets has driven the CCU into insolvency, requiring NCUA to place the CCU into liquidation.

To monetize the distressed assets held by the liquidated CCUs, NCUA embarked on a program in 2010 to securitize and sell those assets in a series of public offerings of senior debt instruments denominated "NCUA Guaranteed Notes" ("NGNs"). Under the NGN program, the Asset Management Estate of each liquidated CCU sells its distressed assets to a trust established by NCUA, which then resecuritizes the distressed assets in the form of NGNs. The trust then passes through to the NGN-holders the monthly cash flows produced by the underlying distressed assets. The NGNs benefit from the credit enhancement provided by the overcollateralization and excess interest generated by the underlying distressed assets.

To reinforce investor confidence in the NGNs, NCUA, as an agency of the Executive Branch of the United States, fully and unconditionally guarantees to investors the timely payment of principal and interest ("the NCUA Guaranty"). The NCUA Guaranty is backed by the full faith and credit of the United States. As a result of the NCUA Guaranty, the NGNs are legally permissible investments for federal "natural person" and CCUs, 12 U.S.C. 1757(7)(B); 12 CFR 704.5(c)(1) (2011), and for state-chartered "natural person" credit unions to the extent permitted by state law at the time of purchase.

3. *Risk-Weighting of "Low-Risk Assets".* Under PCA as it existed prior to this rulemaking, the NGNs held by a natural person credit union would fall within the "investments" risk portfolio. *Id.* § 702.104(c). The minimum risk-weighting applied to assets in that portfolio, based on their weighted average life, is 3 percent. *Id.* § 702.106(c)(1). The "investments" portfolio does not apply a risk-weighting of zero even when an investment carries no credit risk. The "Low-risk assets" risk portfolio, in contrast, does apply a risk-weighting of zero, but the NGNs did not fall within its scope. *Id.* § 702.106(d). Its scope was limited to "Cash on hand * * * and the NCUSIF deposit." *Id.* § 702.104(d).

Recognizing that an obligation supported by the full faith and credit of the United States carries no credit risk, the four other federal financial institution regulators jointly permit their respective institutions to apply a zero percent risk-weighting to the NGNs those institutions purchase because of the unconditional NCUA Guaranty.[3] The purpose of this rulemaking is to accord the same zero percent risk-weighting to NGNs purchased by "natural person" credit unions. Otherwise, potential credit union investors in the NGNs would face a disincentive to invest: A minimum 3 percent risk-weighting—and the adverse effect on PCA net worth—even though the NGNs are free of credit risk.

4. *Comments on Interim Final Rule.* To accord the NGNs a risk-weighting of zero for regulatory capital purposes, the NCUA Board issued an "Interim final rule with request for comments," expanding the definition "low risk assets" to include "debt instruments unconditionally guaranteed by the National Credit Union Administration," and thus backed by the full faith and credit of the United States.[4] 75 FR 66298 (October 28, 2010). NCUA

[1] Part 702 has been amended five times since it was originally adopted in 2000: First, to incorporate limited technical corrections. 65 FR 55439 (Sept. 14, 2000). Second, to delete sections made obsolete by adoption of a uniform quarterly schedule for filing Call Reports. 67 FR 12459 (March 19, 2002). Third, to incorporate a series of revisions and adjustments to improve and simplify PCA implementation. 67 FR 71078 (Nov. 29, 2002). A proposal to modify the criteria for filing a net worth restoration plan, 67 FR 7113 (Nov. 29, 2002), was never adopted. Fourth, to add a third risk-weighting tier to the standard risk-based net worth component for member business loans. 68 FR 56537, 56546 (Oct. 1, 2003). Fifth, to implement a statutory amendment allowing the acquirer in a credit union merger to combine the merging credit union's retained earnings with its own to determine the acquirer's post-merger "net worth." 73 FR 72688 (Dec. 1, 2008). A proposed rule to expand the definition of "net worth" to include assistance provided under section 208 of the Federal Credit Union Act, 12 U.S.C. 1788, was issued by the NCUA Board on March 17, 2011.

[2] "Long-term real estate loans," "Member Business Loans ("MBL") outstanding," "Investments," "Low-risk assets," "Average-risk assets," "Loans sold with recourse," "Unused MBL commitments" and "Allowance." 12 CFR 702.104.

[3] *See* joint letter dated October 13, 2010, from the Federal Reserve Board, Office of Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Office of Thrift Supervision to Director, Division of Supervision, NCUA Office of Examination and Insurance.

[4] To maximize the opportunity for credit union participation in the NGN offerings, the NCUA Board issued the Interim Final Rule and made it effective immediately under the good cause exception to the Administrative Procedure Act's requirement of a public comment period preceding the adoption of a final rule, and of a waiting period of at least 30 days between publication of a final rule and its effective date. 75 FR at 66299.

received two comment letters in response to the Interim Final Rule, both from national credit union industry trade associations.

Both commenters supported the Interim Final Rule without reservation, addressing collateral matters as well. One commenter advocated a separate rulemaking to consider further broadening the definition of "low risk assets" to add other "similar low-risk assets such as credit union investments in Federal Home Loan Bank securities." This final rule leaves open to the NCUA Board the option of adding debt instruments guaranteed by other Government entities to the "low risk assets" portfolio once NCUA has had an opportunity to assess its experience with the NGN offerings in retrospect (including whether the NCUA Guaranty was tapped), and to consider other risks associated with those instruments.

In regard to the NGN offerings, the other commenter encouraged maximum transparency and disclosure of information about the NGNs in order to help those credit unions that lack the expertise and resources to independently asses the NGNs and to make informed business decisions about whether to invest. To ensure comprehensive transparency and disclosure of information about each NGN offering, the offerings are being conducted for NCUA by a Wall Street investment banking firm that specializes in the issuance of structured debt products by governmental entities. Further, as reflected primarily in the Offering Memorandum for each NGN offering, NCUA is relying on the advice of two law firms that have substantial expertise in the legal disclosure requirements that apply to these transactions.

In view of the commenters' support of the Interim Final Rule, there is no reason to revise the amendatory language. Accordingly, the NCUA Board adopts in final the language of the Interim Final Rule without alteration.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a rule may have on a substantial number of small entities (primarily those under ten million dollars in assets). This rule 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 this rule will not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget. Control number 3133–0129 has been issued for Part 702 and will be displayed at the table at 12 CFR part 795.

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 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 rule does not constitute a policy that has federalism implications for purposes of the Executive Order.

Treasury and General Government Appropriations Act, 1999

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

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) (SBREFA) 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 APA. 5 U.S.C. 551. NCUA does not believe this rule is a "major rule" within the meaning of the relevant sections of SBREFA. The Office of Management and Budget has determined that the Interim Final Rule is not a "major rule" for purposes of SBREFA. As required by SBREFA, NCUA will file appropriate reports with Congress and the General Accountability Office so this rule may be reviewed.

List of Subjects in 12 CFR Part 702

Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on March 17, 2011.

Mary F. Rupp,

Secretary of the Board.

Accordingly, the Interim Final Rule amending 12 CFR part 702, which was published at 75 FR 66298 on October 28, 2010, is adopted as a Final Rule without change.

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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 707

RIN 3133–AD58

Corporate Credit Unions, Technical Corrections

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: In 2010, NCUA issued technical corrections to its corporate credit union rule, published in the **Federal Register** of October 20, 2010. NCUA is issuing this final rule adopting the technical corrections without alteration.

DATES: This rule is effective March 23, 2011.

FOR FURTHER INFORMATION CONTACT: Elizabeth Wirick, Staff Attorney, Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428, or *telephone:* (703) 518–6540.

SUPPLEMENTARY INFORMATION:

I. Background

In October 2010, NCUA published a comprehensive overhaul to its corporate credit union rule, 12 CFR part 704. 75 FR 64786 (Oct. 20, 2010). After publication, NCUA discovered that three technical corrections were necessary, and NCUA issued an interim final rule containing the corrections in December. 75 FR 47173 (Dec. 20, 2010). The technical corrections are as follows:

Section 704.2 Definition of "collateralized debt obligation"

The final revisions to part 704 prohibited corporate credit unions (corporates) from purchasing certain overly complex or leveraged investments, including collateralized debt obligations (CDOs). 75 FR 64786, 64793 (October 20, 2010). These prohibitions were intended to protect the corporates from the potential for excessive investment losses. 74 FR 65210, 65237 (December 9, 2009)