Persuasive	The applicant provides documentation supporting how the area's shopping facilities cluster within the area's hub and residents do not have other realistic alternatives to meet their shopping needs.
Not Persuasive	The applicant lists large shopping facilities without providing statistics or other documentation that demonstrates relevance to the proposed community.

13. Geography

Some communities face varying degrees of geographic isolation. As such, travel outside the community can be limited by mountain ranges, forests, national parks, deserts, bodies of waters, etc. This factor, and the relative degree of isolation, may help bolster a finding of interaction or common interests.

Most Persuasive	Area is geographically isolated and/or distinct from immediate surrounding area.
Persuasive	Area has geographic commonalities that influence other aspects of the residents' lives (i.e., tourism, allocation of government resources).
Not Persuasive	The area's geographic features do not appear to influence other social or economic characteristics of the area.

[81 FR 88424, Dec. 7, 2016, as amended at 82 FR 50291, Oct. 30, 2017; 82 FR 60290, 60292, Dec. 20, 2017; 83 FR 30295, June 28, 2018; 84 FR 1605, Feb. 5, 2019; 85 FR 56513, Sept. 14, 2020; 85 FR 62210, Oct. 2, 2020; 86 FR 66930, Nov. 24, 2021]

PART 702—CAPITAL ADEQUACY

Sec.

AUTHORITY: 12 U.S.C. 1757(9), 1766(a), 1784(a), 1786(e), 1790d.

SOURCE: 65 FR 8584, Feb. 18, 2000, unless otherwise noted.

EDITORIAL NOTE: Nomenclature changes to part 702 appear at 84 FR 1606, Feb. 5, 2019.

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

(a) *Authority*. Subparts A and B of this part and subpart L of part 747 of this chapter are issued by the National Credit Union Administration (NCUA) pursuant to sections 120 and 216 of the Federal Credit Union Act (FCUA), 12 U.S.C. 1766 and 1790d (section 1790d), as revised by section 301 of the Credit Union Membership Access Act, Public Law 105–219, 112 Stat. 913 (1998).

(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. Subparts A and B of this part carry out the purpose of prompt corrective action by establishing a framework of minimum capital requirements, and mandatory and discretionary supervisory actions applicable according to a credit union's capital classification, designed primarily to restore and improve the capital adequacy of federally insured credit unions.

(c) *Scope*. Subparts A and B of this part implement 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 section 1790d(b)(2); and to such credit unions defined as ''complex'' pursuant to section 1790d(d). Certain of these provisions also apply to officers and directors of federally insured credit unions. Subpart C applies capital planning and stress testing to credit unions defined as covered credit unions under § 702.302. This part does not apply to corporate credit unions. Unless otherwise provided, 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.

(d) *Other supervisory authority*. Neither section 1790d nor this part in any way limits the authority of the NCUA Board or appropriate state official 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 or appropriate state official, 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.

[80 FR 66706, Oct. 29, 2015; 85 FR 62210, Oct. 2, 2020, as amended at 86 FR 15401, Mar. 23, 2021]

§ 702.2 Definitions.

Unless otherwise provided in this part, 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. All accounting terms not otherwise defined in this section have meanings consistent with the commonly-accepted meanings under United States generally accepted accounting principles (U.S. GAAP). The following definitions apply to this part:

Allowances for loan and lease losses (ALLL) means valuation allowances that have been established through a charge against earnings to cover estimated credit losses on loans, lease financing receivables or other extensions of credit as determined in accordance with GAAP.

Amortized cost means the purchase price of a security adjusted for amortizations of premium or accretion of discount if the security was purchased at other than par or face value.

Appropriate state official means the state commission, board or other supervisory authority that chartered the affected credit union.

Call Report means the Call Report required to be filed by all credit unions under § 741.6(a)(2) of this chapter.

Carrying value means the value of the asset or liability on the statement of financial condition of the credit union, determined in accordance with GAAP.

CCULR means the complex credit union leverage ratio. It is calculated in the same manner as the net worth ratio under § 702.2.

Central counterparty (CCP) means a counterparty (for example, a clearing house) that facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts.

Charitable donation account means an account that satisfies all of the conditions in § 721.3(b)(2)(i), (b)(2)(ii), and (b)(2)(v) of this chapter.

Commercial loan means any loan, line of credit, or letter of credit (including any unfunded commitments) for commercial, industrial, and professional purposes, but not for investment or personal expenditure purposes. Commercial loan excludes loans to CUSOs, first- or junior-lien residential real estate loans, and consumer loans.

Commitment means any legally binding arrangement that obligates the credit union to extend credit, purchase or sell assets, enter into a borrowing agreement, or enter into a financial transaction.

Consumer loan means a loan or lease for household, family, or other personal expenditures, including any loans or leases that, at origination, are wholly or substantially secured by vehicles generally manufactured for personal, family, or household use regardless of the purpose of the loan or lease. Consumer loan excludes commercial loans, loans to CUSOs, first- and junior-lien residential real estate loans, and loans for the purchase of one or more vehicles to be part of a fleet of vehicles.

Contractual compensating balance means the funds a commercial loan borrower must maintain on deposit at the lender credit union as security for the loan in accordance with the loan agreement, subject to a proper account hold and on deposit as of the measurement date.

Credit conversion factor (CCF) means the percentage used to assign a credit exposure equivalent amount for selected off-balance sheet accounts.

Credit derivative means a financial contract executed under standard industry credit derivative documentation that allows one party (the protection purchaser) to transfer the credit risk of one or more exposures (reference exposure(s)) to another party (the protection provider) for a certain period of time.

Credit union means a federally insured, natural person credit union, whether federally- or state-chartered.

Current means, with respect to any loan or lease, that the loan or lease is less than 90 days past due, not placed on non-accrual status, and not restructured.

CUSO means a credit union service organization as defined in part 712 and 741 of this chapter.

Custodian means a financial institution that has legal custody of collateral as part of a qualifying master netting agreement, clearing agreement, or other financial agreement.

Depository institution means a financial institution that engages in the

business of providing financial services; that is recognized as a bank or a credit union by the supervisory or monetary authorities of the country of its incorporation and the country of its principal banking operations; that receives deposits to a substantial extent in the regular course of business; and that has the power to accept demand deposits. Depository institution includes all federally insured offices of commercial banks, mutual and stock savings banks, savings or building and loan associations (stock and mutual), cooperative banks, credit unions and international banking facilities of domestic depository institutions, and all privately insured state chartered credit unions.

Derivative contract means a financial contract that derives its value from the value and performance of some other underlying financial instrument or variable, such as an index or interest rate.

Derivatives Clearing Organization has the meaning as defined by the Commodity Futures Trading Commission (CFTC) in 17 CFR 1.3.

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

Equity investment in CUSOs means the unimpaired value of the credit union's equity investments in a CUSO as recorded on the statement of financial condition in accordance with GAAP.

Exchange means a central financial clearing market where end users can enter into derivative transactions.

Excluded goodwill means the outstanding balance, maintained in accordance with GAAP, of any goodwill originating from a supervisory merger or combination that was completed on or before December 28, 2015.

Excluded other intangible assets means the outstanding balance, maintained in accordance with GAAP, of any other intangible assets such as core deposit intangible, member relationship intangible, or trade name intangible originating from a supervisory merger or combination that was completed on or before December 28, 2015.

Exposure amount means:

(1) The amortized cost for investments classified as held-to-maturity and available-for-sale, and the fair value for trading securities.

(2) The outstanding balance for Federal Reserve Bank Stock, Central Liquidity Facility Stock, Federal Home Loan Bank Stock, nonperpetual capital and perpetual contributed capital at corporate credit unions, and equity investments in CUSOs.

(3) The carrying value for non-CUSO equity investments, and investment funds.

(4) The carrying value for the credit union's holdings of general account permanent insurance, and separate account insurance.

(5) The amount calculated under §702.105 of this part for derivative contracts.

Fair value has the same meaning as provided in GAAP.

Financial collateral means collateral approved by both the credit union and the counterparty as part of the collateral agreement in recognition of credit risk mitigation for derivative contracts.

First-lien residential real estate loan means a loan or line of credit primarily secured by a first-lien on a one-to-four family residential property where:

(1) The credit union made a reasonable and good faith determination at or before consummation of the loan that the member will have a reasonable ability to repay the loan according to its terms; and

(2) In transactions where the credit union holds the first-lien and junior lien(s), and no other party holds an intervening lien, for purposes of this part the combined balance will be treated as a single first-lien residential real estate loan.

Forward agreement means a legally binding contractual obligation to purchase assets with certain drawdown at a specified future date, not including commitments to make residential mortgage loans or forward foreign exchange contracts.

GAAP means generally accepted accounting principles in the United States as set forth in the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC).

General account permanent insurance means an account into which all premiums, except those designated for separate accounts are deposited, including premiums for life insurance and fixed annuities and the fixed portfolio of variable annuities, whereby the general assets of the insurance company support the policy.

General obligation means a bond or similar obligation that is backed by the full faith and credit of a public sector entity.

Goodwill means an intangible asset, maintained in accordance with GAAP, representing the future economic benefits arising from other assets acquired in a business combination (e.g., merger) that are not individually identified and separately recognized. Goodwill does not include excluded goodwill.

Government guarantee means a guarantee provided by the U.S. Government, FDIC, NCUA or other U.S. Government agency, or a public sector entity.

Government-sponsored enterprise (GSE) means an entity established or chartered by the U.S. Government to serve public purposes specified by the U.S. Congress, but whose debt obligations are not explicitly guaranteed by the full faith and credit of the U.S. Government.

Grandfathered Secondary Capital means any secondary capital issued under §701.34 of this chapter, before January 1, 2022 or, in the case of a federally insured, state-chartered credit union, with §741.204(c) of this chapter, before January 1, 2022. (12 CFR 701.34 was recodified as §702.414 as of January 1, 2022). This term also includes issuances of secondary capital to the U.S. Government or any of its subdivisions, under applications approved before January 1, 2022, pursuant to §701.34 or §741.204(c) of this chapter, irrespective of the date of issuance.

Guarantee means a financial guarantee, letter of credit, insurance, or similar financial instrument that allows one party to transfer the credit risk of one or more specific exposures to another party.

Identified losses means those items that have been determined by an evaluation made by NCUA, or in the case of a state chartered credit union the appropriate state official, as measured on the date of examination in accordance with GAAP, to be chargeable against income, equity or valuation allowances such as the allowances for loan and lease losses. Examples of identified losses would be assets classified as losses, off-balance sheet items classified as losses, any provision expenses that are necessary to replenish valuation allowances to an adequate level, liabilities not shown on the books, estimated losses in contingent liabilities, and differences in accounts that represent shortages.

Industrial development bond means a security issued under the auspices of a state or other political subdivision for the benefit of a private party or enterprise where that party or enterprise, rather than the government entity, is obligated to pay the principal and interest on the obligation.

Intangible assets mean assets, maintained in accordance with GAAP, other than financial assets, that lack physical substance.

Investment fund means an investment with a pool of underlying investment assets. Investment fund includes an investment company that is registered under section 8 of the Investment Company Act of 1940, and collective investment funds or common trust investments that are unregistered investment products that pool fiduciary client assets to invest in a diversified pool of investments.

Junior-lien residential real estate loan means a loan or line of credit secured by a subordinate lien on a one-to-four family residential property.

Loan secured by real estate means a loan that, at origination, is secured wholly or substantially by a lien(s) on real property for which the lien(s) is central to the extension of the credit. A lien is ''central'' to the extension of credit if the borrowers would not have been extended credit in the same amount or on terms as favorable without the liens on real property. For a loan to be ''secured wholly or substantially by a lien(s) on real property,'' the estimated value of the real estate collateral at origination (after deducting any more senior liens held by others) must be greater than 50 percent of

the principal amount of the loan at origination.

Loan to a CUSO means the outstanding balance of any loan from a credit union to a CUSO as recorded on the statement of financial condition in accordance with GAAP.

Loans transferred with limited recourse means the total principal balance outstanding of loans transferred, including participations, for which the transfer qualified for true sale accounting treatment under GAAP, and for which the transferor credit union retained some limited recourse (*i.e.,* insufficient recourse to preclude true sale accounting treatment). Loans transferred with limited recourse excludes transfers that qualify for true sale accounting treatment but contain only routine representation and warranty clauses that are standard for sales on the secondary market, provided the credit union is in compliance with all other related requirements, such as capital requirements.

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

Mortgage partnership finance program means a Federal Home Loan Bank program through which loans are originated by a depository institution that are purchased or funded by the Federal Home Loan Banks, where the depository institution receives fees for managing the credit risk of the loans. The credit risk must be shared between the depository institution and the Federal Home Loan Banks.

Mortgage servicing assets mean those assets, maintained in accordance with GAAP, resulting from contracts to service loans secured by real estate (that have been securitized or owned by others) for which the benefits of servicing are expected to more than adequately compensate the servicer for performing the servicing.

Multilateral development bank (MDB) means the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, and any other multilateral lending institution or regional development bank in which the U.S. government is a shareholder or contributing member.

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

Net worth means, with respect to any federally insured, natural person credit union, as of any date of determination:

(1) The retained earnings balance of the credit union at the most recent quarter end, as determined in accordance with U.S. GAAP, subject to paragraph (3) of this definition.

(2) With respect to a low-income designated credit union, the outstanding principal amount of Subordinated Debt treated as Regulatory Capital in accordance with §702.407, and the outstanding principal amount of Grandfathered Secondary Capital treated as Regulatory Capital in accordance with §702.414, in each case that is:

(i) Uninsured; and

(ii) Subordinate to all other claims against the credit union, including claims of creditors, shareholders, and the National Credit Union Share Insurance Fund.

(3) For a credit union that acquires another credit union in a mutual combination, net worth also includes the retained earnings of the acquired credit union, or of an integrated set of activities and assets, less any bargain purchase gain recognized in either case to the extent the difference between the two is greater than zero. The acquired retained earnings must be determined at the point of acquisition under GAAP. A mutual combination, including a supervisory combination, is a transaction in which a credit union acquires another credit union or acquires an integrated set of activities and assets that is capable of being conducted and managed as a credit union.

(4) The term ''net worth'' also includes loans to and accounts in an insured credit union, established pursuant to section 208 of the Act [12 U.S.C. 1788], provided such loans and accounts:

(i) Have a remaining maturity of more than 5 years;

(ii) Are subordinate to all other claims including those of shareholders, creditors, and the NCUSIF;

(iii) Are not pledged as security on a loan to, or other obligation of, any party;

(iv) Are not insured by the NCUSIF;

(v) Have non-cumulative dividends;

(vi) Are transferable; and

(vii) Are available to cover operating losses realized by the insured credit union that exceed its available retained earnings.

Net worth ratio means the ratio of the net worth of the credit union to the total assets of the credit union, expressed as a percentage rounded to two decimal places.

New credit union has the same meaning as in § 702.201.

Nonperpetual capital has the same meaning as in § 704.2 of this chapter.

Non-security beneficial interest is defined as the residual equity interest in the Special Purpose Entity (SPE) that represents a right to receive possible future payments after specified payment amounts are made to third-party investors in the securitized receivables. For purposes of this definition, a SPE means a trust, bankruptcy remote entity or other special purpose entity which is wholly owned, directly or indirectly, by the credit union and which is formed for the purpose of, and engages in no material business other than, acting as an issuer or a depositor in a securitization.

Off-balance sheet exposure means:

(1) For unfunded commitments, excluding unconditionally cancellable commitments, the remaining unfunded portion of the contractual agreement.

(2) For loans transferred with limited recourse, or other seller-provided credit enhancements, and that qualify for true sales accounting, the maximum contractual amount the credit union is exposed to according to the agreement, net of any related valuation allowance.

(3) For loans transferred under the Federal Home Loan Bank (FHLB) mortgage partnership finance program, the outstanding loan balance as of the reporting date, net of any related valuation allowance.

(4) For financial standby letters of credit, the total potential exposure of the credit union under the contractual agreement.

(5) For forward agreements that are not derivative contracts, the future contractual obligation amount.

(6) For sold credit protection through guarantees and credit derivatives, the total potential exposure of the credit union under the contractual agreement.

(7) For off-balance sheet securitization exposures, the notional amount of the off-balance sheet credit exposure (including any credit enhancements, representations, or warranties that obligate a credit union to protect another party from losses arising from the credit risk of the underlying exposures) that arises from a securitization.

(8) For securities borrowing or lending transactions, the amount of all securities borrowed or lent against collateral or on an uncollateralized basis.

Off-balance sheet items means off-balance sheet exposures and the off-balance sheet exposure amount of repurchase transactions.

On-balance sheet means a credit union's assets, liabilities, and equity, as disclosed on the statement of financial condition at a specific point in time.

Other intangible assets means intangible assets, other than servicing assets and goodwill, maintained in accordance with GAAP. Other intangible assets does not include excluded other intangible assets.

Over-the-counter (OTC) interest rate derivative contract means a derivative contract that is not cleared on an exchange.

Part 703 compliant investment fund means an investment fund that is restricted to holding only investments that are permissible under § 703.14(c) of this chapter.

Perpetual contributed capital has the same meaning as in § 704.2 of this chapter.

Public sector entity (PSE) means a state, local authority, or other governmental subdivision of the United States below the sovereign level.

Qualifying master netting agreement means a written, legally enforceable agreement, provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default, including upon an event of conservatorship, receivership, insolvency, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides the credit union the right to accelerate, terminate, and close out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of default, including upon an event of conservatorship, receivership, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, or under any similar insolvency law applicable to GSEs;

(3) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate is a net creditor under the agreement); and

(4) In order to recognize an agreement as a qualifying master netting agreement for purposes of this part, a credit union must conduct sufficient legal review, at origination and in response to any changes in applicable law, to conclude with a well-founded basis (and maintain sufficient written documentation of that legal review) that:

(i) The agreement meets the requirements of paragraph (2) of this definition; and

(ii) In the event of a legal challenge (including one resulting from default or from conservatorship, receivership, insolvency, liquidation, or similar proceeding), the relevant court and administrative authorities would find the agreement to be legal, valid, binding, and enforceable under the law of relevant jurisdictions.

Recourse means a credit union's retention, in form or in substance, of any credit risk directly or indirectly associated with an asset it has transferred that exceeds a *pro rata* share of that credit union's claim on the asset and disclosed in accordance with GAAP. If a credit union has no claim on an asset it has transferred, then the retention of any credit risk is recourse. A recourse obligation typically arises when a credit union transfers assets in a sale and retains an explicit obligation to repurchase assets or to absorb losses due to a default on the payment of principal or interest or any other deficiency in the performance of the underlying obligor or some other party. Recourse may also exist implicitly if the credit union provides credit enhancement beyond any contractual obligation to support assets it has transferred.

Repurchase transactions means either a transaction in which a credit union agrees to sell a security to a counterparty and to repurchase the same or an identical security from that counterparty at a specified future date and at a specified price or a transaction in which an investor agrees to purchase a security from a counterparty and to resell the same or an identical security to that counterparty at a specified future date and at a specified price. The off-balance sheet exposure amount for a repurchase transaction equals all of the positions the credit union has sold or bought subject to repurchase or resale, which equals the sum of the current fair values of all such positions.

Residential mortgage-backed security means a mortgage-backed security backed by loans secured by a first-lien on residential property.

Residential property means a house, condominium unit, cooperative unit, manufactured home, or the construction thereof, and unimproved land zoned for one-to-four family residential use. Residential property excludes

boats or motor homes, even if used as a primary residence, or timeshare property.

Restructured means, with respect to any loan, a restructuring of the loan in which a credit union, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. Restructured excludes loans modified or restructured solely pursuant to the U.S. Treasury's Home Affordable Mortgage Program.

Revenue obligation means a bond or similar obligation that is an obligation of a PSE, but which the PSE is committed to repay with revenues from the specific project financed rather than general tax funds.

Risk-based capital ratio means the percentage, rounded to two decimal places, of the risk-based capital ratio numerator to risk-weighted assets, as calculated in accordance with § 702.104(a).

Risk-weighted assets means the total risk-weighted assets as calculated in accordance with § 702.104(c).

Secured consumer loan means a consumer loan associated with collateral or other item of value to protect against loss where the creditor has a perfected security interest in the collateral or other item of value.

Senior executive officer means a senior executive officer as defined by § 701.14(b)(2) of this chapter.

Separate account insurance means an account into which a policyholder's cash surrender value is supported by assets segregated from the general assets of the carrier.

Share-secured loan means a loan fully secured by shares, and does not include the imposition of a statutory lien under § 701.39 of this chapter.

Shares means deposits, shares, share certificates, share drafts, or any other depository account authorized by federal or state law.

STRIPS means a separately traded registered interest and principal security.

Structured product means an investment that is linked, via return or loss allocation, to another investment or reference pool.

Subordinated means, with respect to an investment, that the investment has a junior claim on the underlying collateral or assets to other investments in the same issuance. An investment that does not have a junior claim to other investments in the same issuance on the underlying collateral or assets is non-subordinated. A Security that is junior only to money market eligible securities in the same issuance is also non-subordinated.

Subordinated Debt has the meaning as provided in subpart D of this part.

Supervisory merger or combination means a transaction that involved the following:

(1) An assisted merger or purchase and assumption where funds from the NCUSIF were provided to the continuing credit union;

(2) A merger or purchase and assumption classified by NCUA as an ''emergency merger'' where the acquired credit union is either insolvent or ''in danger of insolvency'' as defined under appendix B to Part 701 of this chapter; or

(3) A merger or purchase and assumption that included NCUA's or the appropriate state official's identification and selection of the continuing credit union.

Swap Dealer has the meaning as defined by the CFTC in 17 CFR 1.3.

Total assets means a credit union's total assets as measured by either:

(1)(i) Average quarterly balance. The credit union's total assets measured by the average of quarter-end balances of the current and three preceding calendar quarters;

(ii) Average monthly balance. The credit union's total assets measured by the average of month-end balances over the three calendar months of the applicable calendar quarter;

(iii) Average daily balance. The credit union's total assets measured by the average daily balance over the applicable calendar quarter; or

(iv) Quarter-end balance. The credit union's total assets measured by the quarter-end balance of the applicable calendar quarter as reported on the credit union's Call Report.

(2) For each quarter, a credit union must elect one of the measures of total assets listed in paragraph (1) of this definition to apply for all purposes under this part except §§ 702.103 through

702.105 (risk-based capital requirement).

(3) Notwithstanding paragraph (1) of this definition, a credit union may exclude loans pledged as collateral for a non-recourse loan that is provided as part of the Paycheck Protection Program Lending Facility, announced by the Federal Reserve Board on April 7, 2020, from the calculation of total assets for the purpose of calculating its net worth ratio. For the purpose of this provision, a credit union's liability under the Facility must be reduced by the principal amount of the loans pledged as collateral for funds advanced under the Facility.

Trading assets means securities or other assets acquired, not including loans originated by the credit union, for the purpose of selling in the near term or otherwise with the intent to resell in order to profit from short-term price movements. Trading assets would not include shares of a registered investment company or a collective investment fund used for liquidity purposes.

Trading liabilities means the total liability for short positions of securities or other liabilities held for trading purposes.

Tranche means one of a number of related securities offered as part of the same transaction. Tranche includes a structured product if it has a loss allocation based off of an investment or reference pool.

Unconditionally cancelable means with respect to a commitment, that a credit union may, at any time, with or without cause, refuse to extend credit under the commitment (to the extent permitted under applicable law).

Unsecured consumer loan means a consumer loan not secured by collateral.

U.S. Government agency means an instrumentality of the U.S. Government whose obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. Government. U.S. Government agency includes NCUA.

[80 FR 66706, Oct. 29, 2015, as amended at 86 FR 11073, Feb. 23, 2021; 86 FR 72803, Dec. 23, 2021; 86 FR 72809, Dec. 23, 2021]

EDITORIAL NOTE: At 86 FR 72809, Dec. 23, 2021, §702.2 was amended by revising the definition of ''Regulatory Capital''; however, the definition did not exist. The amendment could not be incorporated due to inaccurate amendatory instruction.

Subpart A—Prompt Corrective Action

SOURCE: 80 FR 66706, Oct. 29, 2015, unless otherwise noted.

§ 702.101 Capital measures, capital adequacy, effective date of classification, and notice to NCUA.

(a) *Capital measures.* For purposes of this part, a credit union must determine its capital classification at the end of each calendar quarter using the following measures:

(1) The net worth ratio; and

(2) If determined to be applicable under §702.103, either the risk-based capital ratio under §702.104(a) through (c) or the CCULR framework under §702.104(d).

(b) *Capital adequacy.* (1) Notwithstanding the minimum requirements in this part, a credit union defined as complex must maintain capital commensurate with the level and nature of all risks to which the institution is exposed.

(2) A credit union defined as complex must have a process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive written strategy for maintaining an appropriate level of capital.

(c) *Effective date of capital classification.* For purposes of this part, the effective date of a federally insured credit union's capital classification shall be the most recent to occur of:

(1) *Quarter-end effective date.* The last day of the calendar month following the end of the calendar quarter;

(2) *Corrected capital classification.* The date the credit union received subsequent written notice from NCUA or, if state-chartered, from the appropriate state official, of a decline in capital classification due to correction of an error or misstatement in the credit union's most recent Call Report; or

(3) *Reclassification to lower category.* The date the credit union received written notice from NCUA or, if state-chartered, the appropriate state official, of reclassification on safety and

soundness grounds as provided under §702.102(b) or §702. 202(d).

(d) *Notice to NCUA by filing Call Report.* (1) Other than by filing a Call Report, a federally insured credit union need not notify the NCUA Board of a change in its capital measures that places the credit union in a lower capital category;

(2) Failure to timely file a Call Report as required under this section in no way alters the effective date of a change in capital classification under paragraph (b) of this section, or the affected credit union's corresponding legal obligations under this part.

[80 FR 66706, Oct. 29, 2015, as amended at 86 FR 72804, Dec. 23, 2021]

§702.102 Capital classification.

(a) *Capital categories.* Except for credit unions defined as ''new'' under subpart B of this part, a credit union shall be deemed to be classified (Table 1 of this section)—

(1) *Well capitalized* if:

(i)(A) *Net worth ratio.* The credit union has a net worth ratio of 7.0 percent or greater; and

(B) *Risk-based capital ratio.* The credit union, if complex, has a risk-based capital ratio of 10 percent or greater; or

(ii) *Complex credit union leverage ratio.* (A) The complex credit union is a qualifying complex credit union that has opted into the CCULR framework under §702.104(d) and it has a CCULR of 9.0 percent or greater; or

(B) The complex credit union is a qualifying complex credit union that has opted into the CCULR framework under §702.104(d), is in the grace period, as defined in §702.104(d)(7), and has a CCULR of 7.0 percent or greater.

(2) *Adequately capitalized* if:

(i) *Net worth ratio.* The credit union has a net worth ratio of 6.0 percent or greater; and

(ii) *Risk-based capital ratio.* The credit union, if complex, has a risk-based capital ratio of 8.0 percent or greater; and

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

(3) *Undercapitalized* if:

(i) *Net worth ratio.* The credit union has a net worth ratio of 4.0 percent or more but less than 6.0 percent; or

(ii) *Risk-based capital ratio.* The credit union, if complex, has a risk-based capital ratio of less than 8.0 percent.

(4) *Significantly undercapitalized* if:

(i) The credit union has a net worth ratio of 2.0 percent or more but less than 4.0 percent; or

(ii) The credit union has a net worth ratio of 4.0 percent or more but less than 5.0 percent, and either—

(A) Fails to submit an acceptable net worth restoration plan within the time prescribed in §702.110;

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

(C) Receives notice that a submitted net worth restoration plan has not been approved.

(5) *Critically undercapitalized* if it has a net worth ratio of less than 2.0 percent.

TABLE 1 TO § 702.102—CAPITAL CATEGORIES

Capital classification	Net worth ratio		Risk-based capital ratio, if applicable		CCULR, if applicable	And subject to following condition(s) . . .
Well Capitalized	7% or greater	And	10% or greater	Or	9% or greater*.	And does not meet the criteria to be classified as well capitalized. Or if ''undercapitalized at <5% net worth and (a) fails to timely submit, (b) fails to materially implement, or (c) receives notice of the rejection of a net worth restoration plan.
Adequately Capitalized	6% or greater	And	8% or greater	Or	N/A	
Undercapitalized	4% to 5.99%	Or	Less than 8%	Or	N/A.	
Significantly Undercapitalized.	2% to 3.99%		N/A		N/A	
Critically Undercapitalized	Less than 2%		N/A		N/A.	

* A qualifying complex credit union opting into the CCULR framework should refer to 12 CFR 702.104(d)(7) if its CCULR falls below 9.0 percent.

(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 classified in the next lower capital 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 providing the credit union with 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 providing the credit union with notice and opportunity for hearing pursuant to § 747.2003 of this chapter, that the credit union has not corrected a material unsafe or unsound practice of which it was, or should have been, aware.

(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 consult and seek to work cooperatively with the appropriate state official before reclassifying a federally insured state-chartered credit union under paragraph (b) of this section, and shall promptly notify the appropriate state official of its decision to reclassify.

[80 FR 66706, Oct. 29, 2015, as amended at 86 FR 72804, Dec. 23, 2021]

§ 702.103 Applicability of risk-based capital measures.

For purposes of § 702.102, a credit union is defined as ''complex'' and a risk-based capital measure is applicable only if the credit union's quarter-end total assets exceed five hundred million dollars ($500,000,000), as reflected in its most recent Call Report. A complex credit union may calculate its risk-based capital measure either by using the risk-based capital ratio under § 702.104(a) through (c), or, for a qualifying complex credit union opting into the CCULR framework, by using the CCULR framework under § 702.104(d).

[86 FR 72805, Dec. 23, 2021]

§ 702.104 Risk-based capital ratio.

A complex credit union must calculate its risk-based capital measure in accordance with this section. A complex credit union may calculate its risk-based capital measure either by using the risk-based capital ratio under paragraphs (a) through (c) of this section, or, for a qualifying complex credit union opting into the CCULR framework, by using the CCULR framework under paragraph (d) of this section.

(a) *Calculation of the risk-based capital ratio.* To determine its risk-based capital ratio, a complex credit union must calculate the percentage, rounded to two decimal places, of its risk-based capital ratio numerator as described in paragraph (b) of this section, to its total risk-weighted assets as described in paragraph (c) of this section.

(b) *Risk-based capital ratio numerator.* The risk-based capital ratio numerator is the sum of the specific capital elements in paragraph (b)(1) of this section, minus the regulatory adjustments in paragraph (b)(2) of this section.

(1) *Capital elements of the risk-based capital ratio numerator.* The capital elements of the risk-based capital numerator are:

(i) Undivided earnings;

(ii) Appropriation for non-conforming investments;

(iii) Other reserves;

(iv) Equity acquired in merger;

(v) Net income

(vi) ALLL, maintained in accordance with GAAP;

(vii) The outstanding principal amount of Subordinated Debt treated as Regulatory Capital in accordance with § 702.407 and the outstanding principal amount of Grandfathered Secondary Capital treated as Regulatory Capital in accordance with § 702.414; and

(viii) Section 208 assistance included in net worth (as defined in § 702.2).

(2) *Risk-based capital ratio numerator deductions.* The elements deducted from the sum of the capital elements of the risk-based capital ratio numerator are:

(i) NCUSIF Capitalization Deposit;

(ii) Goodwill;

(iii) Other intangible assets;

(iv) Identified losses not reflected in the risk-based capital ratio numerator; and

(v) Mortgage servicing assets that exceed 25 percent of the sum of the capital elements in paragraph (b)(1) of this section, less deductions required under paragraphs (b)(2)(i) thorough (iv) of this section.

(c) *Risk-weighted assets*—(1) *General.* Risk-weighted assets includes risk-weighted on-balance sheet assets as described in paragraphs (c)(2) and (3) of this section, plus the risk-weighted off-balance sheet assets in paragraph (c)(4) of this section, plus the risk-weighted derivatives in paragraph (c)(5) of this section, less the risk-based capital ratio numerator deductions in paragraph (b)(2) of this section. If a particular asset, derivative contract, or off balance sheet item has features or characteristics that suggest it could potentially fit into more than one risk weight category, then a credit union shall assign the asset, derivative contract, or off balance sheet item to the risk weight category that most accurately and appropriately reflects its associated credit risk.

(2) *Risk weights for on-balance sheet assets.* The risk categories and weights for assets of a complex credit union are as follows:

(i) *Category 1—zero percent risk weight.* A credit union must assign a zero percent risk weight to:

(A) The balance of:

(*1*) Cash, currency and coin, including vault, automatic teller machine, and teller cash.

(*2*) share-secured loans, where the shares securing the loan are on deposit with the credit union.

(B) The exposure amount of:

(*1*) An obligation of the U.S. Government, its central bank, or a U.S. Government agency that is directly and unconditionally guaranteed, excluding detached security coupons, ex-coupon securities, and interest-only mortgage-backed-security STRIPS.

(*2*) Federal Reserve Bank stock and Central Liquidity Facility stock.

(*3*) An obligation of the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, the European Stability Mechanism, the European Financial Stability Facility, or an MDB.

(C) Insured balances due from FDIC-insured depositories or federally insured credit unions.

(D) Covered loans issued under the Small Business Administration's Paycheck Protection Program, 15 U.S.C. 636(a)(36).

(ii) *Category 2—20 percent risk weight.* A credit union must assign a 20 percent risk weight to:

(A) The uninsured balances due from FDIC-insured depositories, federally insured credit unions, and all balances due from privately-insured credit unions.

(B) The exposure amount of:

(*1*) A non-subordinated obligation of the U.S. Government, its central bank, or a U.S. Government agency that is conditionally guaranteed, excluding interest-only mortgage-backed-security STRIPS.

(*2*) A non-subordinated obligation of a GSE other than an equity exposure or preferred stock, excluding interest-only GSE mortgage-backed-security STRIPS.

(*3*) Securities issued by PSEs that represent general obligation securities.

(*4*) Part 703 compliant investment funds that are restricted to holding only investments that qualify for a zero or 20 percent risk-weight under this section.

(*5*) Federal Home Loan Bank stock.

(C) The balances due from Federal Home Loan Banks.

(D) The balance of share-secured loans, where the shares securing the loan are on deposit with another depository institution.

(E) The portions of outstanding loans with a government guarantee.

(F) The portions of commercial loans secured with contractual compensating balances.

(iii) *Category 3—50 percent risk weight.* A credit union must assign a 50 percent risk weight to:

(A) The outstanding balance (net of government guarantees), including loans held for sale, of current first-lien residential real estate loans less than or equal to 35 percent of assets.

(B) The exposure amount of:

(*1*) Securities issued by PSEs in the U.S. that represent non-subordinated revenue obligation securities.

(*2*) Other non-subordinated, non-U.S. Government agency or non-GSE guaranteed, residential mortgage-backed security, excluding interest-only mortgage-backed security STRIPS.

(iv) *Category 4—75 percent risk weight.* A credit union must assign a 75 percent risk weight to the outstanding balance (net of government guarantees), including loans held for sale, of:

(A) Current first-lien residential real estate loans greater than 35 percent of assets.

(B) Current secured consumer loans.

(v) *Category 5—100 percent risk weight.* A credit union must assign a 100 percent risk weight to:

(A) The outstanding balance (net of government guarantees), including loans held for sale, of:

(*1*) First-lien residential real estate loans that are not current.

(*2*) Current junior-lien residential real estate loans less than or equal to 20 percent of assets.

(*3*) Current unsecured consumer loans.

(*4*) Current commercial loans, less contractual compensating balances that comprise less than 50 percent of assets.

(*5*) Loans to CUSOs.

(B) The exposure amount of:

(*1*) Industrial development bonds.

(*2*) Interest-only mortgage-backed security STRIPS.

(*3*) Part 703 compliant investment funds, with the option to use the look-through approaches in paragraph (c)(3)(iii)(B) of this section.

(*4*) Corporate debentures and commercial paper.

(*5*) Nonperpetual capital at corporate credit unions.

(*6*) General account permanent insurance.

(*7*) GSE equity exposure or preferred stock.

(*8*) Non-subordinated tranches of any investment, with the option to use the gross-up approach in paragraph (c)(3)(iii)(A) of this section.

(*9*) Natural person credit union Subordinated Debt, Grandfathered Secondary Capital, and loans or obligations issued by a privately insured credit union that are subordinate to the private insurer.

(C) All other assets listed on the statement of financial condition not specifically assigned a different risk weight under this subpart.

(vi) *Category 6—150 percent risk weight.* A credit union must assign a 150 percent risk weight to:

(A) The outstanding balance, net of government guarantees and including loans held for sale, of:

(*1*) Current junior-lien residential real estate loans that comprise more than 20 percent of assets.

(*2*) Junior-lien residential real estate loans that are not current.

(*3*) Consumer loans that are not current.

(*4*) Current commercial loans (net of contractual compensating balances), which comprise more than 50 percent of assets.

(*5*) Commercial loans (net of contractual compensating balances), which are not current.

(B) The exposure amount of:

(*1*) Perpetual contributed capital at corporate credit unions.

(*2*) Equity investments in CUSOs.

(vii) Category 7—250 percent risk weight. A credit union must assign a 250 percent risk weight to the carrying value of mortgage servicing assets not deducted from the risk-based capital numerator pursuant to § 702.104(b).

(viii) *Category 8—300 percent risk weight.* A credit union must assign a 300 percent risk weight to the exposure amount of:

(A) Publicly traded equity investments, other than a CUSO investment.

(B) Investment funds that do not meet the requirements under § 703.14(c) of this chapter, with the option to use the look-through approaches in paragraph (c)(3)(iii)(B) of this section.

(C) Separate account insurance, with the option to use the look-through approaches in paragraph (c)(3)(iii)(B) of this section.

(ix) *Category 9*—400 percent risk weight. A credit union must assign a 400 percent risk weight to the exposure amount of non-publicly traded equity investments, other than equity investments in CUSOs.

(x) *Category 10—1,250 percent risk weight.* A credit union must assign a

1,250 percent risk weight to the exposure amount of any subordinated tranche of any investment, with the option to use the gross-up approach in paragraph (c)(3)(iii)(A) of this section. However, a credit union may not use the gross-up approach for non-security beneficial interests.

(3) *Alternative risk weights for certain on-balance sheet assets*—(i) *Non-significant equity exposures*—(A) *General.* Notwithstanding the risk weights assigned in paragraph (c)(2) of this section, a credit union must assign a 100 percent risk weight to non-significant equity exposures.

(B) *Determination of non-significant equity exposures.* A credit union has non-significant equity exposures if the aggregate amount of its equity exposures does not exceed 10 percent of the sum of the credit union's capital elements of the risk-based capital ratio numerator (as defined under paragraph (b)(1) of this section).

(C) *Determination of the aggregate amount of equity exposures.* When determining the aggregate amount of its equity exposures, a credit union must include the total amounts (as recorded on the statement of financial condition in accordance with GAAP) of the following:

(*1*) Equity investments in CUSOs,

(*2*) Perpetual contributed capital at corporate credit unions,

(*3*) Nonperpetual capital at corporate credit unions, and

(*4*) Equity investments subject to a risk weight in excess of 100 percent.

(ii) *Charitable donation accounts.* Notwithstanding the risk weights assigned in paragraph (c)(2) of this section, a credit union may assign a 100 percent risk weight to a charitable donation account.

(iii) *Alternative approaches.* Notwithstanding the risk weights assigned in paragraph (c)(2) of this section, a credit union may determine the risk weight of investment funds, and non-subordinated or subordinated tranches of any investment as follows:

(A) *Gross-up approach.* A credit union may use the gross-up approach under appendix A of this part to determine the risk weight of the carrying value of non-subordinated or subordinated tranches of any investment.

(B) *Look-through approaches.* A credit union may use one of the look-through approaches under appendix A of this part to determine the risk weight of the exposure amount of any investment funds, the holdings of separate account insurance, or both.

(4) *Risk weights for off-balance sheet items.* The risk weighted amounts for all off-balance sheet items are determined by multiplying the off-balance sheet exposure amount by the appropriate CCF and the assigned risk weight as follows:

(i) For the outstanding balance of loans transferred to a Federal Home Loan Bank under the mortgage partnership finance program, a 20 percent CCF and a 50 percent risk weight.

(ii) For other loans transferred with limited recourse, a 100 percent CCF applied to the off-balance sheet exposure and:

(A) For commercial loans, a 100 percent risk weight.

(B) For first-lien residential real estate loans, a 50 percent risk weight.

(C) For junior-lien residential real estate loans, a 100 percent risk weight.

(D) For all secured consumer loans, a 75 percent risk weight.

(E) For all unsecured consumer loans, a 100 percent risk weight.

(iii) For unfunded commitments:

(A) For a commitment that is unconditionally cancelable, a 0 percent CCF.

(B) For commercial loans, a 50 percent CCF with a 100 percent risk weight.

(C) For first-lien residential real estate loans, a 10 percent CCF with a 50 percent risk weight.

(D) For junior-lien residential real estate loans, a 10 percent CCF with a 100 percent risk weight.

(E) For all secured consumer loans, a 10 percent CCF with a 75 percent risk weight.

(F) For all unsecured consumer loans, a 10 percent CCF with a 100 percent risk weight.

(iv) For financial standby letter of credits, a 100 percent CCF and a 100 percent risk weight.

(v) For forward agreements that are not derivative contracts, a 100 percent CCF and a 100 percent risk weight.

(vi) For sold credit protection through guarantees and credit derivatives, a 100 percent CCF and a 100 percent risk weight for guarantees; for credit derivatives the risk weight is determined by the applicable provisions of 12 CFR 324.34 or 324.35.

(vii) For off-balance sheet securitization exposures, a 100 percent CCF, and the risk weight is determined as if the exposure is an on-balance sheet securitization exposure.

(viii) For securities borrowing or lending transactions, a 100 percent CCF and a 100 percent risk weight. A credit union may recognize the credit risk mitigation benefits of financial collateral, as defined under 12 CFR 324.2, by risk weighting the collateralized portion of the exposure under the applicable provisions of 12 CFR 324.35 or 324.37.

(ix) For the off-balance sheet portion of repurchase transactions, a 100 percent CCF and a 100 percent risk weight. A credit union may recognize the credit risk mitigation benefits of financial collateral, as defined by 12 CFR 324.2, by risk weighting the collateralized portion of the exposure under the applicable provisions of 12 CFR 324.35 or 324.37.

(x) For all other off-balance sheet exposures not explicitly provided a CCF or risk weight in this paragraph (c) that meet the definition of a commitment, a 100 percent CCF and a 100 percent risk weight.

(5) *Derivative contracts.* A complex credit union must assign a risk-weighted amount to any derivative contracts as determined under § 702.105.

(6) Asset Securitizations Issued by Complex Credit Unions. A credit union must follow the requirements of the applicable provisions of 12 CFR 324.41 when it transfers exposures in connection with a securitization. A credit union may only exclude the transferred exposures from the calculation of its risk-weighted assets if each condition in 12 CFR 324.41 is satisfied. A credit union that meets these conditions, but retains any credit risk for the transferred exposures, must hold risk-based capital against the credit risk it retains in connection with the securitization.

(d) *Complex Credit Union Leverage Ratio (CCULR) Framework*—(1) *General.* A qualifying complex credit union that has opted into the CCULR framework under paragraph (d)(5) of this section is considered to have met the capital ratio requirements for the well capitalized capital category under § 702.102(a)(1) if it has a CCULR of 9.0 percent or greater.

(2) *Qualifying Complex Credit Union.* For purposes of this part, a qualifying complex credit union means a complex credit union under § 702.103 that satisfies all of the following criteria:

(i) Has a CCULR of 9.0 percent or greater;

(ii) Has total off-balance sheet exposures of 25 percent or less of its total assets;

(iii) Has the sum of total trading assets and total trading liabilities of 5 percent or less of its total assets; and

(iv) Has the sum of total goodwill and total other intangible assets of 2 percent or less of its total assets.

(3) *Calculation of Qualifying Criteria.* Each of the qualifying criteria in paragraph (d)(2) of this section is calculated based on data reported in the Call Report as of the end of the most recent calendar quarter.

(4) *Calculation of the CCULR.* A qualifying complex credit union opting into the CCULR framework under this paragraph (d) calculates its CCULR in the same manner as its net worth ratio under § 702.2.

(5) *Opting into the CCULR Framework.* (i) A qualifying complex credit union may opt into the CCULR framework by completing the applicable reporting requirements of its Call Report.

(ii) A qualifying complex credit union can opt into the CCULR framework at the end of each calendar quarter.

(6) *Opting Out of the CCULR Framework.* (i) A qualifying complex credit union may voluntarily opt out of the framework at the end of each calendar quarter.

(ii) [Reserved]

(7) *Treatment when ceasing to meet the qualifying complex credit union requirements.* (i) If a qualifying complex credit union that has opted into the CCULR framework ceases to meet the qualifying criteria in paragraph (d)(2) of this section, the credit union has two calendar quarters (grace period) either to

satisfy the requirements to be a qualifying complex credit union or to calculate its risk-based capital ratio under paragraphs (a) through (c) of this section.

(ii) The grace period begins at the end of the calendar quarter in which the credit union no longer satisfies the criteria to be a qualifying complex credit union. The grace period ends on the last day of the second consecutive calendar quarter following the beginning of the grace period.

(iii) During the grace period, the credit union continues to be treated as a qualifying complex credit union for the purpose of this part and must continue calculating and reporting its CCULR, unless the qualifying complex credit union has opted out of using the CCULR framework under paragraph (d)(6) of this section. The qualifying complex credit union also continues to be considered to have met the capital ratio requirements for the well capitalized capital category under §702.102(a)(1). However, if the qualifying complex credit union has a CCULR of less than seven percent, it will not be considered to have met the capital ratio requirements for the well capitalized capital category under §702.102(a)(1) and its capital classification is determined by its net worth ratio.

(iv) [Reserved]

(v) A qualifying complex credit union that ceases to meet the qualifying criteria in paragraph (d)(2) of this section as a result of a merger or acquisition that is not a supervisory merger or combination has no grace period and must comply with the risk-based capital ratio under paragraphs (a) through (c) of this section in the quarter it ceases to be a qualifying complex credit union.

(e) *Reservation of authority*. The NCUA may require a complex credit union that otherwise would meet the definition of a qualifying complex credit union to comply with the risk-based capital ratio under paragraphs (a) through (c) of this section if the NCUA determines that the complex credit union's capital requirements under paragraph (d) of this section are not commensurate with its risks. Any credit union required to comply with the risk-based capital ratio under this paragraph (e), would be permitted a minimum of a two-quarter grace period before being subject to risk-based capital requirements.

[80 FR 66706, Oct. 29, 2015, as amended at 86 FR 11073, Feb. 23, 2021; 86 FR 72805, Dec. 23, 2021]

§702.105 Derivative contracts.

(a) *OTC interest rate derivative contracts*—(1) *Exposure amount*—(i) *Single OTC interest rate derivative contract*. Except as modified by paragraph (a)(2) of this section, the exposure amount for a single OTC interest rate derivative contract that is not subject to a qualifying master netting agreement is equal to the sum of the credit union's current credit exposure and potential future credit exposure (PFE) on the OTC interest rate derivative contract.

(A) *Current credit exposure*. The current credit exposure for a single OTC interest rate derivative contract is the greater of the fair value of the OTC interest rate derivative contract or zero.

(B) *PFE*. (*1*) The PFE for a single OTC interest rate derivative contract, including an OTC interest rate derivative contract with a negative fair value, is calculated by multiplying the notional principal amount of the OTC interest rate derivative contract by the appropriate conversion factor in Table 1 of this section.

(*2*) A credit union must use an OTC interest rate derivative contract's effective notional principal amount (that is, the apparent or stated notional principal amount multiplied by any multiplier in the OTC interest rate derivative contract) rather than the apparent or stated notional principal amount in calculating PFE.

TABLE 1 TO §702.105—CONVERSION FACTOR MATRIX FOR INTEREST RATE DERIVATIVE CONTRACTS [2]

Remaining maturity	Conversion factor
One year or less	0.00
Greater than one year and less than or equal to five years	0.005
Greater than five years	0.015

[2] Non-interest rate derivative contracts are addressed in paragraph (d) of this section.

(ii) *Multiple OTC interest rate derivative contracts subject to a qualifying master netting agreement.* Except as modified by paragraph (a)(2) of this section, the exposure amount for multiple OTC interest rate derivative contracts subject to a qualifying master netting agreement is equal to the sum of the net current credit exposure and the adjusted sum of the PFE amounts for all OTC interest rate derivative contracts subject to the qualifying master netting agreement.

(A) *Net current credit exposure.* The net current credit exposure is the greater of the net sum of all positive and negative fair value of the individual OTC interest rate derivative contracts subject to the qualifying master netting agreement or zero.

(B) *Adjusted sum of the PFE amounts (Anet).* The adjusted sum of the PFE amounts is calculated as Anet = (0.4 × Agross) + (0.6 × NGR × Agross), where:

(*1*) Agross equals the gross PFE (that is, the sum of the PFE amounts as determined under paragraph (a)(1)(i)(B) of this section for each individual derivative contract subject to the qualifying master netting agreement); and

(*2*) Net-to-gross Ratio (NGR) equals the ratio of the net current credit exposure to the gross current credit exposure. In calculating the NGR, the gross current credit exposure equals the sum of the positive current credit exposures (as determined under paragraph (a)(1)(i) of this section) of all individual derivative contracts subject to the qualifying master netting agreement.

(2) *Recognition of credit risk mitigation of collateralized OTC derivative contracts.* A credit union may recognize credit risk mitigation benefits of financial collateral that secures an OTC derivative contract or multiple OTC derivative contracts subject to a qualifying master netting agreement (netting set) by following the requirements of paragraph (c) of this section.

(b) *Cleared transactions for interest rate derivatives*—(1) *General requirements.* A credit union must use the methodologies described in paragraph (b) of this section to calculate risk-weighted assets for a cleared transaction.

(2) *Risk-weighted assets for cleared transactions.* (i) To determine the risk weighted asset amount for a cleared transaction, a credit union must multiply the trade exposure amount for the cleared transaction, calculated in accordance with paragraph (b)(3) of this section, by the risk weight appropriate for the cleared transaction, determined in accordance with paragraph (b)(4) of this section.

(ii) A credit union's total risk-weighted assets for cleared transactions is the sum of the risk-weighted asset amounts for all its cleared transactions.

(3) *Trade exposure amount.* For a cleared transaction the trade exposure amount equals:

(i) The exposure amount for the derivative contract or netting set of derivative contracts, calculated using the methodology used to calculate exposure amount for OTC interest rate derivative contracts under paragraph (a) of this section; plus

(ii) The fair value of the collateral posted by the credit union and held by the, clearing member, or custodian.

(4) *Cleared transaction risk weights.* A credit union must apply a risk weight of:

(i) Two percent if the collateral posted by the credit union to the DCO or clearing member is subject to an arrangement that prevents any losses to the credit union due to the joint default or a concurrent insolvency, liquidation, or receivership proceeding of the clearing member and any other clearing member clients of the clearing member; and the clearing member credit union has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that in the event of a legal challenge (including one resulting from an event of default or from liquidation, insolvency, or receivership proceedings) the relevant court and administrative authorities would find the arrangements to be legal, valid, binding and enforceable under the law of the relevant jurisdictions; or

(ii) Four percent if the requirements of paragraph (b)(4)(i) are not met.

(5) *Recognition of credit risk mitigation of collateralized OTC derivative contracts.* A credit union may recognize the credit risk mitigation benefits of financial

collateral that secures a cleared derivative contract by following the requirements of paragraph (c) of this section.

(c) *Recognition of credit risk mitigation of collateralized interest rate derivative contracts.* (1) A credit union may recognize the credit risk mitigation benefits of financial collateral that secures an OTC interest rate derivative contract or multiple interest rate derivative contracts subject to a qualifying master netting agreement (netting set) or clearing arrangement by using the simple approach in paragraph (c)(3) of this section.

(2) As an alternative to the simple approach, a credit union may recognize the credit risk mitigation benefits of financial collateral that secures such a contract or netting set if the financial collateral is marked-to-fair value on a daily basis and subject to a daily margin maintenance requirement by applying a risk weight to the exposure as if it were uncollateralized and adjusting the exposure amount calculated under paragraph (a) or (b) of this section using the collateral approach in paragraph (c)(3) of this section. The credit union must substitute the exposure amount calculated under paragraphs (b) or (c) of this section in the equation in paragraph (c)(3) of this section.

(3) *Collateralized transactions*—(i) *General.* A credit union may use the approach in paragraph (c)(3)(ii) of this section to recognize the risk-mitigating effects of financial collateral.

(ii) *Simple collateralized derivatives approach.* To qualify for the simple approach, the financial collateral must meet the following requirements:

(A) The collateral must be subject to a collateral agreement for at least the life of the exposure;

(B) The collateral must be revalued at least every six months; and

(C) The collateral and the exposure must be denominated in the same currency.

(iii) *Risk weight substitution.* (A) A credit union may apply a risk weight to the portion of an exposure that is secured by the fair value of financial collateral (that meets the requirements for the simple collateralized approach of this section) based on the risk weight assigned to the collateral as established under § 702.104(c).

(B) A credit union must apply a risk weight to the unsecured portion of the exposure based on the risk weight applicable to the exposure under this subpart.

(iv) *Exceptions to the 20 percent risk weight floor and other requirements.* Notwithstanding the simple collateralized derivatives approach in paragraph (c)(3)(ii) of this section:

(A) A credit union may assign a zero percent risk weight to an exposure to a derivatives contract that is marked-to-market on a daily basis and subject to a daily margin maintenance requirement, to the extent the contract is collateralized by cash on deposit.

(B) A credit union may assign a 10 percent risk weight to an exposure to a derivatives contract that is marked-to-market daily and subject to a daily margin maintenance requirement, to the extent that the contract is collateralized by an exposure that qualifies for a zero percent risk weight under § 702.104(c)(2)(i).

(v) A credit union may assign a zero percent risk weight to the collateralized portion of an exposure where:

(A) The financial collateral is cash on deposit; or

(B) The financial collateral is an exposure that qualifies for a zero percent risk weight under § 702.104(c)(2)(i), and the credit union has discounted the fair value of the collateral by 20 percent.

(4) *Collateral haircut approach.* (i) A credit union may recognize the credit risk mitigation benefits of financial collateral that secures a collateralized derivative contract by using the standard supervisory haircuts in paragraph (c)(3) of this section.

(ii) The collateral haircut approach applies to both OTC and cleared interest rate derivatives contracts discussed in this section.

(iii) A credit union must determine the exposure amount for a collateralized derivative contracts by setting the exposure amount equal to the max {0,[(exposure amount − value of collateral) + (sum of current fair value of collateral instruments * market price volatility haircut of the collateral instruments)]}, where:

(A) The value of the exposure equals the exposure amount for OTC interest

rate derivative contracts (or netting set) calculated under paragraphs (a)(1)(i) and (ii) of this section.

(B) The value of the exposure equals the exposure amount for cleared interest rate derivative contracts (or netting set) calculated under paragraph (b)(3) of this section.

(C) The value of the collateral is the sum of cash and all instruments under the transaction (or netting set).

(D) The sum of current fair value of collateral instruments as of the measurement date.

(E) A credit union must use the standard supervisory haircuts for market price volatility in Table 2 to this section.

TABLE 2 TO § 702.105—STANDARD SUPERVISORY MARKET PRICE VOLATILITY HAIRCUTS

[Based on a 10 business-day holding period]

Residual maturity	Haircut (in percent) assigned based on:	
	Collateral risk weight (in percent)	
	Zero	20 or 50
Less than or equal to 1 year	0.5	1.0
Greater than 1 year and less than or equal to 5 years	2.0	3.0
Greater than 5 years	4.0	6.0
Cash collateral held	Zero	
Other exposure types	25.0	

(d) *All other derivative contracts and transactions.* Credit unions must follow the requirements of the applicable provisions of 12 CFR part 324, when assigning risk weights to exposure amounts for derivatives contracts not addressed in paragraphs (a) or (b) of this section.

§ 702.106 Prompt corrective action for adequately capitalized credit unions.

(a) *Earnings retention.* Beginning on the effective date of classification as adequately capitalized or lower, a federally insured credit union must increase the dollar amount of its net worth quarterly either in the current quarter, or on average over the current and three preceding quarters, by an amount equivalent to at least 1/10th percent (0.1%) of its total assets (or more by choice), until it is well capitalized.

(b) *Decrease in retention.* Upon written application received no later than 14 days before the quarter end, the NCUA Board, on a case-by-case basis, may permit a credit union to increase the dollar amount of its net worth by an amount that is less than the amount required under paragraph (a) of this section, to the extent the NCUA Board determines that such lesser amount:

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

(ii) Would further the purpose of this part.

(2) Notwithstanding paragraph (a) of this section, from February 28, 2022, until March 31, 2023, for a credit union that is adequately capitalized:

(i) The NCUA Board may issue an administrative order specifying temporary revisions to the earnings retention requirement, to the extent the NCUA Board determines that such lesser amount—

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

(B) Would further the purpose of this part.

(ii) Despite the issuance of an administrative order under paragraph (b)(2) of the section, the Regional Director may require a credit union to submit an earnings retention waiver under paragraph (b)(1) if the credit union poses an undue risk the National Credit Union Share Insurance Fund or exhibits material safety and soundness concerns.

(c) *Decrease by FISCU.* The NCUA Board shall consult and seek to work cooperatively with the appropriate state official before permitting a federally insured state-chartered credit union to decrease its earnings retention under paragraph (b) of this section.

(d) *Periodic review.* A decision under paragraph (b) of this section to permit a credit union to decrease its earnings retention is subject to quarterly review and revocation except when the credit union is operating under an approved net worth restoration plan that provides for decreasing its earnings retention as provided under paragraph (b) of this section.

[80 FR 66706, Oct. 29, 2015, as amended at 87 FR 10950, Feb. 28, 2022]

§ 702.107 Prompt corrective action for undercapitalized credit unions.

(a) *Mandatory supervisory actions by credit union.* A credit union which is undercapitalized must—

(1) *Earnings retention.* Increase net worth in accordance with § 702.106;

(2) *Submit net worth restoration plan.* Submit a net worth restoration plan pursuant to § 702.111, *provided however,* that a credit union in this category having a net worth ratio of less than five percent (5%) which fails to timely submit such a plan, or which materially fails to implement an approved plan, is classified significantly undercapitalized pursuant to § 702.102(a)(4)(i);

(3) *Restrict increase in assets.* Beginning the effective date of classification as undercapitalized or lower, not permit the credit union's assets to increase beyond its total assets for the preceding quarter unless—

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

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

(B) The credit union is implementing steps to increase the net worth ratio consistent with the approved plan;

(ii) *Plan not approved.* The NCUA Board has not approved a net worth restoration plan and total assets of the credit union are increasing because of increases since quarter-end in balances of:

(A) Total accounts receivable and accrued income on loans and investments; or

(B) Total cash and cash equivalents; or

(C) Total loans outstanding, not to exceed the sum of total assets plus the quarter-end balance of unused commitments to lend and unused lines of credit provided however that a credit union which increases a balance as permitted under paragraphs (a)(3)(ii)(A), (B) or (C) of this section cannot offer rates on shares in excess of prevailing rates on shares in its relevant market area, and cannot open new branches;

(4) *Restrict member business loans.* Beginning the effective date of classification as undercapitalized or lower, not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as of the preceding quarter-end unless it is granted an exception under 12 U.S.C. 1757a(b).

(b) *Second tier discretionary supervisory 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, by directive, take one or more of the following actions with respect to an undercapitalized credit union having a net worth ratio of less than five percent (5%), or a director, officer or employee of such a credit union, 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 business entity or financial institution, 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 a 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 dividends paid.* Restrict the dividend rates the credit union pays on shares to the prevailing rates paid on comparable accounts and maturities in the relevant market area, as determined by the NCUA Board, except that dividend rates already declared on shares acquired before imposing a restriction under this paragraph may not be retroactively restricted;

(4) *Prohibiting or reducing asset growth.* Prohibit any growth 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 which poses excessive risk to the credit union;

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

(7) *Dismissing director or senior executive officer.* 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);

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

(9) *Other action to carry out prompt corrective 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 (8) of this section.

(c) *First tier application of discretionary supervisory actions.* An undercapitalized credit union having a net worth ratio of five percent (5%) or more, or which is classified undercapitalized by reason of failing to maintain a risk-based capital ratio equal to or greater than 8 percent under § 702.104, is subject to the discretionary supervisory actions in paragraph (b) of this section if it fails to comply with any mandatory supervisory action in paragraph (a) of this section or fails to timely implement an approved net worth restoration plan under § 702.111, including meeting its prescribed steps to increase its net worth ratio.

§ 702.108 Prompt corrective action for significantly undercapitalized credit unions.

(a) *Mandatory supervisory actions by credit union.* A credit union which is significantly undercapitalized must—

(1) *Earnings retention.* Increase net worth in accordance with § 702.106;

(2) *Submit net worth restoration plan.* Submit a net worth restoration plan pursuant to § 702.111;

(3) *Restrict increase in assets.* Not permit the credit union's total assets to increase except as provided in § 702.107(a)(3); and

(4) *Restrict member business loans.* Not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as provided in § 702.107(a)(4).

(b) *Discretionary supervisory 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, by directive, take one or more of the following actions with respect to any significantly undercapitalized credit union, or a director, officer or employee of such credit union, 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 business entity or financial institution, establishing or acquiring any additional branch office, or engaging in any new line of business, except as provided in § 702.107(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 dividends paid.* Restrict the dividend rates that the credit union pays on shares as provided in § 702.107(b)(3);

(4) *Prohibiting or reducing asset growth.* Prohibit any growth 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 which poses excessive risk to the credit union;

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

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

(8) *Dismissing director or senior executive officer.* 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);

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

(10) *Restricting senior executive officers' compensation*. Except with the prior written approval of the NCUA Board, limit compensation to any senior executive officer to that officer's average rate of compensation (excluding bonuses and profit sharing) during the four (4) calendar quarters preceding the effective date of classification of the credit union as significantly undercapitalized, and prohibit payment of a bonus or profit share to such officer;

(11) *Other actions to carry out prompt corrective 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; and

(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) *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 §702.102(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.

§ 702.109 Prompt corrective action for critically undercapitalized credit unions.

(a) *Mandatory supervisory actions by credit union*. A credit union which is critically undercapitalized must—

(1) *Earnings retention*. Increase net worth in accordance with §702.106;

(2) *Submit net worth restoration plan*. Submit a net worth restoration plan pursuant to §702.111;

(3) *Restrictions on payments on Subordinated Debt*. Beginning 60 days after the effective date of a federally insured, natural person credit union being classified by the NCUA as ''critically undercapitalized'', that credit union shall not pay principal of or interest on its Subordinated Debt, except that unpaid interest shall continue to accrue under the terms of the related Subordinated Debt Note (as defined in subpart D of this part), to the extent permitted by law;

(4) *Restrict increase in assets*. Not permit the credit union's total assets to increase except as provided in §702.107(a)(3); and

(5) *Restrict member business loans*. Not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as provided in §702.107(a)(4).

(b) *Discretionary supervisory 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, by directive, take one or more of the following actions with respect to any critically undercapitalized credit union, or a director, officer or employee of such credit union, 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 business entity or financial institution, establishing or acquiring any additional branch office, or engaging in any new line of business, except as provided by §702.107(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 dividends paid*. Restrict the dividend rates that the credit union pays on shares as provided in §702.107(b)(3);

(4) *Prohibiting or reducing asset growth.* Prohibit any growth 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 which poses excessive risk to the credit union;

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

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

(8) *Dismissing director or senior executive officer.* 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);

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

(10) *Restricting senior executive officers' compensation.* Reduce or, with the prior written approval of the NCUA Board, limit compensation to any senior executive officer to that officer's average rate of compensation (excluding bonuses and profit sharing) during the four (4) calendar quarters preceding the effective date of classification of the credit union as critically undercapitalized, and prohibit payment of a bonus or profit share to such officer;

(11) *Restrictions on payments on Grandfathered Secondary Capital.* Beginning 60 days after the effective date of classification of a credit union as ''critically undercapitalized'', prohibit payments of principal, dividends or interest on the credit union's Grandfathered Secondary Capital (as defined in subpart D of this part), except that unpaid dividends or interest shall continue to accrue under the terms of the account to the extent permitted by law;

(12) *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 not within the scope of an approved net worth restoration plan (or approved revised business plan under subpart C of this part);

(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 comply with any law, regulation, or order;

(iv) Making any material change in accounting methods; and

(v) Paying dividends or interest on new share accounts at a rate exceeding the prevailing rates of interest on insured deposits in its relevant market area;

(13) *Other action to carry out prompt corrective 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 (12) of this section; and

(14) *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 the effective date of classification of a credit union as 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, *provided however*, that other corrective action may consist, in whole or in part, of complying with the quarterly timetable of steps and meeting the quarterly net worth targets prescribed in an approved net worth restoration plan.

(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)(iii) 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 liquidation if it remains critically undercapitalized for a full calendar quarter, on a monthly average basis, following a period of 18 months from the effective date the credit union was first classified critically undercapitalized.

(ii) *Exception.* Notwithstanding paragraph (c)(3)(i) of this section, the NCUA Board may continue to take other corrective action in lieu of 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.

(iii) *Review of exception.* The NCUA Board shall, at least quarterly, review the certification of an exception to liquidation under paragraph (c)(3)(ii) of this section and shall either—

(A) Recertify the credit union if it continues to satisfy the criteria of paragraph (c)(3)(ii) of this section; or

(B) Promptly place the credit union into liquidation, pursuant to 12 U.S.C. 1787(a)(3)(A)(ii), if it fails to satisfy the criteria of paragraph (c)(3)(ii) of this section.

(4) *Nondelegation.* The NCUA Board may not delegate its authority under paragraph (c) 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 by delegated authority under this section within ten (10) calendar days of the date of that decision.

(d) *Mandatory liquidation of insolvent federal credit union.* In lieu of paragraph (c) of this section, a critically undercapitalized federal credit union that has a net worth ratio of less than zero percent (0%) may be placed into liquidation on grounds of insolvency pursuant to 12 U.S.C. 1787(a)(1)(A).

[80 FR 66706, Oct. 29, 2015, as amended at 86 FR 11073, Feb. 23, 2021]

§ 702.110 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 subparts A or B of 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), and give him or her an opportunity to take the proposed action;

(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; and

(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 either to reduce the risk of loss, or to reduce the expected loss, to the NCUSIF with respect to the credit union.

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

(c) *Consultation on proposed discretionary action.* The NCUA Board shall consult and seek to work cooperatively with the appropriate state official before taking any discretionary supervisory action under §§ 702.107(b), 702.108(b), 702.109(b), 702.204(b) and 702.205(b) with respect to a federally insured state-chartered credit union; shall provide prompt notice of its decision to the appropriate state official; and shall allow the appropriate state official to take the proposed action independently or jointly with NCUA.

§ 702.111 Net worth restoration plans (NWRP).

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

(2) *Exception.* An otherwise adequately capitalized credit union that is reclassified undercapitalized on safety and soundness grounds under § 702.102(b) is not required to submit a NWRP solely due to the reclassification, unless the NCUA Board notifies the credit union that it must submit an NWRP.

(3) *Filing of additional plan.* Notwithstanding paragraph (a)(1) of this section, a credit union that has already submitted and is operating under a NWRP approved under this section is not required to submit an additional NWRP due to a change in net worth category (including by reclassification under § 702.102(b)), unless the NCUA Board notifies the credit union that it must submit a new NWRP. A credit union that is notified to submit a new or revised NWRP shall file the NWRP in writing with the appropriate Regional Director within 30 calendar days of receiving such notice, unless the NCUA Board notifies the credit union in writing that the NWRP is to be filed within a different period.

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

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

(c) *Contents of NWRP.* An NWRP must—

(1) Specify—

(i) A quarterly timetable of steps the credit union will take to increase its net worth ratio, and risk-based capital measure if applicable, so that it becomes adequately capitalized by the end of the term of the NWRP, and to remain so for four (4) consecutive calendar quarters;

(ii) The projected amount of net worth increases in each quarter of the term of the NWRP as required under § 702.106(a), or as permitted under § 702.106(b);

(iii) How the credit union will comply with the mandatory and any discretionary supervisory actions imposed on it by the NCUA Board under this subpart;

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

(v) If reclassified to a lower category under § 702.102(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, including any off-balance sheet items, covering a minimum of the next two years; and

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

(4) Notwithstanding paragraphs (c)(1), (2), and (3) of this section, the Board may permit a credit union that is undercapitalized to submit to the Regional Director a streamlined NWRP attesting that its reduction in capital was caused by share growth and that such share growth is a temporary condition due to the COVID–19 pandemic. A streamlined NWRP plan may be accepted from February 28, 2022, until March 31, 2023.

(d) *Criteria for approval of NWRP.* The NCUA Board shall not accept a NWRP plan unless it—

(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; and

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

(e) *Consideration of regulatory capital.* To minimize possible long-term losses to the NCUSIF while the credit union takes steps to become adequately capitalized, the NCUA Board shall, in evaluating an NWRP under this section, consider the type and amount of any form of regulatory capital which may become established by NCUA regulation, or authorized by state law and recognized by NCUA, which the credit union holds, but which is not included in its net worth.

(f) *Review of NWRP*—(1) *Notice of decision.* Within 45 calendar days after receiving an NWRP under this part, the NCUA Board shall notify the credit union in writing whether the NWRP has been approved, and shall provide reasons for its decision in the event of disapproval.

(2) *Delayed decision.* If no decision is made within the time prescribed in paragraph (f)(1) of this section, the NWRP is deemed approved.

(3) *Consultation with state officials.* In the case of an NWRP submitted by a federally insured state-chartered credit union (whether an original, new, additional, revised or amended NWRP), the NCUA Board shall, when evaluating the NWRP, seek and consider the views of the appropriate state official, and provide prompt notice of its decision to the appropriate state official.

(g) *NWRP not approved*—(1) *Submission of revised NWRP.* If an NWRP is rejected by the NCUA Board, the credit union shall submit a revised NWRP within 30 calendar days of receiving notice of disapproval, unless it is notified in writing by the NCUA Board that the revised NWRP is to be filed within a different period.

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

(3) *Disapproval of reclassified credit union's NWRP.* A credit union which has been classified significantly undercapitalized shall remain so classified pending NCUA Board approval of a new or revised NWRP.

(4) *Submission of multiple unapproved NWRPs.* The submission of more than two NWRPs that are not approved is considered an unsafe and unsound condition and may subject the credit union to administrative enforcement actions under section 206 of the FCUA, 12 U.S.C. 1786 and 1790d.

(h) *Amendment of NWRP.* A credit union that is operating under an approved NWRP may, after prior written notice to, and approval by the NCUA Board, amend its NWRP to reflect a change in circumstance. Pending approval of an amended NWRP, the credit union shall implement the NWRP as originally approved.

(i) *Publication.* An NWRP need not be published to be enforceable because publication would be contrary to the public interest.

(j) *Termination of NWRP.* For purposes of this part, an NWRP terminates once the credit union is classified as adequately capitalized and remains so for four consecutive quarters. For example, if a credit union with an active NWRP attains the classification as adequately classified on December 31,

2015 this would be quarter one and the fourth consecutive quarter would end September 30, 2016.

[80 FR 66706, Oct. 29, 2015, as amended at 86 FR 72806, Dec. 23, 2021; 87 FR 10950, Feb. 28, 2022]

§ 702.112 Reserves.

Each credit union shall establish and maintain such reserves as may be required by the FCUA, by state law, by regulation, or in special cases by the NCUA Board or appropriate state official.

§ 702.113 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 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 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, to creditors or to NCUA, shall contain a dual declaration by the treasurer and the chief executive officer, or in the latter's absence, 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 lease losses.* Full and fair disclosure demands that a credit union properly address charges for loan losses as follows:

(1) Charges for loan and lease losses shall be made timely and in accordance with GAAP;

(2) The ALLL must be maintained in accordance with GAAP; and

(3) At a minimum, adjustments to the ALLL shall be made prior to the distribution or posting of any dividend to the accounts of members.

§ 702.114 Payment of dividends.

(a) *Restriction on dividends.* Dividends shall be available only from net worth, net of any special reserves established under § 702.112, if any.

(b) *Payment of dividends and interest refunds.* The board of directors must not pay a dividend or interest refund that will cause the credit union's capital classification to fall below adequately capitalized under this subpart unless the appropriate Regional Director and, if state-chartered, the appropriate state official, have given prior written approval (in an NWRP or otherwise). The request for written approval must include the plan for eliminating any negative retained earnings balance.

Subpart B—Alternative Prompt Corrective Action for New Credit Unions

SOURCE: 80 FR 66706, Oct. 29, 2015, unless otherwise noted.

§ 702.201 Scope and definition.

(a) *Scope.* This subpart B applies in lieu of subpart A of this part exclusively to credit unions defined in paragraph (b) of this section as ''new'' pursuant to section 216(b)(2) of the FCUA, 12 U.S.C. 1790d(b)(2).

(b) *New credit union defined.* A ''new'' credit union for purposes of this subpart is a credit union that both has been in operation for less than ten (10) years and has total assets of not more than $10 million. Once a credit union reports total assets of more than $10 million on a Call Report, the credit union is no longer new, even if its assets subsequently decline below $10 million.

(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 deemed ''new'' if it has been in operation less than 10 years.

(d) *Actions to evade prompt corrective action.* If the NCUA Board determines that a credit union was formed, or was reduced in asset size as a result of a spin-off, or was merged, 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 must determine its capital classification quarterly according to its net worth ratio.

(b) *Effective date of net worth classification of new credit union.* For purposes of subpart B of this part, the effective date of a new credit union's classification within a capital category in paragraph (c) of this section shall be determined as provided in §702.101(c); and written notice of a decline in net worth classification in paragraph (c) of this section shall be given as required by §702.101(c).

(c) *Net worth categories.* A 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;

(2) *Adequately capitalized* if it has a net worth ratio of six percent (6%) or more but less than seven percent (7%);

(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%);

(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%); and

(6) *Uncapitalized* if it has a net worth ratio of less than zero percent (0%).

TABLE 1 TO §702.202—CAPITAL CATEGORIES FOR NEW CREDIT UNIONS

A new credit union's capital classification is	If it's net worth ratio is
Well Capitalized	7% or above.
Adequately Capitalized	6 to 7%.
Moderately Capitalized	3.5% to 5.99%.
Marginally Capitalized	2% to 3.49%.
Minimally Capitalized	0% to 1.99%.
Uncapitalized	Less than 0%.

(d) *Reclassification based on supervisory criteria other than net worth.* Subject to §702.102(b), the NCUA Board may reclassify a well capitalized, adequately capitalized or moderately capitalized new credit union to the next lower capital category (each of such actions is hereinafter referred to generally as ''reclassification'') in either of the circumstances prescribed in §702.102(b).

(e) *Consultation with state officials.* The NCUA Board shall consult and seek to work cooperatively with the appropriate state official before reclassifying a federally insured state-chartered credit union under paragraph (d) of this section, and shall promptly notify the appropriate state official of its decision to reclassify.

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

Beginning on the effective date of classification, an adequately capitalized new credit union must increase the dollar amount of its net worth by the amount reflected in its approved initial or revised business plan in accordance with §702.204(a)(2), or in the absence of such a plan, in accordance with §702.106 until it is well capitalized.

§ 702.204 Prompt corrective action for moderately capitalized, marginally capitalized, or minimally capitalized new credit unions.

(a) *Mandatory supervisory actions by new credit union.* Beginning on the date of classification as moderately capitalized, marginally capitalized or minimally capitalized (including by reclassification under §702.202(d)), a new credit union must—

(1) *Earnings retention.* Increase the dollar amount of its net worth by the

amount reflected in its approved initial or revised business plan;

(2) *Submit revised business plan.* Submit a revised business plan within the time provided by § 702.206 if the credit union either:

(i) Has not increased its net worth ratio consistent with its then-present approved business plan;

(ii) Has no then-present approved business plan; or

(iii) Has failed to comply with paragraph (a)(3) of this section; and

(3) *Restrict member business loans.* Not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as of the preceding quarter-end unless it is granted an exception under 12 U.S.C. 1757a(b).

(b) *Discretionary supervisory 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, by directive, take one or more of the actions prescribed in § 702.109(b) if the credit union's net worth ratio has not increased consistent with its then-present business plan, or the credit union has failed to undertake any mandatory supervisory action prescribed in paragraph (a) of this section.

(c) *Discretionary conservatorship or liquidation.* Notwithstanding any other actions required or permitted to be taken under this section, the NCUA Board may place a new credit union which is moderately capitalized, marginally capitalized or minimally capitalized (including by reclassification under § 702.202(d)) 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 uncapitalized new credit unions.

(a) *Mandatory supervisory actions by new credit union.* Beginning on the effective date of classification as uncapitalized, a new credit union must—

(1) *Earnings retention.* Increase the dollar amount of its net worth by the amount reflected in the credit union's approved initial or revised business plan;

(2) *Submit revised business plan.* Submit a revised business plan within the time provided by § 702.206, providing for alternative means of funding the credit union's earnings deficit, if the credit union either:

(i) Has not increased its net worth ratio consistent with its then-present approved business plan;

(ii) Has no then-present approved business plan; or

(iii) Has failed to comply with paragraph (a)(3) of this section; and

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

(b) *Discretionary supervisory 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, by directive, take one or more of the actions prescribed in § 702.109(b) if the credit union's net worth ratio has not increased consistent with its then-present business plan, or the credit union has failed to undertake any mandatory supervisory action prescribed in paragraph (a) of this section.

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

(1) *Plan not submitted.* May place into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(ii), or conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), 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) *Plan rejected, approved, implemented.* Except as provided in paragraph (c)(3) of this section, must place into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(ii), or conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), an uncapitalized new credit union that remains uncapitalized one hundred twenty (120) calendar days after the later of:

(i) The effective date of classification as uncapitalized; or

(ii) The last day of the calendar month following expiration of the time period provided in the credit union's

initial business plan (approved at the time its charter was granted) to remain uncapitalized, regardless whether a revised business plan was rejected, approved or implemented.

(3) *Exception*. The NCUA Board may decline to place a new credit union into liquidation or conservatorship as provided in paragraph (c)(2) of this section if the credit union documents to the NCUA Board why it is viable and has a reasonable prospect of becoming adequately capitalized.

(d) *Discretionary liquidation of an uncapitalized new credit union*. In lieu of paragraph (c) of this section, an uncapitalized new credit union may be placed into liquidation on grounds of insolvency pursuant to 12 U.S.C. 1787(a)(1)(A).

[80 FR 66706, Oct. 29, 2015, as amended at 86 FR 11073, Feb. 23, 2021]

§ 702.206 Revised business plans (RBP) for new credit unions.

(a) *Schedule for filing*—(1) *Generally*. Except as provided in paragraph (a)(2) of this section, a new credit union classified moderately capitalized or lower 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 either:

(i) The last of the calendar month following the end of the calendar quarter that the credit union's net worth ratio has not increased consistent with the-present approved business plan;

(ii) The effective date of classification as less than adequately capitalized if the credit union has no then-present approved business plan; or

(iii) The effective date of classification as less than adequately capitalized if the credit union has increased the total amount of member business loans in violation of § 702.204(a)(3).

(2) *Exception*. The NCUA Board may notify the credit union in writing that its RBP is to be filed within a different period or that it is not necessary to file an RBP.

(3) *Failure to timely file plan*. When a new credit union fails to file an RBP as provided under paragraphs (a)(1) or (a)(2) 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 chapter 1, section IV.D. of appendix B to part 701 of this chapter, or for state-chartered credit unions under applicable state law;

(2) Establish a timetable of quarterly targets for net worth during each year in which the RBP is in effect so that the credit union becomes adequately capitalized by the time it no longer qualifies as ''new'' per § 702.201;

(3) Specify the projected amount of earnings of net worth increases as provided under § 702.204(a)(1) or 702.205(a)(1);

(4) Explain how the new credit union will comply with the mandatory and discretionary supervisory actions imposed on it by the NCUA Board under this subpart;

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

(6) In the case of a new credit union reclassified to a lower category under § 702.202(d), specify the steps the credit union will take to correct the unsafe or unsound condition or practice; and

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

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

(1) Addresses the items enumerated in paragraph (b) of this section;

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

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

(d) *Review of revised business plan*—(1) *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.

(2) *Delayed decision.* If no decision is made within the time prescribed in paragraph (e)(1) of this section, the RBP is deemed approved.

(3) *Consultation with state officials.* When evaluating an RBP submitted by a federally insured state-chartered new credit union (whether an original, new or additional RBP), the NCUA Board shall seek and consider the views of the appropriate state official, and provide prompt notice of its decision to the appropriate state official.

(e) *Plan not approved*—(1) *Submission of new revised plan.* If an RBP is rejected 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 (f)(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.

(3) *Submission of multiple unapproved RBPs.* The submission of more than two RBPs that are not approved is considered an unsafe and unsound condition and may subject the credit union to administrative enforcement action pursuant to section 206 of the FCUA, 12 U.S.C. 1786 and 1790d.

(f) *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. Pending approval of an amended RBP, the new credit union shall implement its existing RBP as originally approved.

(g) *Publication.* An RBP need not be published to be enforceable because publication would be contrary to the public interest.

[80 FR 66706, Oct. 29, 2015, as amended at 86 FR 11073, Feb. 23, 2021]

§ 702.207 Consideration of Subordinated Debt and Grandfathered Secondary Capital for new credit unions.

(a) *Exception from prompt corrective action for new credit unions.* The requirements of §§ 702.204 and 702.205 do not apply to a new credit union if, as of the applicable date of determination, each of the following conditions is satisfied:

(1) The new credit union has outstanding Subordinated Debt or Grandfathered Secondary Capital;

(2) The Subordinated Debt or Grandfathered Secondary Capital would be treated as Regulatory Capital under subpart D of this part if the new credit union were a complex credit union or a low income-designated credit union;

(3) The ratio of the new credit union's net worth (including the amount of its Subordinated Debt and Grandfathered Secondary Capital treated as Regulatory Capital (as defined in subpart D of this part)) to its total assets is at least seven percent (7%); and

(4) The new credit union's net worth is increasing in a manner consistent with the new credit union's approved initial business plan or RBP.

(b) *Consideration of Subordinated Debt and Grandfathered Secondary Capital in evaluating an RBP.* The NCUA shall, in evaluating an RBP under this subpart, consider a new credit union's aggregate outstanding principal amount of Subordinated Debt and Grandfathered Secondary Capital.

(c) *Prompt corrective action based on other supervisory criteria*—(1) *Application of prompt corrective action to an exempt new credit union.* The NCUA Board may apply prompt corrective action to a new credit union that is otherwise exempt under paragraph (a) of this section in the following circumstances:

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

(ii) *Unsafe or unsound practice.* The NCUA Board has determined, after providing the new credit union with written notice and opportunity for hearing pursuant to § 747.2003 of this chapter,

that the new credit union has not corrected a material unsafe or unsound practice of which it was, or should have been, aware.

(2) *Non-delegation.* The NCUA Board may not delegate its authority under paragraph (c) of this section.

(3) *Consultation with state officials.* The NCUA Board shall consult and seek to work cooperatively with the appropriate state official before taking action under paragraph (c) of this section and shall promptly notify the appropriate state official of its decision to take action under paragraph (c) of this section.

(d) *Discretionary liquidation.* Notwithstanding paragraph (a) of this section, the NCUA may place a new credit union into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A), provided that the new credit union's ratio under paragraph (a)(3) of this section is, as of the applicable date of determination, below six percent (6%) and the new credit union has no reasonable prospect of becoming ''adequately capitalized'' under § 702.202.

(e) *Restrictions on payments on Subordinated Debt.* Beginning 60 days after the effective date of a new credit union being classified by the NCUA as ''uncapitalized'', the new credit union shall not pay principal of or interest on its Subordinated Debt, except that unpaid interest shall continue to accrue under the terms of the related Subordinated Debt Note, to the extent permitted by law.

[86 FR 11073, Feb. 23, 2021]

§ 702.208 Incentives for new credit unions.

(a) *Assistance in revising business plans.* Upon timely request by a credit union having total assets of less than $10 million (regardless how long it has been in operation), the NCUA Board shall provide assistance in preparing a revised business plan required to be filed under § 702.206.

(b) *Assistance.* Management training and other assistance to new credit unions will be provided in accordance with policies approved by the NCUA Board.

(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.

[80 FR 66706, Oct. 29, 2015. Redesignated at 86 FR 11073, Feb. 23, 2021]

§ 702.209 Reserves.

Each new credit union shall establish and maintain such reserves as may be required by the FCUA, by state law, by regulation, or in special cases by the NCUA Board or appropriate state official.

[80 FR 66706, Oct. 29, 2015. Redesignated at 86 FR 11073, Feb. 23, 2021]

§ 702.210 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 new 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 new 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, to creditors or to NCUA, shall contain a dual declaration by the treasurer and the chief executive officer, or in the latter's absence, 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 lease losses.* Full and fair disclosure demands that a new credit union properly address charges for loan losses as follows:

(1) Charges for loan and lease losses shall be made timely in accordance

with generally accepted accounting principles (GAAP);

(2) The ALLL must be maintained in accordance with GAAP; and

(3) At a minimum, adjustments to the ALLL shall be made prior to the distribution or posting of any dividend to the accounts of members.

[80 FR 66706, Oct. 29, 2015. Redesignated at 86 FR 11073, Feb. 23, 2021]

§ 702.211 Payment of dividends.

(a) *Restriction on dividends.* Dividends shall be available only from net worth, net of any special reserves established under § 702.208, if any.

(b) *Payment of dividends and interest refunds.* The board of directors may not pay a dividend or interest refund that will cause the credit union's capital classification to fall below adequately capitalized under subpart A of this part unless the appropriate regional director and, if state-chartered, the appropriate state official, have given prior written approval (in an RBP or otherwise). The request for written approval must include the plan for eliminating any negative retained earnings balance.

[80 FR 66706, Oct. 29, 2015. Redesignated at 86 FR 11073, Feb. 23, 2021]

Subpart C—Capital Planning and Stress Testing

SOURCE: 79 FR 24315, Apr. 30, 2014, unless otherwise noted. Redesignated at 80 FR 66722, Oct. 29, 2015.

§ 702.301 Authority, purpose, and reservation of authority.

(a) *Authority.* This subpart is issued by the National Credit Union Administration (NCUA).

(b) *Purpose.* This subpart requires covered credit unions to develop and maintain capital plans and describes stress testing requirements and actions on covered credit union capital plans.

(c) *Reservation of authority.* Notwithstanding any other provisions of this subpart, NCUA may modify some or all of the requirements of this subpart. Any exercise of authority under this section by NCUA will be in writing and will consider the financial condition, size, complexity, risk profile, scope of operations, and level of capital of the covered credit union, in addition to any other relevant factors. Nothing in this subpart limits the authority of NCUA under any other provision of law or regulation to take supervisory or enforcement action, including action to address unsafe and unsound practices or conditions, or violations of law or regulation.

§ 702.302 Definitions.

For purposes of this subpart—

Baseline scenario means a scenario that reflects the consensus views of the economic and financial outlook.

Capital plan means a written presentation of a covered credit union's capital planning strategies and capital adequacy process that includes the mandatory elements set forth in this subpart.

Capital planning process means development of a capital policy and formulation of a capital plan that conforms to this part.

Covered credit union means a federally insured credit union whose assets are $10 billion or more.

(1) *Timing.* A credit union that crosses the asset threshold as of March 31 of a given calendar year is subject to the applicable requirements of this subpart in the following calendar year.

(2) *Regulatory relief for 2021 and 2022.* If a federally insured credit union reaches or crosses an asset size threshold under this subpart on March 31, 2021, the NCUA will use the assets the federally insured credit union reported on March 31, 2020 for the purpose of determining the applicability of those thresholds.

Planning horizon means the period of 3 years over which capital planning projections extend.

Pre-provision net revenue means the sum of net interest income and non-interest income, less expenses, before adjusting for loss provisions.

Provision for loan and lease losses means the provision for loan and lease losses as reported by the covered credit union on its Call Report.

Reverse stress test means a test that defines severely unfavorable outcomes and then identifies events or scenarios that lead to these outcomes. Examples of severely unfavorable outcomes are

breaching regulatory capital, failing to meet obligations, or being unable to continue independent operations.

Scenarios are those sets of conditions that affect the U.S. economy or the financial condition of a covered credit union that serve as the basis for stress testing, including, but not limited to, NCUA-established baseline, scenarios and stress scenarios.

Sensitivity testing means testing the relationship between specific variables, parameters, and inputs and their impacts on analytical results.

Stress scenario means a scenario that is more adverse than that associated with the baseline scenario.

Stress test means the process to assess the potential impact of expected and stressed economic conditions on the consolidated earnings, losses, and capital of a covered credit union over the planning horizon, taking into account the current state of the covered credit union and the covered credit union's risks, exposures, strategies, and activities.

Stress test capital means net worth (less assistance provided under Section 208 of the Federal Credit Union Act, subordinated debt included in net worth, and NCUSIF deposit) under stress test scenarios.

Stress test capital ratio means a covered credit union's stress test capital divided by its total consolidated assets less NCUSIF deposit.

Tier I credit union means a covered credit union that has less than $15 billion in total assets.

Tier II credit union means a covered credit union that has $15 billion or more in total assets but less than $20 billion in total assets, or is otherwise designated as a tier II credit union by NCUA.

Tier III credit union means a covered credit union that has $20 billion or more in total assets, or is otherwise designated as a tier III credit union by NCUA.

[79 FR 24315, Apr. 30, 2014, as amended at 80 FR 48012, Aug. 11, 2015; 83 FR 17909, Apr. 25, 2018; 86 FR 15401, Mar. 23, 2021]

§ 702.303 Capital policy.

(a) *General requirements.* The extent and sophistication of a covered credit union's governance over its capital planning and analysis process must align with the extent and sophistication of that process. The process must be consistent with the financial condition, size, complexity, risk profile, scope of operations, and level of capital of the covered credit union. The ultimate responsibility for governance over a covered credit union's capital planning and analysis process rests with the credit union's board of directors. Senior management must establish a comprehensive, integrated, and effective process that fits into the broader risk management of the credit union. Senior management responsible for capital planning and analysis must provide regular reports on capital planning and analysis to the credit union's board of directors (or a designated committee of the board).

(b) *Mandatory elements.* A covered credit union's board of directors (or a designated committee of the board) must review and approve a capital policy, along with procedures to implement it. The capital policy must:

(1) State goals and limits for capital levels and risk exposure.

(2) Establish requirements for reviewing and reporting capital levels and breaches of capital limits, with contingency plans for remedying any breaches.

(3) State the governance over the capital analysis process, including all the activities that contribute to the analysis;

(4) Specify capital analysis roles and responsibilities, including controls over external resources used for any part of capital analysis (such as vendors and data providers);

(5) Specify the internal controls that govern capital planning, including review by internal audit, control of changes in capital planning procedures, and required documentation;

(6) Describe the frequency with which capital analyses will be conducted;

(7) State how capital analysis results are used and by whom; and

(8) Be reviewed at least annually and updated as necessary to ensure that it remains current with changes in market conditions, credit union products and strategies, credit union risk exposures and activities, the credit union's

established risk appetite, and industry practices.

§ 702.304 Capital planning.

(a) *Annual capital planning.* (1) A covered credit union must develop and maintain a capital plan. Tier I and tier II credit unions must complete this plan and their capital policy by December 31 each year, but are not required to submit this plan to the NCUA. For tier I and tier II credit unions, the plan must be based on the credit union's financial data from either of the two calendar quarters preceding the quarter in which the plan is approved by the credit union's board of directors (or a designated committee of the board). A tier III credit union must submit this plan and its capital policy to NCUA by May 31 each year, or such later date as directed by NCUA. For tier III credit unions, the plan must be based on the credit union's financial data as of December 31 of the preceding calendar year, or such other date as directed by NCUA.

(2) A covered credit union's board of directors (or a designated committee of the board) must at least annually, and for tier III credit unions, prior to the submission of the capital plan under paragraph (a)(1) of this section:

(i) Review the credit union's process for assessing capital adequacy;

(ii) Ensure that any deficiencies in the credit union's process for assessing capital adequacy are appropriately remedied; and

(iii) Approve the credit union's capital plan.

(b) *Mandatory elements.* A capital plan must contain at least the following elements:

(1) A quarterly assessment of the expected sources and levels of stress test capital over the planning horizon that reflects the covered credit union's financial state, size, complexity, risk profile, scope of operations, and existing level of capital, assuming both expected and unfavorable conditions, including:

(i) Estimates of projected revenues, losses, reserves, and pro forma capital levels, over each quarter of the planning horizon under expected and unfavorable conditions; and

(ii) A detailed description of the credit union's process for assessing capital adequacy;

(2) A discussion of how the credit union will, under expected and unfavorable conditions, maintain stress test capital commensurate with all of its risks, including reputational, strategic, legal, and compliance risks;

(3) A discussion of how the credit union will, under expected and unfavorable conditions, maintain ready access to funding, meet its obligations to all creditors and other counterparties, and continue to serve as an intermediary for its members;

(4) A discussion of any expected changes to the credit union's business plan that are likely to have a material impact on the credit union's capital adequacy and liquidity; and

(5) A program to:

(i) Conduct sensitivity testing to analyze the effect on the credit union's stress test capital of changes in variables, parameters, and inputs used by the credit union in preparing its capital plan;

(ii) Conduct reverse stress testing to identify events and circumstances that cause severely unfavorable outcomes for the credit union; and

(iii) Analyze the impact of credit risk and interest rate risk to capital under unfavorable economic conditions, both separately and in combination with each other.

[79 FR 24315, Apr. 30, 2014, as amended at 80 FR 48012, Aug. 11, 2015; 81 FR 7198, Feb. 11, 2016; 83 FR 17910, Apr. 25, 2018]

EDITORIAL NOTE: At 84 FR 1606, Feb. 5, 2019, § 702.504 (prior to redesignation as § 702.304) was amended in paragraph (b)(4) by revising the citation ''§ 702.306(c)'' to read ''§ 702.506(c)''; however, that citation did not exist in the section and the amendment could not be incorporated due to inaccurate amendatory instruction.

§ 702.305 NCUA action on capital plans.

(a) *Timing*—(1) *Tier I & tier II credit unions.* NCUA will address any deficiencies in the capital plans submitted by tier I and tier II credit unions through the supervisory process.

(2) *Tier III credit unions.* NCUA will notify tier III credit unions of the acceptance or rejection of their capital

plans by August 31 of the year in which their plan is submitted.

(b) *Grounds for rejection of capital plan.* NCUA may reject a capital plan if it determines that:

(1) The covered credit union has material unresolved supervisory issues associated with its capital planning process;

(2) The capital analysis underlying the covered credit union's capital plan, or the covered credit union's methodologies for reviewing the robustness of its capital adequacy, are not reasonable or appropriate;

(3) Data utilized for the capital analysis is insufficiently detailed to capture the risks of the covered credit union, or the data lacks integrity;

(4) The plan does not meet all of the requirements of § 702.304;

(5) Unacceptable weakness in the capital plan or policy, the capital planning analysis, or any critical system or process supporting capital analysis;

(6) The covered credit union's capital planning process constitutes an unsafe or unsound practice, or would violate any law, regulation, NCUA order, directive, or any condition imposed by, or written agreement with, NCUA. In determining whether a capital plan would constitute an unsafe or unsound practice, NCUA considers whether the covered credit union is and would remain in sound financial condition after giving effect to the capital plan.

(c) *Notification in writing.* NCUA will notify the credit union in writing of the reasons for a decision to reject a capital plan.

(d) *Resubmission of a capital plan.* If NCUA rejects a tier III credit union's capital plan, the credit union must update and resubmit an acceptable capital plan to NCUA by November 30 of the year in which the credit union submitted its plan. The resubmitted capital plan must, at a minimum, address:

(1) NCUA-noted deficiencies in the credit union's original capital plan or policy; and

(2) Remediation plans for unresolved supervisory issues contributing to the rejection of the credit union's original capital plan.

(e) *Supervisory actions.* Any tier III credit union operating without a capital plan accepted by NCUA may be subject to supervisory actions on the part of NCUA.

(f) *Consultation on proposed action.* Before taking any action under this section on the capital plan of a federally insured, state-chartered credit union, NCUA will consult and work cooperatively with the appropriate State official.

[79 FR 24315, Apr. 30, 2014, as amended at 80 FR 48012, Aug. 11, 2015; 83 FR 17910, Apr. 25, 2018; 80 FR 66722, Oct. 29, 2015]

§ 702.306 Annual supervisory stress testing.

(a) *General requirements.* Only tier II and tier III credit unions are required to conduct supervisory stress tests. The supervisory stress tests consist of a baseline scenario, and stress scenarios, which NCUA will provide by February 28 of each year. The tests will be based on the credit union's financial data as of December 31 of the preceding calendar year, or such other date as directed by NCUA. The tests will take into account all relevant exposures and activities of the credit union to evaluate its ability to absorb losses in specified scenarios over a planning horizon.

(b) *Credit union-run supervisory stress tests*—(1) *General.* All supervisory stress tests must be conducted according to NCUA's instructions.

(2) *Tier III credit unions.* When conducting its stress test, a tier III credit union must apply the minimum stress test capital ratio to all time periods in the planning horizon. The minimum stress test capital ratio is 5 percent.

(3) *NCUA tests.* NCUA reserves the right to conduct the tests described in this section on any covered credit union at any time. Where both NCUA and a covered credit union have conducted the tests, the results of NCUA's tests will determine whether the covered credit union has met the requirements of this subpart.

(c) *Potential impact on capital.* In conducting stress tests under this subpart, the credit union, or the NCUA if it elects to conduct the stress test under paragraph (b)(3) of this section, will estimate the following for each scenario during each quarter of the planning horizon:

(1) Losses, pre-provision net revenues, loan and lease loss provisions, and net income; and

(2) The potential impact on the stress test capital ratio, incorporating the effects of any capital action over the planning horizon and maintenance of an allowance for loan losses appropriate for credit exposures throughout the horizon. The credit union, or the NCUA if it elects to conduct the stress test under paragraph (b)(3) of this section, will conduct the stress tests without assuming any risk mitigation actions on the part of the credit union, except those existing and identified as part of the credit union's balance sheet, or off-balance sheet positions, such as derivative positions, on the date of the stress test.

(d) *Information collection.* Upon request, the covered credit union must provide NCUA with any relevant qualitative or quantitative information requested by NCUA pertinent to the capital plans or stress tests under this part.

(e) *Stress test results.* A credit union required to conduct stress tests under this section must incorporate the results of its tests in its capital plan. A credit union required to conduct stress tests must submit its stress test results to NCUA by May 31 of each year.

(f) *Supervisory actions.* (1) If a credit union-run stress test shows a tier III credit union does not have the ability to maintain a stress test capital ratio of 5 percent or more under expected and stressed conditions in each quarter of the planning horizon, the credit union must incorporate, into its capital plan, a stress test capital enhancement plan that shows how it will meet that target.

(2) If an NCUA-run stress test shows that a tier III credit union does not have the ability to maintain a stress test capital ratio of 5 percent or more under expected and stressed conditions in each quarter of the planning horizon, the credit union must provide NCUA, by November 30 of the calendar year in which NCUA conducted the tests, a stress test capital enhancement plan showing how it will meet that target.

(3) A tier III credit union operating without an NCUA approved stress test capital enhancement plan required under this section may be subject to supervisory actions.

(g) *Consultation on proposed action.* Before taking any action under this section against a federally insured, state-chartered credit union, NCUA will consult and work cooperatively with the appropriate State official.

[83 FR 17910, Apr. 25, 2018, as amended at 87 FR 45009, July 27, 2022]

Subpart D—Subordinated Debt, Grandfathered Secondary Capital, and Regulatory Capital

SOURCE: 86 FR 11074, Feb. 23, 2021, unless otherwise noted.

§ 702.401 Purpose and scope.

(a) *Subordinated Debt.* This subpart sets forth the requirements applicable to all Subordinated Debt issued by a federally insured, natural person credit union, including the NCUA's review and approval of that credit union's application to issue or prepay Subordinated Debt. This subpart shall apply to a federally insured, state-chartered credit union only to the extent that such federally insured, state-chartered credit union is permitted by applicable state law to issue debt instruments of the type described in this subpart. To the extent that such state law is more restrictive than this subpart with respect to the issuance of such debt instruments, that state law shall apply. Except as provided in the next sentence, any secondary capital, as that term is used in the Federal Credit Union Act, issued after January 1, 2022, is Subordinated Debt and subject to the requirements of this subpart. Issuances of secondary capital, as that term is used in the Federal Credit Union Act, to the U.S. Government or any of its subdivisions, under applications approved before January 1, 2022, pursuant to § 701.34 or § 741.204(c) of this chapter, are not subject to the requirements applicable to Subordinated Debt, discussed elsewhere in this subpart, irrespective of the date of issuance.

(b) *Grandfathered Secondary Capital.* Any secondary capital defined as ''Grandfathered Secondary Capital''

under §702.402, is governed by §702.414. Grandfathered Secondary Capital will no longer be treated as Regulatory Capital as of the later of 30 years from the date of issuance or January 1, 2052.

[86 FR 72809, Dec. 23, 2021, as amended at 88 FR 18010, Mar. 27, 2023]

§ 702.402 Definitions.

To the extent they differ, the definitions in this section apply only to Subordinated Debt and not to Grandfathered Secondary Capital. (Definitions applicable to Grandfathered Secondary Capital are in §702.414.) All other terms in this subpart and not expressly defined in this section have the meanings assigned to them elsewhere in this part. For ease of use, certain key terms are included in this section using cross citations to other sections of this part where those terms are defined.

Accredited Investor means a Natural Person Accredited Investor or an Entity Accredited Investor, as applicable.

Appropriate Supervision Office means, with respect to any credit union, the Regional Office or Office of National Examinations and Supervision that is responsible for supervision of that credit union.

Complex credit union has the same meaning as in subpart A of this part.

Entity Accredited Investor means an entity that, at the time of offering and closing of the issuance and sale of Subordinated Debt to that entity, meets the requirements of 17 CFR 230.501(a).

Grandfathered Secondary Capital means any secondary capital issued under §701.34 of this chapter before January 1, 2022, or, in the case of a federally insured, state-chartered credit union, with §741.204(c) of this chapter, before January 1, 2022. (12 CFR 701.34 was recodified as §702.414 as of January 1, 2022). This term also includes issuances of secondary capital to the U.S. Government or any of its subdivisions, under applications approved before January 1, 2022, pursuant to §701.34 or §741.204(c) of this chapter, irrespective of the date of issuance.

Immediate Family Member means spouse, child, sibling, parent, grandparent, or grandchild (including stepparents, stepchildren, stepsiblings, and adoptive relationships).

Issuing Credit Union means, for purposes of this subpart, a credit union that has issued, or is in the process of issuing, Subordinated Debt or Grandfathered Secondary Capital in accordance with the requirements of this subpart.

Low-income designated credit union (LICU) is a credit union designated as having low-income status in accordance with §701.34 of this chapter.

Natural Person Accredited Investor means a natural person who, at the time of offering and closing of the issuance and sale of Subordinated Debt to that person, meets the requirements of 17 CFR 230.501(a); *provided* that, for purposes of purchasing or holding any Subordinated Debt Note, this term shall not include any board member or Senior Executive Officer of the Issuing Credit Union or any Immediate Family Member of any board member or Senior Executive Officer of the Issuing Credit Union.

Net worth has the same meaning as in §702.2.

Net worth ratio has the same meaning as in §702.2.

New credit union has the same meaning as in §702.201.

Offering Document means the document(s) required by §702.408, including any term sheet, offering memorandum, private placement memorandum, offering circular, or other similar document used to offer and sell Subordinated Debt Notes.

Pro Forma Financial Statements means projected financial statements that show the effects of proposed transactions as if they actually occurred in a variety of plausible scenarios, including both optimistic and pessimistic assumptions, over measurement horizons that align with the credit union's expected activities.

Qualified Counsel means an attorney licensed to practice law who has expertise in the areas of Federal and state securities laws and debt transactions similar to those described in this subpart.

Regulatory Capital means:

(1) With respect to an Issuing Credit Union that is a LICU and not a complex credit union, the aggregate outstanding principal amount of Subordinated Debt and, until the later of 30

years from the date of issuance or January 1, 2052, Grandfathered Secondary Capital that is included in the credit union's net worth ratio;

(2) With respect to an Issuing Credit Union that is a complex credit union and not a LICU, the aggregate outstanding principal amount of Subordinated Debt that is included in the credit union's RBC ratio, if applicable;

(3) With respect to an Issuing Credit Union that is both a LICU and a complex credit union, the aggregate outstanding principal amount of Subordinated Debt and, until the later of 30 years from the date of issuance or January 1, 2052, Grandfathered Secondary Capital that is included in its net worth ratio and in its RBC ratio, if applicable; and

(4) With respect to a new credit union, the aggregate outstanding principal amount of Subordinated Debt and, until the later of 30 years from the date of issuance or January 1, 2052, Grandfathered Secondary Capital that is considered pursuant to § 702.207.

Retained Earnings has a meaning that is consistent with the one for this term under United States GAAP.

Risk-based capital (RBC) ratio has the same meaning as in § 702.2.

Senior Executive Officer means a credit union's chief executive officer (for example, president or treasurer/manager), any assistant chief executive officer (*e.g.*, any assistant president, any vice president or any assistant treasurer/manager) and the chief financial officer (controller). The term ''Senior Executive Officer'' also includes employees and contractors of an entity, such as a consulting firm, hired to perform the functions of positions covered by the term Senior Executive Officer.

Subordinated Debt means an Issuing Credit Union's borrowing that meets the requirements of this subpart, including all obligations and contracts related to such borrowing.

Subordinated Debt Note means the written contract(s) evidencing the Subordinated Debt.

[86 FR 11074, Feb. 23, 2021, as amended at 86 FR 72809, Dec. 23, 2021; 88 FR 18010, Mar. 27, 2023]

§ 702.403 Eligibility.

(a) Subject to receiving approval under § 702.408 or § 702.409, a credit union may issue Subordinated Debt only if, at the time of such issuance, the credit union is:

(1) A complex credit union with a capital classification of at least ''undercapitalized,'' as defined in § 702.102;

(2) A LICU;

(3) Able to demonstrate to the satisfaction of the NCUA that it reasonably anticipates becoming either a complex credit union meeting the requirements of paragraph (a)(1) of this section or a LICU within 24 months after issuance of the Subordinated Debt Notes; or

(4) A new credit union with Retained Earnings equal to or greater than one percent (1%) of assets.

(b) At the time of issuance of any Subordinated Debt, an Issuing Credit Union may not have any investments, direct or indirect, in Subordinated Debt or Grandfathered Secondary Capital (or any interest therein) of another credit union. If a credit union acquires Subordinated Debt or Grandfathered Secondary Capital in a merger or other consolidation, the Issuing Credit Union may still issue Subordinated Debt, but it may not invest (directly or indirectly) in the Subordinated Debt or Grandfathered Secondary Capital of any other credit union while any Subordinated Debt Notes issued by the Issuing Credit Union remain outstanding.

(c) If the Issuing Credit Union is a complex credit union that is not also a LICU, the aggregate outstanding principal amount of all Subordinated Debt issued by that Issuing Credit Union may not exceed 100 percent of its net worth, as determined at the time of each issuance of Subordinated Debt.

§ 702.404 Requirements of the Subordinated Debt Note.

(a) *Requirements.* At a minimum, the Subordinated Debt or the Subordinated Debt Note, as applicable, must:

(1) Be in the form of a written, unconditional promise to pay on a specified date a sum certain in money in return for adequate consideration in money;

(2) Have, at the time of issuance, a fixed stated maturity of at least five years. The stated maturity of the Subordinated Debt Note may not reset and may not contain an option to extend the maturity. A credit union seeking to issue Subordinated Debt Notes with maturities longer than 20 years from the date of issuance must provide the information required in §702.408(b)(14) as part of its application for preapproval to issue Subordinated Debt;

(3) Be subordinate to all other claims in liquidation under §709.5(b) of this chapter, and have the same payout priority as all other outstanding Subordinated Debt and Grandfathered Secondary Capital;

(4) Be properly characterized as debt in accordance with U.S. GAAP;

(5) Be unsecured, including, without limitation, prohibiting the establishment of any legally enforceable claim against funds earmarked for payment of the Subordinated Debt through:

(i) A compensating balance or any other funds or assets subject to a legal right of offset, as defined by applicable state law; or

(ii) A sinking fund, such as a fund formed by periodically setting aside money for the gradual repayment of the Subordinated Debt;

(6) Be applied by the Issuing Credit Union at the end of each of its fiscal years (or more frequently as determined by the Issuing Credit Union) in which the Subordinated Debt remains outstanding to cover any deficit in Retained Earnings on a pro rata basis among all holders of the Subordinated Debt and Grandfathered Secondary Capital of the Issuing Credit Union; it being understood that any amounts applied to cover a deficit in Retained Earnings shall no longer be considered due and payable to the holder(s) of the Subordinated Debt or Grandfathered Secondary Capital;

(7) Except as provided in §§702.411 and 702.412(c), be payable in full by the Issuing Credit Union or its successor or assignee only at maturity;

(8) Disclose any prepayment penalties or restrictions on prepayment;

(9) Be offered, issued, and sold only to Entity Accredited Investors or Natural Person Accredited Investors, in accordance §702.406; and

(10) Be re-offered, reissued, and resold only to an Entity Accredited Investor (if the initial offering, issuance, and sale was solely made to Entity Accredited Investors) or any Accredited Investor (if the initial offering, issuance, and sale involved one or more Natural Person Accredited Investors).

(b) *Restrictions.* The Subordinated Debt or the Subordinated Debt Note, as applicable, must not:

(1) Be structured or identified as a share, share account, or any other instrument in the Issuing Credit Union that is insured by the National Credit Union Administration;

(2) Include any express or implied terms that make it senior to any other Subordinated Debt issued under this subpart or Grandfathered Secondary Capital;

(3) Cause the Issuing Credit Union to exceed the borrowing limit in §741.2 of this chapter or, for federally insured, state-chartered credit unions, any more restrictive state borrowing limit;

(4) Provide the holder thereof with any management or voting rights in the Issuing Credit Union;

(5) Be eligible to be pledged or provided by the investor as security for a loan from, or other obligation owing to, the Issuing Credit Union;

(6) Include any express or implied term, condition, or agreement that would require the Issuing Credit Union to prepay or accelerate payment of principal of or interest on the Subordinated Debt prior to maturity, including investor put options;

(7) Include an express or implied term, condition, or agreement that would trigger an event of default based on the Issuing Credit Union's default on other debts;

(8) Include any condition, restriction, or requirement based on the Issuing Credit Union's credit quality or other credit-sensitive feature; or

(9) Require the Issuing Credit Union to make any form of payment other than in cash.

(c) *Negative covenants.* A Subordinated Debt Note must not include any provision or covenant that unduly restricts or otherwise acts to unduly

limit the authority of the Issuing Credit Union or interferes with the NCUA's supervision of the Issuing Credit Union. This includes, but is not limited to, a provision or covenant that:

(1) Requires the Issuing Credit Union to maintain a minimum amount of Retained Earnings or other metric, such as a minimum net worth ratio or minimum asset, liquidity, or loan ratios;

(2) Unreasonably restricts the Issuing Credit Union's ability to raise capital through the issuance of additional Subordinated Debt;

(3) Provides for default of the Subordinated Debt as a result of the Issuing Credit Union's compliance with any law, regulation, or supervisory directive from the NCUA or, if applicable, the state supervisory authority;

(4) Provides for default of the Subordinated Debt as the result of a change in the ownership, management, or organizational structure or charter of the Issuing Credit Union; provided that, following such change, the Issuing Credit Union or the resulting institution, as applicable:

(i) Agrees to perform all of the obligations, terms, and conditions of the Subordinated Debt; and

(ii) At the time of such change, is not in material default of any provision of the Subordinated Debt Note, after giving effect to the applicable cure period described in paragraph (d) of this section; and

(5) Provides for default of the Subordinated Debt as the result of an act or omission of any third party, including but not limited to a credit union service organization, as defined in §712.1(d) of this chapter.

(d) *Default covenants.* A Subordinated Debt Note that includes default covenants must provide the Issuing Credit Union with a reasonable cure period of not less than 30 calendar days.

(e) *Minimum denominations of issuances to Natural Person Accredited Investors.* An Issuing Credit Union may only issue Subordinated Debt Notes to Natural Person Accredited Investors in minimum denominations of $100,000, and cannot exchange any such Subordinated Debt Notes after the initial issuance or any subsequent resale for Subordinated Debt Notes of the Issuing Credit Union in denominations less than $10,000. Each such Subordinated Debt Note, if issued in certificate form, must include a legend disclosing that it cannot be exchanged for Subordinated Debt Notes of the Issuing Credit Union in denominations less than $100,000, and Subordinated Debt Notes issued in book-entry or other uncertificated form shall include appropriate instructions prohibiting the exchange of such Subordinated Debt Notes for Subordinated Debt Notes of the Issuing Credit Union in denominations that would violate the foregoing restrictions.

[86 FR 11074, Feb. 23, 2021, as amended at 88 FR 18011, Mar. 27, 2023]

§ 702.405 Disclosures.

(a) An Issuing Credit Union must disclose the following language clearly, in all capital letters, on the face of a Subordinated Debt Note:

• THIS OBLIGATION IS NOT A SHARE IN THE ISSUING CREDIT UNION AND IS NOT INSURED BY THE NATIONAL CREDIT UNION ADMINISTRATION.

• THIS OBLIGATION IS UNSECURED AND SUBORDINATE TO ALL CLAIMS AGAINST THE ISSUING CREDIT UNION AND IS INELIGIBLE AS COLLATERAL FOR A LOAN BY THE ISSUING CREDIT UNION.

• AMOUNTS OTHERWISE PAYABLE HEREUNDER MAY BE REDUCED IN ORDER TO COVER ANY DEFICIT IN RETAINED EARNINGS OF THE ISSUING CREDIT UNION. AMOUNTS APPLIED TO COVER ANY SUCH DEFICIT WILL RESULT IN A CORRESPONDING REDUCTION OF THE PRINCIPAL AMOUNT OF ALL OUTSTANDING SUBORDINATED DEBT ISSUED BY THE ISSUING CREDIT UNION, AND WILL NO LONGER BE DUE AND PAYABLE TO THE HOLDERS OF SUCH SUBORDINATED DEBT. AMOUNTS APPLIED TO COVER ANY SUCH DEFICIT MUST BE APPLIED AMONG ALL HOLDERS OF SUCH SUBORDINATED DEBT PRO RATA BASED ON THE AGGREGATE AMOUNT OF SUBORDINATED DEBT OWED BY THE ISSUING CREDIT UNION TO EACH SUCH HOLDER AT THE TIME OF APPLICATION.

• THIS OBLIGATION CAN ONLY BE REPAID AT MATURITY OR IN ACCORDANCE WITH 12 CFR 702.411. THIS OBLIGATION MAY ALSO BE REPAID IN ACCORDANCE WITH 12 CFR PART 710 IF THE ISSUING CREDIT UNION VOLUNTARILY LIQUIDATES.

• THE NOTE EVIDENCING THIS OBLIGATION HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE SECURITIES

ACT OF 1933, AS AMENDED (THE ''SECURITIES ACT''), OR THE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES OR ANY OTHER JURISDICTION, AND MAY BE ISSUED, SOLD, PLEDGED, OR OTHERWISE TRANSFERRED ONLY (A) AS PERMITTED IN THE NOTE AND TO A PERSON WHOM THE ISSUER OR SELLER REASONABLY BELIEVES IS [AN ''ACCREDITED INVESTOR'' (AS DEFINED IN 12 CFR 702.402)] [AN ''ENTITY ACCREDITED INVESTOR'' (AS DEFINED IN 12 CFR 702.402)] (THAT IS NOT A MEMBER OF THE ISSUING CREDIT UNION'S BOARD, A SENIOR EXECUTIVE OFFICER OF THE ISSUING CREDIT UNION (AS THAT TERM IS DEFINED IN 12 CFR 702.402), OR ANY IMMEDIATE FAMILY MEMBER OF ANY SUCH BOARD MEMBER OR SENIOR EXECUTIVE OFFICER), PURCHASING FOR ITS OWN ACCOUNT, (1) TO WHOM NOTICE IS GIVEN THAT THE SALE, PLEDGE, OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON THE EXEMPTION FROM SECURITIES ACT REGISTRATION PROVIDED BY SECTION 3(a)(5) OF THE SECURITIES ACT, OR (2) IN ACCORDANCE WITH ANOTHER EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT (SUBJECT TO THE DELIVERY OF SUCH CERTIFICATIONS, LEGAL OPINIONS, OR OTHER INFORMATION AS THE ISSUING CREDIT UNION MAY REASONABLY REQUIRE TO CONFIRM THAT SUCH SALE, PLEDGE, OR TRANSFER IS BEING MADE PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT), (B) IN COMPLIANCE WITH THE CERTIFICATION AND OTHER REQUIREMENTS SPECIFIED IN THE [INDENTURE OR OTHER DOCUMENT PURSUANT TO WHICH THE SUBORDINATED DEBT NOTE IS ISSUED] REFERRED TO HEREIN, AND (C) IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES AND ANY OTHER APPLICATION JURISDICTION.

(b) An Issuing Credit Union must also clearly and accurately disclose in the Subordinated Debt Note:

(1) The payout priority and level of subordination, as described in §709.5(b) of this chapter, that would apply in the event of the involuntary liquidation of the Issuing Credit Union;

(2) A general description of the NCUA's regulatory authority that includes, at a minimum:

(i) If the Issuing Credit Union is ''undercapitalized'' or, if the Issuing Credit Union is a New Credit Union, ''moderately capitalized'' (each as defined in this part), and fails to submit an acceptable net worth restoration plan, capital restoration plan, or revised business plan, as applicable, or materially fails to implement such a plan that was approved by the NCUA, the Issuing Credit Union may be subject to all of the additional restrictions and requirements applicable to a ''significantly undercapitalized'' credit union or, if the Issuing Credit Union is a new credit union, a ''marginally capitalized'' new credit union; and

(ii) Beginning 60 days after the effective date of an Issuing Credit Union being classified as ''critically undercapitalized'' or, in the case of a new credit union, ''uncapitalized,'' the Issuing Credit Union shall not pay principal of or interest on its Subordinated Debt, until reauthorized to do so by the NCUA; provided, however, that unpaid interest shall continue to accrue under the terms of the Subordinated Debt Note, to the extent permitted by law; and

(3) The risk factors associated with the NCUA's or, if applicable, the state supervisory authority's, authority to conserve or liquidate a credit union under the Federal Credit Union Act (FCU Act) or applicable state law.

§ 702.406 Requirements related to the offer, sale, and issuance of Subordinated Debt Notes.

(a) *Offering Document.* An Issuing Credit Union or person acting on behalf of or at the direction of any Issuing Credit Union may only issue and sell Subordinated Debt Notes if, a reasonable time prior to the issuance and sale of any Subordinated Debt Notes, each purchaser of a Subordinated Debt Note receives an Offering Document that meets the requirements of §702.408(e) and such further material information, if any, as may be necessary to make the required disclosures in that Offering Document, in the light of the circumstances under which they are made, not misleading.

(b) *Territorial limitations.* An Issuing Credit Union may only offer, issue, and sell Subordinated Debt Notes in the United States of America (including any one of the states thereof and the District of Columbia), its territories,

and its possessions. This limitation includes a prohibition on non-U.S. investors holding or purchasing Subordinated Debt Notes.

(c) *Accredited Investors.* An Issuing Credit Union may only offer, issue, and sell Subordinated Debt to Accredited Investors, and the terms of any Subordinated Debt Note must include the restrictions in §702.404(a)(10); provided that no Subordinated Debt Note may be issued, sold, resold, pledged, or otherwise transferred to a member of the board of the Issuing Credit Union, any Senior Executive Officer of the Issuing Credit Union, or any Immediate Family Member of any such board member or Senior Executive Officer. Prior to the offer of any Subordinated Debt Note, the Issuing Credit Union must receive a signed, unambiguous certification from any potential investor of a Subordinated Debt Note. The certification must be in substantially the following form:

CERTIFICATE OF ACCREDITED INVESTOR STATUS

Except as may be indicated by the undersigned below, the undersigned is an accredited investor, as that term is defined in Regulation D under the Securities Act of 1933, as amended (the ''*Act*''). In order to demonstrate the basis on which it is representing its status as an accredited investor, the undersigned has checked one of the boxes below indicating that the undersigned is:

[] Any bank as defined in section 3(a)(2) of the Act, or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Act whether acting in its individual or fiduciary capacity; any broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934; any investment adviser registered pursuant to section 203 of the Investment Advisers Act of 1940 or registered pursuant to the laws of a state; any investment adviser relying on the exemption from registering with the Securities and Exchange Commission under section 203(l) or (m) of the Investment Advisers Act of 1940; any insurance company as defined in section 2(a)(13) of the Act; any investment company registered under the Investment Company Act of 1940 or a business development company as defined in section 2(a)(48) of that act; any Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958; any Rural Business Investment Company as defined in section 384A of the Consolidated Farm and Rural Development Act; any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of $5,000,000; any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 if the investment decision is made by a plan fiduciary, as defined in section 3(21) of such act, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of $5,000,000 or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors; [] A private business development company as defined in section 202(a)(22) of the Investment Advisers Act of 1940;

[] Any organization described in section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, partnership, or limited liability company, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5,000,000; [] Any natural person whose individual net worth, or joint net worth with that person's spouse or spousal equivalent, exceeds $1,000,000; (excluding the value of the person's primary residence). For the purposes of calculating joint net worth in this paragraph: joint net worth can be the aggregate net worth of the investor and spouse or spousal equivalent; assets need not be held jointly to be included in the calculation;

[] Any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse or spousal equivalent in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year; [] A trust with total assets in excess of $5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a person who has such knowledge and experience in financial and business matters that he or she is capable of evaluating the merits and risks of the prospective investment;

[] An entity in which all of the equity holders are accredited investors by virtue of their meeting one or more of the above standards;

[] Any entity, of a type not listed in paragraph (a)(1), (2), (3), (7), or (8) of 17 CFR 230.501(a), not formed for the specific purpose of acquiring the securities offered, owning investments in excess of $5,000,000;

[] Any natural person holding in good standing one or more professional certifications or designations or credentials from an accredited educational institution that the Securities and Exchange Commission has

designated as qualifying an individual for accredited investor status;

[ ] Any natural person who is a ''knowledgeable employee,'' as defined in rule 3c5(a)(4) under the Investment Company Act of 1940 (17 CFR 270.3c-5(a)(4)), of the issuer of the securities being offered or sold where the issuer would be an investment company, as defined in section 3 of such act, but for the exclusion provided by either section 3(c)(1) or section 3(c)(7) of such act;

[ ] Any ''family office,'' as defined in rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940 (17 CFR 275.202(a)(11)(G)-1): (i) With assets under management in excess of $5,000,000, (ii) That is not formed for the specific purpose of acquiring the securities offered, and (iii) Whose prospective investment is directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment; and

[ ] Any ''family client,'' as defined in rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940 (17 CFR 275.202(a)(11)(G)-1)), of a family office meeting the requirements in paragraph (a)(12) of § 275.202(a)(11)(G)-1 and whose prospective investment in the issuer is directed by such family office pursuant to paragraph (a)(12)(iii) of § 275.202(a)(11)(G)-1.

The undersigned understands that [NAME OF ISSUING CREDIT UNION] (the ''Credit Union'') is required to verify the undersigned's accredited investor status AND ELECTS TO DO ONE OF THE FOLLOWING:

[ ] Allow the Credit Union's representative to review the undersigned's tax returns for the two most recently completed years and provide a written representation of the undersigned's reasonable expectation of reaching the income level necessary to qualify as an accredited investor during the current year;

[ ] Allow the Credit Union's representative to: (1) obtain a written representation from the undersigned that states that all liabilities necessary to make a determination of net worth have been disclosed; and (2) review one or more of the following types of documentation dated within the past three months: bank statements, brokerage statements, tax assessments, appraisal reports as to assets, or a consumer report from a nationwide consumer reporting agency;

[ ] Provide the Credit Union with a written confirmation from one of the following persons or entities that such person or entity has taken reasonable steps to verify that the undersigned is an accredited investor within the prior three months and has determined that the undersigned is an accredited investor:

- A registered broker-dealer;
- An investment adviser registered with the Securities Exchange Commission;
- A licensed attorney who is in good standing under the laws of the jurisdictions in which such attorney is admitted to practice law; or
- A certified public accountant who is duly registered and in good standing under the laws of the place of such accountant's residence or principal office.

IN WITNESS WHEREOF, the undersigned has executed this Certificate of Accredited Investor Status effective as of _____, 20_____.

Name of Investor

[Name of Authorized Representative

Title of Authorized Representative]

Signature

Address

Address

Phone Number

Email Address

(d) *Use of trustees.* If using a trustee in connection with the offer, issuance, and sale of Subordinated Debt Notes, the trustee must meet the requirements set forth in the Trust Indenture Act of 1939, as amended, including requirements for qualification set forth in section 310 thereof; any rules related to such act in 17 CFR parts 260, 261, and 269; and any applicable state law.

(e) *Offers, issuances, and sales of Subordinated Debt Notes.* Offers issuances, and sales of Subordinated Debt Notes are required to be made in accordance with the following requirements:

(1) *Application to offer, issue, and sell at offices of Issuing Credit Union.* If the Issuing Credit Union intends to offer and sell Subordinated Debt Notes at one or more of its offices, the Issuing Credit Union must first apply in writing to the Appropriate Supervision Office indicating that it intends to offer, issue, and sell Subordinated Debt Notes at one or more of its offices. The application must include, at a minimum, the physical locations of such offices and a description of how the Issuing Credit Union will comply with the requirements of this paragraph (e);

(2) *Decision on application.* Within 60 calendar days (which may be extended

by the Appropriate Supervision Office) after the date of receipt of a complete application described in paragraph (e)(1) of this section, the Appropriate Supervision Office will provide the Issuing Credit Union with a written determination on its application to conduct offering and sales activity from its office(s). Any denial of an Issuing Credit Union's application under this section will include the reasons for such denial;

(3) *Commissions, bonuses, or comparable payments.* In connection with any offering and sale of Subordinated Debt Notes (whether or not conducted at offices of the Issuing Credit Union), an Issuing Credit Union shall not pay, directly or indirectly, any commissions, bonuses, or comparable payments to any employee of the Issuing Credit Union or any affiliated Credit Union Service Organizations (CUSOs) assisting with the offer, issuance, and sale of such Subordinated Debt Notes, or to any other person in connection with the offer, issuance, and sale of Subordinated Debt Notes; except that compensation and commissions consistent with industry norms may be paid to securities personnel of registered broker-dealers as otherwise permitted by applicable law;

(4) *Issuances by tellers.* No offers or sales may be made by tellers at the teller counter of any Issuing Credit Union, or by comparable persons at comparable locations;

(5) *Permissible issuing personnel.* In connection with an offering or sale of Subordinated Debt Notes (whether or not conducted at offices of the Issuing Credit Union), such activity may be conducted only by regular, full-time employees of the Issuing Credit Union or by securities personnel who are subject to supervision by a registered broker-dealer, which securities personnel may be employees of the Issuing Credit Union's affiliated CUSO that is assisting the Issuing Credit Union with the offer, issuance, and sale of the Subordinated Debt Notes;

(6) *Issuance practices, advertisements, and other literature used in connection with the offer and sale of Subordinated Debt Notes.* In connection with an offering or sale of Subordinated Debt Notes (whether or not conducted at offices of the Issuing Credit Union), issuance practices, advertisements, and other issuance literature used in connection with offers and issuances of Subordinated Debt Notes by Issuing Credit Unions or any affiliated CUSOs assisting with the offer and issuance of such Subordinated Debt Notes shall be subject to the requirements of this subpart; and

(7) *Office of an Issuing Credit Union.* For purposes of this paragraph (e), an ''office'' of an Issuing Credit Union means any premises used by the Issuing Credit Union that is identified to the public through advertising or signage using the Issuing Credit Union's name, trade name, or logo.

(f) *Securities laws.* An Issuing Credit Union must comply with all applicable Federal and state securities laws.

(g) *Resales.* All resales of Subordinated Debt Notes issued by an Issuing Credit Union by holders of such Subordinated Debt Notes must be made pursuant to 17 CFR 230.144 (Rule 144 under the Securities Act of 1933, as amended) (other than paragraphs (c), (e), (f), (g) and (h) of such Rule), 17 CFR 230.144A (Rule 144A under the Securities Act of 1933, as amended), or another exemption from registration under the Securities Act of 1933, as amended. Subordinated Debt Notes must include the restrictions on resales in § 702.404(a)(10).

§ 702.407 Discounting of amount treated as Regulatory Capital.

The amount of outstanding Subordinated Debt that may be treated as Regulatory Capital shall reduce by 20 percent per annum of the initial aggregate principal amount of the applicable Subordinated Debt (as reduced by prepayments or amounts extinguished to cover a deficit under § 702.404(a)(6)), as required by the following schedule:

TABLE 1 TO § 720.407

Remaining maturity	Balance treated as regulatory capital %
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

§ 702.408 Preapproval to issue Subordinated Debt.

(a) *Scope.* This section requires all credit unions to receive written preapproval from the NCUA before issuing Subordinated Debt. Procedures related specifically to applications from federally insured, state-chartered credit unions are contained in § 702.409. A credit union seeking approval to offer and sell Subordinated Debt at one or more of its offices must also follow the application procedures in § 702.406(e). All approvals under this section are subject to the expiration limits specified in paragraph (k) of this section.

(b) *Initial application to issue Subordinated Debt.* A credit union requesting approval to issue Subordinated Debt must first submit an application to the Appropriate Supervision Office that, at a minimum, includes:

(1) A statement indicating how the credit union qualifies to issue Subordinated Debt given the eligibility requirements of § 702.403 with additional supporting analysis if anticipating to meet the requirements of a LICU or complex credit union within 24 months after issuance of the Subordinated Debt;

(2) The maximum aggregate principal amount of Subordinated Debt Notes and the maximum number of discrete issuances of Subordinated Debt Notes that the credit union is proposing to issue within the period allowed under paragraph (k) of this section;

(3) The estimated number of investors and the status of such investors (Natural Person Accredited Investors and/or Entity Accredited Investors) to whom the credit union intends to offer and sell the Subordinated Debt Notes;

(4) A statement identifying any outstanding Subordinated Debt or Grandfathered Secondary Capital previously issued by the credit union;

(5) A copy of the credit union's strategic plan, business plan, and budget, and an explanation of how the credit union intends to use the Subordinated Debt in conformity with those plans;

(6) An analysis of how the credit union will provide for liquidity to repay the Subordinated Debt upon maturity of the Subordinated Debt;

(7) Pro Forma Financial Statements (balance sheet and income statement) and cash flow projections, including any off-balance sheet items, covering at least two years. Analytical support for key assumptions and key assumption changes must be included in the application. Key assumptions include, but are not limited to, interest rate, liquidity, and credit loss scenarios;

(8) A statement indicating how the credit union will use the proceeds from the issuance and sale of the Subordinated Debt;

(9) A statement identifying the governing law specified in the Subordinated Debt Notes and the documents pursuant to which the Subordinated Debt Notes will be issued;

(10) A draft written policy governing the offer, and issuance, and sale of the Subordinated Debt, developed in consultation with Qualified Counsel, which, at a minimum, addresses:

(i) Compliance with all applicable Federal and state securities laws and regulations;

(ii) Compliance with applicable securities laws related to communications with investors and potential investors, including, but not limited to: Who may communicate with investors and potential investors; what information may be provided to investors and potential investors; ongoing disclosures to investors; who will review and ensure the accuracy of the information provided to investors and potential investors; and to whom information will be provided;

(iii) Compliance with any laws that may require registration of credit union employees as broker-dealers; and

(iv) Any use of outside agents, including broker-dealers, to assist in the marketing and issuance of Subordinated Debt, and any limitations on such use;

(11) A schedule that provides an itemized statement of all expenses incurred or expected to be incurred by the credit union in connection with the offer, issuance, and sale of the Subordinated Debt Notes to which the initial application relates, other than underwriting discounts and commissions or similar compensation payable to broker-dealers acting as placement agents. The schedule must include, as

applicable, fees and expenses of counsel, auditors, any trustee or issuing and paying agent or any transfer agent, and printing and engraving expenses. If the amounts of any items are not known at the time of filing of the initial application, the credit union must provide estimates, clearly identified as such;

(12) In the case of a new credit union, a statement that it is subject to either an approved initial business plan or revised business plan, as required by this part, and how the proposed Subordinated Debt would conform with the approved plan. Unless the new credit union has a LICU designation pursuant to §701.34 of this chapter, it must also include a plan for replacing the Subordinated Debt with Retained Earnings before the credit union ceases to meet the definition of new credit union in §702.2;

(13) A statement describing any investments the credit union has in the Subordinated Debt of any other credit union, and the manner in which the credit union acquired such Subordinated Debt, including through a merger or other consolidation;

(14) In the case of a credit union applying to issue Subordinated Debt Notes with maturities longer than 20 years, an analysis demonstrating that the proposed Subordinated Debt Notes would be properly characterized as debt in accordance with U.S. GAAP. The Appropriate Supervision Office may require that such analysis include one or more of the following:

(i) A written legal opinion from a Qualified Counsel;

(ii) A written opinion from a licensed certified public accountant (CPA); and

(iii) An analysis conducted by the credit union or independent third party;

(15) A signature page signed by the credit union's principal executive officer, principal financial officer or principal accounting officer, and a majority 'of the members of its board of directors. Amendments to an initial application must be signed and filed with the NCUA in the same manner as the initial application; and

(16) Any additional information requested in writing by the Appropriate Supervision Office.

(c) *Decision on initial application.* Upon receiving an initial application submitted under this paragraph (c) and any additional information requested in writing by the Appropriate Supervision Office, the Appropriate Supervision Office will evaluate, at a minimum, the credit union's compliance with this subpart and all other NCUA regulations in this chapter, the credit union's ability to manage and safely offer, issue, and sell the proposed Subordinated Debt, the safety and soundness of the proposed use of the Subordinated Debt, the overall condition of the credit union, and any other factors the Appropriate Supervision Office determines are relevant.

(1) *Written determination.* Within 60 calendar days (which may be extended by the Appropriate Supervision Office) after the date of receipt of a complete application, the Appropriate Supervision Office will provide the credit union with a written determination on its application. In the case of a full or partial denial, or conditional approval under paragraph (c)(2) of this section, the written decision will state the reasons for the denial or conditional approval.

(2) *Conditions of approval.* Any approval granted by an Appropriate Supervision Office under this section may include one or more of the following conditions:

(i) Approval of an aggregate principal amount of Subordinated Debt that is lower than what the credit union requested;

(ii) Any applicable minimum level of net worth that the credit union must maintain while the Subordinated Debt Notes are outstanding;

(iii) Approved uses of the Subordinated Debt; and

(iv) Any other limitations or conditions the Appropriate Supervision Office deems necessary to protect the NCUSIF.

(d) *Offering Document.* Following receipt of written approval of its initial application, an Issuing Credit Union must prepare an Offering Document for each issuance of Subordinated Debt Notes. In addition, as required in paragraph (f) of this section, an Issuing Credit Union that intends to offer Subordinated Debt Notes to any Natural

Person Accredited Investors must have the related Offering Document declared ''approved for use'' by the NCUA before its first use. At a reasonable time prior to any issuance and sale of Subordinated Debt Notes, the Issuing Credit Union must provide each investor with an Offering Document as described in this section. All Offering Documents must be filed with the NCUA within two business days after their respective first use.

(e) *Requirements for all Offering Documents*—(1) *Minimum information required in an Offering Document.* An Offering Document must, at a minimum, include the following information:

(i) The name of the Issuing Credit Union and the address of its principal executive office;

(ii) The initial principal amount of the Subordinated Debt being issued;

(iii) The name(s) of any underwriter(s) or placement agents being used for the issuance;

(iv) A description of the material risk factors associated with the purchase of the Subordinated Debt Notes, including any special or distinctive characteristics of the Issuing Credit Union's business, field of membership, or geographic location that are reasonably likely to have a material impact on the Issuing Credit Union's future financial performance;

(v) The disclosures described in §702.405 and such additional material information, if any, as may be necessary to make the required disclosures, in the light of the circumstances under which they are made, not misleading;

(vi) Provisions related to the interest, principal, payment, maturity, and prepayment of the Subordinated Debt Notes;

(vii) All material affirmative and negative covenants that may or will be included in the Subordinated Debt Note, including, but not limited to, the covenants discussed in this subpart;

(viii) Any legends required by applicable state law; and

(ix) The following legend, displayed on the cover page in prominent type or in another manner:

None of the Securities and Exchange Commission (the ''SEC''), any state securities commission or the National Credit Union Administration has passed upon the merits of, or given its approval of, the purchase of any Subordinated Debt Notes offered or the terms of the offering, or passed on the accuracy or completeness of any Offering Document or other materials used in connection with the offer, issuance, and sale of the Subordinated Debt Notes. Any representation to the contrary is unlawful. These Subordinated Debt Notes have not been registered under the Securities Act of 1933, as amended (the ''Act'') and are being offered and sold to [an Entity Accredited Investor][an Accredited Investor] (as defined in 12 CFR 702.402) pursuant to an exemption from registration under the Act; however, neither the SEC nor the NCUA has made an independent determination that the offer and issuance of the Subordinated Debt Notes are exempt from registration.

(2) *Legibility requirements.* An Issuing Credit Union's Offering Document must comply with the following legibility requirements:

(i) Information in the Offering Document must be presented in a clear, concise, and understandable manner, incorporating plain English principles. The body of all printed Offering Documents shall be in type at least as large and as legible as 10-point type. To the extent necessary for convenient presentation, however, financial statements and other tabular data, including tabular data in notes, may be in type at least as large and as legible as 8-point type. Repetition of information should be avoided. Cross-referencing of information within the document is permitted; and

(ii) Where an Offering Document is distributed through an electronic medium, the Issuing Credit Union may satisfy legibility requirements applicable to printed documents, such as paper size, type size and font, bold-face type, italics and red ink, by presenting all required information in a format readily communicated to offerees and, where indicated, in a manner reasonably calculated to draw the attention of offerees to specific information.

(f) *Offering Documents approved for use in offerings of Subordinated Debt to any Natural Person Accredited Investors*—(1) *Filing of a Draft Offering Document.* An Issuing Credit Union that intends to offer Subordinated Debt Notes to any Natural Person Accredited Investors must file a draft Offering Document

with the NCUA and have such draft Offering Document declared ''approved for use'' by the NCUA before its first use.

(i) *Request for additional information, clarifications, or amendments.* Prior to declaring any Offering Document ''approved for use,'' the NCUA may ask questions, request clarifications, or direct the Issuing Credit Union to amend certain sections of the draft Offering Document. The NCUA will make any such requests in writing.

(ii) *Written determination.* Within 60 calendar days (which may be extended by the NCUA) after the date of receipt of each of the initial filing and each filing of additional information, clarifications, or amendments requested by the NCUA under paragraph (f)(1)(i) of this section, the NCUA will provide the Issuing Credit Union with a written determination on the applicable filing. The written determination will include any requests for additional information, clarifications, or amendments, or a statement that the Offering Document is ''approved for use.''

(2) *Filing of a final Offering Document.* At such time as the NCUA declares an Offering Document ''approved for use'' in accordance with paragraph (f)(1)(ii) of this section, the Issuing Credit Union may then use that Offering Document in the offer and sale of the Subordinated Debt Notes. The Issuing Credit Union must file a copy of each of its Offering Documents with the NCUA within two business days after their respective first use.

(g) *Filing of an Offering Document for offerings of Subordinated Debt exclusively to Entity Accredited Investors.* An Issuing Credit Union that is offering Subordinated Debt exclusively to Entity Accredited Investors is not required to have its Offering Document ''approved for use'' by the NCUA under paragraph (f) of this section before using it to offer and sell the Subordinated Debt Notes. As described in this section, however, the Issuing Credit Union must file a copy of each of its Offering Documents with the NCUA within two business days after their respective first use.

(h) *Material changes to any initial application or Offering Document*—(1) *Reapproval of initial application.* If any material event arises or material change in fact occurs after the approval of the initial application by the NCUA, but prior to the completion of the offer and sale of the related Subordinated Debt Notes, then no person shall offer or sell Subordinated Debt Notes to any other person until an amendment to the Offering Document reflecting the event or change has been filed with and approved by the NCUA.

(2) *Reapproval of Offering Document.* If an Offering Document must be approved for use under paragraph (f) of this section, and any event arises or change in fact occurs after the approval for use of any Offering Document, and that event or change in fact, individually or in the aggregate, results in the Offering Document containing any untrue statement of material fact, or omitting to state a material fact necessary in order to make statements made in the Offering Document not misleading in light of the circumstances under which they were made, then no person shall offer or sell Subordinated Debt Notes to any other person until an amendment reflecting the event or change has been filed with and ''approved for use'' by the NCUA.

(3) *Failure to request reapproval.* If an Issuing Credit Union fails to comply with paragraph (h)(1) or (2) of this section, the NCUA may, at its discretion, exercise the full range of administrative remedies available under the FCU Act, including:

(i) Prohibiting the Issuing Credit Union from issuing any additional Subordinated Debt for a specified period; and/or

(ii) Determining not to treat the Subordinated Debt as Regulatory Capital.

(i) *Notification.* Not later than 10 business days after the closing of a Subordinated Debt Note issuance and sale, the Issuing Credit Union must submit to the Appropriate Supervision Office:

(1) A copy of each executed Subordinated Debt Note;

(2) A copy of each executed purchase agreement, if any;

(3) Any indenture or other transaction document used to issue the Subordinated Debt Notes;

(4) Copies of signed certificates of Accredited Investor status, in a form

similar to that in §702.406(c), from all investors;

(5) All documentation provided to investors related to the offer and sale of the Subordinated Debt Note (other than any Offering Document that was previously filed with the NCUA); and

(6) Any other material documents governing the issuance, sale or administration of the Subordinated Debt Notes.

(j) *Resubmissions.* An Issuing Credit Union that receives any adverse written determination from the Appropriate Supervision Office with respect to the approval of its initial application or any amendment thereto or, if applicable, the approval for use of an Offering Document or any amendment thereto, may cure any reasons noted in the written determination and refile under the requirements of this section. This paragraph (j) does not prohibit an Issuing Credit Union from appealing an Appropriate Supervision Office's decision under subpart A of part 746 of this chapter.

(k) *Expiration of authority to issue Subordinated Debt.* (1) Any approvals to issue Subordinated Debt Notes under this section expire two years from the later of the date the Issuing Credit Union receives:

(i) Approval of its initial application, if the Issuing Credit Union is offering Subordinated Notes exclusively to Entity Accredited Investors; or

(ii) The initial approval for use of its Offering Document, if the Issuing Credit Union is offering Subordinated Debt Notes to any Natural Person Accredited Investors.

(2) Failure to issue all or part of the maximum aggregate principal amount of Subordinated Debt Notes approved in the initial application process within the applicable period specified in paragraph (k) of this section will result in the expiration of the NCUA's approval. An Issuing Credit Union may file a written extension request with the Appropriate Supervision Office. The Issuing Credit Union must demonstrate good cause for any extension(s), and must file the request at least 30 calendar days before the expiration of the applicable period specified in paragraph (k) of this section or any extensions granted under paragraph (k) of this section. In any such written application, the Issuing Credit Union must address whether any such extension poses any material securities law implications.

(l) *Filing requirements.* (1) Except as otherwise provided in this section, all initial applications, Offering Documents, amendments, notices, or other documents must be filed electronically with the Appropriate Supervision Office. Documents may be signed electronically using the signature provision in 17 CFR 230.402 (Rule 402 under the Securities Act of 1933, as amended).

(2) Provided the Issuing Credit Union filing the document has complied with all requirements regarding the filing in this section, the date of filing of the document is the date the NCUA receives the filing. An electronic filing that is submitted on a business day by direct transmission commencing on or before 5:30 p.m. Eastern Standard or Daylight Savings Time, whichever is then currently in effect, would be deemed received by the NCUA on the same business day. An electronic filing that is submitted by direct transmission commencing after 5:30 p.m. Eastern Standard or Daylight Savings Time, whichever is then currently in effect, or on a Saturday, Sunday, or Federal holiday, would be deemed received by the NCUA on the next business day. If an electronic filer in good faith attempts to file a document with the NCUA in a timely manner, but the filing is delayed due to technical difficulties beyond the electronic filer's control, the electronic filer may request that the NCUA adjust the filing date of such document. The NCUA may grant the request if it appears that such adjustment is appropriate and consistent with the public interest and the protection of investors.

(3) If an Issuing Credit Union experiences unanticipated technical difficulties preventing the timely preparation and submission of an electronic filing, the Issuing Credit Union may, upon notice to the Appropriate Supervision Office, file the subject filing in paper format no later than one business day after the date on which the filing was to be made.

(4) Any filing of amendments or supplements to an Offering Document

must include two copies, one of which must be marked to indicate clearly and precisely, by underlining or in some other conspicuous manner, the changes made from the previously filed Offering Document.

(m) *Filing fees.* (1) The NCUA may require filing fees to accompany certain filings made under this subpart before it will accept those filings. If the NCUA requires the aforementioned filing fee, the NCUA will publish an applicable fee schedule on its website at *http://www.NCUA.gov*.

(2) Filing fees must be paid to the NCUA by electronic transfer.

[86 FR 11074, Feb. 23, 2021, as amended at 88 FR 18011, Mar. 27, 2023]

§ 702.409 Preapproval for federally insured, state-chartered credit unions to issue Subordinated Debt.

(a) A federally insured, state-chartered credit union is required to submit the information required under § 702.408 and, if applicable, paragraph (b) of this section to both the Appropriate Supervision Office and its state supervisory authority. The Appropriate Supervision Office will issue decisions approving a federally insured, state-chartered credit union's application only after obtaining the concurrence of the federally insured, state-chartered credit union's state supervisory authority. The NCUA will notify a federally insured, state-chartered credit union's state supervisory authority before issuing a decision to ''approve for use'' a federally insured, state-chartered credit union's Offering Document and any amendments thereto, under § 702.408, if applicable.

(b) If the Appropriate Supervision Office has reason to believe that an issuance by a federally insured, state-chartered credit union under this subpart could subject that federally insured, state-chartered credit union to Federal income taxation, the Appropriate Supervision Office may require the federally insured, state-chartered credit union to provide:

(1) A written legal opinion, satisfactory to the NCUA, from nationally recognized tax counsel or letter from the Internal Revenue Service indicating whether the proposed Subordinated Debt would be classified as capital stock for Federal income tax purposes and, if so, describing any material impact of Federal income taxes on the federally insured, state-chartered credit union's financial condition; or

(2) Pro Forma Financial Statements (balance sheet and income statement) and cash flow projections, including any off-balance sheet items, covering at least two years. Analytical support for key assumptions and key assumption changes must be included in the application. Key assumptions include, but are not limited to, interest rate, liquidity, and credit loss scenarios.

(c) If the Appropriate Supervision Office requires additional information from a federally insured, state-chartered credit union under paragraph (b) of this section, the federally insured, state-chartered credit union may determine, in its sole discretion, whether the information it provides is in the form described in paragraph (b)(1) or (2) of this section.

[86 FR 11074, Feb. 23, 2021, as amended at 88 FR 18011, Mar. 27, 2023]

§ 702.410 Interest payments on Subordinated Debt.

(a) *Requirements for interest payments.* An Issuing Credit Union is prohibited from paying interest on Subordinated Debt in accordance with § 702.109.

(b) *Accrual of interest.* Notwithstanding nonpayment pursuant to paragraph (a) of this section, interest on the Subordinated Debt may continue to accrue according to terms provided for in the Subordinated Debt Note and as otherwise permitted in this subpart.

(c) *Interest safe harbor.* Except as otherwise provided in this section, the NCUA shall not impose a discretionary supervisory action that requires the Issuing Credit Union to suspend interest with respect to the Subordinated Debt if:

(1) The issuance and sale of the Subordinated Debt complies with all requirements of this subpart;

(2) The Subordinated Debt is issued and sold in an arms-length, bona fide transaction;

(3) The Subordinated Debt was issued and sold in the ordinary course of business, with no intent to hinder, delay, or

defraud the Issuing Credit Union or its creditors; and

(4) The Subordinated Debt was issued and sold for adequate consideration in U.S. dollars.

(d) *Authority, rights, and powers of the NCUA and the NCUA Board.* This section does not waive, limit, or otherwise affect the authority, rights, or powers of the NCUA or the NCUA Board in any capacity, including the NCUA Board as conservator or liquidating agent, to take any action or to exercise any power not specifically mentioned, including but not limited to any rights, powers, or remedies of the NCUA Board as conservator or liquidating agent regarding transfers or other conveyances taken in contemplation of the Issuing Credit Union's insolvency or with the intent to hinder, delay, or defraud the Issuing Credit Union or the creditors of such Issuing Credit Union, or that is fraudulent under applicable law.

§ 702.411 Prior written approval to prepay Subordinated Debt.

(a) *Prepayment option.* An Issuing Credit Union may include in the terms of its Subordinated Debt an option that allows the Issuing Credit Union to prepay the Subordinated Debt in whole or in part prior to maturity, provided, however, that the Issuing Credit Union is required to:

(1) Clearly disclose the requirements of this section in the Subordinated Debt Note; and

(2) Obtain approval under paragraph (b) of this section before exercising a prepayment option.

(b) *Prepayment application.* Before an Issuing Credit Union can, in whole or in part, prepay Subordinated Debt prior to maturity, the Issuing Credit Union must first submit to the Appropriate Supervision Office an application that must include, at a minimum, the information required in paragraph (d) of this section.

(c) *Federally insured, state-chartered credit union prepayment applications.* Before a federally insured, state-chartered credit union may submit an application for prepayment to the Appropriate Supervision Office, it must obtain written approval from its state supervisory authority to prepay the Subordinated Debt it is proposing to prepay. A federally insured, state-chartered credit union must provide evidence of such approval as part of its application to the Appropriate Supervision Office.

(d) *Application contents.* An Issuing Credit Union's application to prepay Subordinated Debt must include, at a minimum, the following:

(1) A copy of the Subordinated Debt Note and any agreement(s) reflecting the terms and conditions of the Subordinated Debt the Issuing Credit Union is proposing to prepay;

(2) An explanation why the Issuing Credit Union believes it still would hold an amount of capital commensurate with its risk exposure notwithstanding the proposed prepayment or a description of the replacement Subordinated Debt, including the amount of such instrument, and the time frame for issuance, the Issuing Credit Union is proposing to use to replace the prepaid Subordinated Debt; and

(3) Any additional information the Appropriate Supervision Office requests.

(e) *Decision on application to prepay.* (1) Within 45 calendar days (which may be extended by the Appropriate Supervision Office) after the date of receipt of a complete application, the Appropriate Supervision Office will provide the Issuing Credit Union with a written determination on its application. In the case of a full or partial denial, including a conditional approval under paragraph (e)(2) of this section, the written decision will state the reasons for the denial or conditional approval.

(2) The written determination from the Appropriate Supervision Office may approve the Issuing Credit Union's request, approve the Issuing Credit Union's request with conditions, or deny the Issuing Credit Union's request. In the case of a denial or conditional approval, the Appropriate Supervision Office will provide the Issuing Credit Union with a description of why it denied the Issuing Credit Union's request or imposed conditions on the approval of such request.

(3) If the Issuing Credit Union proposes or the NCUA requires the Issuing Credit Union to replace the Subordinated Debt, the Issuing Credit Union must receive affirmative approval

under this subpart and must issue and sell the replacement instrument prior to or concurrently with prepaying the Subordinated Debt.

(f) *Resubmissions.* An Issuing Credit Union that receives an adverse written determination on its application to prepay, in whole or in part, may cure any deficiencies noted in the Appropriate Supervision Office's written determination and reapply under the requirements of this section. This paragraph (f) does not prohibit an Issuing Credit Union from appealing the Appropriate Supervision Office's adverse decision under subpart A of part 746 of this chapter.

§ 702.412 Effect of a merger or dissolution on the treatment of Subordinated Debt as Regulatory Capital.

(a) In the event of a merger of an Issuing Credit Union into or the assumption of its Subordinated Debt by another federally insured credit union, the Subordinated Debt will be treated as Regulatory Capital only to the extent that the resulting credit union is either a LICU, a complex credit union, and/or a new credit union.

(b) In the event the resulting credit union is not a LICU, a complex credit union, or a new credit union, the Subordinated Debt of the merging credit union can either be:

(1) If permitted by the terms of the Subordinated Debt Note, repaid by the resulting credit union upon approval by the NCUA under § 702.411; or

(2) Continue to be held by the resulting credit union as Subordinated Debt, but will not be classified as Regulatory Capital under this subpart, unless the resulting credit union meets the eligibility requirements of § 702.403.

(c) In the event of a voluntary dissolution of an Issuing Credit Union that has outstanding Subordinated Debt, the Subordinated Debt may be repaid in full according to 12 CFR part 710, subject to the requirements in § 702.411.

§ 702.413 Repudiation safe harbor.

(a) The NCUA Board as conservator for a federally insured credit union, or its lawfully appointed designee, shall not exercise its repudiation authorities under 12 U.S.C. 1787(c) with respect to Subordinated Debt if:

(1) The issuance and sale of the Subordinated Debt complies with all requirements of this subpart;

(2) The Subordinated Debt was issued and sold in an arms-length, bona fide transaction;

(3) The Subordinated Debt was issued and sold in the ordinary course of business, with no intent to hinder, delay, or defraud the Issuing Credit Union or its creditors; and

(4) The Subordinated Debt was issued and sold for adequate consideration in U.S. dollars.

(b) This section does not authorize the attachment of any involuntary lien upon the property of either the NCUA Board as conservator or liquidating agent or its lawfully appointed designee. Nor does this section waive, limit, or otherwise affect the authority, rights, or powers of the NCUA or the NCUA Board in any capacity to take any action or to exercise any power not specifically mentioned, including but not limited to any rights, powers, or remedies of the NCUA Board as conservator or liquidating agent (or its lawfully appointed designee) regarding transfers or other conveyances taken in contemplation of the Issuing Credit Union's insolvency or with the intent to hinder, delay or defraud the Issuing Credit Union or the creditors of such Issuing Credit Union, or that is fraudulent under applicable law.

§ 702.414 Regulations governing Grandfathered Secondary Capital.

This section recodifies the requirements from 12 CFR 701.34(b), (c), and (d) that were in effect as of December 31, 2021, with minor modifications. The terminology used in this section is specific to this section. Except as provided in the next sentence, all secondary capital issued under § 701.34 of this chapter before January 1, 2022, or, in the case of a federally insured, state-chartered credit union, § 741.204(c) of this chapter, that is referred to elsewhere in this subpart as ''Grandfathered Secondary Capital,'' is subject to the requirements set forth in this section. Issuances of secondary capital to the

U.S. Government or any of its subdivisions, under applications approved before January 1, 2022, pursuant to §701.34 or §741.204(c) of this chapter, are also considered ''Grandfathered Secondary Capital'' irrespective of the date of issuance.

(a) Secondary capital is subject to the following conditions:

(1) *Secondary capital plan.* A credit union that has Grandfathered Secondary Capital under this section must have a written, NCUA-approved ''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) *Issuances not completed before January 1, 2022.* Except as provided in the next sentence, any issuances of secondary capital not completed by January 1, 2022, are, as of January 1, 2022, subject to the requirements applicable to Subordinated Debt discussed elsewhere in this subpart. Issuances of secondary capital to the U.S. Government or any of its subdivisions, under applications approved before January 1, 2022, pursuant to §701.34 or §741.204(c) of this chapter, are not subject to the requirements applicable to Subordinated Debt, discussed elsewhere in this subpart, irrespective of the date of issuance.

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

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

(5) *Uninsured account.* The secondary capital account is not 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 is 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, are 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. In instances where a LICU accepted secondary capital from the United States Government or any of its subdivisions under the Community Development Capital Initiative of 2010 (''CDCI secondary capital'') and matching funds were required under the Initiative and are on deposit in the form of secondary capital at the time a loss is realized, a LICU must apply either of the following pro-rata loss distribution procedures to its secondary capital accounts with respect to the loss:

(i) If not inconsistent with any agreements governing other secondary capital on deposit at the time a loss is realized, the CDCI secondary capital may be excluded from the calculation of the pro-rata loss distribution until all of its matching secondary capital has been depleted, thereby causing the CDCI secondary capital to be held as senior to all other secondary capital until its matching secondary capital is exhausted. The CDCI secondary capital should be included in the calculation of the pro-rata loss distribution and is available to cover the loss only after

all of its matching secondary capital has been depleted.

(ii) Regardless of any agreements applicable to other secondary capital, the CDCI secondary capital and its matching secondary capital may be considered a single account for purposes of determining a pro-rata share of the loss and the amount determined as the pro-rata share for the combined account must first be applied to the matching secondary capital account, thereby causing the CDCI secondary capital to be held as senior to its matching secondary capital. The CDCI secondary capital is available to cover the loss only after all of its matching secondary capital has been depleted.

(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 have been 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 have executed a ''Disclosure and Acknowledgment'' as set forth in the appendix to this subpart 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 this part, the NCUA may prohibit a LICU as 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.

(b) *Accounting treatment; Recognition of net worth value of accounts*—(1) *Debt*. A LICU that issued secondary capital accounts pursuant to paragraph (a) of this section must record the funds on its balance sheet as a debt titled ''uninsured secondary capital account.''

(2) *Schedule for recognizing net worth value*. The LICU's reflection of the net worth value of the accounts in its financial statement may never exceed the full balance of the secondary capital on deposit after any early redemptions and losses. 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 lesser of:

(i) The remaining balance of the accounts after any redemptions and losses; or

(ii) The amounts calculated based on the following schedule:

TABLE 1 TO PARAGRAPH (b)(2)(ii)

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.

(c) *Redemption of secondary capital*. With the written approval of NCUA, secondary capital that is not recognized as net worth under paragraph (b)(2) of this section may be redeemed according to the remaining maturity schedule in paragraph (c)(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 or any part of each eligible increment, and must demonstrate to the satisfaction of NCUA that:

(i) The LICU will have a post-redemption net worth classification of at least ''adequately capitalized'' under this part;

(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.*

TABLE 2 TO PARAGRAPH (c)(3)

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

(4) *Early redemption exception.* Subject to the written approval of NCUA obtained pursuant to the requirements of paragraphs (c)(1) and (2) of this section, a LICU can redeem all or part of secondary capital accepted from the United States Government or any of its subdivisions at any time after the secondary capital has been on deposit for two years. If the secondary capital was accepted under conditions that required matching secondary capital from a source other than the Federal Government, the matching secondary capital may also be redeemed in the manner set forth in the preceding sentence. For purposes of obtaining NCUA's approval, all secondary capital a LICU accepts from the United States Government or any of its subdivisions, as well as its matching secondary capital, if any, is eligible for early redemption regardless of whether any part of the secondary capital has been discounted pursuant to paragraph (b)(2) of this section.

[86 FR 11074, Feb. 23, 2021, as amended at 86 FR 72809, Dec. 23, 2021; 88 FR 18011, Mar. 27, 2023]

APPENDIX A TO SUBPART D OF PART 702—DISCLOSURE AND ACKNOWLEDGEMENT FORM

A LICU that is authorized to accept uninsured secondary capital accounts and each investor in such an account must have executed and dated 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 702.414, 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 written approval of NCUA.

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 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]

Subparts E–F [Reserved]

Subpart G—CECL Transition Provisions

SOURCE: 86 FR 34932, July 1, 2021, unless otherwise noted.

§ 702.701 Authority, purpose, and scope.

(a) *Authority.* This subpart is issued by the National Credit Union Administration Board pursuant to section 216 of the Federal Credit Union Act, 12 U.S.C. 1790d, as added by section 301 of the Credit Union Membership Access Act, Public Law 105–219, 112 Stat. 913 (1998).

(b) *Purpose.* This subpart provides for the phase in of the adverse effects on the regulatory capital of federally insured credit unions that may result from the adoption of the current expected credit losses (CECL) accounting methodology.

(c) *Scope.* (1) The transition provisions of this subpart apply to Federally insured credit unions, whether Federally or State-chartered, including credit unions defined as ''new'' pursuant to section 1790d(b)(2) that make charges for loan losses in accordance with:

(i) Generally accepted accounting principles (GAAP) under § 702.402(d)(1)(i); or

(ii) In the case of Federally-insured, State-chartered credit unions, any other applicable standard under State law or regulation under § 702.402(d)(1)(ii)(B).

(2) The transition provisions of this subpart do not apply to Federally-insured credit unions, whether Federally or State-chartered, including credit unions defined as ''new'' pursuant to section 1790d(b)(2), that make charges for loan losses using a reasonable reserve methodology under § 702.402(d)(1)(ii)(A).

§ 702.702 Definitions.

In addition to the definitions set forth in § 702.2, the following definitions apply to this subpart:

CECL transitional amount means the decrease of a credit union's retained earnings resulting from its adoption of CECL, as determined pursuant to § 702.703(b).

Current Expected Credit Losses (CECL) means the current expected credit losses methodology under GAAP.

Transition period means the 12-quarter reporting period beginning the first day of the fiscal year in which the credit union adopts CECL.

§ 702.703 CECL transition provisions.

(a) *Eligibility*. The NCUA shall use the transition provisions of this subpart in determining a credit union's net worth category under this part, as applicable, if:

(1) The credit union has not adopted CECL before its first fiscal year beginning after December 15, 2022; and

(2) The credit union records a reduction in retained earnings due to the adoption of CECL.

(b) *Determination of CECL transition amount*. (1) For purposes of calculating the first three quarters of the transition period, as described in paragraph (c)(1) of this section, the CECL transitional amount is equal to the difference between the credit union's retained earnings as of the beginning of the fiscal year in which the credit union adopts CECL and the credit union's retained earnings as of the closing of the fiscal year immediately prior to the credit union's adoption of CECL.

(2) For purposes of calculating the fourth through twelfth quarters of the transition period, as described in paragraphs (c)(2) and (c)(3) of this section, the CECL transitional amount is equal to the difference between the credit union's retained earnings as of the end of the fiscal year in which the credit union adopts CECL and the credit union's retained earnings as of the beginning of its next fiscal year.

(c) *Calculation of CECL transition provision*. In determining the net worth category of a credit union as provided in paragraph (a) of this section, the NCUA shall:

(1) Increase retained earnings and total assets as reported on the Call Report for purposes of the net worth ratio by 100 percent of its CECL transitional amount during the first three quarters of the transition period (first three reporting quarters of the fiscal year in which the credit union adopts CECL);

(2) Increase retained earnings and total assets as reported on the Call Report for purposes of the net worth ratio by sixty-seven percent of its CECL transitional amount during the second four quarters of the transition period (fourth reporting quarter of the fiscal year in which the credit union adopts CECL and first three reporting quarters of the next fiscal year); and

(3) Increase retained earnings and total assets as reported on the Call Report for purposes of the net worth ratio by thirty-three percent of its CECL transitional amount during the final four quarters of the transition period.

APPENDIX A TO PART 702—GROSS-UP APPROACH, AND LOOK-THROUGH APPROACHES

Instead of using the risk weights assigned in §702.104(c)(2) a credit union may determine the risk weight of certain investment funds, and the risk weight of a non-subordinated or subordinated tranche of any investment as follows:

(a) *Gross-up approach*—(1) *Applicability*. Section 702.104(c)(3)(iii)(A) of this part provides that, a credit union may use the gross-up approach in this appendix to determine the risk weight of the carrying value of non-subordinated or subordinated tranches of any investment.

(2) *Calculation*. To use the gross-up approach, a credit union must calculate the following four inputs:

(i) Pro rata share, which is the par value of the credit union's exposure as a percent of the par value of the tranche in which the securitization exposure resides;

(ii) Enhanced amount, which is the par value of tranches that are more senior to the tranche in which the credit union's securitization resides;

(iii) Exposure amount, which is the amortized cost for investments classified as held-to-maturity and available-for-sale, and the fair value for trading securities; and

(iv) Risk weight, which is the weighted-average risk weight of underlying exposures of the securitization as calculated under this appendix.

(3) *Credit equivalent amount*. The ''credit equivalent amount'' of a securitization exposure under this part equals the sum of:

(i) The exposure amount of the credit union's exposure; and

(ii) The pro rata share multiplied by the enhanced amount, each calculated in accordance with paragraph (a)(2) of this appendix.

(4) *Risk-weighted assets*. To calculate risk-weighted assets for a securitization exposure under the gross-up approach, a credit union must apply the risk weight required under

paragraph (a)(2) of this appendix to the credit equivalent amount calculated in paragraph (a)(3) of this appendix.

(5) *Securitization exposure defined.* For purposes of this this paragraph (a), ''securitization exposure'' means:

(i) A credit exposure that arises from a securitization; or

(ii) An exposure that directly or indirectly references a securitization exposure described in paragraph (a)(5)(i) of this appendix.

(6) *Securitization defined.* For purposes of this paragraph (a), ''securitization'' means a transaction in which:

(i) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;

(ii) Performance of the securitization exposures depends upon the performance of the underlying exposures; and

(iii) All or substantially all of the underlying exposures are financial exposures (such as loans, receivables, asset-backed securities, mortgage-backed securities, or other debt securities).

(b) *Look-through approaches.*—(1) *Applicability.* Section 702.104(c)(3)(iii)(B) provides that, a credit union may use one of the look-through approaches in this appendix to determine the risk weight of the exposure amount of any investment fund, or the holding of separate account insurance.

(2) *Full look-through approach.* (i) *General.* A credit union that is able to calculate a risk-weighted asset amount for its proportional ownership share of each exposure held by the investment fund may set the risk-weighted asset amount of the credit union's exposure to the fund equal to the product of:

(A) The aggregate risk-weighted asset amounts of the exposures held by the fund as if they were held directly by the credit union; and

(B) The credit union's proportional ownership share of the fund.

(ii) *Holding report.* To calculate the risk-weighted amount under paragraph (b)(2)(i) of this appendix, a credit union should:

(A) Use the most recently issued investment fund holding report; and

(B) Use an investment fund holding report that reflects holding that are not older than 6-months from the quarter-end effective date (as defined in §702.101(c)(1).

(3) *Simple modified look-through approach.* Under the simple modified look-through approach, the risk-weighted asset amount for a credit union's exposure to an investment fund equals the exposure amount multiplied by the highest risk weight that applies to any exposure the fund is permitted to hold under the prospectus, partnership agreement, or similar agreement that defines the fund's permissible investments (excluding derivative contracts that are used for hedging rather than speculative purposes and that do not constitute a material portion of the fund's exposures).

(4) *Alternative modified look-through approach.* Under the alternative modified look-through approach, a credit union may assign the credit union's exposure amount to an investment fund on a pro rata basis to different risk weight categories under subpart A of this part based on the investment limits in the fund's prospectus, partnership agreement, or similar contract that defines the fund's permissible investments. The risk-weighted asset amount for the credit union's exposure to the investment fund equals the sum of each portion of the exposure amount assigned to an exposure type multiplied by the applicable risk weight under subpart A of this part. If the sum of the investment limits for all exposure types within the fund exceeds 100 percent, the credit union must assume that the fund invests to the maximum extent permitted under its investment limits in the exposure type with the highest applicable risk weight under subpart A of this part and continues to make investments in order of the exposure type with the next highest applicable risk weight under subpart A of this part until the maximum total investment level is reached. If more than one exposure type applies to an exposure, the credit union must use the highest applicable risk weight. A credit union may exclude derivative contracts held by the fund that are used for hedging rather than for speculative purposes and do not constitute a material portion of the fund's exposures.

[80 FR 66722, Oct. 29, 2015]

PART 703—INVESTMENT AND DEPOSIT ACTIVITIES

Subpart A—General Investment and Deposit Activities

Sec.