



September 22, 2011

Proposed Technical Amendments to Corporate Credit Union Rule

EXECUTIVE SUMMARY

- The National Credit Union Administration (NCUA) Board issued a proposal to amend its corporate credit union rule, Part 704. The proposed technical amendments would:
 - Revise the definition of “net assets” in § 704.2 to exclude Central Liquidity Facility (CLF) stock subscriptions;
 - Revise § 704.6 to incorporate current concentration limit and credit rating requirements that trigger § 704.10 consequences that include a written investment action plan;
 - Revise the consequences of weighted average life (WAL) violations so that such violations would not be subject to capital category reclassification or subject to requirements that apply to a violation of the interest rate sensitivity in § 704.8; and
 - Make several other clarifying changes and technical corrections.
- NCUA is accepting public comments until October 6, 2011. **Please send your comments to CUNA by September 30.**

Please send comments to Senior Vice President and Deputy General Counsel [Mary Dunn](#), Regulatory Counsel [Dennis Tsang](#), and Assistant General Counsel [Luke Martone](#), or contact us at (800) 356-9655 ext. 6733 with any questions. [Click here](#) for the proposed rule.

BRIEF DESCRIPTION OF THE CORPORATE PROPOSAL

Definition of “net assets” (§ 704.2)

Section 704.2 of NCUA’s regulations defines “net assets,” in part, as “total assets less loans guaranteed by the NCUSIF [National Credit Union Share Insurance Fund] and member reverse repurchase transactions.” The proposed rule would amend the “net assets” definition to also exclude Central Liquidity Facility (CLF) stock subscriptions. According to the proposal’s supplemental information, the Board believes the credit risk of carrying this asset is negligible and warrants such treatment, as CLF stock is puttable at par. In addition, the Board supports access by all natural person credit unions to a back-up liquidity provider that can meet their liquidity demands in the event of a widespread market disruption. The CLF can supply this liquidity if its borrowing authority is not diminished by a reduction of its stock subscriptions. This proposed change is intended to encourage continued CLF participation

by corporates, which in turn will facilitate corporates providing a systemic liquidity benefit to natural person credit unions through offering CLF access as agents.

Requirements for Investment Action Plans (§ 704.6)

Section 704.10 sets out consequences, potentially including the preparation of a written investment action plan to NCUA Office of Corporate Credit Unions Director, if a credit union holds an investment that fails to meet a requirement of Part 704.

Currently, investments that fail a requirement either under § 704.6(c)(3) on issuer concentration limits or § 704.6(f)(4) on credit rating requirements will trigger § 704.10 consequences.

To clarify the applicability of these triggering provisions, the Board proposes to move these two sections to a new paragraph at § 704.6(h). Under proposed § 704.6(h), an investment will be subject to the consequences of § 704.10 if it violates the issuer concentration limits or credit rating requirements.

The Board notes that § 704.6(f)(4)(i) currently provides that an investment is subject to the requirements of § 704.10 if its credit rating is subsequently downgraded “below the minimum rating requirements of this part.” However, the Dodd-Frank Act requires NCUA to review its regulations for any references to using credit ratings to assess the creditworthiness of an investment, remove those references, and substitute other standards of creditworthiness.

Earlier this year, NCUA issued a proposal to implement the credit ratings requirement of the Dodd-Frank Act. The proposal recodified § 704.6 (f)(4)(i) at § 704.6(f)(3)(i) and revised it to state that an investment is subject to § 704.10 if “there is reason to believe that the obligor no longer has a very strong capacity to meet its financial obligations for the remaining projected life of the security.” Although the NCUA Board has not finalized the credit ratings proposal, this current corporate credit union proposed rule includes the proposed revised language at new § 704.6(h)(1).

Consequences of WAL Violations (§ 704.8)

Section 704.8(j) provides consequences for a corporate’s violation of the interest rate sensitivity and WAL conditions of § 704.8 (d), (f), and (g). These consequences can include reporting requirements, preparation of a written action plan, and capital category reclassification under § 704.4. To reduce regulatory burden, the NCUA Board has determined that a credit union’s violation of WAL conditions should not be subject to capital category reclassification and the proposal would exempt such violations from the requirements of § 704.8(j)(2)(ii) and (iii). However, persistent WAL violations could still trigger the reporting and action plan requirements of § 704.8(j)(1) and (2)(i).

Fidelity Bond Maximum Deductible (§ 704.18)

Section 704.18(e)(1) provides a table for corporates to calculate the maximum deductible allowed for fidelity bonds purchased for employees and officials. The maximum deductible is based on a corporate’s core capital ratio and a percentage of the sum of its retained earnings and paid-in capital. A 2010 amendment to the corporate credit union rule changed the term

“paid-in capital” to “perpetual contributed capital,” but neglected to change the reference in § 704.18.

The NCUA Board is now proposing to change the phrase “the sum of its retained earnings and paid-in capital” to the term “core capital.” § 704.2 defines “core capital” as “the sum of: (1) Retained earnings; (2) Perpetual contributed capital; (3) The retained earnings of any acquired credit union, or of an integrated set of activities and assets, calculated at the point of acquisition, if the acquisition was a mutual combination; and (4) Minority interests in the equity accounts of CUSOs that are fully consolidated. However, minority interests in consolidated ABCP programs sponsored by a corporate credit union are excluded from the credit union’s core capital or total capital base if the corporate credit union excludes the consolidated assets of such programs from risk-weighted assets pursuant to Appendix C of this part.” The Board is proposing this substitution, rather than simply replacing “paid-in capital” with “perpetual contributed capital” because the table already requires the calculation of core capital in deriving the core capital ratio.

Clarifying Amendments and Technical Changes

Definition of “daily average net risk-weighted assets” (§ 704.2): As part of a 2010 amendment to the corporate credit union rule, the Board replaced the denominator of two risk based capital ratios (“daily average net risk-weighted assets” [DANRA]) with a new “moving monthly average net risk weighted assets” (MMANRA). The term “DANRA” is not used in Part 704, and its inclusion in § 704.2 was an oversight. This final rule would remove the DANRA definition from § 704.2.

Clarifying the WAL Tests (§ 704.8): Sections 704.8(f) and 704.8(g) establish certain WAL limits for corporate loan and investment portfolios and require each corporate to test those assets periodically for compliance. NCUA intended to allow corporates to include cash in the WAL calculation, and the proposed rule clarifies that intent. The proposed rule substitutes the phrase “loan and investment portfolio” in paragraphs (f) and (g) with the phrase “financial assets, consisting of cash, investments, and loans.” The proposed rule retains the current rule’s exclusion of derivative contracts and equity investments from the WAL calculation.

Correction to Section Heading (§ 704.19): The proposed rule would remove the words “and director” from the heading of § 704.19, “Disclosure of executive *and director* compensation,” in order to make it consistent with revisions made to § 704.19 in 2010.

Model Form D (Appendix A): The 2010 amendment to the corporate credit union rule included an incorrect date instruction on Model Form D in Appendix A. Model Form D included introductory text indicating that the form was for use before October 20, 2011. The proposed correction would replace the word “before” with the phrase “on and after.”

QUESTIONS REGARDING THE CORPORATE PROPOSAL

- 1) Section 704.2 of NCUA’s regulations defines “net assets,” in part, as “total assets less loans guaranteed by the NCUSIF and member reverse repurchase transactions.” The

proposed rule would amend the definition of “net assets” to also exclude CLF stock subscription, which have low investment risk. Do you agree with the amendment?

2) Section 704.10 sets out consequences, potentially including the preparation of a written investment action plan, for possessing an investment that fails to meet a requirement of Part 704. The proposal would move current §§ 704.6(c)(3) and (f)(4) that trigger the investment action plan for violations of certain concentration limits and credit rating requirements to a new paragraph at § 704.6(h). Do you agree with the amendment?

3) NCUA has not yet finalized its proposed rule on references to credit ratings, which is required under the Dodd-Frank Act. Do you agree with the inclusion of the proposed credit rating alternatives?

4) Do you agree with the amendment that violations of WAL conditions would not be subject to capital category reclassification and such violations would also be exempt from the requirements of § 704.8(j)(2)(ii) and (iii) that apply to a corporate’s violation of the interest rate sensitivity and WAL conditions?

5) Do you agree with the amendment to change the phrase “the sum of its retained earnings and paid-in capital” to the term “core capital” under Section 704.18(e)(1)’s table to calculate the maximum deductible for fidelity bonds on employees and officials?

6) Other Clarifying Amendments and Technical Changes:

a. *Definition of “daily average net risk-weighted assets” (§ 704.2):* Do you agree with the proposed removal of the DANRA definition from § 704.2?

b. *Clarifying the WAL Tests (§ 704.8):* NCUA intended to allow corporates to include cash in the WAL calculation. Do you agree with the proposed rule to substitute the phrase “loan and investment portfolio” under §§ 704.8(f) and 704.8(g) (f) and (g) with the phrase “financial assets, consisting of cash, investments, and loans?”

c. *Correction to Section Heading (§ 704.19):* Do you agree with the proposed removal of the words “and director” from the heading of § 704.19, “Disclosure of executive and director compensation,” in order to make it consistent with revisions made to § 704.19 in 2010?

7) Any other questions or comments.
