

Part 704 Corporate Credit Unions

§ 704.1 Scope.

- (a) This part establishes special rules for all federally insured corporate credit unions. Non-federally insured corporate credit unions must agree, by written contract, to both adhere to the requirements of this part and submit to examinations, as determined by NCUA, as a condition of receiving shares or deposits from federally insured credit unions. This part grants certain additional authorities to federal corporate credit unions. Except to the extent that they are inconsistent with this part, other provisions of NCUA's Rules and Regulations (12 CFR chapter VII) and the Federal Credit Union Act apply to federally chartered corporate credit unions and federally insured state-chartered corporate credit unions to the same extent that they apply to other federally chartered and federally insured state-chartered credit unions, respectively.
- (b) The Board has the authority to issue orders which vary from this part. This authority is provided under Section 120(a) of the Federal Credit Union Act, 12 U.S.C. 1766(a). Requests by state-chartered corporate credit unions for waivers to this part and for expansions of authority under Appendix B of this part must be approved by the state regulator before being submitted to NCUA.

§ 704.2 Definitions.

Adjusted trading means any method or transaction whereby a corporate credit union sells a security to a vendor at a price above its current market price and simultaneously purchases or commits to purchase from the vendor another security at a price above its current market price.

Asset-backed security (ABS) means a security that is primarily serviced by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the security holders. This definition excludes mortgage related securities.

Capital means the sum of a corporate credit union's retained earnings, paid-in capital, and membership capital.

Capital ratio means the corporate credit union's capital divided by its moving daily average net assets.

Collateralized mortgage obligation (CMO) means a multi-class mortgage-related security.

Core capital means the corporate credit union's retained earnings and paid-in capital.

Core capital ratio means the corporate credit union's core capital divided by its moving daily average net assets.

Corporate credit union means an organization that:

- (1) Is chartered under Federal or state law as a credit union;
- (2) Receives shares from and provides loan services to credit unions;
- (3) Is operated primarily for the purpose of serving other credit unions;
- (4) Is designated by NCUA as a corporate credit union;

- (5) Limits natural person members to the minimum required by state or federal law to charter and operate the credit union; and
- (6) Does not condition the eligibility of any credit union to become a member on that credit union's membership in any other organization.

Correspondent services means services provided by one financial institution to another, and includes check clearing, credit and investment services, and any other banking services.

Credit enhancement means collateral, third party guarantees, and other features that are designed to provide structural support and protection against losses to investors in a particular security.

Daily average net assets means the average of net assets calculated for each day during the period.

Dealer bid indication means a dealer's approximation of the bid price of a security.

Dollar roll means the purchase or sale of a mortgage-backed security to a counterparty with an agreement to resell or repurchase a substantially identical security at a future date and at a specified price.

Embedded option means a characteristic of certain assets and liabilities which gives the issuer of the instrument the ability to change the features such as final maturity, rate, principal amount and average life. Options include, but are not limited to, calls, caps, and prepayment options.

Fair value means the amount at which an instrument could be exchanged in a current, arms-length transaction between willing parties, as opposed to a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value. If a quoted market price in an active market is not available, fair value may be estimated using a valuation technique that is reasonable and supportable, a quoted market price in an active market for a similar instrument, or a current appraised value. Examples of valuation techniques include the present value of estimated future cash flows, option-pricing models, and option-adjusted spread models. Valuation techniques should incorporate assumptions that market participants would use in their estimates of values, future revenues, and future expenses, including assumptions about interest rates, default, prepayment and volatility.

Federal funds transaction means a short-term or open-ended unsecured transfer of immediately available funds by one depository institution to another depository institution or entity.

Foreign bank means an institution which is organized under the laws of a country other than the United States, is engaged in the business of banking, and is recognized as a bank by the banking supervisory authority of the country in which it is organized.

Forward settlement of a transaction means settlement on a date later than regular-way settlement.

Immediate family member means a spouse or other family member living in the same household.

Limited liquidity investment means a private placement or funding agreement.

Member reverse repurchase transaction means an integrated transaction in which a corporate credit union purchases a security from one of its member credit unions under agreement by that member credit union to repurchase the same security at a specified time in the future. The corporate credit union then sells that same security, on the same

day, to a third party, under agreement to repurchase it on the same date on which the corporate credit union is obligated to return the security to its member credit union.

Membership capital means funds contributed by members that: are adjustable balance with minimum withdrawal notice of 3 years or are term certificates with a minimum term of 3 years; are available to cover losses that exceed retained earnings and paid-in capital; are not insured by the NCUSIF or other share or deposit insurers; and cannot be pledged against borrowings.

Mortgage related security means a security as defined in Section 3(a)(41) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(41)), e.g., a privately issued security backed by mortgages secured by real estate upon which is located a dwelling, mixed residential and commercial structure, residential manufactured home, or commercial structure that is rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization.

Moving daily average net assets means the average of daily average net assets for the month being measured and the previous 11 months. *NCUA* means NCUA Board (Board), unless the particular action has been delegated by the Board.

Net assets means total assets less Central Liquidity Facility (CLF) stock subscriptions, CLF loans guaranteed by the NCUSIF, U.S. Central CLF certificates, and member reverse repurchase transactions. For its own account, a corporate credit union's payables under reverse repurchase agreements and receivables under repurchase agreements may be netted out if the Generally Accepted Accounting Principles (GAAP) conditions for offsetting are met.

Net economic value (NEV) means the fair value of assets minus the fair value of liabilities. All fair value calculations must include the value of forward settlements and embedded options. The amortized portion of membership capital and paid-in capital, which do not qualify as capital, are treated as liabilities for purposes of this calculation. The NEV ratio is calculated by dividing NEV by the fair value of assets.

Obligor means the primary party obligated to repay an investment, e.g., the issuer of a security, the taker of a deposit, or the borrower of funds in a federal funds transaction. Obligor does not include an originator of receivables underlying an asset-backed security, the servicer of such receivables, or an insurer of an investment.

Official means any director or committee member.

Paid-in capital means accounts or other interests of a corporate credit union that: are perpetual, non cumulative dividend accounts; are available to cover losses that exceed retained earnings; are not insured by the NCUSIF or other share or deposit insurers; and cannot be pledged against borrowings.

Pair-off transaction means a security purchase transaction that is closed out or sold at, or prior to, the settlement or expiration date.

Quoted market price means a recent sales price or a price based on current bid and asked quotations.

Regular way settlement means delivery of a security from a seller to a buyer within the time frame that the securities industry has established for immediate delivery of that type of security. For example, regular-way settlement of a Treasury security includes settlement on the trade date ("cash"), the business day following the trade date ("regular way"), and the second business day following the trade date ("skip day").

Repurchase transaction means a transaction in which a corporate credit union agrees to purchase a security from a counterparty and to resell the same or any identical security to that counterparty at a specified later date and at a specified price.

Residual interest means the remainder cash flows from a CMO or ABS transaction after payments due bondholders and trust administrative expenses have been satisfied.

Retained earnings means the total of the corporate credit union's undivided earnings, reserves, and any other appropriations designated by management or regulatory authorities. For purposes of this regulation, retained earnings does not include the allowance for loan and lease losses account, accumulated unrealized gains and losses on available for sale securities, or other comprehensive income items.

Retained earnings ratio means the corporate credit union's retained earnings divided by its moving daily average net assets.

Section 107(8) institution means an institution described in Section 107(8) of the Federal Credit Union Act (12 U.S.C. 1757(8)).

Securities lending means lending a security to a counterparty, either directly or through an agent, and accepting collateral in return.

Senior management employee means a chief executive officer, any assistant chief executive officer (e.g., any assistant president, any vice president or any assistant treasurer/manager), and the chief financial officer (controller).

Settlement date means the date originally agreed to by a corporate credit union and a counterparty for settlement of the purchase or sale of a security.

Short sale means the sale of a security not owned by the seller.

Short-term investment means, for the purpose of issue ratings, an investment that has an initial maturity, or expected maturity, of one year or less.

Small business related security means a security as defined in Section 3(a)(53) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(53)), i.e., a security, rated in one of the four highest rating categories by a nationally recognized statistical rating organization, that represents ownership of one or more promissory notes or leases of personal property which evidence the obligation of a small business concern. It does not mean a security issued or guaranteed by the Small Business Administration.

Stripped mortgage-backed security means a security that represents either the principal or interest only portion of the cash flows of an underlying pool of mortgages.

Trade association means an association of organizations or persons formed to promote their common interests. For the purposes of § 704.14, the term includes entities owned or controlled directly or indirectly by such an association but does not include credit unions.

Trade date means the date a corporate credit union originally agrees, whether orally or in writing, to enter into the purchase or sale of a security.

Weighted average life means the weighted average time to principal repayment of a security based upon the proportional balances of the cash flows that make up the security.

When-issued trading means the buying and selling of securities in the period between the announcement of an offering and the issuance and payment date of the securities.

Wholesale corporate credit union means a corporate credit union which primarily serves other corporate credit unions.

§ 704.3 Corporate Credit Union Capital.

- (a) Capital plan. A corporate credit union must develop and ensure implementation of written short and long-term capital goals, objectives, and strategies which provide for the building of capital consistent with regulatory requirements, the maintenance of sufficient capital to support the risk exposures that may arise from current and projected activities, and the periodic review and reassessment of the capital position of the corporate credit union.
- (b) *Requirements for membership capital*
 - (1) *Form.* Membership capital funds may be in the form of a term certificate or an adjusted balance account.
 - (2) *Disclosure.* The terms and conditions of a membership capital account must be disclosed to the recorded owner of the account at the time the account is opened and at least annually thereafter.
 - (i) The initial disclosure must be signed by either all of the directors of the member credit union or, if authorized by board resolution, the chair and secretary of the board; and
 - (ii) The annual disclosure notice must be signed by the chair of the corporate credit union. The chair must sign a statement that certifies that the notice has been sent to member credit unions with membership capital accounts. The certification must be maintained in the corporate credit union's files and be available for examiner review.
 - (3) *Three-year remaining maturity.* When a membership capital account has been placed on notice or has a remaining maturity of less than three years, the amount of the account that can be considered membership capital is reduced by a constant monthly amortization that ensures membership capital is fully amortized one year before the date of maturity or one year before the end of the notice period. The full balance of a membership capital account being amortized, not just the remaining non-amortized portion, is available to absorb losses in excess of the sum of retained earnings and paid-in capital until the funds are released by the corporate credit union at the time of maturity or the conclusion of the notice period.
 - (4) *Release.* Membership capital may not be released due solely to the merger, charter conversion or liquidation of a member credit union. In the event of a merger, the membership capital transfers to the continuing credit union. In the event of a charter conversion, the membership capital transfers to the new institution. In the event of liquidation, the membership capital may be released to facilitate the payout of shares with the prior written approval of the OCCU Director.
 - (5) *Sale.* A member may sell its membership capital to another member in the corporate credit union's field of membership, subject to the corporate credit union's approval.
 - (6) *Liquidation.* In the event of liquidation of a corporate credit union, membership capital is payable only after satisfaction of all liabilities of the liquidation estate, including uninsured share obligations to shareholders and the National Credit Union Share Insurance Fund (NCUSIF), but excluding paid-in capital.

- (7) *Merger*. In the event of a merger of a corporate credit union, membership capital transfers to the continuing corporate credit union. The minimum three-year notice period for withdrawal of membership capital remains in effect.
- (8) *Adjusted balance accounts*:
- (i) May be adjusted no more frequently than once every six months; and
 - (ii) Must be adjusted in relation to a measure, e.g., one percent of a member credit union's assets, established and disclosed at the time the account is opened without regard to any minimum withdrawal period. If the measure is other than assets, the corporate credit union must address the measure's permanency characteristics in its capital plan.
 - (iii) *Notice of withdrawal*. Upon written notice of intent to withdraw membership capital, the balance of the account will be frozen (no further adjustments) until the conclusion of the notice period.
- (9) *Grandfathering*. Membership capital issued before the effective date of this regulation is exempt from the limitation of § 704.3(b)(8)(i).
- (c) *Requirements for paid-in capital*
- (1) *Disclosure*. The terms and conditions of any paid-in capital instrument must be disclosed to the recorded owner of the instrument at the time the instrument is created and must be signed by either all of the directors of the member credit union or, if authorized by board resolution, the chair and secretary of the board.
 - (2) *Release*. Paid-in capital may not be released due solely to the merger, charter conversion or liquidation of a member credit union. In the event of a merger, the paid-in capital transfers to the continuing credit union. In the event of a charter conversion, the paid-in capital transfers to the new institution. In the event of liquidation, the paid-in capital may be released to facilitate the payout of shares with the prior written approval of the OCCU Director.
 - (3) *Callability*. Paid-in capital accounts are callable on a pro-rata basis across an issuance class only at the option of the corporate credit union and only if the corporate credit union meets its minimum level of required capital and NEV ratios after the funds are called.
 - (4) *Liquidation*. In the event of liquidation of the corporate credit union, paid-in capital is payable only after satisfaction of all liabilities of the liquidation estate, including uninsured share obligations to shareholders, the NCUSIF, and membership capital holders.
 - (5) *Merger*. In the event of a merger of a corporate credit union, paid-in capital shall transfer to the continuing corporate credit union.
 - (6) *Paid-in capital*. Paid-in capital includes both member and nonmember paid-in capital.
 - (i) Member paid-in capital means paid-in capital that is held by the corporate credit union's members. A corporate credit union may not condition membership, services, or prices for services on a credit union's ownership of paid-in capital.
 - (ii) Nonmember paid-in capital means paid-in capital that is not held by the corporate credit union's members.

- (7) *Grandfathering.* A corporate credit union's authority to include paid-in capital as a component of capital is governed by the regulation in effect at the time the paid-in capital was issued. When a grandfathered paid-in capital instrument has a remaining maturity of less than 3 years, the amount that may be considered paid-in capital is reduced by a constant monthly amortization that ensures the paid-in capital is fully amortized 1 year before the date of maturity. The full balance of grandfathered paid-in capital being amortized, not just the remaining non-amortized portion, is available to absorb losses in excess of retained earnings until the funds are released by the corporate credit union at maturity.
- (d) Capital ratio. A corporate credit union will maintain a minimum capital ratio of 4 percent, except as otherwise provided in this part. A corporate credit union must calculate its capital ratio at least monthly.
- (e) Individual capital ratio requirement.
- (1) When significant circumstances or events warrant, the OCCU Director may require a different minimum capital ratio for an individual corporate credit union based on its circumstances. Factors that might warrant a different minimum capital ratio include, but are not limited to:
- (i) An expectation that the corporate credit union has or anticipates losses resulting in capital inadequacy;
 - (ii) Significant exposure exists, unsupported by adequate capital or risk management processes, due to credit, liquidity, market, fiduciary, operational, and similar types of risks;
 - (iii) A merger has been approved; or
 - (iv) An emergency exists because of a natural disaster.
- (2) When the OCCU Director determines that a different minimum capital ratio is necessary or appropriate for a particular corporate credit union, he or she will notify the corporate credit union in writing of the proposed capital ratio and the date by which the capital ratio must be reached. The OCCU Director also will provide an explanation of why the proposed capital ratio is considered necessary or appropriate.
- (3)
- (i) The corporate credit union may respond to any or all of the items in the notice. The response must be in writing and delivered to the OCCU Director within 30 calendar days after the date on which the corporate credit union received the notice. The OCCU Director may shorten the time period when, in its opinion, the condition of the corporate credit union so requires, provided that the corporate credit union is informed promptly of the new time period, or with the consent of the corporate credit union. In its discretion, the OCCU Director may extend the time period for good cause.
 - (ii) Failure to respond within 30 calendar days or such other time period as may be specified by the OCCU Director shall constitute a waiver of any objections to any item in the notice. Failure to address any item in a response shall constitute a waiver of any objection to that item.

- (iii) After the close of the corporate credit union's response period, the OCCU Director will decide, based on a review of the corporate credit union's response and other information concerning the corporate credit union, whether a different minimum capital ratio should be established for the corporate credit union and, if so, the capital ratio and the date the requirement must be reached. The corporate credit union will be notified of the decision in writing. The notice will include an explanation of the decision, except for a decision not to establish a different minimum capital ratio for the corporate credit union.
- (f) Failure to maintain minimum capital ratio requirement. When a corporate credit union's capital ratio falls below the minimum required by paragraphs (d) or (e) of this section, or Appendix B to this part, as applicable, operating management of the corporate credit union must notify its board of directors, supervisory committee, and the OCCU Director within 10 calendar days.
- (g) Capital restoration plan.
 - (1) A corporate credit union must submit a plan to restore and maintain its capital ratio at the minimum requirement when either of the following conditions exist:
 - (i) The capital ratio falls below the minimum requirement and is not restored to the minimum requirement by the next month end; or
 - (ii) Regardless of whether the capital ratio is restored by the next month end, the capital ratio falls below the minimum requirement for three months in any 12 month period.
 - (2) The capital restoration plan must, at a minimum, include the following:
 - (i) Reasons why the capital ratio fell below the minimum requirement;
 - (ii) Descriptions of steps to be taken to restore the capital ratio to the minimum requirement within specific time frames;
 - (iii) Actions to be taken to maintain the capital ratio at the minimum required level and increase it thereafter;
 - (iv) Balance sheet and income projections, including assumptions, for the current calendar year and one additional calendar year; and
 - (v) Certification from the board of directors that it will follow the proposed plan if approved by the OCCU Director.
 - (3) The capital restoration plan must be submitted to the OCCU Director within 30 calendar days of the occurrence. The OCCU Director will respond to the corporate credit union regarding the adequacy of the plan within 45 calendar days of its receipt.
- (h) Capital directive.
 - (1) If a corporate credit union fails to submit a capital restoration plan; or the plan submitted is not deemed adequate to either restore capital or restore capital within a reasonable time; or the credit union fails to implement its approved capital restoration plan, NCUA may issue a capital directive.
 - (2) A capital directive may order a corporate credit union to:
 - (i) Achieve adequate capitalization within a specified time frame by taking any action deemed necessary, including but not limited to the following:
 - (A) Increase the amount of capital to specific levels;
 - (B) Reduce dividends;

- (C) Limit receipt of deposits to those made to existing accounts;
 - (D) Cease or limit issuance of new accounts or any or all classes of accounts;
 - (E) Cease or limit lending or making a particular type or category of loans;
 - (F) Cease or limit the purchase of specified investments;
 - (G) Limit operational expenditures to specified levels;
 - (H) Increase and maintain liquid assets at specified levels; and
 - (I) Restrict or suspend expanded authorities issued under Appendix B of this part.
- (ii) Adhere to a previously submitted plan to achieve adequate capitalization.
 - (iii) Submit and adhere to a capital plan acceptable to NCUA describing the means and a time schedule by which the corporate credit union shall achieve adequate capitalization.
 - (iv) Meet with NCUA.
 - (v) Take a combination of these actions.
- (3) Prior to issuing a capital directive, NCUA will notify a corporate credit union in writing of its intention to issue a capital directive.
- (i) The notice will state:
 - (A) The reasons for the issuance of the directive; and
 - (B) The proposed content of the directive.
 - (ii) A corporate credit union must respond in writing within 30 calendar days of receipt of the notice stating that it either concurs or disagrees with the notice. If it disagrees with the notice, it must state the reasons why the directive should not be issued and/or propose alternative contents for the directive. The response should include all matters that the corporate credit union wishes to be considered. For good cause, including the following conditions, the response time may be shortened or lengthened:
 - (A) When the condition of the corporate requires, and the corporate credit union is notified of the shortened response period in the notice;
 - (B) With the consent of the corporate credit union; or
 - (C) When the corporate credit union already has advised NCUA that it cannot or will not achieve adequate capitalization.
 - (iii) Failure to respond within 30 calendar days, or another time period specified in the notice, shall constitute a waiver of any objections to the proposed directive.
- (4) After the closing date of the corporate credit union's response period, or the receipt of the response, if earlier, NCUA shall consider the response and may seek additional information or clarification. Based on the information provided during the response period, NCUA will determine whether or not to issue a capital directive and, if issued, the form it should take.
- (5) Upon issuance, a capital directive and a statement of the reasons for its issuance will be delivered to the corporate credit union. A directive is effective immediately upon receipt by the corporate credit union, or upon such later date as may be specified therein, and shall remain effective and enforceable until it is stayed, modified, or terminated by NCUA.

- (6) A capital directive may be issued in addition to, or in lieu of, any other action authorized by law in response to a corporate credit union's failure to achieve or maintain the applicable minimum capital ratios.
- (7) Upon a change in circumstances, a corporate credit union may request reconsideration of the terms of the directive. Requests that are not based on a significant change in circumstances or are repetitive or frivolous will not be considered. Pending a decision on reconsideration, the directive shall continue in full force and effect.
- (i) *Earnings retention requirement.* A corporate credit union must increase retained earnings if the prior month-end retained earnings ratio is less than 2 percent.
- (A) Its retained earnings must increase:
- (i) During the current month, by an amount equal to or greater than the monthly earnings retention amount; or
- (ii) During the current and prior two months, by an amount equal to or greater than the quarterly earnings retention amount.
- (B) Earnings retention amounts are calculated as follows:
- (i) The monthly earnings retention amount is determined by multiplying the earnings retention factor by the prior month-end moving daily average net assets; and
- (ii) The quarterly earnings retention amount is determined by multiplying the earnings retention factor by moving daily average net assets for each of the prior three month-ends.
- (C) The earnings retention factor is determined as follows:
- (i) If the prior month-end retained earnings ratio is less than 2 percent and the core capital ratio is less than 3 percent, the earnings retention factor is .15 percent per annum; or
- (ii) If the prior month-end retained earnings ratio is less than 2 percent and the core capital ratio is equal to or greater than 3 percent, the earnings retention factor is .10 percent per annum.
- (D) The OCCU Director may approve a decrease to the earnings retention amount if it is determined a lesser amount is necessary to avoid a significant adverse impact upon a corporate credit union.
- (E) Operating management of the corporate credit union must notify its board of directors, supervisory committee, the OCCU Director and, if applicable, the state regulator within 10 calendar days of determining that the retained earnings ratio has declined below 2 percent. If the decline in the retained earnings ratio is due, in full or in part, to a decline in the dollar amount of retained earnings and the retained earnings ratio is not restored to at least 2 percent by the next month end, a retained earnings action plan is required to be submitted within 30 calendar days.
- (F) The retained earnings action plan must be submitted to the OCCU Director and, if applicable, the state regulator and, at a minimum, include the following:

- (i) Reasons why the dollar amount of retained earnings has decreased;
- (ii) Description of actions to be taken to increase the dollar amount of retained earnings within specific time frames; and
- (iii) Monthly balance sheet and income projections, including assumptions, for the next 12-month period.

§ 704.4 Board Responsibilities.

- (a) General. A corporate credit union's board of directors must approve comprehensive written strategic plans and policies, review them annually, and provide them upon request to the auditors, supervisory committee, and NCUA.
- (b) Policies. A corporate credit union's policies must be commensurate with the scope and complexity of the corporate credit union.
- (c) Other requirements. The board of directors of a corporate credit union must ensure:
 - (1) Senior managers have an in-depth, working knowledge of their direct areas of responsibility and are capable of identifying, hiring, and retaining qualified staff;
 - (2) Qualified personnel are employed or under contract for all line support and audit areas, and designated backup personnel or resources with adequate cross-training are in place;
 - (3) GAAP is followed, except where law or regulation has provided for a departure from GAAP;
 - (4) Accurate balance sheets, income statements, and internal risk assessments (e.g., risk management measures of liquidity, market, and credit risk associated with current activities) are produced timely in accordance with §§ 704.6, 704.8, and 704.9;
 - (5) Systems are audited periodically in accordance with industry established standards;
 - (6) Financial performance is evaluated to ensure that the objectives of the corporate credit union and the responsibilities of management are met; and
 - (7) Planning addresses the retention of external consultants, as appropriate, to review the adequacy of technical, human, and financial resources dedicated to support major risk areas.

§ 704.5 Investments.

- (a) Policies. A corporate credit union must operate according to an investment policy that is consistent with its other risk management policies, including, but not limited to, those related to credit risk management, asset and liability management, and liquidity management. The policy must address, at a minimum:
 - (1) Appropriate tests and criteria for evaluating investments and investment transactions before purchase; and
 - (2) Reasonable and supportable concentration limits for limited liquidity investments in relation to capital.

- (b) General. All investments must be U.S. dollar denominated and subject to the credit policy restrictions set forth in § 704.6.
- (c) Authorized activities. A corporate credit union may invest in:
 - (1) Securities, deposits, and obligations set forth in Sections 107(7), 107(8), and 107(15) of the Federal Credit Union Act, 12 U.S.C. 1757(7), 1757(8), and 1757(15), except as provided in this section;
 - (2) Deposits in, the sale of federal funds to, and debt obligations of corporate credit unions, Section 107(8) institutions, and state banks, trust companies, and mutual savings banks not domiciled in the state in which the corporate credit union does business;
 - (3) Corporate CUSOs, as defined in and subject to the limitations of § 704.11;
 - (4) Marketable debt obligations of corporations chartered in the United States. This authority does not apply to debt obligations that are convertible into the stock of the corporation;
 - (5) Domestically-issued asset-backed securities.
- (d) Repurchase agreements. A corporate credit union may enter into a repurchase agreement provided that:
 - (1) The corporate credit union, directly or through its agent, receives written confirmation of the transaction, and either takes physical possession or control of the repurchase securities or is recorded as owner of the repurchase securities through the Federal Reserve Book Entry Securities Transfer System;
 - (2) The repurchase securities are legal investments for that corporate credit union;
 - (3) The corporate credit union, directly or through its agent, receives daily assessment of the market value of the repurchase securities and maintains adequate margin that reflects a risk assessment of the repurchase securities and the term of the transaction; and
- (e) Securities Lending. A corporate credit union may enter into a securities lending transaction provided that:
 - (1) The corporate credit union, directly or through its agent, receives written confirmation of the loan, obtains a first priority security interest in the collateral, by taking physical possession or control of the collateral, or is recorded as owner of the collateral through the Federal Reserve Book Entry Securities Transfer System;
 - (2) The collateral is a legal investment for that corporate credit union;
 - (3) The corporate credit union, directly or through its agent, receives daily assessment of the market value of collateral and maintains adequate margin that reflects a risk assessment of the collateral and terms of the loan; and
 - (4) The corporate credit union has entered into signed contracts with all agents and, directly or through its agent, has executed a written loan and security agreement with the borrower. The corporate or its agent ensures compliance with the agreements.
- (f) Investment companies. A corporate credit union may invest in an investment company registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a), provided that the prospectus of the company restricts the investment portfolio to investments and investment transactions that are permissible for that corporate credit union.

- (g) Forward settlement of transactions later than regular way. A corporate credit union may enter into an agreement to purchase or sell an instrument, with settlement later than regular way, provided that:
 - (1) Delivery and acceptance are mandatory;
 - (2) The transaction is clearly disclosed in the appropriate risk reporting required under § 704.8(b);
 - (3) If the corporate credit union is the purchaser, it has adequate cash flow projections evidencing its ability to purchase the instrument;
 - (4) If the corporate credit union is the seller, it owns the instrument on the trade date; and
 - (5) The transaction is settled on a cash basis at the settlement date.
- (h) Prohibitions. A corporate credit union is prohibited from:
 - (1) Purchasing or selling off balance sheet financial derivatives, such as futures, options, interest rate swaps, or forward rate agreements;
 - (2) Engaging in trading securities unless accounted for on a trade date basis;
 - (3) Engaging in adjusted trading or short sales; and
 - (4) Purchasing stripped mortgage-backed securities, mortgage servicing rights, small business related securities, or residual interests in CMOs or asset-backed securities.
- (i) Conflicts of interest. A corporate credit union's officials, employees, and immediate family members of such individuals, may not receive pecuniary consideration in connection with the making of an investment or deposit by the corporate credit union. Employee compensation is exempt from this prohibition. All transactions not specifically prohibited by this paragraph must be conducted at arm's length and in the interest of the corporate credit union.
- (j) Grandfathering. A corporate credit union's authority to hold an investment is governed by the regulation in effect at the time of purchase. However, all grandfathered investments are subject to the requirements of §§ 704.8 and 704.9.

§ 704.6 Credit Risk Management.

- (a) *Policies.* A corporate credit union must operate according to a credit risk management policy that is commensurate with the investment risks and activities it undertakes. The policy must address at a minimum:
 - (1) The approval process associated with credit limits;
 - (2) Due diligence analysis requirements;
 - (3) Maximum credit limits with each obligor and transaction counter-party, set as a percentage of capital. In addition to addressing deposits and securities, limits with transaction counter parties must address aggregate exposures of all transactions including, but not limited to, repurchase agreements, securities lending, and forward settlement of purchases or sales of investments; and
 - (4) Concentrations of credit risk (e.g., originator of receivables, insurer, industry type, sector type, and geographic).
- (b) *Exemption.* The requirements of this section do not apply to investments that are issued or fully guaranteed as to principal and interest by the U.S. government or its agencies or enterprises (excluding subordinated debt) or are fully insured (including accumulated interest) by the NCUSIF or Federal Deposit Insurance Corporation.

(c) *Concentration limits*—

- (1) *General rule.* The aggregate of all investments in any single obligor is limited to 50 percent of capital or \$5 million, whichever is greater.
- (2) *Exceptions.* Exceptions to the general rule are:
 - (i) Aggregate investments in repurchase and securities lending agreements with any one counterparty are limited to 200 percent of capital;
 - (ii) Investments in corporate CUSOs are subject to the limitations of § 704.11; and
 - (iii) Aggregate investments in corporate credit unions are not subject to the limitations of paragraph (c)(1) of this section.
- (3) For purposes of measurement, each new credit transaction must be evaluated in terms of the corporate credit union's capital at the time of the transaction. An investment that fails a requirement of this section because of a subsequent reduction in capital will be deemed non-conforming. A corporate credit union is required to exercise reasonable efforts to bring non-conforming investments into conformity within 90 calendar days. Investments that remain non-conforming for 90 calendar days will be deemed to fail a requirement of this section and the corporate credit union will have to comply with § 704.10.

(d) *Credit ratings*.—

- (1) All investments, other than in a corporate credit union or CUSO, must have an applicable credit rating from at least one nationally recognized statistical rating organization (NRSRO).
- (2) At the time of purchase, investments with long-term ratings must be rated no lower than AA– (or equivalent) and investments with short-term ratings must be rated no lower than A–1 (or equivalent).
- (3) Any rating(s) relied upon to meet the requirements of this part must be identified at the time of purchase and must be monitored for as long as the corporate owns the investment.
- (4) When two or more ratings are relied upon to meet the requirements of this part at the time of purchase, the board or an appropriate committee must place on the § 704.6(e)(1) investment watch list any investment for which a rating is downgraded below the minimum rating requirements of this part.
- (5) Investments are subject to the requirements of § 704.10 if:
 - (i) One rating was relied upon to meet the requirements of this part and that rating is downgraded below the minimum rating requirements of this part; or
 - (ii) Two or more ratings were relied upon to meet the requirements of this part and at least two of those ratings are downgraded below the minimum rating requirements of this part.

(e) *Reporting and documentation*.

- (1) At least annually, a written evaluation of each credit limit with each obligor or transaction counterparty must be prepared and formally approved by the board or an appropriate committee. At least monthly, the board or an appropriate committee must receive an investment watch list of existing and/or potential credit problems and summary credit exposure reports, which demonstrate compliance with the corporate credit union's risk management policies.
- (2) At a minimum, the corporate credit union must maintain:

- (i) A justification for each approved credit limit;
- (ii) Disclosure documents, if any, for all instruments held in portfolio. Documents for an instrument that has been sold must be retained until completion of the next NCUA examination; and
- (iii) The latest available financial reports, industry analyses, internal and external analyst evaluations, and rating agency information sufficient to support each approved credit limit.

§ 704.7 Lending.

- (a) *Policies.* A corporate credit union must operate according to a lending policy which addresses, at a minimum:
 - (1) Loan types and limits;
 - (2) Required documentation and collateral; and
 - (3) Analysis and monitoring standards.
- (b) *General.* Each loan or line of credit limit will be determined after analyzing the financial and operational soundness of the borrower and the ability of the borrower to repay the loan.
- (c) *Loans to members—*
 - (1) *Credit unions.*
 - (i) The maximum aggregate amount in unsecured loans and lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, must not exceed 50 percent of capital.
 - (ii) The maximum aggregate amount in secured loans and lines of credit to any one member credit union, excluding those secured by shares or marketable securities and member reverse repurchase transactions, must not exceed 100 percent of capital.
 - (2) *Corporate CUSOs.* Any loan or line of credit must comply with § 704.11.
 - (3) *Other members.* The maximum aggregate amount of loans and lines of credit to any other one member must not exceed 15 percent of the corporate credit union's capital plus pledged shares.
- (d) *Loans to nonmembers—*
 - (1) *Credit unions.* A loan to a nonmember credit union, other than through a loan participation with another corporate credit union, is only permissible if the loan is for an overdraft related to the providing of correspondent services pursuant to § 704.12. Generally, such a loan will have a maturity of one business day.
 - (2) *Corporate CUSOs.* Any loan or line of credit must comply with § 704.11.
- (e) *Member business loan rule.* Loans, lines of credit and letters of credit to:
 - (1) Member credit unions are exempt from part 723 of this chapter;
 - (2) Corporate CUSOs must comply with § 704.11; and
 - (3) Other members not excluded under § 723.1(b) of this chapter must comply with part 723 of this chapter unless the loan or line of credit is fully guaranteed by a credit union or fully secured by U.S. Treasury or agency securities. Those guaranteed and secured loans must comply with the aggregate limits of § 723.16 but are exempt from the other requirements of part 723.
- (f) *Participation loans with other corporate credit unions.* A corporate credit union is permitted to participate in a loan with another corporate credit union provided the corporate retains an interest of at least 5 percent of the face amount of the loan and a master participation loan agreement is in place before the purchase or the sale of a participation. A participating corporate credit union must exercise the same due diligence as if it were the originating corporate credit union.
- (g) *Prepayment penalties.* If provided for in the loan contract, a corporate credit union is authorized to assess prepayment penalties on loans.

§ 704.8 Asset and Liability Management.

- (a) Policies. A corporate credit union must operate according to a written asset and liability management policy which addresses, at a minimum:
- (1) The purpose and objectives of the corporate credit union's asset and liability activities;
 - (2) The maximum allowable percentage decline in net economic value (NEV), compared to base case NEV;
 - (3) The minimum allowable NEV ratio;
 - (4) Policy limits and specific test parameters for the interest rate risk simulation tests set forth in paragraph (d) of this section; and
 - (5) The modeling of indexes that serve as references in financial instrument coupon formulas; and
 - (6) The tests that will be used, prior to purchase, to estimate the impact of investments on the percentage decline in NEV, compared to base case NEV. The most recent NEV analysis, as determined under paragraph (d)(1)(i) of this section may be used as a basis of estimation.
- (b) Asset and liability management committee (ALCO). A corporate credit union's ALCO must have at least one member who is also a member of the board of directors. The ALCO must review asset and liability management reports on at least a monthly basis. These reports must address compliance with Federal Credit Union Act, NCUA Rules and Regulations (12 CFR chapter VII), and all related risk management policies.
- (c) Penalty for early withdrawals. A corporate credit union that permits early certificate/share withdrawals must assess market-based penalties sufficient to cover the estimated replacement cost of the certificate/share redeemed. This means the minimum penalty must be reasonably related to the rate that the corporate credit union would be required to offer to attract funds for a similar term with similar characteristics.
- (d) Interest rate sensitivity analysis.
- (1) A corporate credit union must:
 - (i) Evaluate the risk in its balance sheet by measuring, at least quarterly, the impact of an instantaneous, permanent, and parallel shock in the yield curve of plus and minus 100, 200, and 300 basis points on its NEV, and NEV ratio. If the base case NEV ratio falls below 3 percent at the last testing date, these tests must be calculated at least monthly until the base case NEV ratio again exceeds 3 percent;
 - (ii) Limit its risk exposure to levels that do not result in a base case NEV ratio or any NEV ratio resulting from the tests set forth in paragraph (d)(1)(i) of this section below 2 percent; and
 - (iii) Limit its risk exposures to levels that do not result in a decline in NEV of more than 15 percent.
 - (2) A corporate credit union must assess annually if it should conduct periodic additional tests to address market factors that may materially impact that corporate credit union's NEV. These factors should include, but are not limited to, the following:
 - (i) Changes in the shape of the Treasury yield curve;

- (ii) Adjustments to prepayment projections used for amortizing securities to consider the impact of significantly faster/slower prepayment speeds;
 - (iii) Adjustments to the market spread assumptions for non-Treasury instruments to consider the impact of widening spreads; and
 - (iv) Adjustments to volatility assumptions to consider the impact that changing volatilities have on embedded option values.
- (e) *Regulatory violations.* If a corporate credit union's decline in NEV, base case NEV ratio or any NEV ratio resulting from the tests set forth in paragraph (d)(1)(i) of this section violates the limits established by this rule and is not brought into compliance within 10 calendar days, operating management of the corporate credit union must immediately report the information to the board of directors, supervisory committee, and the OCCU Director. If any violation persists for 30 calendar days, the corporate credit union must submit a detailed, written action plan to the OCCU Director that sets forth the time needed and means by which it intends to correct the violation. If the OCCU Director determines that the plan is unacceptable, the corporate credit union must immediately restructure the balance sheet to bring the exposure back within compliance or adhere to an alternative course of action determined by the OCCU Director.
- (f) *Policy violations.* If a corporate credit union's decline in NEV, base case NEV ratio, or any NEV ratio resulting from the tests set forth in paragraph (d)(1)(i) of this section violates the limits established by its board, it must determine how it will bring the exposure within policy limits. The disclosure to the board of the violation must occur no later than its next regularly scheduled board meeting.

§ 704.9 Liquidity Management.

- (a) General. In the management of liquidity, a corporate credit union must:
- (1) Evaluate the potential liquidity needs of its membership in a variety of economic scenarios;
 - (2) Regularly monitor sources of internal and external liquidity;
 - (3) Demonstrate that the accounting classification of investment securities is consistent with its ability to meet potential liquidity demands; and
 - (4) Develop a contingency funding plan that addresses alternative funding strategies in successively deteriorating liquidity scenarios. The plan must:
 - (i) List all sources of liquidity, by category and amount, that are available to service an immediate outflow of funds in various liquidity scenarios;
 - (ii) Analyze the impact that potential changes in fair value will have on the disposition of assets in a variety of interest rate scenarios; and
 - (iii) Be reviewed by the board or an appropriate committee no less frequently than annually or as market or business conditions dictate.
- (b) Borrowing. A corporate credit union may borrow up to 10 times capital or 50 percent of shares (excluding shares created by the use of member reverse repurchase agreements) and capital, whichever is greater. CLF borrowings and borrowed funds created by the use of member reverse repurchase agreements are excluded from this limit. The corporate credit union must demonstrate that sufficient contingent sources of liquidity remain available.

§ 704.10 Investment action plan.

- (a) Any corporate credit union in possession of an investment, including a derivative, that fails to meet a requirement of this part must, within 30 calendar days of the failure, report the failed investment to its board of directors, supervisory committee, and the OCCU Director. If the corporate credit union does not sell the failed investment, and the investment continues to fail to meet a requirement of this part, the corporate credit union must, within 30 calendar days of the failure, provide to the OCCU Director a written action plan that addresses:
 - (1) The investment's characteristics and risks;
 - (2) The process to obtain and adequately evaluate the investment's market pricing, cash flows, and risk;
 - (3) How the investment fits into the credit union's asset and liability management strategy;
 - (4) The impact that either holding or selling the investment will have on the corporate credit union's earnings, liquidity, and capital in different interest rate environments; and
 - (5) The likelihood that the investment may again pass the requirements of this part.
- (b) The OCCU Director may require, for safety and soundness reasons, a shorter time period for plan development than that set forth in paragraph (a) of this section.
- (c) If the plan described in paragraph (a) of this section is not approved by the OCCU Director, the credit union must adhere to the OCCU Director's directed course of action.

§ 704.11 Corporate Credit Union Service Organizations (Corporate CUSOs).

- (a) A corporate CUSO is an entity that:
 - (1) Is at least partly owned by a corporate credit union;
 - (2) Primarily serves credit unions;
 - (3) Restricts its services to those related to the normal course of business of credit unions; and
 - (4) Is structured as a corporation, limited liability company, or limited partnership under state law.
- (b) *Investment and loan limitations.*
 - (1) The aggregate of all investments in member and nonmember corporate CUSOs must not exceed 15 percent of a corporate credit union's capital.
 - (2) The aggregate of all investments in and loans to member and nonmember corporate CUSOs must not exceed 30 percent of a corporate credit union's capital. A corporate credit union may lend to member and nonmember corporate CUSOs an additional 15 percent of capital if the loan is collateralized by assets in which the corporate has a perfected security interest under state law.
 - (3) If the limitations in paragraphs (b)(1) and (b)(2) of this section are reached or exceeded because of the profitability of the CUSO and the related GAAP valuation of the investment under the equity method without an additional cash outlay by the corporate, divestiture is not required. A corporate credit union may continue to invest up to the regulatory limit without regard to the increase in the GAAP valuation resulting from the corporate CUSO's profitability.

- (4) The aggregate of all loans to corporate CUSOs must comply with the aggregate limit of § 723.16 of this chapter. This requirement does not apply to loans excluded under § 723.1(b).
- (c) *Due diligence.* A corporate credit union must comply with the due diligence requirements of §§ 723.5 and 723.6(f) through (l) of this chapter for all loans to corporate CUSOs. This requirement does not apply to loans excluded under § 723.1(b).
- (d) *Separate entity.*
- (1) A corporate CUSO must be operated as an entity separate from a corporate credit union.
 - (2) A corporate credit union investing in or lending to a corporate CUSO must obtain a written legal opinion that concludes the corporate CUSO is organized and operated in a manner that the corporate credit union will not reasonably be held liable for the obligations of the corporate CUSO. This opinion must address factors that have led courts to “pierce the corporate veil,” such as inadequate capitalization, lack of corporate identity, common boards of directors and employees, control of one entity over another, and lack of separate books and records.
- (e) *Prohibited activities.* A corporate credit union may not use this authority to acquire control, directly or indirectly, of another depository financial institution or to invest in shares, stocks, or obligations of an insurance company, trade association, liquidity facility, or similar organization.
- (f) An official of a corporate credit union which has invested in or loaned to a corporate CUSO may not receive, either directly or indirectly, any salary, commission, investment income, or other income, compensation, or consideration from the corporate CUSO. This prohibition also extends to immediate family members of officials.
- (g) Prior to making an investment in or loan to a corporate CUSO, a corporate credit union must obtain a written agreement that the corporate CUSO will:
- (1) Follow GAAP;
 - (2) Provide financial statements to the corporate credit union at least quarterly;
 - (3) Obtain an annual CPA opinion audit and provide a copy to the corporate credit union. A wholly owned or majority owned CUSO is not required to obtain a separate annual audit if it is included in the corporate credit union’s annual consolidated audit; and
 - (4) Allow the auditor, board of directors, and NCUA complete access to its books, records, and any other pertinent documentation.
- (h) Corporate credit union authority to invest in or loan to a CUSO is limited to that provided in this section. A corporate credit union is not authorized to invest in or loan to a CUSO under part 712 of this chapter.

§ 704.12 Permissible Services.

- (a) *Preapproved services.* A corporate credit union may provide to members the preapproved services set out in this section. NCUA may at any time, based upon supervisory, legal, or safety and soundness reasons, limit or prohibit any preapproved service. The specific activities listed within each preapproved category

are provided as illustrations of activities permissible under the particular category, not as an exclusive or exhaustive list.

- (1) *Correspondent services agreement.* A corporate credit union may only provide financial services to nonmembers through a correspondent services agreement. A correspondent services agreement is an agreement between two corporate credit unions, whereby one of the corporate credit unions agrees to provide services to the other corporate credit union or its members.
 - (2) *Credit and investment services.* Credit and investment services are advisory and consulting activities that assist the member in lending or investment management. These services may include loan reviews, investment portfolio reviews and investment advisory services.
 - (3) *Electronic financial services.* Electronic financial services are any services, products, functions, or activities that a corporate credit union is otherwise authorized to perform, provide or deliver to its members but performed through electronic means. Electronic services may include automated teller machines, online transaction processing through a website, website hosting services, account aggregation services, and internet access services to perform or deliver products or services to members.
 - (4) *Excess capacity.* Excess capacity is the excess use or capacity remaining in facilities, equipment or services that: a corporate credit union properly invested in or established, in good faith, with the intent of serving its members; and it reasonably anticipates will be taken up by the future expansion of services to its members. A corporate credit union may sell or lease the excess capacity in facilities, equipment or services, such as office space, employees and data processing.
 - (5) *Liquidity and asset and liability management.* Liquidity and asset and liability management services are any services, functions or activities that assist the member in liquidity and balance sheet management. These services may include liquidity planning and balance sheet modeling and analysis.
 - (6) *Operational services.* Operational services are services established to deliver financial products and services that enhance member service and promote safe and sound operations. Operational services may include tax payment, electronic fund transfers and providing coin and currency service.
 - (7) *Payment systems.* Payment systems are any methods used to facilitate the movement of funds for transactional purposes. Payment systems may include Automated Clearing House, wire transfer, item processing and settlement services.
 - (8) *Trustee or custodial services.* Trustee services are services in which the corporate credit union is authorized to act under a written trust agreement to the extent permitted under part 724 of this chapter. Custodial and safekeeping services are services a corporate credit union performs on behalf of its member to act as custodian or safekeeper of investments.
- (b) *Procedure for adding services that are not preapproved.* To provide a service to its members that is not preapproved by NCUA:
- (1) A federal corporate credit union must request approval from NCUA. The request must include a full explanation and complete documentation of the service and

how the service relates to a corporate credit union's authority to provide services to its members. The request must be submitted jointly to the OCCU Director and the Secretary of the Board. The request will be treated as a petition to amend § 704.12 and NCUA will request public comment or otherwise act on the petition within a reasonable period of time. Before engaging in the formal approval process, a corporate credit union should seek an advisory opinion from NCUA's Office of General Counsel as to whether a proposed service is already covered by one of the authorized categories without filing a petition to amend the regulation; and

- (2) A state-chartered corporate credit union must submit a request for a waiver that complies with § 704.1(b) to the OCCU Director.
- (c) *Prohibition.* A corporate credit union is prohibited from purchasing loan servicing rights.

§ 704.13 [Removed and Reserved].

§ 704.14 Representation.

- (a) Board representation. The board will be determined as stipulated in its bylaws governing election procedures, provided that:
 - (1) At least a majority of directors, including the chair of the board, must serve on the board as representatives of member credit unions;
 - (2) The chair of the board may not serve simultaneously as an officer, director, or employee of a credit union trade association;
 - (3) A majority of directors may not serve simultaneously as officers, directors, or employees of the same credit union trade association or its affiliates (not including chapters or other sub-units of a state trade association);
 - (4) For purposes of meeting the requirements of paragraphs (a)(2) and (a)(3) of this section, an individual may not serve as a director or chair of the board if that individual holds a subordinate employment relationship to another employee who serves as an officer, director, or employee of a credit union trade association; and
 - (5) In the case of a corporate credit union whose membership is composed of more than 25 percent non-credit unions, the majority of directors serving as representatives of member credit unions, including the chair, must be elected only by member credit unions.
- (b) Credit union trade association. As used in this section, a credit union trade association includes but is not limited to, state credit union leagues and league service corporations and national credit union trade associations.
- (c) Representatives of organizational members.
 - (1) An organizational member of a corporate credit union is a member that is not a natural person. An organizational member may appoint one of its members or officials as a representative to the corporate credit union. The representative shall be empowered to attend membership meetings, to vote, and to stand for election on behalf of the member. No individual may serve as the representative of more than one organizational member in the same corporate credit union.

- (2) Any vacancy on the board of a corporate credit union caused by a representative being unable to complete his or her term shall be filled by the board of the corporate credit union according to its bylaws governing the filling of board vacancies.
- (d) Recusal provision.
- (1) No director, committee member, officer, or employee of a corporate credit union shall in any manner, directly or indirectly, participate in the deliberation upon or the determination of any question affecting his or her pecuniary interest or the pecuniary interest of any entity (other than the corporate credit union) in which he or she is interested, except if the matter involves general policy applicable to all members, such as setting dividend or loan rates or fees for services.
- (2) An individual is “interested” in an entity if he or she:
- (i) Serves as a director, officer, or employee of the entity;
 - (ii) Has a business, ownership, or deposit relationship with the entity; or
 - (iii) Has a business, financial, or familial relationship with an individual whom he or she knows has a pecuniary interest in the entity.
- (3) In the event of the disqualification of any directors, by operation of paragraph (c)(1) of this section, the remaining qualified directors present at the meeting, if constituting a quorum with the disqualified directors, may exercise, by majority vote, all the powers of the board with respect to the matter under consideration. Where all of the directors are disqualified, the matter must be decided by the members of the corporate credit union.
- (4) In the event of the disqualification of any committee member by operation of paragraph (c)(1) of this section, the remaining qualified committee members, if constituting a quorum with the disqualified committee members, may exercise, by majority vote, all the powers of the committee with respect to the matter under consideration. Where all of the committee members are disqualified, the matter shall be decided by the board of directors.
- (e) Administration.
- (1) A corporate credit union shall be under the direction and control of its board of directors. While the board may delegate the performance of administrative duties, the board is not relieved of its responsibility for their performance. The board may employ a chief executive officer who shall have such authority and such powers as delegated by the board to conduct business from day to day. Such chief executive officer must answer solely to the board of the corporate credit union, and may not be an employee of a credit union trade association.
- (2) The provisions of § 701.14 of this chapter apply to corporate credit unions, except that where “Regional Director” is used, read “NCUA Board.”

§ 704.15 Audit Requirements.

- (a) External audit. The corporate credit union supervisory committee shall cause an annual opinion audit of the financial statements to be made. The audit must be performed in accordance with generally accepted auditing standards and the audited financial statements must be prepared consistent with GAAP, except where law or regulation has provided for a departure from GAAP. The supervisory committee shall submit the audit report to the board of directors. A

copy of the audit report, and copies of all communications that are provided to the corporate credit union by the external auditor, shall be submitted to the OCCU Director within 30 calendar days after receipt by the board of directors. If requested by the OCCU Director, the external auditor's work papers shall be made available, at the auditor's office or elsewhere, for the OCCU Director's review. The corporate credit union shall submit a summary of the audit report to the membership at the next annual meeting.

- (b) Internal audit. A corporate credit union with average daily assets in excess of \$400 million for the preceding calendar year, or as ordered by NCUA, must employ or contract, on a full or part-time basis, the services of an internal auditor. The internal auditor's responsibilities will, at a minimum, comply with the Standards and Professional Practices of Internal Auditing, as established by the Institute of Internal Auditors. The internal auditor will report directly to the chair of the corporate credit union's supervisory committee, who may delegate supervision of the internal auditor's daily activities to the chief executive officer of the corporate credit union. The internal auditor's reports, findings, and recommendations will be in writing and presented to the supervisory committee no less than quarterly, and will be provided upon request to the external auditor and NCUA.

§ 704.16 Contracts/Written Agreements.

Services, facilities, personnel, or equipment shared with any party shall be supported by a written contract, with the duties and responsibilities of each party specified and the allocation of service fee/expenses fully supported and documented.

§ 704.17 State-Chartered Corporate Credit Unions.

- (a) This part does not expand the powers and authorities of any state-chartered corporate credit union, beyond those powers and authorities provided under the laws of the state in which it was chartered.
- (b) A state-chartered corporate credit union that is not insured by the NCUSIF, but that receives funds from federally insured credit unions, is considered an "institution-affiliated party" within the meaning of Section 206(r) of the Federal Credit Union Act, 12 U.S.C. 1786(r).
- (c) NCUA will notify, consult with, and provide explanation to the appropriate state supervisory authority before taking administrative action against a state-chartered corporate credit union.

§ 704.18 Fidelity Bond Coverage.

- (a) Scope. This section provides the fidelity bond requirements for employees and officials in corporate credit unions.
- (b) Review of coverage. The board of directors of each corporate credit union shall, at least annually, carefully review the bond coverage in force to determine its adequacy in relation to risk exposure and to the minimum requirements in this section.

- (c) Minimum coverage; approved forms. Every corporate credit union will maintain bond coverage with a company holding a certificate of authority from the Secretary of the Treasury. All bond forms, and any riders and endorsements which limit the coverage provided by approved bond forms, must receive the prior written approval of NCUA. Fidelity bonds must provide coverage for the fraud and dishonesty of all employees, directors, officers, and supervisory and credit committee members. Notwithstanding the foregoing, all bonds must include a provision, in a form approved by NCUA, requiring written notification by surety to NCUA:
- (1) When the bond of a credit union is terminated in its entirety;
 - (2) When bond coverage is terminated, by issuance of a written notice, on an employee, director, officer, supervisory or credit committee member; or
 - (3) When a deductible is increased above permissible limits. Said notification shall be sent to NCUA and shall include a brief statement of cause for termination or increase.
- (d) Minimum coverage amounts.
- (1) The minimum amount of bond coverage will be computed based on the corporate credit union's daily average net assets for the preceding calendar year. The following table lists the minimum requirements:

Daily average net assets	Maximum Deductible (millions)
Less than \$50 million	1.0
\$50–\$99 million	2.0
\$100–\$499 million	4.0
\$500–\$999 million	6.0
\$1.0–\$1.999 billion	8.0
\$2.0–\$4.999 billion	10.0
\$5.0–\$9.999 billion	15.0
\$10.0–\$24.999 billion	20.0
\$25.0 billion plus	25.0

- (2) It is the duty of the board of directors of each corporate credit union to provide adequate protection to meet its unique circumstances by obtaining, when necessary, bond coverage in excess of the minimums in the table in paragraph (d)(1) of this section.
- (e) Deductibles.
- (1) The maximum amount of deductibles allowed are based on the corporate credit union's core capital ratio. The following table sets out the maximum deductibles, except that in each category the maximum deductible shall be \$5 million:

Core Capital Ratio	Maximum Deductible
Less than 1.0 percent	7.5 percent of the sum of retained earnings and paid-in capital.
1.0–1.74 percent	10.0 percent of the sum of retained earnings and paid-in capital
1.75–2.24 percent	12.0 percent of the sum of retained earnings and paid-in capital.
Greater than 2.25 percent	15.0 percent of the sum of retained earnings and paid-in capital.

- (2) A deductible may be applied separately to one or more insuring clauses in a blanket bond. Deductibles in excess of those showing in this section must have the written approval of NCUA at least 30 calendar days prior to the effective date of the deductibles.
- (f) Additional coverage. NCUA may require additional coverage for any corporate credit union when, in the opinion of NCUA, current coverage is insufficient. The board of directors of the corporate credit union must obtain additional coverage within 30 calendar days after the date of written notice from NCUA.

§ 704.19 Wholesale Corporate Credit Unions.

- (a) General. Wholesale corporate credit unions are subject to the preceding requirements of this part, except as set forth in this section.
- (b) *Earnings retention requirement.* A wholesale corporate credit union must increase retained earnings if the prior month-end retained earnings ratio is less than 1 percent.
- (1) Its retained earnings must increase:
- (i) During the current month, by an amount equal to or greater than the monthly earnings retention amount; or
 - (ii) During the current and prior two months, by an amount equal to or greater than the quarterly earnings retention amount.
- (2) Earnings retention amounts are calculated as follows:
- (i) The monthly earnings retention amount is determined by multiplying the earnings retention factor by the prior month-end moving daily average net assets; and
 - (ii) The quarterly earnings retention amount is determined by multiplying the earnings retention factor by moving daily average net assets for each of the prior three month-ends.
- (3) The earnings retention factor is determined as follows:
- (i) If the prior month-end retained earnings ratio is less than 1 percent and the core capital ratio is less than 3 percent, the earnings retention factor is .15 percent per annum; or
 - (ii) If the prior month-end retained earnings ratio is less than 1 percent and the core capital ratio is equal to or greater than 3 percent, the earnings retention factor is .075 percent per annum.
- (4) The OCCU Director may approve a decrease to the earnings retention amount set forth in this section if it is determined a lesser amount is

- necessary to avoid a significant adverse impact upon a wholesale corporate credit union.
- (5) Operating management of the wholesale corporate credit union must notify its board of directors, supervisory committee, OCCU Director and, if applicable, the state regulator within 10 calendar days of determining the retained earnings ratio has declined below 1 percent. If the decline in the retained earnings ratio is due in full or in part, to a decline in the dollar amount of retained earnings and the retained earnings ratio is not restored to at least 1 percent by the next month end, a retained earnings action plan is required to be submitted within 30 calendar days.
 - (6) The retained earnings action plan must be submitted to the OCCU Director and, if applicable, the state regulator and, at a minimum, include the following:
 - (i) Reasons why the dollar amount of retained earnings has decreased;
 - (ii) Description of actions to be taken to increase the dollar amount of retained earnings within specific time frames; and
 - (iii) Monthly balance sheet and income projections, including assumptions for the ensuing 12-month period.

Appendix A to Part 704—Model Forms.

This appendix contains sample forms intended for use by corporate credit unions to aid in compliance with the membership capital account and paid-in capital disclosure requirements of § 704.3.

SAMPLE FORM 1

Terms and Conditions of Membership Capital Account

- (1) A membership capital account is not subject to share insurance coverage by the NCUSIF or other deposit insurer.
- (2) A membership capital account is not releasable due solely to the merger, charter conversion or liquidation of the member credit union. In the event of a merger, the membership capital account transfers to the continuing credit union. In the event of a charter conversion, the membership capital account transfers to the new institution. In the event of liquidation, the membership capital account may be released to facilitate the payout of shares with the prior written approval of NCUA.
- (3) A member credit union may withdraw membership capital with three years' notice.
- (4) Membership capital cannot be used to pledge borrowings.
- (5) Membership capital is available to cover losses that exceed retained earnings and paid-in capital.
- (6) Where the corporate credit union is liquidated, membership capital accounts are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF.
- (7) Where the corporate credit union is merged into another corporate credit union, the membership capital account will transfer to the continuing corporate credit union. The three-year notice period for withdrawal of the membership capital account will remain in effect.

(8) {If an adjusted balance account : The membership capital balance will be adjusted _____ (1 or 2) _____ time(s) annually in relation to the member credit union's _____ (assets or other measure) _____ as of _____ (date(s)) _____. {If a term certificate : The membership capital account is a term certificate that will mature on _____ (date) _____ .

I have read the above terms and conditions and I understand them.

I further agree to maintain in the credit union's files the annual notice of terms and conditions of the membership capital account.

The notice form must be signed by either all of the directors of the member credit union or, if authorized by board resolution, the chair and secretary of the board of the credit union.

The annual disclosure notice form must be signed by the chair of the corporate credit union. The chair must then sign a statement that certifies that the notice has been sent to member credit unions with membership capital accounts. The certification must be maintained in the corporate credit union's files and be available for examiner review.

SAMPLE FORM 2

Terms and Conditions of Paid-In Capital

- (1) A paid-in capital account is not subject to share insurance coverage by the NCUSIF or other deposit insurer.
- (2) A paid-in capital account is not releasable due solely to the merger, charter conversion or liquidation of the member credit union. In the event of a merger, the paid-in capital account transfers to the continuing credit union. In the event of a charter conversion, the paid-in capital account transfers to the new institution. In the event of liquidation, the paid-in capital account may be released to facilitate the payout of shares with the prior written approval of NCUA.
- (3) The funds are callable only at the option of the corporate credit union and only if the corporate credit union meets its minimum required capital and NEV ratios after the funds are called.
- (4) Paid-in capital cannot be used to pledge borrowings.
- (5) Paid-in capital is available to cover losses that exceed retained earnings.
- (6) Where the corporate credit union is liquidated, paid-in capital accounts are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF, and membership capital holders.
- (7) Where the corporate credit union is merged into another corporate credit union, the paid-in capital account will transfer to the continuing corporate credit union.
- (8) Paid-in capital is perpetual maturity and noncumulative dividend.

I have read the above terms and conditions and I understand them. I further agree to maintain in the credit union's files the annual notice of terms and conditions of the paid-in capital instrument.

The notice form must be signed by either all of the directors of the credit union or, if authorized by board resolution, the chair and secretary of the board of the credit union.

Appendix B to Part 704— Expanded Authorities and Requirements.

A corporate credit union may obtain all or part of the expanded authorities contained in this Appendix if it meets the applicable requirements of Part 704 and Appendix B, fulfills additional management, infrastructure, and asset and liability requirements, and receives NCUA's written approval. Additional guidance is set forth in the NCUA publication *Guidelines for Submission of Requests for Expanded Authority*.

A corporate credit union seeking expanded authorities must submit to NCUA a self-assessment plan supporting its request. A corporate credit union may adopt expanded authorities when NCUA has provided final approval. If NCUA denies a request for expanded authorities, it will advise the corporate credit union of the reason(s) for the denial and what it must do to resubmit its request. NCUA may revoke these expanded authorities at any time if an analysis indicates a significant deficiency. NCUA will notify the corporate credit union in writing of the identified deficiency. A corporate credit union may request, in writing, reinstatement of the revoked authorities by providing a self-assessment plan detailing how it has corrected the deficiency.

Minimum Requirement

In order to participate in any of the authorities set forth in Base-Plus, Part I, Part II, Part III, Part IV, and Part V of this Appendix, a corporate credit union must evaluate monthly the changes in NEV and the NEV ratio for the tests set forth in § 704.8(d)(1)(i).

Base-Plus

A corporate that has met the requirements for this Base-plus authority may, in performing the rate stress tests set forth in § 704.8(d)(1)(i), allow its NEV to decline as much as 20 percent.

Part I

- (a) A corporate credit union that has met the requirements for this Part I may:
- (1) Purchase investments with long-term ratings no lower than A– (or equivalent);
 - (2) Purchase investments with short-term ratings no lower than A–2 (or equivalent), provided that the issuer has a long-term rating no lower than A– (or equivalent) or the investment is a domestically-issued asset-backed security;
 - (3) Engage in short sales of permissible investments to reduce interest rate risk;
 - (4) Purchase principal only (PO) stripped mortgage-backed securities to reduce interest rate risk; and
 - (5) Enter into a dollar roll transaction.
- (b) Aggregate investments in repurchase and securities lending agreements with any one counterparty are limited to 300 percent of capital.
- (c) In performing the rate stress tests set forth in § 704.8(d)(1)(i), the NEV of a corporate credit union that has met the requirements of this Part I may decline as much as:
- (1) 20 percent;
 - (2) 28 percent if the corporate credit union has a 5 percent minimum capital ratio and is specifically approved by NCUA; or

- (3) 35 percent if the corporate credit union has a 6 percent minimum capital ratio and is specifically approved by NCUA.
- (d) The maximum aggregate amount in unsecured loans and lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, must not exceed 100 percent of the corporate credit union's capital. The board of directors must establish the limit, as a percent of the corporate credit union's capital plus pledged shares, for secured loans and lines of credit.

Part II

- (a) A corporate credit union that has met the requirements for this Part II may:
 - (1) Purchase investments with long-term ratings no lower than BBB (flat) (or equivalent). The aggregate of all investments rated BBB+ (or equivalent) or lower in any single obligor is not to exceed 25 percent of capital;
 - (2) Purchase investments with short-term ratings no lower than A-2 (or equivalent), provided that the issuer has a long-term rating no lower than BBB (flat) (or equivalent) or the investment is a domestically issued asset-backed security;
 - (3) Engage in short sales of permissible investments to reduce interest rate risk;
 - (4) Purchase principal only (PO) stripped mortgage-backed securities to reduce interest rate risk; and
 - (5) Enter into a dollar roll transaction.
- (b) Aggregate investments in repurchase and securities lending agreements with any one counterparty are limited to 400 percent of capital.
- (c) In performing the rate stress tests set forth in § 704.8(d)(1)(i), the NEV of a corporate credit union which has met the requirements of this Part II may decline as much as:
 - (1) 20 percent;
 - (2) 28 percent if the corporate credit union has a 5 percent minimum capital ratio and is specifically approved by NCUA; or
 - (3) 35 percent if the corporate credit union has a 6 percent minimum capital ratio and is specifically approved by NCUA.
- (d) The maximum aggregate amount in unsecured loans and lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, must not exceed 100 percent of the corporate credit union's capital. The board of directors must establish the limit, as a percent of the corporate credit union's capital plus pledged shares, for secured loans and lines of credit.

Part III

- (a) A corporate credit union that has met the requirements of either Part I or Part II of this Appendix and the additional requirements for Part III may invest in:
 - (1) Debt obligations of a foreign country;
 - (2) Deposits and debt obligations of foreign banks or obligations guaranteed by these banks;
 - (3) Marketable debt obligations of foreign corporations. This authority does not apply to debt obligations that are convertible into the stock of the corporation; and

- (4) Foreign issued asset-backed securities.
- (b) All foreign investments are subject to the following requirements:
 - (1) Investments must be rated no lower than the minimum permissible domestic rating under the corporate credit union's Part I or Part II authority;
 - (2) A sovereign issuer, and/or the country in which an obligor is organized, must have a long-term foreign currency (non-local currency) debt rating no lower than AA- (or equivalent);
 - (3) For each approved foreign bank line, the corporate credit union must identify the specific banking centers and branches to which it will lend funds;
 - (4) Obligations of any single foreign obligor may not exceed 50 percent of capital; and (5) Obligations in any single foreign country may not exceed 250 percent of capital.

Part IV

- (a) A corporate credit union that has met the requirements for this Part IV may enter into derivative transactions specifically approved by NCUA to:
 - (1) Create structured products;
 - (2) Manage its own balance sheet; and
 - (3) Hedge the balance sheets of its members.
- (b) Credit Ratings:
 - (1) All derivative transactions are subject to the following requirements:
 - (i) If the counterparty is domestic, the counterparty rating must be no lower than the minimum permissible rating for comparable term permissible investments; and
 - (ii) If the counterparty is foreign, the corporate must have Part III expanded authority and the counterparty rating must be no lower than the minimum permissible rating for a comparable term investment under Part III Authority.
 - (iii) Any rating(s) relied upon to meet the requirements of this part must be identified at the time the transaction is entered into and must be monitored for as long as the contract remains open.
 - (iv) Section 704.10 of this part if:
 - (A) one rating was relied upon to meet the requirements of this part and that rating is downgraded below the minimum rating requirements of this part; or
 - (B) two or more ratings were relied upon to meet the requirements of this part and at least two of those ratings are downgraded below the minimum rating requirements of this part.
 - (2) Exceptions. Credit ratings are not required for derivative transactions with:
 - (i) Domestically chartered credit unions;
 - (ii) U.S. government sponsored enterprises; or
 - (iii) Counterparties if the transaction is fully guaranteed by an entity with a minimum permissible rating for comparable term investments.

Part V

A corporate credit union that has met the requirements for this Part V may participate in loans with member natural person credit unions as approved by the OCCU Director and subject to the following:

- (a) The maximum aggregate amount of participation loans with any one member credit union must not exceed 25 percent of capital; and
- (b) The maximum aggregate amount of participation loans with all member credit unions will be determined on a case-by-case basis by the OCCU Director.