

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 704

RIN 3133-AE43

Corporate Credit Unions

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The NCUA Board (Board) is amending its regulations governing corporate credit unions (Corporates) and the scope of their activities. The amendments clarify the mechanics of a number of regulatory provisions and make several non-substantive, technical corrections.

DATES: This final rule is effective June 5, 2015.

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I. Background

In 2010, in response to the preceding financial crisis, the Board comprehensively revised NCUA's regulations governing Corporates and their activities.¹ The Board also amended those regulations twice more in 2011.² In November 2014, the Board issued a proposed rule (Proposal) to further amend the Corporate regulations by clarifying or modifying several provisions and making several non-substantive, technical corrections.³ The Proposal not only clarified and streamlined the Corporate regulations, but it also enhanced their readability and provided a degree of regulatory relief to Corporates. This final rule adopts all of the amendments in the Proposal, with one change.

II. Summary of Comments and Final Amendments

In response to the Proposal, NCUA received 20 comments, nine from Corporates, 10 from trade associations and state credit union leagues, and one from a natural person credit union. All of the commenters generally supported the clarifications and technical changes. As discussed more fully below, however, most commenters suggested additional changes beyond the scope of the Proposal or commented on provisions of the current Corporate regulations that were not addressed in the Proposal. The Board adopts the Proposal as issued with only one modification.

1. Section 704.2—Definitions

In the definitions section, the Board deleted several terms it determined were duplicative and redefined a number of other terms to minimize confusion and enhance the effectiveness of the Corporate regulations. The Board removed the definitions of “adjusted core capital” and “core capital” and incorporated them into the definition of “Tier 1 capital.” The Board also deleted the term “capital” when that term was used as a specific measure, and replaced it with the term “total capital.” The Board removed the definition of “supplementary capital” and incorporated it into the definition of “Tier 2 capital.” The Board also eliminated the definitions of certain terms in Appendix C to part 704, which are no longer relevant to Corporates. Finally, the Board modified a number of additional definitions to provide greater clarity or to make them consistent with other NCUA regulations.

In response to these proposed changes, NCUA received one comment that supported the proposed definition of retained earnings, stating that the change would make it easier for the continuing credit union in a merger situation to count retained earnings carried on the books of the merging credit union. In addition, there were a number of comments on definitions in the Corporate regulations that were outside the scope of the Proposal. Specifically, 16 commenters objected to the requirement that perpetual contributed capital (PCC) be discounted over time from what may be counted as Tier 1 capital. This requirement, which is in the current rule, was not the subject of any proposed amendment. Commenters, however, stated that PCC is consistent with the definition of “Tier 1 capital” or “core capital” as used by banking regulators, the Securities and Exchange Commission, and the U.S.

Treasury, and thus questioned the rationale of requiring certain amounts to be excluded from the calculation of Tier 1 Capital, as discussed below. Some commenters suggested that the mandatory phase-out of PCC would have the effect of altering a Corporate's Tier 1 Capital after the specified dates, even though nothing substantive had changed in the structure of the PCC account because of its nature as permanent capital. Another commenter suggested that the rule be changed to provide for a more explicit retained earnings requirement.

With respect to the comments on PCC and a more explicit retained earnings requirement, the Board notes that these are outside the scope of the Proposal. However, the Board notes that it was NCUA's intent, with the adoption of the final Corporate regulations in 2010, to ensure that the Corporates would never again present the sort of systemic risk to the entire credit union system that the Corporates did in that time period and which required NCUA to take extraordinary regulatory action.

An aspect of the 2010 Corporate regulations was to incent Corporates to build greater reserves of retained earnings to absorb potential losses. Retained earnings are considered to be the most superior form of capital carried by a Corporate, as retained earnings absorb losses without causing a corresponding loss to another party, such as a natural person credit union that purchased contributed capital from that Corporate. As referenced in the comment letters, part 704 contains provisions, effective in 2016, that limit the amount of contributed capital, including PCC, which may be counted toward a Corporate's regulatory capital. NCUA intended this provision to encourage a Corporate to build its retained earnings. By increasing retained earnings, a Corporate could count more contributed capital as regulatory capital.

As noted by commenters, PCC has elements that are consistent with Tier 1 capital. However, one distinguishing element of PCC is that it is almost entirely sourced from member credit unions. Accordingly, losses that deplete PCC would summarily impair investments made by credit union members and their corresponding capital. This downstream effect poses increased risk to the National Credit Union Share Insurance Fund that capital sourced from external sources would not. Should Corporates successfully raise meaningful amounts of capital from external sources, the Board may consider easing the

¹ 12 CFR part 704; 75 FR 64786 (Oct. 20, 2010).

² 76 FR 23861 (Apr. 29, 2011); 76 FR 79531 (Dec. 22, 2011). The Board also made technical changes to the regulations in 2011 and 2013. 76 FR 16235 (Mar. 23, 2011); 78 FR 77563 (Dec. 24, 2013).

³ 79 FR 65353 (Nov. 4, 2014).

restrictions on contributed capital in a future rulemaking.

The Board is finalizing the proposed amendments to the definitions section and Appendix C to part 704 without change.

2. Section 704.3—Corporate credit union capital

The Proposal included amendments to § 704.3(b)(5) and (c)(3) regarding corporate capital. The proposed amendments clarified that upon redeeming or calling nonperpetual capital accounts or PCC instruments, a Corporate must continue to meet its minimum required capital and net economic value ratios. These clarifications made the provisions consistent with each other and with the terms and conditions of contributed capital included in the Model Forms in Appendix A to part 704. The Proposal also deleted § 704.3(f)(4), as that provision refers to a regulatory requirement that Corporates were to have complied with before December 20, 2011.

NCUA received only one comment on this section. That commenter requested that the rule be modified to provide enhanced guidance to Corporates on how to handle the redemption of PCC. The Board notes that this comment is outside the scope of the Proposal. Further, the Board does not believe it is appropriate to consider issuing a proposed rule to address this comment at this time. However, if Corporates continue to satisfactorily rebuild retained earnings that were depleted during the credit crisis of 2007, then NCUA may consider revisiting this issue in the future.

The Board is finalizing the proposed amendments to this section as proposed.

3. Section 704.5—Investments

The Proposal included an amendment to § 704.5(j) regarding grandfathering certain Corporate investments. This amendment clarified that, while a Corporate may continue to hold an investment that was permissible at the time of purchase but later became impermissible because of a regulatory change, the investment is still subject to all other sections of part 704 that apply to investments, including those pertaining to credit risk management, asset and liability management, liquidity management, and investment action plans.

NCUA received no comments on this section and is adopting the amendment as proposed.

4. Section 704.6—Credit risk management

The Proposal provided clarification on how to value investments when calculating whether a Corporate is in compliance with various sector and issuer limits. NCUA received one comment on this section, which suggested that the Board should amend the rule to provide an exception to the single issuer limit for auto and equipment dealer floor plan asset-backed securities so that such securities would receive treatment similar to credit card master trust asset-backed securities. This comment is outside the scope of the Proposal, and the Board does not believe such an exception is warranted as auto and equipment asset-backed security issuances are widely available. The Board is adopting the amendments to this section as proposed.

5. Section 704.7—Lending

Section 704.7(c) currently restricts a Corporate's unsecured member lending to 50 percent of capital and its secured member lending to 100 percent of capital. The Proposal provided greater flexibility to Corporates by permitting them to lend on a secured basis up to 150 percent of their total capital to any individual credit union borrower. No commenters opposed this change, but eight commenters recommended that NCUA include an additional exclusion from the lending limit for a bridge loan made to a natural person member credit union in connection with that credit union receiving approval for a loan from the Central Liquidity Facility (CLF). All of the commenters who commented on this aspect of the Proposal supported a ten-day maturity limit on these bridge loans.

The Board agrees with these commenters and intends to provide an exclusion from the lending limit for bridge loans related to CLF loans. As this issue was not included in the Proposal, the Board, in compliance with the Administrative Procedure Act, will issue a subsequent notice of proposed rulemaking to effect this change.

6. Section 704.8—Asset and liability management

Current § 704.8 establishes requirements to identify, measure, monitor, and control risk in the management of assets and liabilities. These requirements include interest rate sensitivity analyses, net interest income modeling, and limiting the weighted average life of assets. Current § 704.8(j) also imposes reporting and other requirements on Corporates that experience a decline in net economic

value (NEV) or other NEV-related measures beyond certain thresholds. The Proposal included an amendment to clarify that if a Corporate experiences such NEV-related breaches, but is able to adjust its balance sheet to meet required regulatory limits within 10 days, then the Corporate will not be considered to be in violation of the regulation. The Proposal clarified that a regulatory violation would exist only if a Corporate could not timely resolve a breach.

NCUA received several comments on this section. One commenter suggested that Corporates should be given more than 10 days to complete an adjustment to its balance sheet to satisfy the requirements of § 704.8(d), (f), and (g). This commenter suggested a 60-day grace period and an opportunity to re-test at the expiration of the grace period.

The Board recognizes that, through the normal course of business, a Corporate may temporarily experience an NEV-related breach. Often, a Corporate can resolve the breach within a timely manner, which is why the current regulation permits a Corporate to resolve any breach within 10 days prior to further regulatory action being taken. The Board is concerned that lengthening the grace period could allow a Corporate to circumvent the purpose of the regulation, which is to address breaches that are not resolved in a timely manner. The Board, therefore, continues to believe the proposed 10-day grace period is appropriate.

In addition, four commenters suggested that the rule be expanded to provide for treatment of government securities, including agency securities, as cash equivalent for purposes of assigning weighted average life (WAL) values, resulting in such securities receiving a zero WAL valuation. The Board recognizes that government-guaranteed securities present a different risk profile than other investments that Corporates are permitted to purchase. However, these securities can pose risks to a Corporate. Specifically, government-issued or government-guaranteed securities may have longer-dated maturities that do not match a Corporate's funding structure. In addition, they are subject to prepayment, extension, and interest rate risks. Given those risks, the Board does not believe that government-issued or government-guaranteed securities merit a cash equivalent designation for purposes of assigning WAL values. It is also important to note that government-guaranteed securities (when compared to non-government-issued or non-government-guaranteed securities) are allowed a preferential factoring for

purposes of calculating WAL tests pursuant to § 704.8.

Four commenters also suggested that NCUA should anticipate that certain government-sponsored enterprises will increasingly require that investors in their mortgage-backed securities agree to certain credit-risk sharing features. These commenters suggested that NCUA should amend its regulations to specifically allow Corporates to acquire these types of investments. This issue is outside the scope of the Proposal, but the Board will continue to consider these comments for future rulemakings.

7. Section 704.9—Liquidity management

Section 704.9(b) currently restricts a Corporate's general borrowing limit to the lower of 10 times capital or 50 percent of capital and shares. The Proposal included several changes to this section. First, the Proposal changed the limit to 10 times *total* capital, consistent with the definitional changes discussed above. Second, the Proposal removed the restriction of 50 percent of capital and shares. Finally, the Proposal increased the secured borrowing maturity limit from 30 days to 120 days to accommodate seasonality in the borrowing patterns of member credit unions.

Fifteen commenters requested that the borrowing maturity limit be increased beyond 120 days. Most of the commenters addressing this topic advocated an extension of one to two years. In addition, one commenter advocated the elimination of any specific maturity limit. Another commenter sought to tie the maturity limit to the use of highly liquid collateral. Finally, several commenters argued for a system that would allow a Corporate to request a waiver from the borrowing limits.

The Board has considered all of these comments and has determined to extend the maturity limit to 180 days. The Board believes this additional extension will not materially increase risk, yet will provide the corporate greater flexibility in accommodating the fluctuation of its share base attributed to seasonal changes in member credit union liquidity demands. For example, credit unions incur routine deposit and withdrawal patterns associated with payrolls and consumer spending that can occur on an intra-month or multi-month basis. This seasonality of behavior has a direct impact on credit union funds held on deposit with the corporate. The Board believes the extension of the maturity limit will allow corporate credit unions to better serve the unique attributes of their members.

One commenter recommended that the Board remove the current limitation on the amount of secured borrowings permitted for non-liquidity purposes, and to simply allow such borrowings as long as all capital ratios continue to exceed the levels required to remain well capitalized. The Board believes that Corporates should be limited in their ability to borrow on a secured basis for other than liquidity purposes. The borrowing limitation is intended to preclude leveraging for investment purposes, which can introduce greater risk when markets encounter disruption. Secured lenders require collateral to be valued at market, and they impose an additional margin to ensure the borrowing is fully and continuously collateralized. Market shocks can create short-term market values that are significantly below long-term intrinsic values, which can magnify potential losses if the creditor seizes the collateral and sells it as permitted by the lending agreements. The Board is adopting the amendments as proposed, except as noted above.

8. Section 704.11—Corporate credit union service organizations (Corporate CUSOs)

The Proposal included several amendments to this section of the regulations. First, the Proposal eliminated dates included in § 704.11(e) that have since passed and are no longer relevant. Second, the Proposal added a requirement to § 704.11(g) that a Corporate CUSO provide to NCUA and, if applicable, the appropriate state supervisory authority (SSA), the kinds of reports required to be produced and submitted by natural person credit union service organizations pursuant to a recent revision to NCUA's natural person credit union service organization rule.⁴

Three commenters opposed this provision, all of whom challenged NCUA's authority to impose this requirement. Two of these commenters noted that the effect of this provision is likely to place CUSOs at a competitive disadvantage relative to other service providers. One commenter noted that this provision could expose a CUSO to the public release of confidential materials should its report become the subject of a Freedom of Information Act (FOIA) request. One commenter requested further clarification in the rule of the term "level of activity of each credit union" which the commenter mistakenly asserted appears in this section. One commenter, while not

opposing the substance of this provision, opposed NCUA's use of incorporation by reference to the natural person credit union service organization rule.

The Board recognizes the concerns raised by commenters and notes that FOIA, as well as applicable FOIA exemptions, apply to any data or information submitted by natural person credit union service organizations and Corporate CUSOs to NCUA. The Board anticipates that natural person credit union service organization and Corporate CUSO submissions often will contain or consist of "trade secrets and commercial or financial information obtained from a person [that is] privileged or confidential."⁵ This type of information generally is subject to withholding under exemption 4 of FOIA. In addition, information that is "contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions" is generally subject to withholding under exemption 8 of FOIA. To the extent, however, that natural person credit union service organization or Corporate CUSO submissions may contain or consist of data or information not subject to an applicable FOIA exemption, for example, an entity's name, address, or other publicly available information, that data or information would be releasable under FOIA.

Further, pursuant to approved Corporate CUSO activities, as found on the agency Web site, all Corporate CUSOs engaged in a particular approved activity must currently provide NCUA with quarterly and annual reports. Most of the reporting required by the Proposal is currently required by NCUA via the agency Web site. The Board is adopting the proposed changes to this section.

9. Section 704.14—Representation

The Proposal clarified the provisions in the current regulation pertaining to the qualifications required of a Corporate's directors, and specified that any candidate for a position on the board of a Corporate must currently hold a senior management position at a member credit union and hold that position at the time he or she is seated on the board of a Corporate. The Board received no comments in opposition to this proposed change and is adopting it as proposed.

⁴ 12 CFR 712.3(d)(4) and (5); 78 FR 72537 (Dec. 3, 2013).

⁵ 5 U.S.C. 552(b)(4).

10. Section 704.15—Audit and reporting requirements

The Proposal made technical changes to this section by eliminating dates that are no longer relevant and corrected a typographical error. The Board received no comment on these changes and is adopting them as proposed.

11. Section 704.18—Fidelity bond coverage

The Proposal changed the measure in this section from *core capital* to *Tier 1 capital*, consistent with the definitional changes discussed above. The Board received no comments on this change and is adopting it as proposed.

12. Section 704.21—Enterprise risk management (ERM)

The Proposal removed the minimum education and background requirements in this section applicable to an independent risk management expert. The Board received two comments, which advocated that this entire section be the subject of guidance, rather than included in the regulations. The Board disagrees with these comments and believes ERM should be addressed formally through regulation. Without emphasis placed on a strong ERM program, Corporates may be practicing good risk management on an exposure-by-exposure basis, but they may not be paying close enough attention to the aggregation of exposures across the entire institution. A Corporate must measure and understand all the individual risks associated with its various business components, and also understand how they interact dynamically. Accordingly, the Board is adopting the changes in this section as proposed.

13. Appendix A to Part 704—Capital Prioritization and Model Forms

The Proposal removed expired forms and redesignated the remaining forms as A–D. The Proposal also removed a sentence from the introductory note to current Model Form G, redesignated as Model Form C, to clarify that in some instances previously issued “paid-in capital” may not be considered PCC. The Board received no comments on these changes and is adopting them as proposed.

14. Appendix B to Part 704—Expanded Authorities and Requirements

Consistent with the earlier discussion regarding the simplification of terms relating to capital, the Proposal substituted “leverage ratio” for “capital ratio” and “total capital” for “capital” in this appendix. The Board received no

comments on these changes and is adopting them as proposed.

15. Appendix C to Part 704—Risk-Based Capital Credit Risk-Weight Categories

The Proposal removed references to assets and activities that are not consistent with the regular business activities of Corporates. The Board received no comments on these changes and is adopting them as proposed.

III. Regulatory Procedures

1. Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis of any significant economic impact a regulation may have on a substantial number of small entities (primarily those under \$50 million in assets).⁶ This final rule only affects Corporates, all of which have more than \$50 million in assets. Furthermore, the final rule consists primarily of technical and clarifying amendments. Accordingly, NCUA certifies the rule will not have a significant economic impact on a substantial number of small credit unions.

2. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) applies to rulemakings in which an agency by rule creates a new paperwork burden or increases an existing burden.⁷ For purposes of the PRA, a paperwork burden may take the form of a reporting or recordkeeping requirement, both referred to as information collections. Under the final rule, a Corporate with an investment in or loan to a Corporate CUSO will need to revise the current agreement it has with the Corporate CUSO to provide that the Corporate CUSO will prepare and submit basic or expanded reports directly to NCUA and, if applicable, the appropriate SSA.

Currently, there are 13 Corporates and approximately 16 Corporate CUSOs, 13 of which provide the complex or high-risk services that require expanded reporting. The information collection burdens imposed, on an annual basis, are analyzed below.

Changing the written agreement relating to reports to NCUA.

Frequency of response: One-time.
Initial hour burden: 4.
4 hours × 13 = 52 hours.

Initial Corporate CUSO reporting to NCUA and SSA—basic information.

Frequency of response: One-time.
Initial hour burden: 0.5.
0.5 hours × 16 = 8 hours.

Initial Corporate CUSO reporting to NCUA and SSA—expanded information.

Frequency of response: One-time.
Initial hour burden: 3.
3 hours × 13 = 39 hours.

Annual Corporate CUSO reporting to NCUA and SSA—expanded information.

Frequency of response: Annual.
Annual hour burden: 3.
3 hours × 13 = 39 hours.

As required by the PRA, NCUA submitted a copy of this Proposal to OMB for its review and approval.

3. Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order to adhere to fundamental federalism principles. The final rule does not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has, therefore, determined that this final rule does not constitute a policy that has federalism implications for purposes of the executive order.

4. Assessment of Federal Regulations and Policies on Families

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

5. Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996⁸ (SBREFA) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act.⁹ NCUA does not believe this final rule is a “major rule” within the meaning of the relevant sections of SBREFA because it only clarifies the mechanics of a number of regulatory provisions and makes several non-substantive, technical corrections. NCUA has submitted the rule to the Office of Management and

⁶ 5 U.S.C. 603(a); 12 U.S.C. 1787(c)(1).

⁷ 44 U.S.C. 3507(d); 5 CFR part 1320.

⁸ Public Law 104–121, 110 Stat. 857 (1996).

⁹ 5 U.S.C. 551.

Budget for its determination in that regard.

List of Subjects in 12 CFR Part 704

Credit unions, Corporate credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on April 30, 2015.

Gerard Poliquin, Secretary of the Board.

For the reasons discussed above, the National Credit Union Administration amends 12 CFR part 704 as follows:

PART 704—CORPORATE CREDIT UNIONS

■ 1. The authority citation for part 704 continues to read as follows:

Authority: 12 U.S.C. 1766(a), 1781, and 1789.

■ 2. Amend § 704.2 by:

- a. Removing the definitions of "Adjusted core capital" and "Asset-backed commercial paper program";
■ b. Revising the first two sentences of the definition of "Available to cover losses that exceed retained earnings";
■ c. Removing the definitions of "Capital", "Capital ratio", "Core capital", "Core capital ratio", and "Credit-enhancing interest-only strip";
■ d. Revising the definition of "Derivatives";
■ e. Removing the definition of "Eligible ABCP liquidity facility";
■ f. Revising the definitions of "Equity investment", "Equity security", "Fair value", and "Internal control";
■ g. Removing the two definitions of "Leverage ratio";
■ h. Adding a new definition, in alphabetical order, for "Leverage ratio";
■ i. Revising the definitions of "Net assets", "Net risk-weighted assets", and "Retained earnings";
■ j. Removing the definition of "Supplementary Capital";
■ k. Revising the definitions of "Tier 1 capital";
■ l. Adding a definition, in alphabetical order, for "Tier 1 risk-based capital ratio";
■ m. Revising the definition of "Tier 2 capital"; and
■ n. Revising the definition of "Total capital".

The revisions and additions read as follows:

§ 704.2 Definitions.

* * * * *

Available to cover losses that exceed retained earnings means that the funds are available to cover operating losses realized, in accordance with generally accepted accounting principles (GAAP),

by the corporate credit union that exceed retained earnings and equity acquired in a combination. Likewise, available to cover losses that exceed retained earnings and perpetual contributed capital (PCC) means that the funds are available to cover operating losses realized, in accordance with GAAP, by the corporate credit union that exceed retained earnings and equity acquired in a combination and PCC.

* * *

* * * * *

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

* * * * *

Equity investment means an investment in an equity security and other ownership interest, including, for example, an investment in a partnership or limited liability company.

Equity security means any security representing an ownership interest in an enterprise (for example, common, preferred, or other capital stock) or the right to acquire (for example, warrants and call options) or dispose of (for example, put options) an ownership interest in an enterprise at fixed or determinable prices. However, the term does not include Federal Home Loan Bank stock, convertible debt, or preferred stock that by its terms either must be redeemed by the issuing enterprise or is redeemable at the option of the investor.

* * * * *

Fair value means the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date, as defined by GAAP.

* * * * *

Internal control means the process, established by the corporate credit union's board of directors, officers and employees, designed to provide reasonable assurance of reliable financial reporting and safeguarding of assets against unauthorized acquisition, use, or disposition. A credit union's internal control structure generally consists of five components: Control environment; risk assessment; control activities; information and communication; and monitoring. Reliable financial reporting refers to preparation of Call Reports as well as financial data published and presented to members that meet management's financial reporting objectives. Internal control over safeguarding of assets against unauthorized acquisition, use, or

disposition refers to prevention or timely detection of transactions involving such unauthorized access, use, or disposition of assets which could result in a loss that is material to the financial statements.

* * * * *

Leverage ratio means the ratio of Tier 1 capital to moving daily average net assets.

* * * * *

Net assets means total assets less Central Liquidity Facility (CLF) stock subscriptions, loans guaranteed by the National Credit Union Share Insurance Fund (NCUSIF), 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 GAAP conditions for offsetting are met. Also, any amounts deducted in calculating Tier 1 capital are also deducted from net assets.

* * * * *

Net risk-weighted assets means risk-weighted assets less CLF stock subscriptions, CLF loans guaranteed by the NCUSIF, 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 GAAP conditions for offsetting are met. Also, any amounts deducted in calculating Tier 1 capital are also deducted from net risk-weighted assets.

* * * * *

Retained earnings means undivided earnings, regular reserve, reserve for contingencies, supplemental reserves, reserve for losses, and other appropriations from undivided earnings as designated by management or NCUA.

* * * * *

Tier 1 capital means the sum of paragraphs (1) through (4) of this definition from which paragraphs (5) through (9) of this definition are deducted:

- (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;
(4) Minority interests in the equity accounts of CUSOs that are fully consolidated;
(5) Deduct the amount of the corporate credit union's intangible assets that exceed one half percent of its moving daily average net assets (however, NCUA may direct the

corporate credit union to add back some of these assets on NCUA's own initiative, by petition from the applicable state regulator, or upon application from the corporate credit union);

(6) Deduct investments, both equity and debt, in unconsolidated CUSOs;

(7) Deduct an amount equal to any PCC or NCA that the corporate credit union maintains at another corporate credit union;

(8) Beginning on October 20, 2016, and ending on October 20, 2020, deduct any amount of PCC that causes PCC minus retained earnings, all divided by moving daily net average assets, to exceed two percent; and

(9) Beginning after October 20, 2020, deduct any amount of PCC that causes PCC to exceed retained earnings.

Tier 1 risk-based capital ratio means the ratio of Tier 1 capital to the moving monthly average net risk-weighted assets.

Tier 2 capital means the sum of paragraphs (1) through (4) of this definition:

(1) Nonperpetual capital accounts, as amortized under § 704.3(b)(3);

(2) Allowance for loan and lease losses calculated under GAAP to a maximum of 1.25 percent of risk-weighted assets;

(3) Any PCC deducted from Tier 1 capital; and

(4) Forty-five percent of unrealized gains on available-for-sale equity securities with readily determinable fair values. Unrealized gains are unrealized holding gains, net of unrealized holding losses, calculated as the amount, if any, by which fair value exceeds historical cost. NCUA may disallow such inclusion in the calculation of Tier 2 capital if NCUA determines that the securities are not prudently valued.

Total capital means the sum of Tier 1 capital and Tier 2 capital, less the corporate credit union's equity investments not otherwise deducted when calculating Tier 1 capital.

■ 3. Amend § 704.3 by revising paragraphs (b)(5), (c)(3), and (e)(3)(i) and removing paragraph (f)(4) to read as follows:

§ 704.3 Corporate credit union capital.

* * * * *

(b) * * *

(5) *Redemption.* A corporate credit union may redeem NCAs prior to maturity or prior to the end of the notice period only if it meets its minimum required capital and net economic value ratios after the funds are redeemed and

only with the prior approval of NCUA and, for state chartered corporate credit unions, the applicable state regulator.

* * * * *

(c) * * *

(3) *Callability.* A corporate credit union may call PCC instruments only if it meets its minimum required capital and net economic value ratios after the funds are called and only with the prior approval of the NCUA and, for state chartered corporate credit unions, the applicable state regulator. PCC accounts are callable on a pro-rata basis across an issuance class.

* * * * *

(e) * * *

(3) * * * (i) Notwithstanding the definitions of Tier 1 capital and Tier 2 capital in paragraph (d) of this section, NCUA may find that a particular asset or Tier 1 capital or Tier 2 capital component has characteristics or terms that diminish its contribution to a corporate credit union's ability to absorb losses, and NCUA may require the discounting or deduction of such asset or component from the computation of Tier 1 capital, Tier 2 capital, or total capital.

* * * * *

■ 4. Amend § 704.5 by revising paragraph (j) to read as follows:

§ 704.5 Investments.

* * * * *

(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 other requirements of this part.

■ 5. Amend § 704.6 by revising paragraphs (c), (d), and (e) to read as follows:

§ 704.6 Credit risk management.

* * * * *

(c) *Issuer concentration limits*—(1) *General rule.* The aggregate value recorded on the books of the corporate credit union of all investments in any single obligor is limited to 25 percent of total capital or \$5 million, whichever is greater.

(2) *Exceptions.* (i) Investments in one obligor where the remaining maturity of all obligations is less than 30 days are limited to 50 percent of total capital;

(ii) Investments in credit card master trust asset-backed securities are limited to 50 percent of total capital in any single obligor;

(iii) Aggregate investments in repurchase and securities lending agreements with any one counterparty are limited to 200 percent of total capital;

(iv) Investments in non-money market registered investment companies are limited to 50 percent of total capital in any single obligor;

(v) Investments in money market registered investment companies are limited to 100 percent of total capital in any single obligor; and

(vi) Investments in corporate CUSOs are subject to the limitations of section 11 of this part.

(d) *Sector concentration limits.* (1) A corporate credit union must establish sector limits based on the value recorded on the books of the corporate credit union that do not exceed the following maximums:

(i) Mortgage-backed securities (inclusive of commercial mortgage-backed securities)—the lower of 1000 percent of total capital or 50 percent of assets;

(ii) Commercial mortgage-backed securities—the lower of 300 percent of total capital or 15 percent of assets;

(iii) Federal Family Education Loan Program student loan asset-backed securities—the lower of 1000 percent of total capital or 50 percent of assets;

(iv) Private student loan asset-backed securities—the lower of 500 percent of total capital or 25 percent of assets;

(v) Auto loan/lease asset-backed securities—the lower of 500 percent of total capital or 25 percent of assets;

(vi) Credit card asset-backed securities—the lower of 500 percent of total capital or 25 percent of assets;

(vii) Other asset-backed securities not listed in paragraphs (d)(1)(ii) through (vi) of this section—the lower of 500 percent of total capital or 25 percent of assets;

(viii) Corporate debt obligations—the lower of 1000 percent of total capital or 50 percent of assets; and

(ix) Municipal securities—the lower of 1000 percent of total capital or 50 percent of assets.

(2) Registered investment companies—A corporate credit union must limit its investment in registered investment companies to the lower of 1000 percent of total capital or 50 percent of assets. In addition to applying the limit in this paragraph, a corporate credit union must also include the underlying assets in each registered investment company in the relevant sectors described in paragraph (d)(1) of this section when calculating those sector limits.

(3) A corporate credit union must limit its aggregate holdings in any investments not described in paragraphs (d)(1) or (2) of this section to the lower of 100 percent of total capital or 5 percent of assets. The NCUA may

approve a higher percentage in appropriate cases.

(4) Investments in other federally insured credit unions, deposits and federal funds investments in other federally insured depository institutions, and investment repurchase agreements are excluded from the concentration limits in paragraphs (d)(1), (2), and (3) of this section.

(e) *Corporate debt obligation subsector limits.* In addition to the limitations in paragraph (d)(1)(viii) of this section, a corporate credit union must not exceed the lower of 200 percent of total capital or 10 percent of assets in any single North American Industry Classification System (NAICS) industry sector based on the value recorded on the books of the corporate credit union. If a corporation in which a corporate credit union is interested in investing does not have a readily ascertainable NAICS classification, a corporate credit union will use its reasonable judgment in assigning such a classification. NCUA may direct, however, that the corporate credit union change the classification.

* * * * *

■ 6. Amend § 704.7 by revising paragraph (c) to read as follows:

§ 704.7 Lending.

* * * * *

(c) *Loans to members—*(1) *Credit unions.* (i) The maximum aggregate amount in unsecured loans and lines of credit from a corporate credit union to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, must not exceed 50 percent of the corporate credit union's total capital.

(ii) The maximum aggregate amount in secured loans (excluding those secured by shares or marketable securities and member reverse repurchase transactions) and unsecured loans (excluding pass-through and guaranteed loans from the CLF and the NCUSIF) and lines of credit from a corporate credit union to any one member credit union must not exceed 150 percent of the corporate credit union's total capital.

(2) *Corporate CUSOs.* Any loan or line of credit from a corporate credit union to a corporate CUSO must comply with § 704.11.

(3) *Other members.* The maximum aggregate amount of loans and lines of credit from a corporate credit union to any other one member must not exceed 15 percent of the corporate credit union's total capital plus pledged shares.

* * * * *

■ 7. Amend § 704.8 by revising paragraph (j) to read as follows:

§ 704.8 Asset and liability management.

* * * * *

(j) *Limit breaches.* (1)(i) If a corporate credit union's decline in NEV, base case NEV ratio, or any NEV ratio calculated under paragraph (d) of this section exceeds established or permitted limits, or the corporate is unable to satisfy the tests in paragraphs (f) or (g) of this section, the operating management of the corporate must immediately report this information to its board of directors and ALCO; and

(ii) If the corporate credit union cannot adjust its balance sheet to meet the requirements of paragraphs (d), (f), or (g) of this section within 10 calendar days after detection by the corporate, the corporate must notify in writing the Director of the Office of National Examinations and Supervision.

(2) If any breach described in paragraph (j)(1) of this section persists for 30 or more calendar days, the corporate credit union:

(i) Must immediately submit a detailed, written action plan to the NCUA that sets forth the time needed and means by which it intends to come into compliance and, if the NCUA determines that the plan is unacceptable, the corporate credit union must immediately restructure its balance sheet to bring the exposure back within compliance or adhere to an alternative course of action determined by the NCUA; and

(ii) If presently categorized as adequately capitalized or well capitalized for prompt corrective action purposes, and the breach was of paragraph (d) of this section, the corporate credit union will immediately be recategorized as undercapitalized until coming into compliance, and

(iii) If presently categorized as less than adequately capitalized for prompt corrective action purposes, and the breach was of paragraph (d) of this section, the corporate credit union will immediately be downgraded one additional capital category.

* * * * *

■ 8. Amend § 704.9 by revising paragraph (b) to read as follows:

§ 704.9 Liquidity management.

* * * * *

(b) *Borrowing limits.* A corporate credit union may borrow up to 10 times its total capital.

(1) *Secured borrowings.* A corporate credit union may borrow on a secured basis for liquidity purposes, but the maturity of the borrowing may not exceed 180 days. Only a corporate credit

union with Tier 1 capital in excess of five percent of its moving daily average net assets (DANA) may borrow on a secured basis for nonliquidity purposes, and the outstanding amount of secured borrowing for nonliquidity purposes may not exceed an amount equal to the difference between the corporate credit union's Tier 1 capital and five percent of its moving DANA.

(2) *Exclusions.* CLF borrowings and borrowed funds created by the use of member reverse repurchase agreements are excluded from the limit in paragraph (b)(1) of this section.

■ 9. Amend § 704.11 by:

■ a. Revising paragraphs (b)(1) and (2) and (e)(1) introductory text;

■ b. Removing paragraph (e)(2);

■ c. Redesignating paragraph (e)(3) as paragraph (e)(2);

■ d. Redesignating paragraphs (g)(4) through (7) as paragraphs (g)(5) through (8), respectively; and

■ e. Adding new paragraph (g)(4).

The revisions and addition read as follows:

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

* * * * *

(b) *Investment and loan limitations.*

(1) The aggregate of all investments in member and non-member corporate CUSOs that a corporate credit union may make must not exceed 15 percent of a corporate credit union's total capital.

(2) The aggregate of all investments in and loans to member and nonmember corporate CUSOs a corporate credit union may make must not exceed 30 percent of a corporate credit union's total capital. A corporate credit union may lend to member and nonmember corporate CUSOs an additional 15 percent of total capital if the loan is collateralized by assets in which the corporate has a perfected security interest under state law.

* * * * *

(e) *Permissible activities.* (1) A corporate CUSO must agree to limit its activities to:

* * * * *

(g) * * *

(4) Will provide the reports as required by § 712.3(d)(4) and (5) of this chapter;

* * * * *

■ 10. Amend § 704.14 by revising paragraphs (a)(2), (a)(9), and (e)(2) to read as follows:

§ 704.14 Representation.

(a) * * *

(2) Only an individual who currently holds the position of chief executive officer, chief financial officer, chief

operating officer, or treasurer/manager at a member credit union, and will hold that position at the time he or she is seated on the corporate credit union board if elected, may seek election or re-election to the corporate credit union board;

(9) At least a majority of directors of every corporate credit union, including the chair of the board, must serve on the corporate board as representatives of natural person credit union members.

(2) The provisions of § 701.14 of this chapter apply to corporate credit unions, except that where “Regional Director” is used, read “Director of the Office of National Examinations and Supervision.”

■ 11. Amend § 704.15 by revising paragraph (a)(2)(iii) introductory text, the first sentence of paragraph (b)(2), and the first sentence of paragraph (d)(1) to read as follows:

§ 704.15 Audit and reporting requirements.

(iii) An assessment by management of the effectiveness of the corporate credit union’s internal control structure and procedures as of the end of the past calendar year that must include the following:

(2) * * * The independent public accountant who audits the corporate credit union’s financial statements must examine, attest to, and report separately on the assertion of management concerning the effectiveness of the corporate credit union’s internal control structure and procedures for financial reporting.

(1) * * * Each corporate credit union must establish a supervisory committee, all of whose members must be independent.

§ 704.18 [Amended]

■ 12. Amend § 704.18 by:
 ■ a. Removing the words “core capital ratio” from the introductory text of paragraph (e)(1) and adding in their place “leverage ratio”;
 ■ b. Removing the words “Core capital ratio” from the table heading of paragraph (e)(1) and adding in their place “Leverage ratio”; and
 ■ c. Removing the words “of core capital” wherever they appear in the table in paragraph (e)(1) and adding in their place “of Tier 1 capital”.

■ 13. Amend § 704.21 by revising paragraph (c) to read as follows:

§ 704.21 Enterprise risk management.

(c) The ERMC must include at least one independent risk management expert. The risk management expert must have at least five years of experience in identifying, assessing, and managing risk exposures. This experience must be commensurate with the size of the corporate credit union and the complexity of its operations. The board of directors may hire the independent risk management expert to work full-time or part-time for the ERMC or as a consultant for the ERMC.

Appendix A to Part 704—[Amended]

■ 14. Amend Appendix A to part 704 by:
 ■ a. Removing Model Forms A, B, E, and F and redesignating Model Forms C, D, G, and H as Model Forms A, B, C, and D, respectively; and
 ■ b. Removing the second sentence of the note in newly redesignated Model Form C.

Appendix B to Part 704—[Amended]

■ 15. Amend Appendix B to part 704 by:
 ■ a. Removing the words “capital ratio” wherever they appear and adding in their place “leverage ratio”;
 ■ b. Removing the words “corporate credit union’s capital” wherever they appear and adding in their place “corporate credit union’s total capital”;
 ■ c. Removing the words “25 percent of capital” from paragraph (b)(3) of Part II and adding in their place “25 percent of total capital”; and
 ■ d. Removing paragraph (e) from part 1.

■ 16. Amend Appendix C to part 704 by:
 ■ a. In part I(b):
 ■ (i) Revising paragraph (8) of the definition of “Direct credit substitute”;
 ■ (ii) Revising paragraph (8) of the definition of “Recourse”; and
 ■ (iii) Revising paragraph (2) of the definition of “Residual interest”;
 ■ b. In part II(a), revising paragraph (4)(xiii);
 ■ c. In part II(b):
 ■ (i) Removing paragraphs (1)(iv) and (4);
 ■ (ii) Redesignating paragraphs (5) and (6) as paragraphs (4) and (5), respectively;
 ■ (iii) Revising newly redesignated paragraph (4)(i); and
 ■ (iv) Removing newly redesignated paragraph (5)(v)(C).
 ■ d. In part II(c):
 ■ (i) Removing paragraph (2)(i);

■ (ii) Redesignating paragraphs (2)(ii) and (iii) as paragraphs (2)(i) and (ii), respectively; and

■ (iii) Revising newly redesignated paragraph (2)(i) and the introductory text of newly redesignated paragraph (2)(ii).

The revisions read as follows:

Appendix C to Part 704—Risk-Based Capital Credit Risk-Weight Categories

Part I: Introduction
 (b) Definitions
 Direct credit substitute* * *
 (8) Liquidity facilities that provide support to asset-backed commercial paper.

Recourse* * *
 (8) Liquidity facilities that provide support to asset-backed commercial paper.

Residual interest* * *
 (2) Residual interests generally include spread accounts, cash collateral accounts, retained subordinated interests (and other forms of overcollateralization), and similar assets that function as a credit enhancement. Residual interests further include those exposures that, in substance, cause the corporate credit union to retain the credit risk of an asset or exposure that had qualified as a residual interest before it was sold.

Part II: Risk-Weightings
 (a) On-Balance Sheet Assets
 (4)* * *
 (xiii) Interest-only strips receivable;
 (b) Off-Balance Sheet Activities
 (4) * * * (i) Unused portions of commitments with an original maturity of one year or less;
 (c) Recourse Obligations, Direct Credit Substitutes, and Certain Other Positions

(2)(i) Other residual interests. A corporate credit union must maintain risk-based capital for a residual interest equal to the face amount of the residual interest, even if the amount of risk-based capital that must be maintained exceeds the full risk-based capital requirement for the assets transferred.

(ii) Residual interests and other recourse obligations. Where a corporate credit union holds a residual interest and another recourse obligation in connection with the same transfer of assets, the corporate credit union must maintain risk-based capital equal to the greater of: