

Proposed Rule Summary [ANPR]

Prepared by the NASCUS Regulatory Affairs Department

January 30, 2009

NCUA

Part 704 Corporate Credit Unions

On January 28, 2009, NCUA took action to stabilize the corporate credit union system after mounting losses threatened confidence in the system. Among the actions taken were 1) an infusion of \$1 billion in capital into U.S. Central Federal Credit Union; and 2) a temporary NCUSIF guarantee of all member shares for any corporate credit union that decides to participate in a voluntary guarantee program. In addition, NCUA published an ANPR soliciting comments on the structure of the corporate credit union system.

The ANPR invites all comments about the future structure and regulation of the corporate credit union system, including:

- corporates' membership structure, and size
- services offered by corporate
- corporate capital
- permissible investments
- management of credit risk and liquidity
- corporate governance

Comments due:

Comments are due to the NCUA 60 days from publication in the Federal Register. Comments are due to NASCUS no later than MARCH 20, 2009.

The complete ANPR may be viewed here:

http://www.ncua.gov/CoporateStabilizationProgram/ANPR_12CFRPart_704.pdf

Summary

1) The Role of Corporates in the Credit Union System

NCUA is considering whether comprehensive changes to the structure of the corporate system are warranted: the current organization of payments systems, ways to elevate liquidity preservation to the core function, revisiting the wisdom of national fields of membership, modifying the expanded authority regulations, and elimination of US Central FCU.

Payment systems

NCUA is considering whether payment system services should be isolated from other services to separate the risk, and if so, what is the best structure for isolating these services from other business risks? NCUA is considering creating 2 charter types: 1) a strictly payment system charter (with no other authorized activities); and a 2) charter for investment services.

NCUA is also considering establishing distinct capital requirements for payment systems risk and other service risk; requiring a legal and operational firewall between payment system services and other services.

Liquidity and liquidity management

NCUA notes that traditionally corporate investments were made with an eye towards ensuring funds would be available to meet members' short-term liquidity needs. NCUA asks whether liquidity ought to be considered a core service of the corporate system, and if so, what steps should be taken, and by whom, to preserve and strengthen corporates' ability to offer that service? NCUA also asks:

- should a corporate's ability to offer other specific types of products and services be limited in order to preserve and defend the liquidity function?
- what specific types of products and services should corporates be authorized to provide?

NCUA is considering additional cash flow measuring requirements to assist corporates in achieving and maintaining proper liquidity management. Therefore, NCUA asks whether aggregate cash flow duration limitations should be added to Part 704. If so, how should it be structured? What cash flow duration limits would be appropriate for corporate credit unions, particularly in an evolving interest rate market with previously unseen credit risk spreads?

Field of membership issues

NCUA acknowledges that despite its intention of fostering competition, the decision to allow corporates to have national fields of membership may have resulted in significant, and unforeseen, risk taking. NCUA asks whether the system should return to defined FOMs, for example, state or regional FOMs.

Expanded investment authority

Part 704 provides for expanded investment authority for a corporate meeting certain criteria: for example, authority to purchase investments with relatively lower credit ratings than otherwise permissible. NCUA asks whether the rule should continue to provide for expanded authorities; and if so, should there be additional procedures and qualifications, such as higher capital standards. Should NCUA reduce the expanded authorities available? If so, which ones?

Structure; two-tiered system

NCUA solicits comment about whether the two-tier corporate system in its current form meets the needs of credit unions: is there a need for a wholesale corporate credit union [US Central FCU]. If so, NCUA asks:

- what should be its primary role?
- should there be a different powers and authorities for retail and wholesale corporates?
- does the current structure of the system contribute to the inappropriate transfer of risk from the retail corporates to the wholesale corporate

Finally, if the two-tiered system is retained, should capital requirements and risk measurement criteria (e.g., NEV volatility), and the range of permissible investments be different for the wholesale corporate than for a retail corporate credit union.

2) Corporate Capital

NCUA is considering revising various definitions and standards for determining appropriate capital requirements for corporate credit unions. NCUA is considering are 1) establishing a new required capital ratio consisting only of core capital, excluding membership capital accounts as a component of regulatory capital; 2) increasing the required capital ratio to more than four percent; and 3) establishing new ratio based risk-weighted asset classifications, which could include some form of membership capital. NCUA notes that these changes would bring the corporate capital requirements more into line with standards applied by the OCC and FDIC.

Core capital

NCUA is considering several issues relating to core capital (i.e., the traditional “tier one capital” definition as used by the several federal financial institution regulators). Under the current rule, core capital is defined as retained earnings plus paid-in capital. NCUA seeks comments on:

- whether a new “core capital only” ratio should be established, and if so, what would be the appropriate level and what actions are necessary to enable corporates to attain the level
- what is an appropriate time frame for corporates to attain sufficient capital; and what is the appropriate method to measure core capital given the significant fluctuation in corporate assets that occur

Membership capital

NCUA is also considering several issues involving membership capital, including whether NCUA should continue to allow membership capital in its current configuration, or eliminate/modify certain features, such as the adjustment feature, so that membership capital meets the traditionally accepted definition of tier two capital. Another issue is whether to tie adjusted balance requirements, as set out currently in §704.3(b)(8), only to assets, as well as whether to impose limits on the frequency of adjustments. NCUA is also considering:

- whether to require that any attempted reduction in membership capital based on downward adjustment automatically result in the account being placed on notice, within the meaning of current §704.3(b)(3), so that only a delayed payout after the three-year notice expires is permissible
- whether to require that any withdrawal of membership capital be conditioned on the corporate’s ability to meet all applicable capital requirements following withdrawal

Risk-based capital and contributed capital requirements

Should NCUA consider risk-based capital for corporates consistent with other federally regulated financial institutions? What regulatory and statutory changes, if any, would be required to effectuate such a change? Should a natural person credit union be required to maintain a contributed capital account with its corporate as a prerequisite to obtaining services from the corporate? Should contributed capital be calculated as a function of share balances maintained with the corporate?

3) **Permissible Investments**

Should corporate investment authorities be constrained or restricted? Specifically, NCUA asks whether it should limit corporate credit union investment authorities to those allowed for natural person credit unions; whether to prohibit certain categories of investments: collateralized debt obligations (CDOs), net interest margin securities (NIMs), and subprime and Alt-A asset-backed securities.

4) **Credit Risk Management**

Because it questions the reliability of credit ratings for investments, NCUA is considering curbing the extent to which a corporate may rely on credit ratings provided by Nationally Recognized Statistical Rating Organizations (NRSROs). Comments are sought on whether NCUA should require more than one rating for an investment; and whether to require additional stress modeling tools in the regulation to enhance credit risk management.

NCUA asks whether Part 704 should be revised to provide specific concentration limits, including sector and obligor limits; and what specific limits would be appropriate for corporate credit unions. Should corporates be required to obtain independent evaluations of credit risk in their investment portfolios, and what would be appropriate standards for these contractors? Finally, should corporates be required to test sensitivities to credit spread widening, and what standards should apply to that effort?

5) **Asset Liability Management**

Part 704 used to require performance of net interest income modeling and stress testing, and NCUA is considering re-instating this requirement, or some form of mandatory modeling/testing.

6) **Corporate Governance**

NCUA is considering minimum standards for directors that would require a director possess an appropriate level of experience and independence. The agency is also considering:

- term limits; director compensation; and greater transparency for executive compensation
- whether the current structure of credit union boards is appropriate
- whether more stringent minimum qualifications and training requirements for individuals serving as corporate credit union directors are appropriate (and what those should be)
- whether to establish a category of “outside director,” and if so, who should they be and how many there should be
- whether a wholesale corporate credit union be required to have some directors from natural person credit unions

This has been a SUMMARY of NCUA’s ANPR on the structure of the corporate credit union system. NASCUS encourages everyone to view the complete ANPR at this link:

http://www.ncua.gov/CorporateStabilizationProgram/ANPR_12CFRPart_704.pdf

-end-