

[Insert NASCUS Title page]

## Introduction:

The following is a Compendium of Part 741 of the Code of Federal Regulations (“CFR”). Part 741 governs Federally-Insured State-Chartered Credit Unions (“FISCUs”). Part 741 is divided into two subparts. Subpart A contains regulations that apply directly to FISCUs and are not codified elsewhere in the U.S. Code (“U.S.C.”) or CFR. While the regulations of Subpart A are not fully codified elsewhere, they regularly reference other provisions of the U.S.C. and CFR. Subpart B incorporates by reference complete provisions of the U.S.C. and CFR and applies them to FISCUs.

Some provisions of Part 741 refer to sections of the U.S.C. or CFR that discuss activities that may not be permitted under the law of the state in which the FISCU is chartered. Please note that Part 741 does not enlarge the scope of a FISCU’s authority beyond what is permitted under applicable state law.

## How to use this Compendium:

This document is an integrated roadmap of Part 741. Each Section of Part 741 is listed in its entirety. Where the text of Part 741 includes a cross-reference to other provisions of the U.S.C. or CFR, such cross-reference is indicated in **bold**. Click the **bold** text and your web browser will automatically open the relevant provision at [www.gpo.gov](http://www.gpo.gov) (for the U.S.C.) or [www.ecfr.gov](http://www.ecfr.gov) (for the CFR).

Some provisions include a “Special Notes” section. These notes are not part of the text of Part 741. Rather, they are helpful links and guidance meant to make use the Compendium more efficient.

## Definitions:



“FISCU” refers to entities regulated under Part 741. The original text of Part 741 refers to the regulated entities variously as “credit unions,” “credit unions insured pursuant to title II of the Act,” “state-chartered credit unions,” etc. Inconsistent identification makes it difficult to determine when a particular provision applies. Therefore, for ease of reference, the term “FISCU” is inserted throughout the text of Part 741 wherever applicable.

“The Act” refers to the Federal Credit Union Act (12 U.S.C. §§1751 - 1795k).

“NCUA” refers to the National Credit Union Administration.

## Troubleshooting:

Problem 1. I clicked the bold text in the body of a Section, but my browser did not open.

A: Make sure your cursor shows that you are using either the Selection Tool  or the Hand Tool . The hyperlinks in the bold text may not appear if you are using other editing tools.

Problem 2. My browser opened a provision other than the one I clicked. My browser tried to open the website, but I got an error message.

A: The bold text sends you to websites maintained by the U.S. Government Printing Office. The web addresses of each provisions may change unexpectedly. If you are directed to the incorrect provision or you receive an error message indicating that you entered the wrong address, please contact [      ].

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## **§741.0 Scope.**

The provisions of this part apply to federal credit unions, federally insured state-chartered credit unions, and credit unions making application for insurance of accounts pursuant to **title II of the Act**, unless the context of a provision indicates its application is otherwise limited. This part prescribes various requirements for obtaining and maintaining federal insurance and the payment of insurance premiums and capitalization deposit. Subpart A of this part contains substantive requirements that are not codified elsewhere in this chapter. Subpart B of this part lists additional regulations, set forth elsewhere in this chapter as applying to federal credit unions, that also apply to federally insured state-chartered credit unions. As used in this part, “insured credit union” means a credit union whose accounts are insured by the National Credit Union Share Insurance Fund (NCUSIF).

**Subpart A - Regulations That Apply to Both Federal Credit Unions  
and Federally Insured State-Chartered Credit Unions and That Are  
Not Codified Elsewhere in NCUA's Regulations**

## **§741.1. Examination.**

As provided in **Sections 201 and 204 of the Act (12 U.S.C. 1781 and 1784)**, the NCUA Board is authorized to examine any insured [FISCU] or any credit union making application for insurance of its accounts. Such examination may require access to all records, reports, contracts to which the credit union is a party, and information concerning the affairs of the credit union. Upon request, such documentation must be provided to the NCUA Board or its representative. Any credit union which makes application for insurance will be required to pay the cost of such examination and processing. To the maximum extent feasible, the NCUA Board will utilize examinations conducted by state regulatory agencies.

## **§741.2 Maximum borrowing authority.**

(a) Any credit union which makes application [to become a FISCU] or any [FISCU], must not borrow, from any source, an aggregate amount in excess of 50 per centum of its paid-in and unimpaired capital and surplus (shares and undivided earnings, plus net income or minus net loss).

(b) A [FISCU] may apply to the regional director for a waiver of paragraph (a) of this section up to the amount permitted under the applicable state law or by the state regulator. The waiver request must include:

- (1) Written approval from the state regulator;
- (2) A detailed analysis of the safety and soundness implications of the proposed waiver;
- (3) A proposed aggregate dollar amount or percentage of paid-in and unimpaired capital and surplus limitation; and
- (4) An explanation demonstrating the need to raise the limit.

(c) The regional director will approve the waiver request if the proposed borrowing limit will not adversely affect the safety and soundness of the [FISCU].

[60 FR 58504, Nov. 28, 1995, as amended at 69 FR 8547, Feb. 25, 2004]

### §741.3. Criteria.

In determining the insurability of a credit union which makes application [to be a FISCU] and in continuing [its status as an FISCU], the following criteria shall be applied:

(a) Reserves—

(1) General rule. State-chartered credit unions are subject to **section 216 of the Act, 12 U.S.C. 1790d**, and to **part 702** and **subpart L of part 747 of this chapter**.

(2) Special reserve for nonconforming investments. State-chartered credit unions (except state-chartered corporate credit unions) are required to establish an additional special reserve for investments if those credit unions are permitted by their respective state laws to make investments beyond those authorized in the Act or the NCUA Rules and Regulations. For purposes of this paragraph, if a state-chartered credit union conducts and documents an analysis that reasonably concludes an investment is at least investment grade, as defined in **§703.2 of this chapter**, and the investment is otherwise permissible for Federal credit unions, that investment is not considered to be beyond those authorized by the Act or the NCUA Rules and Regulations. For any investment other than loans to members and obligations or securities expressly authorized in **title I of the Act and part 703 of this chapter**, as amended, state-chartered credit unions (except state-chartered corporate credit unions) are required to establish and maintain at the end of each accounting period and prior to payment of any dividend, an Appropriation for Non-conforming Investments in an amount at least equal to the net excess of book value over current market value of the investments. If the market value cannot be determined, an amount equal to the full book value will be established. When at the end of any dividend period, the amount in the Appropriation for Non-conforming Investments exceeds the difference between book value and market value, the board of directors may authorize the transfer of the excess to Undivided Earnings.

(b) Financial condition and policies. The following factors are to be considered in determining whether the credit union's financial condition and policies are both safe and sound:

(1) The existence of unfavorable trends which may include excessive losses on loans (i.e., losses which exceed the regular reserve or its equivalent [in the case of state-chartered credit unions] plus other irrevocable reserves established as a contingency against losses on loans), the presence of special reserve accounts used specifically for charging off loan balances of deceased borrowers, and an expense ratio so high that the required transfers to reserves create a net operating loss for the period or that the net gain after these transfers is not sufficient to permit the payment of a nominal dividend;

(2) The existence of written lending policies, including adequate documentation of secured loans and the protection of security interests by recording, bond, insurance or other adequate means, adequate determination of the financial capacity of borrowers and co-makers for repayment of the loan, adequate determination of value of security on loans to ascertain that said security is adequate to repay the loan in the event of default, loan workout arrangements, and nonaccrual standards that include the discontinuance of interest accrual on loans past due by 90 days or more and requirements for returning such loans, including member business loans, to accrual status.

(3) Investment policies which are within the provisions of applicable law and regulations, i.e., the Act and part 703 of this chapter for federal credit unions and the laws of the state in which the credit union operates for state-chartered credit unions, except state-chartered corporate credit unions. State-chartered corporate credit unions are permitted to make only those investments that are in conformance with **part 704 of this chapter** and applicable state laws and regulations;



(4) The presence of any account or security, the form of which has not been approved by the Board, except for accounts authorized by state law for state-chartered credit unions.

(5) The existence of a written interest rate risk policy (“IRR policy”) and an effective interest rate risk management program (“effective IRR program”) as part of asset liability management. [FISCU] with assets of more than \$50 million, as measured by the most recent Call Report filing, must adopt a written IRR policy and implement an effective IRR program. **Appendix B to this part 741** provides guidance on how to develop an IRR policy and an effective IRR program. The guidance describes widely accepted best practices in the management of interest rate risk for the benefit of all [FISCU].

(c) Fitness of management. The officers, directors, and committee members of the credit union must have conducted its operations in accordance with provisions of applicable law, regulations, its charter and bylaws. No person shall serve as a director, officer, committee member, or employee of a [FISCU] who has been convicted of any criminal offense involving dishonesty or breach of trust, except with the written consent of the Board.

(d) Insurance of member accounts would not otherwise involve undue risk to the NCUSIF. The credit union must maintain adequate fidelity bond coverage as specified in **§741.201**. Any circumstances which may be unique to the particular credit union concerned shall also be considered in arriving at the determination of whether or not an undue risk to the NCUSIF is or may be present. For purposes of this section, the term “undue risk to the NCUSIF” is defined as a condition which creates a probability of loss in excess of that normally found in a credit union and which indicates a reasonably foreseeable probability of the credit union becoming insolvent because of such condition, with a resultant claim against the NCUSIF.

(e) Powers and purposes. The credit union must not perform services other than those which are consistent with the promotion of thrift and the creation of a source of credit for its members, except as otherwise permitted by law or regulation.

(f) Letter of disapproval. A credit union whose application for share insurance is disapproved shall receive a letter indicating the reasons for such disapproval, a citation of the authority for such disapproval, and suggested methods by which the applying credit union may correct its deficiencies and thereby qualify for share insurance.

(g) Nothing in this section shall preclude the NCUA Board from imposing additional terms or conditions pursuant to the insurance agreement.

[60 FR 58504, Nov. 28, 1995, as amended at 64 FR 41040, July 29, 1999; 65 FR 8593, Feb. 18, 2000; 67 FR 71094, Nov. 29, 2002; 77 FR 32001, May 31, 2012; 77 FR 5162, Feb. 2, 2012; 77 FR 74112, Dec. 13, 2012; 78 FR 4037, Jan. 18, 2013]

## §741.4 Insurance premium and one percent deposit.

(a) Scope. This section implements the requirements of **Section 202 of the Act (12 U.S.C. 1782)** providing for capitalization of the NCUSIF through the maintenance of a deposit by each [FISCU] in an amount equaling one percent of its insured shares and payment of an insurance premium.

(b) Definitions. For purposes of this section:

Available assets ratio means the ratio of:

(i) The amount determined by subtracting all liabilities of the NCUSIF, including contingent liabilities for which no provision for losses has been made, from the sum of cash and the market value of unencumbered investments authorized under **Section 203(c) of the Act (12 U.S.C. 1783(c))**, to:

(ii) The aggregate amount of the insured shares in all [FISCU].

(iii) Shown as an abbreviated mathematical formula, the available assets ratio is:

Equity ratio which shall be calculated using the financial statements of the NCUSIF alone, without any consolidation or combination with the financial statements of any other fund or entity, means the ratio of:

(i) The amount of NCUSIF's capitalization, meaning [FISCUs'] one percent capitalization deposits plus the retained earnings balance of the NCUSIF (less contingent liabilities for which no provision for losses has been made) to:

(ii) The aggregate amount of the insured shares in all [FISCUs].

(iii) Shown as an abbreviated mathematical formula, the equity ratio is:

Insured shares means the total amount of a [FISCU's] share, share draft and share certificate accounts, or their equivalent under state law (which may include deposit accounts), authorized to be issued to members, other credit unions, public units, or nonmembers (where permitted under the Act or equivalent state law), but does not include amounts in excess of insurance coverage as provided in **part 745 of this chapter**. For a credit union or other entity that is not federally insured, "insured shares" means, for purposes of this section only, the amount of deposits or shares that would have been insured by the NCUSIF under **part 745** had the institution been federally insured on the date of measurement.

Modified premium/distribution ratio means one minus the premium/distribution ratio.

Normal operating level means an equity ratio not less than 1.2 percent and not more than 1.5 percent, as established by action of the NCUA Board.

Premium/distribution ratio means the number of full remaining months in the calendar year following the date of the institution's conversion or merger divided by 12.

Reporting period means calendar year for [FISCUs] with total assets of less than \$50,000,000 and means semiannual period for credit union with total assets of \$50,000,000 or more.

(c) One percent deposit. Each [FISCU] must maintain with the NCUSIF during each reporting period a deposit in an amount equaling one percent of the total of the [FISCU's] insured shares at the close of the preceding reporting period. For [FISCU]s with total assets of less than \$50,000,000, insured shares will be measured and adjusted annually based on the insured shares reported in the credit union's 5300 report for December 31 of each year. For [FISCU]s with total assets of \$50,000,000 or more, insured shares will be measured and adjusted semiannually based on the insured shares reported in the [FISCU's] 5300 reports for December 31 and June 30 of each year.

(d) Insurance premium charges—

(1) In general. Each [FISCU] will pay to the NCUSIF, on dates the NCUA Board determines, but not more than twice in any calendar year, an insurance premium in an amount stated as a percentage of insured shares, which will be the same percentage for all insured credit unions.

(2) Relation of premium charge to equity ratio of NCUSIF.

(i) The NCUA Board may assess a premium charge only if the NCUSIF's equity ratio is less than 1.3 percent and the premium charge does not exceed the amount necessary to restore the equity ratio to 1.3 percent.

(ii) If the equity ratio of the NCUSIF falls to between 1.0 and 1.2 percent, the NCUA Board is required to assess a premium in an amount it determines is necessary to restore the equity ratio to at least 1.2 percent, as provided for in the restoration plan adopted under **Section 202(c)(2)(D) of the Act (12 U.S.C. 1782(c)(20)(D))**. If the equity ratio of the NCUSIF falls below 1.0 percent, the NCUA Board is required to assess a deposit replenishment charge in an amount it determines is necessary to restore the equity ratio to 1.0 percent and to assess a premium charge in an amount it determines is necessary to restore the equity ratio to, at least 1.2 percent, as provided for in the restoration plan adopted under **Section 202(c)(2)(D) of the Act (12 U.S.C. 1782(c)(20)(D))**.

(e) Distribution of NCUSIF equity. If, as of the end of a calendar year, the NCUSIF exceeds its normal operating level and its available assets ratio exceeds 1.0 percent, the NCUA Board will make a proportionate distribution of NCUSIF equity to [FISCU]s. The distribution will be the maximum amount possible that does not reduce the NCUSIF's equity ratio below its normal operating level and does not reduce its available assets ratio below 1.0 percent. The distribution will be after the calendar year and in the form determined by the NCUA Board. The form of the distribution may include a waiver of insurance premiums, premium rebates, or distributions from NCUSIF equity in the form of dividends. The NCUA Board will use the aggregate amount of the insured shares from all insured credit unions from the final reporting period of the calendar year in calculating the NCUSIF's equity ratio and available assets ratio for purposes of this paragraph.

(f) Invoices. The NCUA provides invoices to all [FISCU]s stating any change in the amount of a [FISCU's] one percent deposit and the computation and funding of any NCUSIF premium or deposit replenishment assessments due. Invoices for [FISCU]s also include any annual operating fees that are due. Invoices are calculated based on a [FISCU's] insured shares as of the most recently ended reporting period. The invoices may also provide for any distribution the NCUA Board declares in accordance with paragraph (e) of this section, resulting in a single net transfer of funds between a [FISCU] and the NCUA.

(g) New charters. A newly-chartered [FISCU] that obtains share insurance coverage from the NCUSIF during the calendar year in which it has obtained its charter will not be required to pay an insurance premium for that calendar year. The [FISCU] will fund its one percent deposit on a date to be determined by the NCUA Board in the following calendar year, but will not participate in any distribution from NCUSIF equity related to the period prior to the [FISCU's] funding of its deposit.

(h) Depletion of one percent deposit. All or part of the one percent deposit may be used by the NCUSIF if necessary to meet its expenses. The NCUSIF may invoice[FISCU] in an amount necessary to replenish the one percent deposit at any time following the effective date of the depletion.

(i) Conversion to Federal insurance.

(1) A credit union or other institution that converts to insurance coverage with the NCUSIF will:

(i) Immediately fund its one percent deposit based on the total of its insured shares as of the last day of the most recently ended reporting period prior to the date of conversion;

(ii) If the NCUSIF assesses a premium in the calendar year of conversion, pay a premium based on the institution's insured shares as of the last day of the most recently ended reporting period preceding the invoice date times the institution's premium/distribution ratio;

(iii) If the NCUSIF declares, in the calendar year of conversion on or before the date of conversion, an assessment to replenish the one-percent deposit, pay nothing related to that assessment;

(iv) If the NCUSIF declares, at any time after the date of conversion through the end of that calendar year, an assessment to replenish the one-percent deposit, pay a replenishment amount based on the institution's insured shares as of the last day of the most recently ended reporting period preceding the invoice date; and

(v) If the NCUSIF declares a distribution in the year following conversion based the NCUSIF's equity at the end of the year of conversion, receive a distribution based on the institution's insured shares as of the end of the year of conversion times the institution's premium/distribution ratio. With regard to distributions declared in the calendar year of conversion but based on the NCUSIF's equity from the end of the preceding year, the converting institution will receive no distribution.

(2) A [FISCU] that merges with a nonfederally insured credit union or other nonfederally insured institution (the “merging institution”), where the [FISCU] is the continuing institution, will:

(i) Immediately on the date of merger increase the amount of its NCUSIF deposit by an amount equal to one percent of the merging institution's insured shares as of the last day of the merging institution's most recently ended reporting period preceding the date of merger;

(ii) With regard to any NCUSIF premiums assessed in the calendar year of merger, pay a two-part premium, with one part calculated on the merging institution's insured shares as described in paragraph (i)(1)(ii) of this section, and the other part calculated on the continuing institution's insured shares as of the last day of its most recently ended reporting period preceding the date of merger; and

(iii) If the NCUSIF declares a distribution in the year following the merger based the NCUSIF's equity at the end of the year of merger, receive a distribution based on the continuing institution's insured shares as of the end of the year of merger. With regard to distributions declared in the calendar year of merger but based on the NCUSIF's equity from the end of the preceding year, the institution will receive a distribution based on its insured shares as of the end of the preceding year.

(j) Conversion from, or termination of, Federal share insurance.

(1) A [FISCU] whose insurance coverage with the NCUSIF terminates, including through a conversion to, or merger into, a [FISCU] or a noncredit union entity, will:

(i) Receive the full amount of its NCUSIF deposit paid, less any amounts applied to cover NCUSIF losses that exceed NCUSIF retained earnings, immediately after the final date on which any shares of the credit union are NCUSIF-insured;

(ii) If the NCUSIF declares a distribution at the end of the calendar year of conversion, receive a distribution based on the institution's insured shares as of the last day of the most recently ended reporting period preceding the date of conversion times the institution's modified premium/distribution ratio; and

(iii) If the NCUSIF assesses a premium in the calendar year of conversion or merger on or before the day in which the conversion or merger is completed, pay a premium based on the institution's insured shares as of the last day of the most recently ended reporting period preceding the conversion or merger date times the institution's modified premium/distribution ratio. If the institution has previously paid a premium based on this same assessment that exceeds this amount, the institution will receive a refund of the difference following completion of the conversion or merger.

(2) Notwithstanding the requirements of paragraph (j)(1) of this section:

(i) Any insolvent [FISCU] that is closed for involuntary liquidation will not be entitled to a return of its deposit;

(ii) Any solvent [FISCU] that is closed due to voluntary or involuntary liquidation will be entitled to a return of its deposit paid, less any amounts applied to cover NCUSIF losses that exceed NCUSIF retained earnings, prior to final distribution of member shares; and

(iii) The Board reserves the right to delay return of the deposit to any [FISCU] converting from or terminating its federal insurance, or voluntarily liquidating, for up to one year if the Board determines that immediate repayment would jeopardize the NCUSIF.

(k) Assessment of administrative fee and interest for delinquent payment. Each [FISCU] must pay to the NCUA an administrative fee, the costs of collection, and interest on any delinquent payment of its capitalization deposit or insurance premium. A payment will be considered delinquent if it is postmarked or electronically posted later than the date stated in the invoice provided to the credit union. The NCUA may waive or abate charges or collection of interest, if circumstances warrant.

(1) The administrative fee for a delinquent payment shall be an amount as fixed from time to time by the NCUA Board based upon the administrative costs of such delinquent payments to the NCUA in the preceding year.

(2) The costs of collection shall be calculated as the actual hours expended by NCUA personnel multiplied by the average hourly cost of the salaries and benefits of such personnel.

(3) The interest rate charged on any delinquent payment shall be the U.S. Department of the Treasury Tax and loan Rate in effect on the date when the loan payment is due as provided in **31 U.S.C. 3717**.

(4) The Act contains specific penalties and other consequences for delinquent payments, including, but not limited to:

(i) **Section 202(d)(2)(B) of the Act (12 U.S.C. 1782(d)(2)(B))** provides that the Board may assess and collect a penalty from an [FISCU] of not more than \$20,000 for each day the [FISCU] fails or refuses to pay any deposit or premium due to the fund; and

(ii) **Section 202(d)(3) of the Act (12 U.S.C. 1782(d)(3))** provides, generally, that no [FISCU] shall pay any dividends on its insured shares or distribute any of its assets while it remains in default in the payment of its deposit or any premium charge due to the fund. **Section 202(d)(3)** further provides that any director or officer of any [FISCU] who knowingly participates in the declaration or payment of any such dividend or in any such distribution shall, upon conviction, be fined not more than \$1,000 or imprisoned more than one year, or both.

[74 FR 63279, Jan. 4, 2010, as amended at 76 FR 60367, Sept. 29, 2011]

**§741.5 Notice of termination of excess insurance coverage.**

In the event of a [FISCU's] termination of share insurance coverage other than that provided by the NCUSIF, the [FISCU] must notify all members in writing of such termination at least thirty days prior to the effective date of termination.

## **§741.6 Financial and statistical and other reports.**

(a) Upon written notice from the NCUA Board, Regional Director, Director of the Office of Examination and Insurance, or Director of the Office of National Examinations and Supervision, [FISCU]s must file financial and other reports in accordance with the instructions in the notice. [FISCU]s must use NCUA's information management system, or other electronic means specified by NCUA, to submit their data online.

(1) Credit Union Profile. [FISCU]s must submit to NCUA a Credit Union Profile, NCUA Form 4501 or its equivalent, within 10 days after an election or appointment of senior management or volunteer officials or within 30 days of any change of the information in the profile.

(2) Financial and statistical report. Natural person [FISCU]s must file a Call Report with NCUA quarterly in accordance with the instructions in the NCUA Form 5300. Corporate [FISCU]s must file a Corporate Credit Union Call Report with NCUA monthly in accordance with the instructions in the NCUA Form 5310. [FISCU]s must submit a corrected Call Report upon notification or the discovery of a need for correction.

(b) Consistency with GAAP. The accounts of financial statements and reports required to be filed quarterly under paragraph (a) of this section must reflect GAAP if the [FISCU] has total assets of \$10 million or greater, but may reflect regulatory accounting principles other than GAAP if the [FISCU] has total assets of less than \$10 million (except that a [FISCU] may be required by its state credit union supervisor to follow GAAP regardless of asset size).

(c) GAAP sources. GAAP means generally accepted accounting principles, as defined in **§715.2(e) of this chapter**. GAAP is distinct from GAAS, which means generally accepted auditing standards, as defined in **§715.2(f) of this chapter**. Authoritative sources of GAAP include, but are not limited to, pronouncements of the Financial Accounting Standards Board (FASB) and its predecessor organizations, the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA), the FASB's Emerging Issues Task Force (EITF), and the applicable AICPA Audit and Accounting Guide.

[60 FR 58504, Nov. 28, 1995, as amended at 64 FR 41040, July 29, 1999; 67 FR 12464, Mar. 19, 2002; 71 FR 4034, Jan. 25, 2006; 74 FR 35769, July 21, 2009; 78 FR 32545, May 31, 2013; 78 FR 64885, Oct. 30, 2013]



### **§741.7 Conversion to a state-chartered credit union.**

Any federal credit union that petitions to convert to a [FISCU] is required to apply to the Regional Director for continued insurance of its accounts and meet the requirements as stated in the Act and this part. If the application for continued insurance is not approved, such insurance will terminate subject to the conditions set forth in **section 206(d) of the Act.**

## **§741.8 Purchase of assets and assumption of liabilities.**

(a) Any [FISCU] must receive approval from the NCUA before purchasing loans or assuming an assignment of deposits, shares, or liabilities from:

- (1) Any credit union that is not insured by the NCUSIF;
- (2) Any other financial-type institution (including depository institutions, mortgage banks, consumer finance companies, insurance companies, loan brokers, and other loan sellers or liability traders); or
- (3) Any successor in interest to any institution identified in paragraph (a)(1) or (a)(2) of this section.

(b) Approval is not required for:

- (1) Purchases of student loans or real estate secured loans to facilitate the packaging of a pool of loans to be sold or pledged on the secondary market under **§701.23(b)(1)(iii) or (iv) of this chapter** or comparable state law for state-chartered credit unions, or purchases of member loans under **§701.23(b)(1)(i) of this chapter** or comparable state law for state-chartered credit unions;
- (2) Assumption of deposits, shares or liabilities as rollovers or transfers of member retirement accounts or in which a [FISCU] perfects a security interest in connection with an extension of credit to any member.
- (3) Purchases of assets, including loans, or assumptions of deposits, shares, or liabilities by any [FISCU] from another [FISCU], except a purchase or assumption as a part of a merger under **part 708b**; or
- (4) Purchases of loan participations as defined in and meeting the requirements of **§701.22 of this chapter**.

(c) A [FISCU] seeking approval under paragraph (a) of this section must submit a letter to the regional office with jurisdiction for the state where the [FISCU] is headquartered. A corporate [FISCU] seeking approval under paragraph (a) of this section must submit a letter to the Office of National Examinations and Supervision. The letter must request approval and state the nature of the transaction and include copies of relevant transaction documents. The NCUA will make a decision to approve or disapprove the request as soon as possible depending on the complexity of the proposed transaction. [FISCU]s should submit a request for approval in sufficient time to close the transaction.

[70 FR 75725, Dec. 21, 2005, as amended at 75 FR 34622, June 18, 2010; 78 FR 32545, May 31, 2013; 78 FR 37958, June 25, 2013]

## **§741.9 Uninsured membership shares.**

Any [FISCU] may not offer membership shares that, due to the terms and conditions of the account, are not eligible for insurance coverage. This prohibition does not apply to shares that are uninsured solely because the amount is in excess of the maximum insurance coverage provided pursuant to **part 745 of this chapter**

[74 FR 55751, Oct. 29, 2009, as amended at 75 FR 34622, June 18, 2010]

## **§741.10 Disclosure of share insurance.**

Any [FISCU which] is permitted by state law to accept nonmember shares or deposits from sources other than other credit unions and public units (or, for low-income designated credit unions, any nonmembers), shall identify such nonmember accounts as nonmember shares or deposits on any statement or report required by the NCUA Board for insurance purposes. Immediately after a [FISCU] receives notice from NCUA that its member accounts are federally insured, the [FISCU] shall advise any present nonmember share and deposit holders by letter that their accounts are not insured by the NCUSIF. Also, future nonmember share and deposit fund holders will be so advised by letter as they open accounts.

## **§741.11 Foreign branching.**

(a) Application and Prior NCUA Approval Required. Any [FISCU] must apply for and receive approval from the regional director before establishing a credit union branch outside the United States unless the foreign branch is located on a United States military installation or embassy outside the United States. The regional director will have 60 days to approve or deny the request.

(b) Contents of Application. The application must include a business plan, written approval by the state supervisory agency if the applicant is a[FISCU], and documentation evidencing written permission from the host country to establish the branch that explicitly recognizes NCUA's authority to examine and take any enforcement action, including conservatorship and liquidation actions.

(c) Contents of Business Plan. The written business plan must address the following:

- (1) Analysis of market conditions in the area where the branch is to be established;
- (2) The [FISCU's] plan for addressing foreign currency risk;
- (3) Operating facilities, including office space/equipment and supplies;
- (4) Safeguarding of assets, bond coverage, insurance coverage, and records preservation;
- (5) Written policies regarding the branch (shares, lending, capital, charge-offs, collections);
- (6) The field of membership or portion of the field of membership to be served through the foreign branch and the financial needs of the members to be served and services and products to be provided;
- (7) Detailed pro forma financial statements for branch operations (balance sheet and income and expense projections) for the first and second year including assumptions;
- (8) Internal controls including cash disbursement procedures for shares and loans at the branch;
- (9) Accounting procedures used to identify branch activity and performance; and
- (10) Foreign income taxation and employment law.

(d) Revocation of Approval. A state regulator that revokes approval of the branch office must notify NCUA of the action once it issues the notice of revocation. The regional director may revoke approval of the branch office for failure to follow the business plan in a material respect or for substantive and documented safety and soundness reasons. If the regional director revokes the approval, the [FISCU] will have six months from the date of the revocation letter to terminate the operations of the branch. The [FISCU] can appeal this revocation directly to the NCUA Board within 30 days of the date of the revocation letter.

(e) Insurance Coverage. Accounts at foreign branches are insured by the NCUSIF only if denominated in U.S. dollars and only if payable, by the terms of the account agreement, at a U.S. office of the [FISCU]. If the host country requires insurance from its own system, accounts will not be insured by the National Credit Union Share Insurance Fund.

[68 FR 23030, Apr. 30, 2003]

## **§741.12 Liquidity and contingency funding plans.**

(a) Any [FISCU] that has assets of less than \$50 million must maintain a basic written policy that provides a credit union board-approved framework for managing liquidity and a list of contingent liquidity sources that can be employed under adverse circumstances.

(b) Any [FISCU] that has assets of \$50 million or more must establish and document a contingency funding plan (CFP) that meets the requirements of paragraph (d) of this section.

(c) In addition to the requirement specified in paragraph (b) of this section to establish and maintain a CFP, any [FISCU] that has assets of \$250 million or more must establish and document access to at least one contingent federal liquidity source for use in times of financial emergency and distressed economic circumstances. These [FISCU]s must conduct advance planning and periodic testing to ensure that contingent funding sources are readily available when needed. A [FISCU] subject to this paragraph may demonstrate access to a contingent federal liquidity source by:

- (1) Maintaining regular membership in the Central Liquidity Facility (Facility), as described in **part 725 of this chapter**;
- (2) Maintaining membership in the Facility through an Agent, as described in **part 725 of this chapter**; or
- (3) Establishing borrowing access at the Federal Reserve Discount Window by filing the necessary lending agreements and corporate resolutions to obtain credit from a Federal Reserve Bank pursuant to **12 CFR part 201**.

(d) Contingency Funding Plan: A [FISCU] must have a written CFP commensurate with its complexity, risk profile, and scope of operations that sets out strategies for addressing liquidity shortfalls in emergency situations. The CFP may be a separate policy or may be incorporated into an existing policy such as an asset/liability policy, a funds management policy, or a business continuity policy. The CFP must address, at a minimum, the following:

- (1) The sufficiency of the institution's liquidity sources to meet normal operating requirements as well as contingent events;
- (2) The identification of contingent liquidity sources;
- (3) Policies to manage a range of stress environments, identification of some possible stress events, and identification of likely liquidity responses to such events;
- (4) Lines of responsibility within the institution to respond to liquidity events;
- (5) Management processes that include clear implementation and escalation procedures for liquidity events; and
- (6) The frequency that the institution will test and update the plan.

(e) A [FISCU] is subject to the requirements of paragraphs (b) or (c) of this section when two consecutive Call Reports show its assets to be at least \$50 million or \$250 million, respectively. A [FISCU] then has 120 days from the effective date of that second Call Report to meet the greater requirements.

[78 FR 64883, Oct. 30, 2013]

**Subpart B - Regulations Codified Elsewhere in NCUA's Regulations  
as Applying to Federal Credit Unions That Also Apply to Federally  
Insured State-Chartered Credit Unions**

## **§741.201 Minimum fidelity bond requirements.**

(a) Any [FISCU] must possess the minimum fidelity bond coverage stated in **part 713 of this chapter** in order for its application for such insurance to be approved and for such insurance coverage to continue. A [FISCU] whose fidelity bond coverage is terminated shall mail notice of such termination to the Regional Director not less than 35 days prior to the effective date of such termination.

(b) Corporate [FISCU]s must comply with **§704.18 of this chapter** in lieu of part 713 of this chapter.

[60 FR 58504, Nov. 28, 1995, as amended at 64 FR 28721, May 27, 1999; 70 FR 61716, Oct. 26, 2005]



## **§741.202 Audit and verification requirements.**

(a) The supervisory committee of each [FISCU] shall make or cause to be made an audit of the credit union at least once every calendar year covering the period elapsed since the last audit. The audit must fully meet the applicable requirements set forth in **part 715 of this chapter** or applicable state law, whichever requirement is more stringent.

(b) Each [FISCU] shall verify or cause to be verified, under controlled conditions, all passbooks and accounts with the records of the financial officer not less frequently than once every 2 years. The verification must fully meet the requirements set forth in **§715.8 of this chapter**.

[60 FR 58504, Nov. 28, 1995, as amended at 64 FR 41040, July 29, 1999]

### **§741.203 Minimum loan policy requirements.**

Any [FISCU] must:

- (a) Adhere to the requirements stated in **part 723 of this chapter** concerning member business loans, **§701.21(c)(8)** of this chapter concerning prohibited fees, and **§701.21(d)(5) of this chapter** concerning nonpreferential loans. [FISCU]s in a given state are exempt from these requirements if the state supervisory authority for that state adopts substantially equivalent regulations as determined by the NCUA Board or, in the case of the member business loan requirements, if the state supervisory authority adopts member business loan regulations that are approved by the NCUA Board pursuant to **§723.20**. In nonexempt states, all required NCUA reviews and approvals will be handled in coordination with the state credit union supervisory authority; and
- (b) Adhere to the requirements stated in **part 722 of this chapter** concerning appraisals.
- (c) Adhere to the requirements stated in **§701.21(h) of this chapter** concerning third-party servicing of indirect vehicle loans. Before a state-chartered credit union applies to a regional director for a waiver under **§701.21(h)(2)**, it must first notify its state supervisory authority. The regional director will not grant a waiver unless the appropriate state official concurs in the waiver. The 45-day period for the regional director to act on a waiver request, as described **§701.21(h)(3)**, will not begin until the regional director has received the state official's concurrence and any other necessary information.

[60 FR 58504, Nov. 28, 1995, as amended at 63 FR 51802, Sept. 29, 1998; 64 FR 28733, May 27, 1999; 71 FR 36667, June 28, 2006]

Link to amendment published at **81 FR 13559** (Effective date: January 1, 2017)

## **§741.204 Maximum public unit and nonmember accounts, and low-income designation.**

Any [FISCU], or [credit union] that makes application [to be a FISCU] must:

(a) Adhere to the requirements of **§701.32 of this chapter** regarding public unit and nonmember accounts, provided it has the authority to accept such accounts. Requests by [FISCU]s for an exemption from the limitation of **§701.32 of this chapter** will be made and reviewed on the same basis as that provided in **§701.32 of this chapter** for federal credit unions, provided, however that NCUA will not grant an exemption without the concurrence of the appropriate state regulator.

(b) Obtain a low-income designation in order to accept nonmember accounts, other than from public units or other credit unions, provided it has the authority to accept such accounts under state law. The state regulator shall make the low-income designation with the concurrence of NCUA. The designation will be made and reviewed by the state regulator on the same basis as that provided in **§701.34(a) of this chapter** for federal credit unions. Removal of the designation by the state regulator for such credit unions shall be with the concurrence of NCUA.

(c) Receive secondary capital accounts only if the credit has a low-income designation pursuant to paragraph (b) of this section, and then only in accordance with the terms and conditions authorized for Federal credit unions pursuant to **§701.34(b)(1)** of this chapter and to the extent not inconsistent with applicable state law and regulation. [FISCU]s offering secondary capital accounts must submit the plan required by **§701.34(b)(1)** to both the state supervisory authority and the NCUA for approval. The state supervisory authority must approve or disapprove the plan with the concurrence of NCUA.

(d) Redeem secondary capital accounts only in accordance with the terms and conditions authorized for federal credit unions pursuant to **§701.34(d)** of this chapter and to the extent not inconsistent with applicable state law and regulation. [FISCU]s seeking to redeem secondary capital accounts must submit the request required by **§701.34(d)(1)** to both the state supervisory authority and the NCUA. The state supervisory authority must grant or deny the request with the concurrence of NCUA.

[60 FR 58504, Nov. 28, 1995, as amended at 61 FR 3792, Feb. 2, 1996; 71 FR 4240, Jan. 26, 2006; 78 FR 4032, Jan. 18, 2013]

## **§741.205 Reporting requirements for credit unions that are newly chartered or in troubled condition.**

Any [FISCU] chartered for less than 2 years or any credit union defined to be in troubled condition as set forth in **§701.14(b)(3) of this chapter** must adhere to the requirements stated in **§701.14(c)** of this chapter concerning the prior notice and NCUA review. [FISCUs] must submit required information to both the appropriate NCUA Regional Director and their state supervisor. NCUA will consult with the state supervisor before making its determination. NCUA will notify the state supervisor of its approval/disapproval no later than the time that it notifies the affected individual.

[60 FR 58504, Nov. 28, 1995, as amended at 78 FR 4029, Jan. 18, 2013]

**§741.206 Corporate credit unions.**

Any corporate [FISCU] shall adhere to the requirements of **part 704 of this chapter**.

**§741.207 Community development revolving loan program for credit unions.**

Any [FISCU which] is a “participating credit union,” as defined in **§705.2 of this chapter**, shall adhere to the requirements stated in **part 705 of this chapter**.

[60 FR 58504, Nov. 28, 1995, as amended at 76 FR 67591, Nov. 2, 2011]

**§741.208 Mergers of federally insured credit unions: voluntary termination or conversion of insured status.**

Any [FISCU] which merges with another credit union or non-credit union institution, and any state-chartered credit union which voluntarily terminates its status as a federally-insured credit union, or converts from federal insurance to other insurance from a government or private source authorized to insure member accounts, shall adhere to the applicable requirements stated in **section 206 of the Act** and **parts 708a and 708b of this chapter** concerning mergers and voluntary termination or conversion of insured status.

## **§741.209 Management official interlocks.**

Any [FISCU] shall adhere to the requirements stated in **part 711 of this chapter** concerning management official interlocks, issued under the provisions of the Depository Institution Management Interlocks Act (12 U.S.C. 3201 et seq.).



**§741.210 Central liquidity facility.**

Any [FISCU which] is a member of the Central Liquidity Facility, shall adhere to the requirements stated in **part 725 of this chapter.**

## **§741.211 Advertising.**

Any [FISCU] shall adhere to the requirements prescribed by **part 740 of this chapter**.

### Special Notes:

- **Part 740** refers to the advertising provisions of **section 707.8**.

**§741.212 Share insurance.**

(a) Member share accounts received by any[FISCU] in its usual course of business, including regular shares, share certificates, and share draft accounts, are insured subject to the limitations and rules in **subpart A of part 745 of this chapter**.

(b) The payment of share insurance and the appeal process applicable to any [FISCU] are addressed in **subpart B of part 745 of this chapter**.

**§741.213 Administrative actions, adjudicative hearings, rules of practice and procedure.**

Any [FISCU] shall adhere to the applicable rules of practice and procedures for administrative actions and adjudicative hearings prescribed by **part 747 of this chapter**. **Subpart E of part 747 of this chapter** applies only to federal credit unions.

**§741.214 Report of crime or catastrophic act and Bank Secrecy Act compliance.**

Any [FISCU] shall adhere to the requirements stated in **part 748 of this chapter**.

Special Notes:

- **Appendices A and B to part 748** provide helpful guidance for compliance with this provision.

## **§741.215 Records preservation program.**

Any [FISCU] shall maintain a records preservation program as prescribed by **part 749 of this chapter**.

### Special Notes:

- **Part 749 of this chapter** uses the defined term “catastrophic act.” The definition, found in **section 748.1**, is as follows:

A catastrophic act is any disaster, natural or otherwise, resulting in physical destruction or damage to the credit union or causing an interruption in vital member services, as defined in **§749.1 of this chapter**, projected to last more than two consecutive business days. Within a reasonable time after a catastrophic act occurs, the credit union shall ensure that a record of the incident is prepared and filed at its main office. In the preparation of such record, the credit union should include information sufficient to indicate the office where the catastrophic act occurred; when it took place; the amount of the loss, if any; whether any operational or mechanical deficiency(ies) might have contributed to the catastrophic act; and what has been done or is planned to be done to correct the deficiency(ies).

**§741.216 Flood insurance.**

Any [FISCU] shall adhere to the requirements stated in **part 760 of this chapter**.

## **§741.217 Truth in savings.**

Any [FISCU] shall adhere to the requirements stated in **part 707 of this chapter**.

### Special Notes:

- **Appendix C to part 707 of this chapter** provides official NCUA staff interpretations, which may be helpful for compliance with this provision.



## **§741.218 Involuntary liquidation and creditor claims.**

Any [FISCU] shall adhere to the applicable provisions in **part 709 of this chapter**. **Section 709.3 of this chapter** applies only to federal credit unions.

### Special Notes:

- **Part 709** uses the defined term “insolvency.” The definition, found in section **700.2 of this chapter**, is as follows:

Insolvency.

(1) A credit union will be determined to be insolvent when the total amount of its shares exceeds the present cash value of its assets after providing for liabilities unless:

- (i) It is determined by the Board that the facts that caused the deficient share-asset ratio no longer exist; and
- (ii) The likelihood of further depreciation of the share-asset ratio is not probable; and
- (iii) The return of the share-asset ratio to its normal limits within a reasonable time for the credit union concerned is probable; and
- (iv) The probability of a further potential loss to the insurance fund is negligible.

(2) For purposes of this section, the following definitions are used:

- (i) Cash value of assets. Recorded value will be considered the cash value of any asset account providing accepted accounting principles and practices are followed and the provisions of law, regulation, and bylaws are met.
- (ii) Liabilities. Recorded liabilities which are due and payable, excluding shares of members and non-members, are considered liabilities.

## **§741.219 Investment requirements.**

(a) Any [FISCU] must adhere to the requirements stated in **part 703 of this chapter** concerning transacting business with corporate credit unions.

(b) Any [FISCU] must notify the applicable NCUA Regional Director or the Director of the Office of National Examinations and Supervision in writing at least 30 days before it begins engaging in derivatives.

[79 FR 5247, Jan. 31, 2014]

## **§741.220 Privacy of consumer financial information.**

Any [FISCU] must adhere to the requirements stated in **part 1016 of this title (Regulation P)**.

[65 FR 31750, May 18, 2000, as amended at 78 FR 32545, May 31, 2013]

### Special Notes:

- **Regulation P** applies to a variety of financial institutions, not just credit unions. Accordingly, some of its provisions may not apply to FISCUs.

## **§741.221 Suretyship and guaranty requirements.**

Any [FISCU] must adhere to the requirements in **§701.20 of this chapter**. [FISCUs] may only enter into suretyship and guaranty agreements to the extent authorized under state law.

[69 FR 8548, Feb. 25, 2004]

### Special Notes:

- **Section 701.20** notes that a suretyship or guaranty agreement must comply with, among other requirements, the following sections of this chapter: **701.21(c)(5), 701.21(d), 723.2 and 723.8**. However, **section 701.20** requires compliance only with the “applicable lending regulations” under these cross-referenced sections. In some cases, the cross-referenced regulations will not be applicable.

## **§741.222 Credit union service organizations.**

(a) Any [FISCU] must adhere to the requirements in §§**712.2(d)(2)(ii), 712.3(d), 712.4 and 712.11(b) and (c) of this chapter** concerning permissible investment limits for less than adequately capitalized credit unions, agreements between credit unions and their credit union service organizations (CUSOs), the requirement to maintain separate corporate identities, and investments and loans to CUSOs investing in other CUSOs. For purposes of this section, a CUSO is any entity in which a credit union has an ownership interest or to which a credit union has extended a loan, and that entity is engaged primarily in providing products or services to credit unions or credit union members, or, in the case of checking and currency services, including cashing checks and money orders for a fee, and selling negotiable checks, including travelers checks, money orders, and other similar money transfer instruments (including international and domestic electronic fund transfers and remittance transfers, as defined in **section 919 of the Electronic Fund Transfer Act, 15 U.S.C. 1693o-1**), to persons eligible for membership in any credit union having a loan, investment or contract with the entity. A CUSO also includes any entity in which a CUSO has an ownership interest of any amount, if that entity is engaged primarily in providing products or services to credit unions or credit union members.

(b) This section shall have no preemptive effect with respect to the laws or rules of any state providing for access to CUSO books and records or CUSO examination by credit union regulatory authorities.

[78 FR 72550, Dec. 3, 2013]

**§741.223 Registration of residential mortgage loan originators.**

Any [FISCU] must adhere to the requirements stated in **part 1007 of this title (Regulation G)**.

[75 FR 44704, July 28, 2010, as amended at 78 FR 32545, May 31, 2013]

**§741.224 Golden parachute and indemnification payments.**

Any[FISCU] must adhere to the requirements stated in **part 750 of this chapter**.

[76 FR 30517, May 26, 2011]

## **§741.225 Loan participations.**

Any [FISCU] must adhere to the requirements stated in **§701.22 of this chapter**, except that federally insured, state-chartered credit unions are exempt from the requirement in **§701.22(b)(4)**.

[78 FR 37958, June 25, 2013]

### Special Notes:

- Please see **NCUA Legal Opinion 15-0813** for more guidance on loan participations in indirect loans.



## **Appendix A to Part 741—Examples of Partial-Year NCUSIF Assessment and Distribution Calculations Under §741.4**

The following examples illustrate the calculation of deposit and premium assessments under each circumstance addressed in paragraphs (i) and (j) of §741.4.

### A. Direct Conversion to NCUSIF Insurance

1. Paragraph (i)(1)(i) provides that a credit union or other institution that converts to insurance coverage with the NCUSIF will immediately fund its one percent deposit based on the total of its insured shares as of the last day of the most recently ended reporting period prior to the date of conversion.

i. The following hypothetical illustrates the application of this provision. Assume Main Street Credit Union completes its conversion from nonfederal to federal insurance on May 15 of Year One. Assume further that Main Street credit union had 1,000 insured shares for the end of month in December of the previous year (Year zero), 1,100 insured shares for at the end of May, the month of conversion, and 1,200 insured shares at the end of June. This information is presented in this Table A:<sup>1</sup>

Table A

	<b>End of month, December, year zero</b>	<b>End of month, May, year one (month conversion completed)</b>	<b>End of month, June, year one</b>
Main Street Credit Union's Federally Insured Shares	1,000	1,100	1,200

ii. Paragraph (i)(1)(i) requires that on the date of its conversion, Main Street fund its one percent deposit based on “the total of its insured shares as of the last day of the most recently ended reporting period prior to the date of conversion.” Since Main Street has less than \$50,000,000 in assets, its reporting period is annual, and ends on December 31. 12 CFR 741.4(b)(6) (definition of “reporting period”). Main Street had \$1,000 in insured shares on that date, and one percent of that is \$10, and so that is the amount Main Street must immediately remit to the NCUSIF to establish its one percent deposit.

2. Paragraph (i)(1)(ii) provides that a credit union or other institution that converts to insurance coverage with the NCUSIF will, if the NCUSIF assesses a premium in the calendar year of conversion, pay a premium based on the institution's insured shares as of the last day of the most recently ended reporting period preceding the invoice date times the institution's premium/distribution ratio \* \* \*.

i. To illustrate the application of paragraph (i)(1)(ii), take the same facts in hypothetical A related to the conversion of Main Street from nonfederal to federal insurance. Now, further assume that on the previous March 15, NCUA had declared a premium assessment, and on September 15 following the conversion NCUA sent out the invoices for the March 15 assessment. Also assume that Main Street had grown to 1,300 insured shares at the end of September, the month the invoices were sent to Main Street and other credit unions. This information is presented in this Table B:

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<sup>1</sup> Although Main Street Credit Union was not federally insured as of December 31 of Year Zero, proposed §741.4(b)(3) provides that “For a credit union or other entity that is not federally insured, ‘insured shares’ means, for purposes of this section only, the amount of deposits or shares that would have been insured by the NCUSIF under part 745 had the institution been federally insured on the date of measurement.”

Table B

	<b>End of month, December, year zero</b>	<b>End of month, May, year one (month conversion completed)</b>	<b>End of month, June, year one</b>	<b>End of month, September, year one (month invoice sent)</b>
Main Street Credit Union's Federally Insured Shares	1,000	1,100	1,200	1,300

ii. Paragraph (i)(1)(ii) requires Main Street pay a premium based on the institution's "insured shares as of the last day of the most recently ended reporting period preceding the invoice date times the institution's premium/distribution ratio." Again, because Main Street is under \$50 million in assets, the most recently ended reporting period preceding the September 15 invoice date is all the way back to December of Year Zero, when Main Street had \$1,000 in shares. Main Street's "premium/distribution ratio," as defined in §741.4(b)(5), is "the number of full remaining months in the calendar year following the date of the institution's conversion or merger divided by 12." Since Main Street completed its conversion in May, there are seven full months remaining in the calendar year (June through December), and Main Street's premium/distribution ratio is seven divided by 12. Accordingly, Main Street's premium will be assessed on \$1,000 times seven divided by 12, or about \$583.<sup>2</sup> Note that if Main Street's assets had exceeded \$50 million as of June 30, it would have had semiannual reporting periods under §741.4(b)(6), and its "insured shares as of the last day of the most recently ended reporting period preceding the invoice date" would have been its insured shares as of June 30, Year One, and not as of December 31, Year Zero.

3. Paragraphs (i)(1)(iii) and (iv) describe the responsibility of a credit union or other entity converting to federal insurance to replenish a depleted NCUSIF deposit, as follows: A credit union or other institution that converts to insurance coverage with the NCUSIF will, if the NCUSIF declares, in the calendar year of conversion but on or before the date of conversion, an assessment to replenish the one-percent deposit, pay nothing related to that assessment; if the NCUSIF declares, at any time after the date of conversion through the end of that calendar year, an assessment to replenish the one-percent deposit, pay a replenishment amount based on the institution's insured shares as of the last day of the most recently ended reporting period preceding the invoice date.

i. Paragraph (i)(1)(iii) clarifies that a converting credit union has no responsibility to pay anything toward the replenishment of a depleted deposit that is declared on or before the date of conversion, even if NCUA sends out invoices related to the depletion after the date of conversion. Paragraph (i)(1)(iv) requires that a converting credit union replenish its deposit with regard to a depletion declared after the date of conversion through the end of the calendar year. Again, assume the same facts for Main Street as in Table B, but that the deposit depletion was announced in June, after Main Street converted, and that NCUA sent the invoices in September.

Table B

	<b>End of month, December, year zero</b>	<b>End of month, May, year one (month conversion completed)</b>	<b>End of month, June, year one</b>	<b>End of month, September, year one (month invoice sent)</b>
Main Street Credit Union's Federally Insured Shares	1,000	1,100	1,200	1,300

<sup>2</sup> Main Street's actual premium charge will be this \$583 divided by the aggregate insured shares of all federally insured credit unions times the aggregate premium for all federally insured credit unions.

ii. Main Street would receive an invoice amount “based on the [Main Street's] insured shares as of the last day of the most recently ended reporting period preceding the invoice date.” Since Main Street has less than \$50 million in shares, the most recently ended reporting period preceding the September invoice date was December 31, Year Zero, and it would pay for the replenishment based on \$1,000 in insured shares. If Main Street, however, had had \$50 million or more in assets on June 30, its most recently ended reporting period preceding the invoice date would have been the semiannual period ending on June 30, and Main Street would have used its insured shares as of June 30 to calculate the replenishment amount due to the NCUSIF.

4. Under the Federal Credit Union Act, distributions, if any, are declared once a year, early in the year, based on excess funds in the NCUSIF as of the prior December 31. Paragraph (i)(1)(v) describes the right of a credit union or other entity converting to federal insurance to receive a distribution from the NCUSIF, specifically: A credit union or other institution that converts to insurance coverage with the NCUSIF will, if the NCUSIF declares a distribution in the year following conversion based the NCUSIF's equity at the end of the year of conversion, receive a distribution based on the institution's insured shares as of the end of the year of conversion times the institution's premium/distribution ratio. With regard to distributions declared in the calendar year of conversion but based on the NCUSIF's equity at the end of the preceding year, the converting institution will receive no distribution.

i. To illustrate how paragraph (i)(1)(v) works, assume that Main Street Credit Union converts to federal insurance in May of Year One, and that the NCUA declares a distribution in January of Year Two based on the NCUSIF equity as of December 31 of Year One. Then Main Street will be entitled to a pro rata portion of the distribution, calculated on its insured shares as of December 31 of Year One times its premium/distribution ratio. Since it converted in May of Year One, and there were seven full months remaining in Year One at on the date of conversion, Main Street's premium/distribution ratio under §741.4(b)(6) equals seven divided by 12.

ii. On the other hand, if the NCUA declared a distribution a year earlier, that is, in January of Year One based on the NCUSIF's equity ratio as of December 31 in Year Zero, then under paragraph (i)(1)(v) Main Street would receive no part of this distribution. Main Street is not entitled to any part of this distribution because Main Street, which completed its conversion in Year One, did not contribute in any way to the excess funds in the NCUSIF as of the end of Year Zero.

**B. Conversion to NCUSIF Coverage Through Merger with a Federally Insured Credit Union.**

Paragraph (i)(2) addresses the NCUSIF premiums, deposit replenishments, and distribution calculations when a nonfederally insured credit union or entity converts to NCUSIF coverage by merging with a federally insured credit union.

1. Paragraph (i)(2)(i) provides that a federally-insured credit union that merges with a nonfederally-insured credit union or other non-federally insured institution (the “merging institution”), where the federally-insured credit union is the continuing institution, will immediately on the date of merger increase the amount of its NCUSIF deposit by an amount equal to one percent of the merging institution's insured shares as of the last day of the merging institution's most recently ended reporting period preceding the date of merger.

i. To illustrate this provision, and the other provisions of paragraph (i)(2) related to mergers of nonfederally insured entities into federally-insured credit unions, consider the following hypothetical. Nonfederally-insured Credit Union A merges into federally-insured Credit Union B on August 15 of Year One. The relevant insured shares of Credit Union A and Credit Union B at various dates before and after the merger are reflected in Table D:

Table D

	<b>End of month</b>	<b>End of month</b>	<b>End of month August,</b>	<b>End of Month September,</b>
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	December, year zero	June, year one	year one (month merger completed)	year one (month invoice sent)
Credit Union A Insured shares	1,000	1,100	N/A	N/A
Credit Union B Insured shares	9,000	9,900	12,900	14,000

ii. Paragraph (i)(2)(i) requires that Credit Union B, the continuing credit union, immediately increase the amount of its deposit with the NCUSIF in an amount “equal to one percent of the merging institution's insured shares as of the last day of the merging institution's most recently ended reporting period preceding the date of merger.” Since Credit Union A, the merging institution, has less than \$50 million in assets, its reporting period is the calendar year, and its most recently ended reporting period preceding the August merger date is December 31 in Year Zero. Credit Union A had \$1,000 in insured shares on that date. Accordingly, Credit Union B, the continuing credit union, must immediately increase the amount of its deposit with the NCUSIF by one percent of \$1,000, or \$10. Note that if Credit Union A had been a larger credit union, with \$50 million or more in assets on June 30 in Year One, then Credit Union B would have used Credit Union A's insured shares as of June 30 in this calculation.

2. Paragraph (i)(2)(ii), relating to NCUSIF premium assessments, provides that the continuing institution will, with regard to any NCUSIF premiums assessed in the calendar year of merger, pay a two-part premium, with one part calculated on the merging institution's insured shares as described in subparagraph (1)(ii) above, and the other part calculated on the continuing institution's insured shares as of the last day of its most recently ended reporting period preceding the date of merger.

i. Paragraph (i)(2)(ii) provides for a two-part calculation, with the first part relating to the merging credit union and the second part relating to the continuing credit union. Assuming the facts as in Table D, and assuming the premium is assessed sometime in Year One, calculate the insured shares of Credit Union A, the merging credit union, as in the example for paragraph (i)(1)(ii). Once again, because Credit Union A is under \$50 million in assets, the most recently ended reporting period preceding the invoice date is December of Year Zero, when Credit Union A had \$1,000 in shares. The merger was completed in August, leaving four full months in the calendar year, so the premium/distribution ratio is four divided by 12. Accordingly, this part of the premium will be assessed on \$1,000 times four divided by 12, or about \$333. Then calculate the insured shares of Credit Union B, the continuing credit union, “as of the last day of its most recently ended reporting period preceding the merger date.” Since Credit Union B is also under \$50 million in assets, “the last day of the most recently ended reporting period” is also December 31 of Year Zero. Credit Union B's insured shares on that date were \$9,000, and so the combined insured shares for purposes of the premium assessment is \$9,333. Note that if Credit Union B had \$50 million or more in assets on June 30 of Year One, then Credit Union B's “most recently ended reporting period preceding the merger date” would have been June 30 of Year One, and not December 31 of Year Zero. The Board is aware that the NCUA might declare a NCUSIF premium, invoice it, and receive the premiums in Year One from the continuing institution before the continuing institution consummates its merger. In that case, the Board would invoice the continuing credit union again after the merger, but only for the difference between the amount previously invoiced and the amount calculated under paragraph (i)(2)(ii).

3. Paragraph (i)(2)(iii) prescribes the procedures for calculating the NCUSIF distribution when a nonfederally insured credit union or entity merges into a federally insured credit union. Paragraph (i)(2)(iii) provides that the federally insured credit union will, if the NCUSIF declares a distribution in the year following the merger based on the NCUSIF's equity at the end of the year of merger, receive a distribution based on the continuing institution's insured shares as of the end of the year of merger. With regard to distributions declared in the calendar year of

merger but based on the NCUSIF's equity from the end of the preceding year, the institution will receive a distribution based on its insured shares as of the end of the preceding year.

i. This formula recognizes that the merging institution did not contribute to the NCUSIF equity as of the end of the year preceding the merger and so no distribution is allotted against the merging institution's shares. As for distributions based on the NCUSIF equity at the end of the year of merger, this formula does not include any pro rata reduction for the merging institution's contribution. The Board determined that a pro rata reduction was unnecessary, given the generally small relative size of merging institutions to continuing institutions, and the fact that the Federal Credit Union Act does not require any sort of pro rata reduction or other pro rata calculation with regard to distributions.

#### C. Conversion from, or termination of, Federal share insurance.

Paragraph (j)(1) addresses direct insurance conversions and conversions by merger. Paragraph (j)(2) addresses liquidations and insurance termination.

1. Paragraph (j)(1)(i) provides that a federally insured credit union whose insurance coverage with the NCUSIF terminates, including through a conversion to, or merger into, a nonfederally insured credit union or a noncredit union entity, will receive the full amount of its NCUSIF deposit paid, less any amounts applied to cover NCUSIF losses that exceed NCUSIF retained earnings, immediately after the final date on which any shares of the credit union are NCUSIF-insured.

i. To illustrate the application of this paragraph (j)(1)(i), consider the following hypothetical. Assume Anytown Credit Union, a credit union with \$30 million in assets, converts from federal to nonfederal insurance on November 15. Also assume Anytown Credit Union had \$20 million in insured shares as of the previous December 31, the end of its most recent reporting period. 12 CFR 741.4(b)(5), (c). The NCUSIF would return one-percent of \$20 million, or \$200,000 to Anytown Credit Union immediately following the effective date of its conversion. Note that, if Anytown Credit Union had reported \$50 million or more in assets on June 30, then June 30 would have been the end of its most recent reporting period. Now further assume that, on July 15 of that same year, the NCUSIF had announced an expense that reduced the equity ratio from 1.3 to .75, which would have included a write-off (depletion) of 25%, or 25 basis points, of the one-percent deposit. The amount of the deposit returned to Anytown would be reduced by 25%, from \$200,000 to \$150,000. If the NCUSIF had announced expenses reducing the equity ratio to .75 after the November 15 conversion date, this announcement would have no effect on Anytown and it would still receive the full \$200,000 from the NCUSIF.

2. Paragraph (j)(1)(ii) provides that a federally insured credit union whose insurance coverage with the NCUSIF terminates, including through a conversion to, or merger into, a nonfederally insured credit union or a noncredit union entity, will, if the NCUSIF declares a distribution at the end of the calendar year of conversion, receive a distribution based on the institution's insured shares as of the last day of the most recently ended reporting period preceding the date of conversion times the institution's modified premium/distribution ratio.

i. To illustrate the application of this paragraph (j)(1)(ii), again assume Anytown Credit Union converts to nonfederal insurance on November 15, and in January of the following year, the NCUSIF declares a distribution based on the NCUSIF's equity ratio as of December 31. Anytown would receive a pro rata distribution calculated as its \$20 million in insured shares multiplied by the modified premium/distribution ratio. Anytown's modified premium/distribution ratio, from the definition in §741.4(b)(5), is one minus Anytown's premium/distribution ratio, which is one minus the ratio of the full number of months remaining in the year divided by twelve, which is one minus (one divided by twelve), which is eleven divided by twelve. So Anytown would receive a pro rata distribution based on \$20 million of insured shares times eleven-twelfths, or based on about \$18.33 million in shares.<sup>3</sup>

3 Anytown's actual distribution would be \$18.33 million times the aggregate amount of the distribution divided by the aggregate amount of all insured shares at all federally insured credit unions.

3. Paragraph (j)(1)(iii) provides that a federally insured credit union whose insurance coverage with the NCUSIF terminates, including through a conversion to, or merger into, a nonfederally insured credit union or a noncredit union entity, will, if the NCUSIF assesses a premium in the calendar year of conversion or merger on or before the day in which the conversion or merger is completed, pay a premium based on the institution's insured shares as of the last day of the most recently ended reporting period preceding the conversion or merger date times the institution's modified premium/distribution ratio. If the institution has previously paid a premium based on this same assessment that exceeds this amount, the institution will receive a refund of the difference following completion of the conversion or merger.

i. To illustrate these premium provisions, again assume Anytown Credit Union is a credit union with \$30 million in assets that converts from federal to nonfederal insurance on November 15 of Year One, and that Anytown Credit Union had \$20 million in insured shares as of the previous December 31 (of Year Zero), the end of its most recent reporting period. Further assume that NCUA declares a premium on February 12 of Year One and invoices the premium on November 15. Since the premium was declared “on or before the day in which [Anytown's] conversion [was] completed,” §741.4(j)(1)(iii) applies. Anytown would then pay a premium based on \$20 million (its “insured shares as of the last day of the most recently ended reporting period preceding the conversion or merger date”) times eleven-twelfths (its “modified premium/distribution ratio”), or based on about \$18.33 million. Note that NCUA might have already have invoiced Anytown for the premium sometime between February 12 and Anytown's merger on November 15. If so, Anytown will likely receive a refund of some of this earlier premium, as provided in the last sentence of §741.1(j)(1)(iii), since it may have overpaid the earlier premium.

[74 FR 63281, Dec. 3, 2009]

# **Appendix B to Part 741—Guidance for an Interest Rate Risk Policy and an Effective Program**

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#### I. Introduction

This appendix provides guidance to FICUs in developing an interest rate risk (IRR) policy and program that addresses aspects of asset liability management in a single framework. An effective IRR management program identifies, measures, monitors, and controls IRR and is central to safe and sound credit union operations. Given the differences among credit unions, each credit union should use the guidance in this appendix to formulate a policy that embodies its own practices, metrics and benchmarks appropriate to its operations.

These practices should be established in light of the nature of the credit union's operations and business, as well as its complexity, risk exposure, and size. As these elements increase, NCUA believes the IRR practices should be implemented with increasing degrees of rigor and diligence to maintain safe and sound operations in the area of IRR management. In particular, rigor and diligence are required to manage complexity and risk exposure. Complexity relates to the intricacy of financial instrument structure, and to the composition of assets and liabilities on the balance sheet. In the case of financial instruments, the structure can have numerous characteristics that act simultaneously to affect the behavior of the instrument. In the case of the balance sheet, which contains multiple

instruments, assets and liabilities can act in ways that are compounding or can be offsetting because their impact on the IRR level may act in the same or opposite directions. High degrees of risk exposure require a credit union to be diligently aware of the potential earnings and net worth exposures under various interest rate and business environments because the margin for error is low.

#### A. Complexity

In influencing the behavior of instruments and balance sheet composition, complexity is a function of the predictability of the cash flows. As cash flows become less predictable, the uncertainty of both instrument and balance sheet behavior increases. For example, a residential mortgage is subject to prepayments that will change at the option of the borrower. Mortgage borrowers may pay off their mortgage loans due to geographical relocation, or may increase the amount of their monthly payment above the minimum contractual schedule due to other changes in the borrower's circumstances. This cash flow unpredictability is also found in investments, such as collateralized mortgage obligations, because these contain mortgage loans. Additionally, cash flow unpredictability affects liabilities. For example, nonmaturity share balances vary at the discretion of the depositor making deposits and withdrawals, and this may be influenced by a credit union's pricing of its share accounts.

#### B. IRR Exposure

Exposure to IRR is the vulnerability of a credit union's financial condition to adverse movements in market interest rates. Although some IRR exposure is a normal part of financial intermediation, a high degree of this exposure may negatively affect a credit union's earnings and net economic value. Changes in interest rates influence a credit union's earnings by altering interest-sensitive income and expenses (e.g. loan income and share dividends). Changes in interest rates also affect the economic value of a credit union's assets and liabilities, because the present value of future cash flows and, in some cases, the cash flows themselves may change when interest rates change. Consequently, the management of a credit union's pricing strategy is critical to the control of IRR exposure.

All FICUs required to have an IRR policy and program should incorporate the following five elements into their IRR program:

1. Board-approved IRR policy.
2. Oversight by the board of directors and implementation by management.
3. Risk measurement systems assessing the IRR sensitivity of earnings and/or asset and liability values.
4. Internal controls to monitor adherence to IRR limits.
5. Decision making that is informed and guided by IRR measures.

#### II. IRR Policy

The board of directors is responsible for ensuring the adequacy of an IRR policy and its limits. The policy should be consistent with the credit union's business strategies and should reflect the board's risk tolerance, taking into account the credit union's financial condition and risk measurement systems and methods commensurate with the balance sheet structure. The policy should state actions and authorities required for exceptions to policy, limits, and authorizations.

Credit unions have the option of either creating a separate IRR policy or incorporating it into investment, ALM, funds management, liquidity or other policies. Regardless of form, credit unions must clearly document their IRR policy in writing.



The scope of the policy will vary depending on the complexity of the credit union's balance sheet. For example, a credit union that offers short-term loans, invests in non-complex or short-term bullet investments (i.e. a debt security that returns 100 percent of principal on the maturity date), and offers basic share products may not need to create an elaborate policy. The policy for these credit unions may limit the loan portfolio maturity, require a minimum amount of short-term funds, and restrict the types of permissible investments (e.g. Treasuries, bullet investments). More complex balance sheets, especially those containing mortgage loans and complex investments, may warrant a comprehensive IRR policy due to the uncertainty of cash flows.

The policy should establish responsibilities and procedures for identifying, measuring, monitoring, controlling, and reporting IRR, and establish risk limits. A written policy should:

- Identify committees, persons or other parties responsible for review of the credit union's IRR exposure;
- Direct appropriate actions to ensure management takes steps to manage IRR so that IRR exposures are identified, measured, monitored, and controlled;
- State the frequency with which management will report on measurement results to the board to ensure routine review of information that is timely (e.g. current and at least quarterly) and in sufficient detail to assess the credit union's IRR profile;
- Set risk limits for IRR exposures based on selected measures (e.g. limits for changes in repricing or duration gaps, income simulation, asset valuation, or net economic value);
- Choose tests, such as interest rate shocks, that the credit union will perform using the selected measures;
- Provide for periodic review of material changes in IRR exposures and compliance with board approved policy and risk limits;
- Provide for assessment of the IRR impact of any new business activities prior to implementation (e.g. evaluate the IRR profile of introducing a new product or service); and
- Provide for at least an annual evaluation of policy to determine whether it is still commensurate with the size, complexity, and risk profile of the credit union.

IRR policy limits should maintain risk exposures within prudent levels. Examples of limits are as follows:

GAP: less than  $\pm 10$  percent change in any given period, or cumulatively over 12 months.

Income Simulation: net interest income after shock change less than 20 percent over any 12-month period.

Asset Valuation: after shock change in book value of net worth less than 50 percent, or after shock net worth of 4 percent or greater.

Net Economic Value: after shock change in net economic value less than 25 percent, or after shock net economic value of 6 percent or greater.

NCUA emphasizes these are only for illustrative purposes, and management should establish its own limits that are reasonably supported. Where appropriate, management may also set IRR limits for individual portfolios, activities, and lines of business.

### III. IRR Oversight and Management

#### A. Board of Directors Oversight

The board of directors is responsible for oversight of their credit union and for approving policy, major strategies, and prudent limits regarding IRR. To meet this responsibility, understanding the level and nature of IRR taken by the credit union is essential. Accordingly, the board should ensure management executes an effective IRR program.

Additionally, the board should annually assess if the IRR program sufficiently identifies, measures, monitors, and controls the IRR exposure of the credit union. Where necessary, the board may consider obtaining professional advice and training to enhance its understanding of IRR oversight.

#### B. Management Responsibilities

Management is responsible for the daily management of activities and operations. In order to implement the board's IRR policy, management should:

- Develop and maintain adequate IRR measurement systems;
- Evaluate and understand IRR risk exposures;
- Establish an appropriate system of internal controls (e.g. separation between the risk taker and IRR measurement staff);
- Allocate sufficient resources for an effective IRR program. For example, a complex credit union with an elevated IRR risk profile will likely necessitate a greater allocation of resources to identify and focus on IRR exposures;
- Develop and support competent staff with technical expertise commensurate with the IRR program;
- Identify the procedures and assumptions involved in implementing the IRR measurement systems; and
- Establish clear lines of authority and responsibility for managing IRR; and
- Provide a sufficient set of reports to ensure compliance with board approved policies.

Where delegation of management authority by the board occurs, this may be to designated committees such as an asset liability committee or other equivalent. In credit unions with limited staff, these responsibilities may reside with the board or management. Significant changes in assumptions, measurement methods, tests performed, or other aspects involved in the IRR process should be documented and brought to the attention of those responsible.

#### IV. IRR Measurement and Monitoring

##### A. Risk Measurement Systems

Generally, credit unions should have IRR measurement systems that capture and measure all material and identified sources of IRR. An IRR measurement system quantifies the risk contained in the credit union's balance sheet and integrates the important sources of IRR faced by a credit union in order to facilitate management of its risk exposures. The selection and assessment of appropriate IRR measurement systems is the responsibility of credit union boards and management.

Management should:

- Rely on assumptions that are reasonable and supportable;
- Document any changes to assumptions based on observed information;

- Monitor positions with uncertain maturities, rates and cash flows, such as nonmaturity shares, fixed rate mortgages where prepayments may vary, adjustable rate mortgages, and instruments with embedded options, such as calls; and
- Require any interest rate risk calculation techniques, measures and tests to be sufficiently rigorous to capture risk.

## B. Risk Measurement Methods

The following discussion is intended only as a general guide and should not be used by credit unions as an endorsement of a particular method. An IRR measurement system may rely on a variety of different methods. Common examples of methods available to credit unions are GAP analysis, income simulation, asset valuation, and net economic value. Any measurement method(s) used by a credit union to analyze IRR exposure should correspond with the complexity of the credit union's balance sheet so as to identify any material sources of IRR.

### GAP Analysis

GAP analysis is a simple IRR measurement method that reports the mismatch between rate sensitive assets and rate sensitive liabilities over a given time period. GAP can only suffice for simple balance sheets that primarily consist of short-term bullet type investments and non mortgage-related assets. GAP analysis can be static, behavioral, or based on duration.

### Income Simulation

Income simulation is an IRR measurement method used to estimate earnings exposure to changes in interest rates. An income simulation analysis projects interest cash flows of all assets, liabilities, and off-balance sheet instruments in a credit union's portfolio to estimate future net interest income over a chosen timeframe. Generally, income simulations focus on short-term time horizons (e.g. one to three years). Forecasting income is assumption sensitive and more uncertain the longer the forecast period. Simulations typically include evaluations under a base-case scenario, and instantaneous parallel rate shocks, and may include alternate interest-rate scenarios. The alternate rate scenarios may involve ramped changes in rates, twisting of the yield curve, and/or stressed rate environments devised by the user or provided by the vendor.

### NCUA Asset Valuation Tables

For credit unions lacking advanced IRR methods that seek simple valuation measures, the NCUA Asset Valuation Tables are available and prepared quarterly by the NCUA. These are available on the NCUA Web site through [www.ncua.gov](http://www.ncua.gov).

These measures provide an indication of a credit union's potential interest rate risk, based on the risk associated with the asset categories of greatest concern—(e.g., mortgage loans and investment securities).

The tables provide a simple measure of the potential devaluation of a credit union's mortgage loans and investment securities that occur during  $\pm 300$  basis point parallel rate shocks, and report the resulting impact on net worth.

### Net Economic Value (NEV)

NEV measures the effect of interest rates on the market value of net worth by calculating the present value of assets minus the present value of liabilities. This calculation measures the long-term IRR in a credit union's balance sheet at a fixed point in time. By capturing the impact of interest rate changes on the value of all future cash flows,

NEV provides a comprehensive measurement of IRR. Generally, NEV computations demonstrate the economic value of net worth under current interest rates and shocked interest rate scenarios.

One NEV method is to discount cash flows by a single interest rate path. Credit unions with a significant exposure to assets or liabilities with embedded options should consider alternative measurement methods such as discounting along a yield curve (e.g. the U.S. Treasury curve, LIBOR curve) or using multiple interest rate paths. Credit unions should apply and document appropriate methods, based on available data (e.g. utilizing observed market values), when valuing individual or groups of assets and liabilities.

### C. Components of IRR Measurement Methods

In the initial setup of IRR measurement, critical decisions are made regarding numerous variables in the method. These variables include but are not limited to the following.

#### Chart of Accounts

Credit unions using an IRR measurement method should define a sufficient number of accounts to capture key IRR characteristics inherent within their product lines. For example, credit unions with significant holdings of adjustable-rate mortgages should differentiate balances by periodic and lifetime caps and floors, the reset frequency, and the rate index used for rate resets. Similarly, credit unions with significant holdings of fixed-rate mortgages should differentiate at least by original term, e.g., 30 or 15-year, and coupon level to reflect differences in prepayment behaviors.

#### Aggregation of Data Input

As the credit union's complexity, risk exposure, and size increases, the degree of detail should be based on data that is increasingly disaggregated. Because imprecision in the measurement process can materially misstate risk levels, management should evaluate the potential loss of precision from any aggregation and simplification used in its measurement of IRR.

#### Account Attributes

Account attributes define a product, including: Principal type, rate type, rate index, repricing interval, new volume maturity distribution, accounting accrual basis, prepayment driver, and discount rate.

#### Assumptions

IRR measurement methods rely on assumptions made by management in order to identify IRR. The simplest example is of future interest rate scenarios. The management of IRR will require other assumptions such as: Projected balance sheet volumes; prepayment rates for loans and investment securities; repricing sensitivity, and decay rates of nonmaturity shares. Examples of these assumptions follow.

Example 1. Credit unions should consider evaluating the balance sheet under flat (i.e. static) and/or planned growth scenarios to capture IRR exposures. Under a flat scenario, runoff amounts are reinvested in their respective asset or liability account. Conducting planned growth scenarios allows management to assess the IRR impact of the projected change in volume and/or composition of the balance sheet.

Example 2. Loans and mortgage related securities contain prepayment options that enable the borrower to prepay the obligation prior to maturity. This prepayment option makes it difficult to project the value and earnings stream from these assets because the future outstanding principal balance at any given time is unknown. A number of factors affect prepayments, including the refinancing incentive, seasonality (the particular time of year), seasoning (the age of the loan), member mobility, curtailments (additional principal payments), and burnout

(borrowers who don't respond to changes in the level of rates, and pay as scheduled). Prepayment speeds may be estimated or derived from numerous national or vendor data sources.

Example 3. In the process of IRR measurement, the credit union must estimate how each account will reprice in response to market rate fluctuations. For example, when rates rise 300 basis points, the credit union may raise its asset or liability rates in a like amount or not, and may choose to lag the timing of its pricing change.

Example 4. Nonmaturity shares include those accounts with no defined maturity such as share drafts, regular shares, and money market accounts. Measuring the IRR associated with these accounts is difficult because the risk measurement calculations require the user to define the principal cash flows and maturity. Credit unions may assume that there is no value when measuring the associated IRR and carry these values at book value or par. Many credit unions adopt this approach because it keeps the measurement method simple.

Alternatively, a credit union may attribute value to these shares (i.e. premium) on the basis that these shares tend to be lower cost funds that are core balances by virtue of being relatively insensitive to interest rates. This method generally results in nonmaturity shares priced/valued in a way that will produce an increased net economic value. Therefore, the underlying assumptions of the shares require scrutiny.

Credit unions that forecast share behavior and incorporate those assumptions into their risk identification and measurement process should perform sensitivity analysis.

#### V. Internal Controls

Internal controls are an essential part of a safe and sound IRR program. If possible, separation of those responsible for the risk taking and risk measuring functions should occur at the credit union.

Staff responsible for maintaining controls should periodically assess the overall IRR program as well as compliance with policy. Internal audit staff would normally assume this role; however, if there is no internal auditor, management, or a supervisory committee that is independent of the IRR process, may perform this role. Where appropriate, management may also supplement the internal audit with outside expertise to assess the IRR program. This review should include policy compliance, timeliness, and accuracy of reports given to management and the board.

Audit findings should be reported to the board or supervisory committee with recommended corrective actions and timeframes. The individuals responsible for maintaining internal controls should periodically examine adherence to the policy related to the IRR program.

#### VI. Decision-Making Informed by IRR Measurement Systems

Management should utilize the results of the credit union's IRR measurement systems in making operational decisions such as changing balance sheet structure, funding, pricing strategies, and business planning. This is particularly the case when measures show a high level of IRR or when measurement results approach board-approved limits.

NCUA recognizes each credit union has its own individual risk profile and tolerance levels. However, when measures of fair value indicate net worth is low, declining, or even negative, or income simulations indicate reduced earnings, management should be prepared to identify steps, if necessary, to bring risk within acceptable levels. In any case, management should understand and use their IRR measurement results, whether generated internally or externally, in the normal course of business. Management should also use the results proactively as a tool to adjust asset liability management for changes in interest rate environments.

#### VII. Guidelines for Adequacy of IRR Policy and Effectiveness of Program

The following guidelines will assist credit unions in determining the adequacy of their IRR policy and the effectiveness of their program to manage IRR.

<b>Policy</b>	
Board oversight	Policy is consistent with credit union strategy and balance sheet complexity, clearly defines board risk tolerances through reasonable interest rate risk limits, and states actions required to address policy exceptions.
Responsible parties identified	A committee or individual(s) is designated as being responsible for IRR management activities, including review and monitoring of IRR.
Direct appropriate action to measure, monitor, control IRR	Policy states all actions that are sufficient to manage IRR, including measurement and monitoring methods, and interest rate risk reduction alternatives.
Reporting frequency specified	Reporting of results is required with sufficient frequency and detail to alert management to emerging IRR.
Risk limits stated with appropriate measures	Clearly defined risk limits are established and are appropriate for the size and complexity of the credit union.
Tests for limits	Tests substantially display the level and range of credit union IRR.
Review of material IRR changes	Any changes beyond a stated level are reported to management and, where appropriate, the Board.
Impact of new business	IRR impact of all business initiatives (new products, lines of business, pricing changes) is required where these will affect future IRR.
Periodic policy review	Review by Board required at least annually to ensure continued relevance and applicability of policy to management of IRR.
<b>IRR Oversight &amp; Management</b>	
Oversight	Board approves policy and strategies and understands IRR faced by its own credit union.
Oversight assessment of program effectiveness	Board periodically evaluates program effectiveness by monitoring management's IRR knowledge. Use of third-party professional advice is acceptable, but does not absolve the Board of its responsibility for informed and knowledgeable oversight and governance.
Choice of IRR measurement systems	Management selects and maintains systems that are able to capture the complexity of IRR risks. The systems used by the credit union must be able to capture IRR (e.g., balance sheet contains material options in investments, mortgage loans or core deposits - calls, prepayments, or administered rates).
Evaluation of IRR risk exposures	Credit union understands all material IRR exposures and evaluates these accordingly relative to credit union strategy. If management relies on outside parties to evaluate credit union's IRR, it must be able to explain the IRR measurement method or the results.
System of internal controls	Internal controls encompass and effectively evaluate programs that manage elements of IRR at the credit union. Internal audit has addressed the correction of IRR deficiencies (e.g. processes for tracking changes in measurement assumptions, such as repricing of core deposits).
IRR resource management	Credit union has allocated initial or additional qualified staff resources sufficient to properly measure and manage IRR by means that address sources of risk.
Expertise of IRR program staff	Staff responsible for IRR measurement and monitoring correctly identifies sources of IRR and can quantify these risks, and is knowledgeable about the operation and limitations of the IRR model, even if modeling is performed by a third party vendor.
Procedures and assumptions of IRR measurement systems	Credit union identifies reasonable procedures and is responsible for supportable assumptions, even if modeling is performed by a third party vendor.
Accountability of IRR management	Responsibility for managing IRR is specific and clearly delineated.
Transparency of changes in assumptions, methods and IRR tests.	Management requires clear disclosure of relevant changes in all material assumptions and methods.
<b>IRR Measurement and Monitoring</b>	
Reasonable and supportable assumptions	Credit union carefully evaluates all assumptions and assesses the sensitivity of results relative to each key assumption. Key assumptions should be demonstrated to be supportable (e.g. mortgage prepayments capture contraction and extension risk and core deposit premiums indicate reasonable maturities).
Assumption changes from observed information	All material changes in assumptions are based on tested internal data or reliable industry sources.
Rigor of calculations and conformity of concepts	Techniques used appropriately capture complexity of balance sheet instruments. Methods to attribute cash flows, and rate sensitivities are based on correct techniques.

	[e.g. proper use of statistical correlations].
Positions with uncertain maturities, rates and cash flows	Activity is monitored on a regular basis and compared to projected behavior in order to validate reasonableness of modeling assumptions.
Rigor of interest rate measures and tests	Measures and tests employed capture the material risks embedded in the credit union's balance sheet (e.g., rate shocks trigger the embedded options in some products).
<b>Components of IRR Measurement Methods</b>	
Chart of accounts	A sufficient number of accounts have been defined to capture key IRR characteristics inherent within each product (e.g. 15- and 30-year fixed-rate mortgages are modeled separately in order to capture various coupons and prepayment behaviors).
Data aggregation	The level of data disaggregation is sufficient given the credit union's complexity and risk exposure (e.g. instrument level processing).
Account attributes	Account set-up is appropriate to allow for the capture of key IRR characteristics (e.g. adjustable-rate mortgages are modeled with periodic and lifetime caps and floors).
Discounting methodology	Methodology used properly calculates the value of the asset or liability being modeled (e.g., discount rates or maturities or cash flows are accurate and appropriate in discounting calculations).
Assumptions	Credit union carefully evaluates all assumptions and assesses the sensitivity of results relative to each key assumption (e.g. mortgage prepayments reflect contraction and extension risk and core deposit premiums indicate reasonable maturities).
<b>Internal Controls</b>	
Internal assessment of IRR program	Staff is identified and have annually assessed policy and program to correct any weaknesses.
Compliance with policy	IRR program is evaluated semi-annually for any policy exceptions, including compliance with approved limits.
Timeliness and accuracy of reports	Reports that are routinely provided to management and the Board successfully communicate material IRR exposure of the credit union.
Audit findings reported to board or supervisory committee	IRR program deficiencies and policy exceptions are reported to the Board in accordance with the policy.
<b>Decision-making and IRR</b>	
Use of IRR measurement results in operational decisions	Measured IRR results form part of the credit union's ongoing business decisions and are substantive considerations routinely included in the business decision process.
Escalated use of results when IRR exposure is raised or approaching limits	Procedure specifies review escalation at specific levels with increasing contingency triggers close to limits.
Application to reduce elevated levels of IRR	Credit union utilizes IRR results to clearly define and formulate response (balance sheet structure, funding or pricing strategies) to increased IRR levels.

NCUA acknowledges both the range of IRR exposures at credit unions, and the diverse means that they may use to accomplish an effective program to manage this risk. NCUA therefore does not stipulate specific quantitative standards or limits for the management of IRR applicable to all credit unions, and does not rely solely on the results of quantitative approaches to evaluate the effectiveness of IRR programs. Assumptions, measures and methods used by a credit union in light of its size, complexity and risk exposure determine the specific appropriate standard. However, NCUA strongly affirms the need for adequate practices for a program to effectively manage IRR. For example, policy limits on IRR exposure are not adequate if they allow a credit union to operate with an exposure that is unsafe or unsound, which means that the credit union may suffer material losses under plausible adverse circumstances as a result of this exposure. Credit unions that do not have a written IRR policy or that do not have an effective IRR program are out of compliance with §741.3 of NCUA's regulations.

#### VIII. Additional Guidance for Large Credit Unions With Complex or High Risk Balance Sheets

FICUs with assets of \$500 million or greater must obtain an annual audit of their financial statements performed in accordance with generally accepted accounting standards. 12 CFR 715.5, 715.6, 741.202. For purposes of data collection, NCUA also uses \$500 million and above as its largest credit union asset range. In order to gather information and to monitor IRR exposure at larger credit unions as it relates to the share insurance fund, NCUA will use this as the criterion for definition of large credit unions for purposes of this section of the guidance. Given the increased exposure to the share insurance fund, NCUA encourages the responsible officials at large credit unions that are complex or high risk to fully understand all aspects of interest rate risk, including but not limited to the credit union's IRR assessment and potential directional changes in IRR exposures. For example, the credit union should consider the following:

- A policy which provides for the use of outside parties to validate the tests and limits commensurate with the risk exposure and complexity of the credit union;
- IRR measurement systems that report compliance with policy limits as shown both by risks to earnings and net economic value of equity under a variety of defined and reasonable interest rate scenarios;
- The effect of changes in assumptions on IRR exposure results (e.g. the impact of slower or faster prepayments on earnings and economic value); and,
- Enhanced levels of separation between risk taking and risk assessment (e.g. assignment of resources to separate the investments function from IRR measurement, and IRR monitoring and oversight).

#### IX. Definitions

**Basis risk:** The risk to earnings and/or value due to a financial institution's holdings of multiple instruments, based on different indices that are imperfectly correlated.

**Interest rate risk:** The risk that changes in market rates will adversely affect a credit union's net economic value and/or earnings. Interest rate risk generally arises from a mismatch between the timing of cash flows from fixed rate instruments, and interest rate resets of variable rate instruments, on either side of the balance sheet. Thus, as interest rates change, earnings or net economic value may decline.

**Option risk:** The risk to earnings and/or value due to the effect on financial instruments of options associated with these instruments. Options are embedded when they are contractual within, or directly associated with, the instrument. An example of a contractual embedded option is a call option on an agency bond. An example of a behavioral embedded option is the right of a residential mortgage holder to vary prepayments on the mortgage through time, either by making additional premium payments, or by paying off the mortgage prior to maturity.

**Repricing risk:** The repricing of assets or liabilities following market changes can occur in different amounts and/or at different times. This risk can cause returns to vary.

**Spread risk:** The risk to earnings and/or value resulting from variations through time of the spread between assets or liabilities to an underlying index such as the Treasury curve.

**Yield curve risk:** The risk to earnings and/or value due to changes in the level or slope of underlying yield curves. Financial instruments can be sensitive to different points on the curve. This can cause returns to vary as yield curves change.

[77 FR 5162, Feb. 2, 2012, as amended at 77 FR 57990, Sept. 19, 2012]



## **Appendix C to Part 741—Interpretive Ruling and Policy Statement on Loan Workouts, Nonaccrual Policy, and Regulatory Reporting of Troubled Debt Restructured Loans**

This Interpretive Ruling and Policy Statement (IRPS) establishes requirements for the management of loan workout<sup>3</sup> arrangements, loan nonaccrual, and regulatory reporting of troubled debt restructured loans (herein after referred to as TDR or TDRs).

This IRPS applies to all federally insured credit unions.

Under this IRPS, TDR loans are as defined in generally accepted accounting principles (GAAP) and the Board does not intend through this policy to change the Financial Accounting Standards Board's (FASB) definition of TDR in any way. In addition to existing agency policy, this IRPS sets NCUA's supervisory expectations governing loan workout policies and practices and loan accruals.

### **Written Loan Workout Policy and Monitoring Requirements<sup>4</sup>**

For purposes of this policy statement, types of workout loans to borrowers in financial difficulties include re-agings, extensions, deferrals, renewals, or rewrites. See the Glossary entry on “workouts” for further descriptions of each term. Borrower retention programs or new loans are not encompassed within this policy nor considered by the Board to be workout loans.

Loan workouts can be used to help borrowers overcome temporary financial difficulties, such as loss of job, medical emergency, or change in family circumstances like loss of a family member. Loan workout arrangements should consider and balance the best interests of both the borrower and the credit union.

The lack of a sound written policy on workouts can mask the true performance and past due status of the loan portfolio. Accordingly, the credit union board and management must adopt and adhere to an explicit written policy and standards that control the use of loan workouts, and establish controls to ensure the policy is consistently applied. The loan workout policy and practices should be commensurate with each credit union's size and complexity, and must be in line with the credit union's broader risk mitigation strategies. The policy must define eligibility requirements (i.e., under what conditions the credit union will consider a loan workout), including establishing limits on the number of times an individual loan may be modified.<sup>5</sup> The policy must also ensure credit unions make loan workout decisions based on the borrower's renewed willingness and ability to repay the loan. If a credit union engages in restructuring activity on a loan that results in restructuring the loan more often than once a year or twice in five years, examiners will have higher expectations for the documentation of the borrower's renewed willingness and ability to repay the loan. NCUA is concerned about restructuring activity that pushes existing losses into future reporting periods without improving the loan's collectability. One way a credit union can provide convincing evidence that multiple restructurings improve collectability is to perform validation of completed

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<sup>3</sup> Terms defined in the Glossary will be italicized on their first use in the body of this guidance.

<sup>4</sup> For additional guidance on member business lending extension, deferral, renewal, and rewrite policies, see Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts (October 30, 2009) transmitted by Letter to Credit Unions No. 10-CU-07, and available at <http://www.ncua.gov>.

<sup>5</sup> Broad based credit union programs commonly used as a member benefit and implemented in a safe and sound manner limited to only accounts in good standing, such as Skip-a-Pay programs, are not intended to count toward these limits.

multiple restructurings that substantiate the claim. Examiners will ask for such validation documentation if the credit union engages in multiple restructurings of a loan.

In addition, the policy must establish sound controls to ensure loan workout actions are appropriately structured.<sup>6</sup> The policy must provide that in no event may the credit union authorize additional advances to finance unpaid interest and credit union fees. The credit union may, however, make advances to cover third-party fees, excluding credit union commissions, such as force-placed insurance or property taxes. For loan workouts granted, the credit union must document the determination that the borrower is willing and able to repay the loan.

Management must ensure that comprehensive and effective risk management and internal controls are established and maintained so that loan workouts can be adequately controlled and monitored by the credit union's board of directors and management, to provide for timely recognition of losses,<sup>7</sup> and to permit review by examiners. The credit union's risk management framework must include thresholds based on aggregate volume of loan workout activity that trigger enhanced reporting to the board of directors. This reporting will enable the credit union's board of directors to evaluate the effectiveness of the credit union's loan workout program, any implications to the organization's financial condition, and to make any compensating adjustments to the overall business strategy. This information will also then be available to examiners upon request.

To be effective, management information systems need to track the principal reductions and charge-off history of loans in workout programs by type of program. Any decision to re-age, extend, defer, renew, or rewrite a loan, like any other revision to contractual terms, needs to be supported by the credit union's management information systems. Sound management information systems are able to identify and document any loan that is re-aged, extended, deferred, renewed, or rewritten, including the frequency and extent such action has been taken. Documentation normally shows that the credit union's personnel communicated with the borrower, the borrower agreed to pay the loan in full under any new terms, and the borrower has the ability to repay the loan under any new terms.

#### Regulatory Reporting of Workout Loans Including TDR Past Due Status

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<sup>6</sup> In developing a written policy, the credit union board and management may wish to consider similar parameters as those established in the FFIEC's "Uniform Retail Credit Classification and Account Management Policy" (FFIEC Policy). 65 FR 36903 (June 12, 2000). The FFIEC Policy sets forth specific limitations on the number of times a loan can be re-aged (for open-end accounts) or extended, deferred, renewed or rewritten (for closed-end accounts). Additionally, NCUA Letter to Credit Unions (LCU) 09-CU-19, "Evaluating Residential Real Estate Mortgage Loan Modification Programs," outlines policy requirements for real estate modifications. Those requirements remain applicable to real estate loan modifications but could be adapted in part by the credit union in their written loan workout policy for other loans.

<sup>7</sup> Refer to NCUA guidance on charge-offs set forth in LCU 03-CU-01, "Loan Charge-off Guidance," dated January 2003. Examiners will require that a reasonable written charge-off policy is in place and that it is consistently applied. Additionally, credit unions need to adjust historical loss factors when calculating ALLL needs for pooled loans to account for any loans with protracted charge-off timeframes (e.g., 12 months or greater). See discussions on the latter point in the 2006 Interagency ALLL Policy Statement transmitted by Accounting Bulletin 06-1 (December 2006).

The past due status of all loans will be calculated consistent with loan contract terms, including amendments made to loan terms through a formal restructure. Credit unions will report delinquency on the Call Report consistent with this policy.<sup>8</sup>

#### Loan Nonaccrual Policy

Credit unions must ensure appropriate income recognition by placing loans in nonaccrual status when conditions as specified below exist, reversing or charging-off previously accrued but uncollected interest, complying with the criteria under GAAP for Cash or Cost Recovery basis of income recognition, and following the specifications below regarding restoration of a nonaccrual loan to accrual status.<sup>9</sup> This policy on loan accrual is consistent with longstanding credit union industry practice as implemented by the NCUA over the last several decades. The balance of the policy relates to member business loan workouts and is similar to the FFIEC policies adopted by the federal banking agencies<sup>10</sup> as set forth in the FFIEC Call Report for banking institutions and its instructions.<sup>11</sup>

#### Nonaccrual Status

Credit unions may not accrue interest<sup>12</sup> on any loan upon which principal or interest has been in default for a period of 90 days or more, unless the loan is both “well secured” and “in the process of collection.”<sup>13</sup> Additionally, loans will be placed in nonaccrual status if maintained on a Cash (or Cost Recovery) basis because of deterioration in the financial condition of the borrower, or for which payment in full of principal or interest is not expected. For purposes of applying the “well secured” and “in process of collection” test for nonaccrual status listed above, the date on which a loan reaches nonaccrual status is determined by its contractual terms.

While a loan is in nonaccrual status, some or all of the cash interest payments received may be treated as interest income on a cash basis as long as the remaining recorded investment in the loan (i.e., after charge-off of identified losses, if any) is deemed to be fully collectable. The reversal of previously accrued, but uncollected,

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<sup>8</sup> Subsequent Call Reports and accompanying instructions will reflect this policy, including focusing data collection on loans meeting the definition of TDR under GAAP. In reporting TDRs on regulatory reports, the data collections will include all TDRs that meet the GAAP criteria for TDR reporting, without the application of materiality threshold exclusions based on scoping or reporting policy elections of credit union preparers or their auditors. Credit unions should also refer to the recently revised standard from the FASB, Accounting Standards Update No. 2011-02 (April 2011) to the FASB Accounting Standards Codification entitled, Receivables (Topic 310), “A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring.” This clarified the definition of a TDR, which has the practical effect in the current economic environment to broaden loan workouts that constitute a TDR. This standard is effective for annual periods ending on or after December 15, 2012.

<sup>9</sup> Placing a loan in nonaccrual status does not change the loan agreement or the obligations between the borrower and the credit union. Only the parties can effect a restructuring of the original loan terms or otherwise settle the debt.

<sup>10</sup> The federal banking agencies are the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency.

<sup>11</sup> FFIEC Report of Condition and Income Forms and User Guides, Updated September 2011, <http://www.fdic.gov>.

<sup>12</sup> Nonaccrual of interest also includes the amortization of deferred net loan fees or costs, or the accretion of discount. Nonaccrual of interest on loans past due 90 days or more is a longstanding agency policy and credit union practice.

<sup>13</sup> A purchased credit impaired loan asset need not be placed in nonaccrual status as long as the criteria for accrual of income under the interest method in GAAP is met. Also, the accrual of interest on workout loans is covered in a separate section of this IRPS later in the policy statement.

interest applicable to any loan placed in nonaccrual status must be handled in accordance with GAAP.<sup>14</sup> Where assets are collectable over an extended period of time and, because of the terms of the transactions or other conditions, there is no reasonable basis for estimating the degree of collectability—when such circumstances exist, and as long as they exist—consistent with GAAP the Cost Recovery Method of accounting must be used.<sup>15</sup> Use of the Cash or Cost Recovery basis for these loans and the statement on reversing previous accrued interest is the practical implementation of relevant accounting principles.

#### Restoration to Accrual Status for All Loans except Member Business Loan Workouts

A nonaccrual loan may be restored to accrual status when:

- Its past due status is less than 90 days, GAAP does not require it to be maintained on the Cash or Cost Recovery basis, and the credit union is plausibly assured of repayment of the remaining contractual principal and interest within a reasonable period;
- When it otherwise becomes both well secured and in the process of collection; or
- The asset is a purchased impaired loan and it meets the criteria under GAAP for accrual of income under the interest method specified therein.

In restoring all loans to accrual status, if any interest payments received while the loan was in nonaccrual status were applied to reduce the recorded investment in the loan the application of these payments to the loan's recorded investment must not be reversed (and interest income must not be credited). Likewise, accrued but uncollected interest reversed or charged-off at the point the loan was placed on nonaccrual status cannot be restored to accrual; it can only be recognized as income if collected in cash or cash equivalents from the member.

#### Restoration to Accrual Status on Member Business Loan Workouts<sup>16</sup>

A formally restructured member business loan workout need not be maintained in nonaccrual status, provided the restructuring and any charge-off taken on the loan are supported by a current, well documented credit evaluation of the borrower's financial condition and prospects for repayment under the revised terms. Otherwise, the restructured loan must remain in nonaccrual status. The evaluation must include consideration of the borrower's sustained historical repayment performance for a reasonable period prior to the date on which the loan is returned to

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<sup>14</sup> Acceptable accounting treatment includes a reversal of all previously accrued, but uncollected, interest applicable to loans placed in a nonaccrual status against appropriate income and balance sheet accounts. For example, one acceptable method of accounting for such uncollected interest on a loan placed in nonaccrual status is: (1) To reverse all of the unpaid interest by crediting the “accrued interest receivable” account on the balance sheet, (2) to reverse the uncollected interest that has been accrued during the calendar year-to-date by debiting the appropriate “interest and fee income on loans” account on the income statement, and (3) to reverse any uncollected interest that had been accrued during previous calendar years by debiting the “allowance for loan and lease losses” account on the balance sheet. The use of this method presumes that credit union management's additions to the allowance through charges to the “provision for loan and lease losses” on the income statement have been based on an evaluation of the collectability of the loan and lease portfolios and the “accrued interest receivable” account.

<sup>15</sup> When a purchased impaired loan or debt security that is accounted for in accordance with ASC Subtopic 310-30, “Receivables-Loans and Debt Securities Acquired with Deteriorated Credit Quality,” has been placed on nonaccrual status, the cost recovery method should be used, when appropriate.

<sup>16</sup> This policy is derived from the “Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts” NCUA and the other financial regulators issued on October 30, 2009.

accrual status. A sustained period of repayment performance would be a minimum of six consecutive payments and would involve timely payments under the restructured loan's terms of principal and interest in cash or cash equivalents. In returning the member business workout loan to accrual status, sustained historical repayment performance for a reasonable time prior to the restructuring may be taken into account. Such a restructuring must improve the collectability of the loan in accordance with a reasonable repayment schedule and does not relieve the credit union from the responsibility to promptly charge off all identified losses.

The graph below provides an example of a schedule of repayment performance to demonstrate a determination of six consecutive payments. If the original loan terms required a monthly payment of \$1,500, and the credit union lowered the borrower's payment to \$1,000 through formal member business loan restructure, then based on the first row of the graph, the “sustained historical repayment performance for a reasonable time prior to the restructuring” would encompass five of the pre-workout consecutive payments that were at least \$1,000 (Months 1 through 5); so, in total, the six consecutive repayment burden would be met by the first month post workout (Month 6). In the second row, only one of the pre-workout payments would count toward the six consecutive repayment requirement (Month 5), because it is the first month in which the borrower made a payment of at least \$1,000, after failing to pay at least that amount. The loan, therefore, would remain on nonaccrual for at least five post-workout consecutive payments (Months 6 through 10) provided the borrower continues to make payments consistent with the restructured terms.

Pre-workout					Post-workout				
Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10
\$1,500	\$1,200	\$1,200	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000
1,500	1,200	900	875	1,000	1,000	1,000	1,000	1,000	1,000

After a formal restructure of a member business loan, if the restructured loan has been returned to accrual status, the loan otherwise remains subject to the nonaccrual standards of this policy. If any interest payments received while the member business loan was in nonaccrual status were applied to reduce the recorded investment in the loan the application of these payments to the loan's recorded investment must not be reversed (and interest income must not be credited). Likewise, accrued but uncollected interest reversed or charged-off at the point the member business workout loan was placed on nonaccrual status cannot be restored to accrual; it can only be recognized as income if collected in cash or cash equivalents from the member.

The following tables summarize nonaccrual and restoration to accrual requirements previously discussed:

Action	Condition identified	Additional consideration
Nonaccrual on All Loans	90 days or more past due unless loan is both well secured and in the process of collection; or If the loan must be maintained on the Cash or Cost Recovery basis because there is a deterioration in the financial condition of the borrower, or for which payment in full of principal or interest is not expected	See Glossary descriptors for “well secured” and “in the process of collection.” Consult GAAP for Cash or Cost Recovery basis income recognition guidance. See also Glossary Descriptors.
Nonaccrual on Member Business Loan Workouts	Continue on nonaccrual at workout point and until restore to accrual criteria are met	See Table 2—Restore to Accrual.

Action	Condition identified	Additional consideration
Restore to Accrual on All Loans except Member Business Loan Workouts	When the loan is past due less than 90 days, GAAP does not require it to be maintained on the Cash or Cost Recovery basis, and the credit union is plausibly assured of repayment of the remaining contractual principal and interest within a reasonable period When it otherwise becomes both “well secured” and “in the process of collection”; or The asset is a purchased impaired loan and it meets the criteria under GAAP for accrual of income under the interest method	See Glossary descriptors for “well secured” and “in the process of collection.” Interest payments received while the loan was in nonaccrual status and applied to reduce the recorded investment in the loan must not be reversed and income credited. Likewise, accrued but uncollected interest reversed or charged-off at the point the loan was placed on nonaccrual status cannot be restored to accrual.
Restore to Accrual on Member Business Loan Workouts	Formal restructure with a current, well documented credit evaluation of the borrower's financial condition and prospects for repayment under the revised terms	The evaluation must include consideration of the borrower's sustained historical repayment performance for a minimum of six timely consecutive payments comprised of principal and interest. In returning the loan to accrual status, sustained historical repayment performance for a reasonable time prior to the restructuring may be taken into account. Interest payments received while the member business loan was in nonaccrual status and applied to reduce the recorded investment in the loan must not be reversed and income credited. Likewise, accrued but uncollected interest reversed or charged-off at the point the member business loan was placed on nonaccrual status cannot be restored to accrual.

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“Cash Basis” method of income recognition is set forth in GAAP and means while a loan is in nonaccrual status, some or all of the cash interest payments received may be treated as interest income on a cash basis as long as the remaining recorded investment in the loan (i.e., after charge-off of identified losses, if any) is deemed to be fully collectible.<sup>18</sup>

“Charge-off” means a direct reduction (credit) to the carrying amount of a loan carried at amortized cost resulting from uncollectability with a corresponding reduction (debit) of the ALLL. Recoveries of loans previously charged off should be recorded when received.

<sup>17</sup> Terms defined in the Glossary will be italicized on their first use in the body of this guidance.

<sup>18</sup> Acceptable accounting practices include: (1) Allocating contractual interest payments among interest income, reduction of the recorded investment in the asset, and recovery of prior charge-offs. If this method is used, the amount of income that is recognized would be equal to that which would have been accrued on the loan's remaining recorded investment at the contractual rate; and, (2) accounting for the contractual interest in its entirety either as income, reduction of the recorded investment in the asset, or recovery of prior charge-offs, depending on the condition of the asset, consistent with its accounting policies for other financial reporting purposes.

“Cost Recovery” method of income recognition means equal amounts of revenue and expense are recognized as collections are made until all costs have been recovered, postponing any recognition of profit until that time.<sup>19</sup>

“Generally accepted accounting principles (GAAP)” means official pronouncements of the FASB as memorialized in the FASB Accounting Standards Codification® as the source of authoritative principles and standards recognized to be applied in the preparation of financial statements by federally-insured credit unions in the United States with assets of \$10 million or more.

“In the process of collection” means collection of the loan is proceeding in due course either: (1) Through legal action, including judgment enforcement procedures, or (2) in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to a current status in the near future, i.e., generally within the next 90 days.

“Member Business Loan” is defined consistent with Section 723.1 of NCUA's Member Business Loan Rule, 12 CFR 723.1.

“New Loan” means the terms of the revised loan are at least as favorable to the credit union (i.e., terms are market-based, and profit driven) as the terms for comparable loans to other customers with similar collection risks who are not refinancing or restructuring a loan with the credit union, and the revisions to the original debt are more than minor.

“Past Due” means a loan is determined to be delinquent in relation to its contractual repayment terms including formal restructures, and must consider the time value of money. Credit unions may use the following method to recognize partial payments on “consumer credit,” i.e., credit extended to individuals for household, family, and other personal expenditures, including credit cards, and loans to individuals secured by their personal residence, including home equity and home improvement loans. A payment equivalent to 90 percent or more of the contractual payment may be considered a full payment in computing past due status.

“Recorded Investment in a Loan” means the loan balance adjusted for any unamortized premium or discount and unamortized loan fees or costs, less any amount previously charged off, plus recorded accrued interest.

“Troubled Debt Restructuring” is as defined in GAAP and means a restructuring in which a credit union, for economic or legal reasons related to a member borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider.<sup>20</sup> The restructuring of a loan may include, but is not necessarily limited to: (1) The transfer from the borrower to the credit union of real estate, receivables from third parties, other assets, or an equity interest in the borrower in full or partial satisfaction of the loan, (2) a modification of the loan terms, such as a reduction of the stated interest rate, principal, or accrued interest or an extension of the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk, or (3) a combination of the above. A loan extended or renewed at a stated interest rate equal to the current market interest rate for new debt with similar risk is not to be reported as a restructured troubled loan.

“Well secured” means the loan is collateralized by: (1) A perfected security interest in, or pledges of, real or personal property, including securities with an estimable value, less cost to sell, sufficient to recover the recorded investment in the loan, as well as a reasonable return on that amount, or (2) by the guarantee of a financially responsible party.

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<sup>19</sup> FASB Accounting Standards Codification (ASC) 605-10-25-4, “Revenue Recognition, Cost Recovery.”

<sup>20</sup> FASB ASC 310-40, “Troubled Debt Restructuring by Creditors.”

“Workout Loan” means a loan to a borrower in financial difficulty that has been formally restructured so as to be reasonably assured of repayment (of principal and interest) and of performance according to its restructured terms. A workout loan typically involves a re-aging, extension, deferral, renewal, or rewrite of a loan.<sup>21</sup> For purposes of this policy statement, workouts do not include loans made to market rates and terms such as refinances, borrower retention actions, or new loans.<sup>22</sup>

“Extension” means extending monthly payments on a closed-end loan and rolling back the maturity by the number of months extended. The account is shown current upon granting the extension. If extension fees are assessed, they should be collected at the time of the extension and not added to the balance of the loan.

“Deferral” means deferring a contractually due payment on a closed-end loan without affecting the other terms, including maturity, of the loan. The account is shown current upon granting the deferral.

“Renewal” means underwriting a matured, closed-end loan generally at its outstanding principal amount and on similar terms.

“Rewrite” means significantly changing the terms of an existing loan, including payment amounts, interest rates, amortization schedules, or its final maturity.

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<sup>21</sup> “Re-Age” means returning a past due account to current status without collecting the total amount of principal, interest, and fees that are contractually due.

<sup>22</sup> There may be instances where a workout loan is not a TDR even though the borrower is experiencing financial hardship. For example, a workout loan would not be a TDR if the fair value of cash or other assets accepted by a credit union from a borrower in full satisfaction of its receivable is at least equal to the credit union's recorded investment in the loan, e.g., due to charge-offs.