



National Credit Union Administration

BOARD ACTION MEMORANDUM

TO: NCUA Board **DATE:** July 5, 2011

FROM: Scott Hunt **SUBJ:** Clarification of specific
Director, calculations pursuant to Part
Office of Corporate 704
Credit Unions

ACTIONS REQUESTED: Board action to clarify and standardize corporate credit union calculations of Moving Daily Average Net Assets (MDANA) and Moving Monthly Average Net Risk-Weighted Assets (MMANRA).

DATE ACTION REQUESTED: July 21, 2011.

OTHER OFFICES CONSULTED: Office of Examination and Insurance and Office of General Counsel.

VIEWS OF OTHER OFFICES CONSULTED: Concur.

BUDGET IMPACT IF ANY: None.

RESPONSIBLE STAFF MEMBERS: Scott Hunt, Director, Office of Corporate Credit Unions.

BACKGROUND: On September 24, 2010, the NCUA Board approved significant revisions to Part 704 of NCUA's Rules and Regulations. The revisions included stronger capital requirements, as set forth in Section 704.3. The capital requirements include: a leverage ratio; a Tier I risk-based capital ratio, and a total risk-based capital ratio. The denominator in the calculation of the leverage ratio is MDANA. The denominator in the calculation of the risk-based capital ratios is MMANRA. There is no discussion in the preamble of the corporate rule revisions on how to transition MDANA and MMANRA as the corporate system moves forward under the phase-in of the new capital rules. Guidance is necessary to ensure consistent reporting and full compliance with the agency's expectations that capital be commensurate with the risks of the corporate.

Below are the regulatory definitions of the two denominators:

- *MDANA* means the average of daily average net assets for the month being measured and the previous eleven (11) months. This definition has been retained from its original incorporation in Part 704 in 1998.

- *MMANRA* means the average of the net risk-weighted assets for the month being measured and the previous eleven (11) months. Measurements must be taken on the last day of each month. This definition originated in the September 2010 revisions to Part 704 with the introduction of a risk-based capital requirement.

Using average assets measured over the current month and previous 11 months smoothes out the impact of seasonal liquidity fluctuations in the credit union system on corporate credit union capital ratios. In times when natural person credit unions accumulate liquidity, typically in the early part of the calendar year, a corporate need not raise additional capital if the average asset base does not significantly increase.

Throughout the corporate resolution, the corporates have been encouraged to retain high deposit levels to mitigate the risk of having to sell distressed assets (i.e., to achieve corporate stabilization). This was accomplished under the Temporary Corporate Credit Union Share Guarantee Program. Thus, many corporates and NCUA encouraged natural person credit union deposits, possibly beyond optimal levels. As we near the close of the NGN securitization, NCUA will no longer need to encourage corporate deposits as the distressed assets will have largely been funded by sources outside the credit union system.

Further, as corporates draw closer to the October 20, 2011, effective date of the new capital requirements, many corporates plan to decrease their assets to facilitate compliance with the new capital standards. In establishing their capitalization plans, corporates generally project significantly smaller asset-sized balance sheets as of October 2011. However, the corporates will not be able to shed the legacy of inflated balance sheets until several months pass due to averaging the prior 12 months' assets. This may lead to initially diluted capital ratios, or require a corporate to raise capital beyond an amount commensurate with its targeted asset range.

MDANA calculations become more complex when business combinations occur such as through merger, or purchase and assumptions. Generally, each entity's historic assets are carried forward in calculating the new entity's MDANA. Accordingly, such combinations also become entangled in carrying capital against historical balance sheets.

MMANRA is new to the corporate rule and does not go into effect until October 2011. When corporates begin to calculate the MMANRA, there will not be 11 previous months of data to incorporate into the calculation of the average.

In terms of the calculation of MDANA, it would appear equitable to allow each corporate credit union to decide whether to continue using the existing MDANA history in order to smooth out the impact of any one-month asset increases, or to begin a new MDANA history which would eliminate the months of high assets due to the corporate stabilization efforts. Should the corporate opt to begin a new MDANA history, it must understand that it may be subject to the rule's prompt corrective action stipulations should assets increase shortly thereafter and dilute capital below the standards to be

adequately capitalized. This may require a corporate to raise additional capital. A corporate must make a deliberate decision which method to adopt as NCUA will not approve a subsequent change to the MDANA calculation merely to obtain mathematical compliance with the regulation.

In the terms of the calculation of MMANRA, staff proposes 1) requiring corporates to go back and calculate MMANRA for the 11 months before the regulatory requirement went into effect, or 2) starting the calculation as of October 31, 2011. Under this second option, 12 month MMANRA will be built out over time, with the first month's calculation using one month's MMANRA, the second month's calculation using 2 months MMANRA, and so on for the first 12 months.

For consolidations, this guidance remains the same. If a consolidated entity opts to retain the historical 12 months MDANA or MMANRA calculations, it must include the historical balances of the corporates prior to consolidation. If a consolidated entity adopts the option to begin the MDANA and MMANRA calculation anew, the calculation will commence effective the date of the first consolidated financial statement.

In no respect does this clarification of the computation of MDANA and MMANRA restrict the NCUA's ability to establish a higher minimum capital level as prescribed by Section 704.3(e).

A draft Letter to Corporate Credit Unions explaining the calculation options is attached.

RECOMMENDATION:

The NCUA Board adopt the following clarification for the calculation of MDANA and MMANRA pursuant to Part 704:

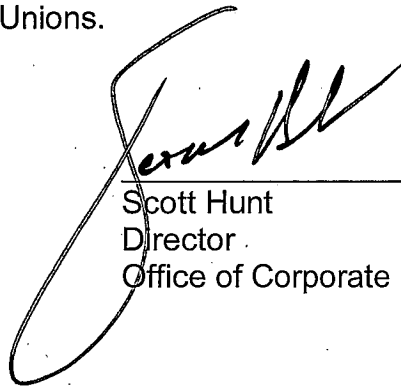
- As of October 31, 2011, corporate credit unions will have the option to calculate MDANA under one of the following two methods: (1) using the average of daily average net assets for the month being measured and the previous 11 months; or (2) using October 31, 2011, as the starting point with no inclusion of earlier months in the calculation. Under the second option, each following month the calculation will include the previous months going back to the October 31, 2011, starting point until such time 12 months of data is included in the calculation. Once 12 months of data are included in the calculation, the calculation going forward will be equivalent to option (1), which is the calculation as set forth in the regulation.
- As of October 31, 2011, corporate credit unions will have the option to calculate MMANRA under one of the following two methods: (1) using the average of the net risk-weighted assets for the month being measured and the previous 11 months. Measurements must be taken on the last day of each month; or (2) using October 31, 2011, as the starting point with no inclusion of earlier months in the calculation. Under the second option, each following month the calculation

will include the previous months going back to the October 31, 2011, starting point until such time 12 months of data is included in the calculation. Once 12 months of data are included in the calculation, the calculation going forward will be equivalent to option (1), which is the calculation as set forth in the regulation.

It is NCUA's intent that corporate credit unions only make the choice of methods for the MDANA and MMANRA calculations once and adhere to the chosen options going forward. Any change in calculation method after the initial selection will require the approval of the Director of the Office of Corporate Credit Unions.

ATTACHMENTS:

OGC and E&I concurrence memorandum.
Draft Letter to Corporate Credit Unions.

A handwritten signature in black ink, appearing to read "Scott Hunt", is written over a horizontal line. The signature is stylized and cursive.

Scott Hunt
Director
Office of Corporate Credit Unions

July 21, 2011

To the Corporate Credit Union Addressed:

On September 24, 2010, the NCUA Board approved significant revisions to Part 704 of NCUA's Rules and Regulations. The revisions included stronger capital requirements, as set forth in Section 704.3. The capital requirements include: a leverage ratio, a Tier I risk-based capital ratio, and a total risk-based capital ratio. The denominator in the calculation of the leverage ratio is MDANA. The denominator in the calculation of the risk-based capital ratios is MMANRA. This Letter provides guidance to ensure consistent reporting and full compliance with the agency's expectations that capital be commensurate with the risks of the corporate.

Below are the regulatory definitions of the two denominators:

- *MDANA* means the average of daily average net assets for the month being measured and the previous eleven (11) months.
- *MMANRA* means the average of the net risk-weighted assets for the month being measured and the previous eleven (11) months. Measurements must be taken on the last day of each month.

Using average assets measured over the current month and previous 11 months smoothes out the impact of seasonal liquidity fluctuations in the credit union system on corporate credit union capital ratios. In times when natural person credit unions accumulate liquidity, typically in the early part of the calendar year, a corporate need not raise additional capital if the average asset base does not significantly increase.

MMANRA is new to the corporate rule and does not go into effect until October 2011. When corporates begin to calculate the MMANRA, there will not be 11 previous months of data to incorporate into the calculation of the average unless each corporate reconstructed that data from their earlier financial statements.

In terms of the calculation of MDANA, it would appear equitable to allow each corporate credit union to decide whether to continue using the existing MDANA history in order to smooth out the impact of any one-month asset increases, or to begin a new MDANA history which would eliminate the months of high assets due to the corporate stabilization efforts. This is due to the fact that many corporate credit unions maintained high levels of shares during the stabilization efforts to preserve adequate liquidity and avoid the sale of distressed assets. Should the corporate opt to begin a new MDANA history, it must understand that it may be subject to the rule's prompt corrective action requirements should assets increase shortly thereafter and dilute capital below the standards to be adequately capitalized. This may require a corporate to raise additional capital. A corporate must make a deliberate decision which method to adopt as NCUA will not approve a subsequent change to the MDANA calculation merely to obtain mathematical compliance with the regulation.

Corporate credit unions are permitted to select from the following options in relation to MDANA and MMANRA regulatory calculations:

- As of October 31, 2011, corporate credit unions will have the option to calculate MDANA under one of the following two methods: (1) using the average of daily average net assets for the month being measured and the previous 11 months; or (2) using October 31, 2011, as the starting point with no inclusion of earlier months in the calculation. Under the second option, each following month the calculation will include the previous months going back to the October 31, 2011, starting point until such time 12 months of data is included in the calculation. Once 12 months of data are included in the calculation, the calculation going forward will be equivalent to option (1), which is the calculation as set forth in the regulation.
- As of October 31, 2011, corporate credit unions will have the option to calculate MMANRA under one of the following two methods: (1) using the average of the net risk-weighted assets for the month being measured and the previous 11 months. Measurements must be taken on the last day of each month; or (2) using October 31, 2011, as the starting point with no inclusion of earlier months in the calculation. Under the second option, each following month the calculation will include the previous months going back to the October 31, 2011, starting point until such time 12 months of data is included in the calculation. Once 12 months of data are included in the calculation, the calculation going forward will be equivalent to option (1), which is the calculation as set forth in the regulation.

For consolidations, this guidance remains the same. If a consolidated entity opts to retain the historical 12 months MDANA or MMANRA calculations, it must include the historical balances of the corporates prior to consolidation. If a consolidated entity adopts the option to begin the MDANA and MMANRA calculation anew, the calculation will commence effective the date of the first consolidated financial statement.

It is NCUA's intent that corporate credit unions only make the choice of methods for the MDANA and MMANRA calculations once and adhere to the chosen options going forward. Any change in calculation method after the initial selection will require the approval of the Director of the Office of Corporate Credit Unions (OCCU). In no respect does this clarification of the computation of MDANA and MMANRA restrict the NCUA's ability to establish a higher minimum capital level as prescribed by Section 704.3(e).

Each corporate credit union should notify OCCU, via OCCUMAIL@NCUA.GOV, by no later than September 30, 2011, of the option it intends to use for calculating MDANA and for calculating MMANRA beginning with the October 31, 2011, NCUA 5310 Call Report cycle.

If you have any questions, please contact my office at (703) 518-6640.

Sincerely,

Scott Hunt
Director
Office of Corporate Credit Unions

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