

CORPORATE CREDIT UNION GUIDANCE LETTER

No. 1999-02

DATE: October 5, 1999

SUBJ: Section 704.6(d) of the NCUA Rules and Regulations (Credit Ratings)

TO: The Corporate Credit Union Addressed

It has come to our attention that there is a discrepancy within Part 704 regarding the review of debt instruments downgraded by a national recognized statistical rating organization (NRSRO). A strict interpretation of the regulation may result in a corporate credit union needlessly divesting itself of an investment. A side effect would be to discourage a corporate from using more than one NRSRO in evaluating its instruments.

Section 704.6(d) requires all debt instruments to have a credit rating from at least one NRSRO. It has three other requirements. First, the rating must be monitored for as long as the corporate owns the investment. Secondly, at the time of purchase, securities must be rated no lower than A-1 to AAA (or equivalent), depending upon the type and length of the security. Finally, any rated instrument that is downgraded by the NRSRO used to meet the requirements at the time of purchase are subject to the requirements of Section 704.10 (Divestiture).

Section 704.6(d) is quite clear regarding the use of one NRSRO. Conversely, if a corporate uses more than one NRSRO, this Section does not directly address this concern and hence could be interpreted and applied differently.

Some corporates may utilize all available ratings (as many as four) in their credit analysis process. When this happens, the following question arises. What is the regulatory requirement if one of the four NRSRO downgrades the instrument? One could interpret Section 704.6(d)(4) as subjecting that instrument to the divestiture requirements of Section 704.10.

To address this concern, the Office of Corporate Credit Unions (OCCU) plans to review this section of the regulation as it reviews Part 704 for possible revisions. Until such time the regulation is revised, OCCU examiners will not object if corporates follow the guidelines outlined on the next page, when applying Section 704.6(d)(4).

1) When a corporate identifies and relies on more than one NRSRO at the time of purchase of a debt instrument to meet the minimum credit rating requirements of Section 704.6(d)(3), the following will apply when NRSROs downgrade the instrument:

a) A debt instrument downgraded below the minimum required credit rating by one such NRSRO is not subject to the requirements of Section 704.10, but must be placed on the corporate's investment "watch list" required by Section 704.6(e).

b) A debt instrument downgraded below the minimum required credit rating by two or more such NRSROs is subject to the requirements of Section 704.10.

2) When a corporate identifies and relies on one NRSRO at the time of purchase of an instrument to meet the minimum credit rating requirements of section 704.6(d)(3), the regulation applies as written.

I have instructed my staff not to take exceptions during examinations as long as your corporate meets the requirements noted above.

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

Sincerely,

Robert F. Schafer
Director
Office of Corporate Credit Unions

OCCU/GWC:gc
SSIC 3500

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NASCUS
ACCU

bcc: Reading File
Regional Directors
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