

February 25, 2010

Richard S. Schulman, Esq.  
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RE: Membership Capital Shares

Dear Mr. Schulman:

You have asked whether Membership Capital Shares (MCS) maintained by a member of a corporate credit union (corporate) are available during the notice period to cover losses in excess of retained earnings and paid-in capital after the owner of the MCS has notified the corporate of its intent to withdraw the MCS. The answer to this question is yes.

The question arises in the context of adjustable balance MCS accounts, which are specifically permissible under NCUA regulations. 12 C.F.R. §704.3(b)(8). In accordance with the rule, a corporate may establish and offer its members the choice of investing in an MCS account with a feature calling for adjustments to or from the balance based on fluctuations in an external index. Adjustments may be made at six-month intervals or longer, but not more frequently than once every six months. If the corporate selects an index other than the asset size of its member, it “must address the measure’s permanency characteristics in its capital plan.” 12 C.F.R. §704.3(b)(8)(ii).

The rule specifies that, after the owner of an adjustable MCS account has notified the corporate of an intention to withdraw the funds, no “further adjustments” to the account balance may be made during the three-year notice period. 12 C.F.R. §704.3(b)(8)(iii). The question you raise is whether this prohibition on further adjustments precludes the corporate from assessing the MCS account with its share of losses that the corporate sustains during the notice period.

The plain language of the rule requires that the entire MCS balance be exposed to losses arising during the pendency of the notice period:

[T]he full balance of a membership capital account being amortized, not just the remaining nonamortized portion, is available to absorb losses in excess of the sum of retained earnings and paid-in capital until the funds are released by the corporate credit union at . . . the conclusion of the notice period.

12 C.F.R. §704.3(b)(3). This language is consistent with the rule's definitional provisions, which specify, among other characteristics, that funds in an MCS account "are available to cover losses that exceed retained earnings and paid-in capital." 12 C.F.R. §704.2. The language in §704.3(b)(8)(iii) of the rule, indicating that funds in an adjustable balance MCS account are "frozen" once notice of intent to withdraw has been submitted, is merely a reference to the inapplicability, post-notice of intent to withdraw, of the adjustment criteria. In other words, following the placement of an adjustable MCS account on notice of intent to withdraw, funds in that account are no longer subject to adjustment based on subsequent changes in the specified index. During the notice period, the owner of the MCS account is neither entitled to a return of some portion of the funds, nor obligated to make an additional contribution, regardless of fluctuations that may occur in the index. However, the funds remain subject to impairment and depletion during the notice period due to losses that exceed available retained earnings and paid-in capital.

This interpretation is consistent with the language in both subsections of the rule, i.e., the language requiring that the funds be "frozen" during the notice period and the language requiring that the funds be "available to cover losses" during the notice period. By contrast, the alternative interpretation, i.e., that funds in an adjustable balance MCS account are immune from exposure to losses arising during the notice period, renders a portion of the rule text a nullity.

You may address any questions to me or to Trial Attorney Ross Kendall.

Sincerely,

/S/

John K. Ianno  
Associate General Counsel