March 31, 2010

Clifford Rosenthal
President/CEO
National Federation of
Community Development Credit Unions
116 John Street, 33rd Floor
New York, NY 10038

Re: National Credit Union Administration Regulations and the Community Development Capital Initiative.

Dear Mr. Rosenthal:

You have asked for clarification regarding how the National Credit Union Administration's (NCUA) recently-issued interim final rule on early redemption of government-funded secondary capital applies to qualifying low-income designated credit unions (LICUs) under the United States Treasury Department's (Treasury) Community Development Capital Initiative (CDCI). This letter explains the terms of the CDCI and the options NCUA's rule provides to LICUs that accept secondary capital under the CDCI.

On February 3, 2010, Treasury announced the implementation of the CDCI under the Troubled Asset Relief Program (TARP), which was established pursuant to the Emergency Economic Stabilization Act of 2008. The CDCI provides an opportunity for federally-insured credit unions with a low-income designation under 12 C.F.R. § 701.34, and with a Community Development Financial Institution certification from the Community Development Financial Institution Fund, to expand their credit and services by accepting TARP funds as secondary capital. TARP funds under the CDCI were originally offered with a 13-year maturity, bearing a two-percent interest rate for their first eight years and a nine-percent interest rate for their remaining five years.

In order to be approved for CDCI funding, some LICUs will be required to recruit matching secondary capital on a dollar-for-dollar basis from a non-government source. This matching secondary capital must be held subordinate to the TARP funds and must be on deposit for as long as the TARP funds remain on deposit. This means LICUs must recruit matching secondary capital with a maturity of at least 13 years to ensure subordination in the event the TARP funds are held for their entire 13-year maturity. Because of the difficulty in recruiting 13-year matching secondary capital from private investors, Treasury is considering allowing LICUs to instead accept TARP funds with an eight-year maturity, bearing interest at two percent annually for the entire term. This accommodation will increase the number of LICUs able to participate in the CDCI by making it easier to recruit matching secondary capital in instances where it is required. NCUA is communicating regularly with Treasury as it considers whether to offer TARP funds with an eight-year maturity to LICUs.

In conjunction with the CDCI, NCUA issued an interim final rule, effective February 19, 2010, to facilitate LICU participation. In particular, the rules applicable to redemption of secondary capital were amended to allow LICUs to redeem all or part of government-funded secondary capital and its matching secondary capital, if any, at any time after it has been on deposit for two years, subject to the approval of the appropriate Regional Director.[1] *See* 12 C.F.R. § 701.34(d)(4). This change exempts government-funded secondary capital and its match from the restrictions of the redemption schedule that otherwise applies pursuant to § 701.34(d)(3), allowing LICUs to avoid the accelerated interest rate on TARP funds that goes into effect in year nine in the case of 13-year funds. In addition, the procedures applicable to pro-rata distribution of a loss were amended to give LICUs two options for ensuring matching secondary capital would be held subordinate to the CDCI TARP funds with which they were paired. *See* § 701.34(b)(7).

Aside from these limited adjustments to early redemption and priority, the provisions of the former rule are unchanged. In instances where LICUs accept TARP funds with a 13-year maturity, all of the TARP funds will be eligible for redemption at any time after they have been on deposit for two years. If all of the funds are not redeemed before the beginning of year nine, the schedule for reduction of net-worth recognition set forth in 12 C.F.R. § 701.34(c)(2) will apply and LICUs must reduce net-worth recognition of the TARP funds by 20 percent of the original balance per year, through maturity or redemption. However, LICUs may still redeem all or part of the funds at any time during application of the net-worth recognition schedule if they apply for and receive the appropriate Regional Director's approval. The same rules apply for secondary capital accepted as a match to the TARP funds.[2]

If Treasury proceeds with its accommodation that would allow LICUs to choose to accept TARP funds with an eight-year maturity, the same rules apply. A LICU can redeem all or part of the TARP funds at any time after they have been on deposit for two years if the Regional Director approves. If the TARP funds are not redeemed before their fourth year, the schedule for reduction of net-worth recognition will apply and the LICU must reduce net-worth recognition by 20 percent of the original balance

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[1] Although permissible under the regulations, under the subordination terms of the CDCI, a LICU will not be able to redeem matching secondary capital at a rate greater than it redeems the TARP funds with which they are paired. On the other hand, it would be permissible under the CDCI for a LICU to redeem the TARP funds sooner than it redeems secondary capital accepted as a match to the TARP funds if this is also allowed under the LICU's contract with the match investor.

[2] In cases where a LICU redeems some, but not all, of its TARP funds and/or matching funds prior to or during the last five years to maturity, the net-worth recognition schedule of 12 C.F.R. § 701.34(c)(2) should be applied so that the LICU recognizes 80, 60, 40, 20, or zero percent of the balance on hand after the redemption(s) has occurred, depending on whether the account is in its 5th, 4th, 3rd, 2nd or last year prior to maturity. Once the balance is redeemed in full, no net-worth recognition is permitted.

per year, through maturity or redemption. The LICU may still redeem all or part of the funds at any time during application of the net-worth recognition schedule if it applies for and receives the Regional Director's approval. Once again, the same rules apply for secondary capital accepted as a match to the eight-year TARP funds.

If you have further questions, please contact me or Trial Attorney Kevin Tuininga at (703) 518-6543.

Sincerely,

/S/

Robert M. Fenner
General Counsel
National Credit Union Administration

GC/KST:bhs