CORPORATE CREDIT UNION REGULATORY REFORM
Side-by-side Comparison of Current Rule, Major Proposed Revisions (11-19-2009) and Changes from Proposed to Draft Final Rule (as of 9-8-2010)

Rule Location	Current Rule	Proposed Revisions (Nov 2009)	Changes (from Proposed to Final Rule)[1]
	Capital and Prompt Corrective Action (PCA)		
704.2, 704.3, 704.4	Currently, corporates have only one mandatory minimum capital requirement: they must maintain total capital (retained earnings, paid-in capital, and membership capital accounts) in an amount equal to or greater than 4% of their moving average daily assets. Failure by a corporate to meet this minimum capital ratio triggers the requirement to file a capital restoration plan with NCUA and may cause NCUA to issue a capital restoration directive to cease or limit certain activities.	The proposal modifies the corporate capital requirements to make them stronger and more consistent with the Basel I capital requirements imposed by the banking regulators on banks. To be considered adequately capitalized, the proposal replaces the current 4% minimum total capital ratio with three minimum capital ratios: • 4% minimum "leverage" ratio (5% to be well-capitalized (WC)), • 4% tier one risk-based capital ratio (6% to be WC), and • 8% total risk-based capital ratio (10% to be WC). The two risk-weighted ratios ensure that the corporate has enough capital to protect it against credit risk and the leverage ratio ensures that the corporate has enough capital to protect it against other, noncredit risk (e.g., market and operational risk). Failure to meet any of these three minimum ratios triggers a capital restoration plan requirement and, potentially, other new prompt corrective action (PCA) provisions as discussed below. The proposal replaces the term "paid-in capital" with "perpetual contributed capital" (PCC), and the term "membership capital account" with "nonperpetual contributed capital account" (NCA). The proposal limits the capital that a corporate may use to calculate the leverage ratio and the tier-one risk based capital ratio to "core" capital, which would generally include only the more permanent forms of corporate capital (i.e., retained earnings and PCC, but	No significant changes from proposed.

[1] This fourth column contains only staff recommendations. The NCUA Board has <u>not</u> formally approved these changes. Also, any proposed changes referenced in the third column will carry over into the final rule unless the fourth column states otherwise.

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		not NCAs). All three forms of capital are used to calculate the total risk-based capital ratio. The proposal also provides for certain adjustments to capital; for example, by requiring that a corporate that contributes capital to another corporate after the effective date of the rule must, generally, deduct this new investment from its own capital.	
New 704.3	The current rule provides that retail corporates with a retained earnings ratio of less than two percent must increase their retained earnings by a certain amount each quarter, but this reserving requirement only applies to a wholesale corporate credit union if its retained earnings ratio falls below one percent. There are no specific supervisory actions or penalties for failing to meet these ratios or reserving levels.	The proposal also requires that RE constitute a certain portion of Tier One capital by requiring that PCC be deducted from the Tier One capital ratios if PCC exceeds a certain amount of RE. For example, to be adequately capitalized, the corporate must have at least 100 basis points (bp) of retained earnings (RE) after six years and at least 200 bp after ten years. Similarly, to be well capitalized, the corporate must have at least 150 bp of RE after six years and 250 bp after ten years. A corporate that fails to make some progress towards these requirements (i.e., 45 bp after three years) will have to submit and comply with a retained earnings accumulation plan (REAP), however, NCUA retains flexibility to establish appropriate REAP milestones.	Permit PCC that is deducted from Tier One capital to count towards Tier Two capital. For state chartered corporates, consult with state regulator on preparation of REAP.
Appdx A	Appendix A contains model forms for use by the corporates in disclosing to members the terms and conditions of their contributed capital accounts.	Appendix A is retitled as *Capital Prioritization and Model Forms*, with the revised Appendix A divided into two parts (I and II). To facilitate the rebuilding of corporate capital, the new Part I permits corporates, at their option, to give capital contributed 60 days after publication of the final rule higher priority than existing contributed capital for purposes of absorption of operating losses and payment of liquidation claims. Part II has the model disclosure forms.	Changes effective date of contributed capital prioritization from 60 days to 90 days following publication.
704.2, Appdx A	Permits three year term, three year notice, and adjustable balance MCA accounts.	The proposal lengthens the three year term and notice requirement to five years and eliminates adjustable balance accounts.	Clarifies that MCAs not converted to new five year term or notice accounts do not qualify as capital.
704.2 704.3	PIC may be issued to both members and nonmembers. MCAs, however,	The proposal clarifies that corporates may issue subordinated debt and states that if such debt meets the necessary conditions (e.g., minimum five year notice or maturity), it qualifies as nonperpetual	Limits potential transferees to nonnatural persons:

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	may only be issued to members.	contributed capital -- whether issued to members or nonmembers. Specifically authorizes members that own PCC and NCAs to transfer their interests to third-parties, without regard to membership status of the third-party.	Requires disclosure to potential transferees of corporate's financial data to ensure transfers are completed without violating securities laws (e.g., anti-fraud provisions).
704.2, 704.3, Appdx A	PIC may be called (redeemed) without prior NCUA approval if a corporate would continue to meet its minimum NEV and capital levels.	The proposal forbids a corporate from redeeming any contributed capital, including both PCC and NCAs, prior to maturity without NCUA's prior approval and the prior approval of the appropriate state regulator (for state chartered corporates).	No significant changes.
704.3	Corporate may not condition membership, services, or the prices for services on the purchase of PIC.	The proposal eliminates this prohibition.	Provides that corporate must give six months notice to an existing member before conditioning membership, services, or prices for services on purchase of PIC (renamed PCC).
New Appdx. C	N/A.	The proposal defines how a corporate's assets and activities will be risk-weighted for purposes of determining their risk-based capital ratios. Assets that appear on the corporate's balance sheet will, generally, be risk-weighted at zero percent, 20 percent, 50 percent, or 100 percent, with less risky assets (e.g., treasury bills) given lower percentages, and more risky assets (e.g., fixed assets) given higher percentages. Activities that involve risk but that do not appear on a corporate's balance sheet (e.g., an interest rate swap, or a guaranteed line of credit not yet drawn upon) are assigned a conversion factor and then risk weighted as if the underlying assets were, in fact, on the corporate's balance sheet. Recourse obligations (e.g., a recourse obligation on a transferred loan) and direct credit substitutes (e.g., a mortgage backed security that is subordinated to other securities in the same issuance) are generally treated as if the entire amount of the supported asset is on the credit union's balance sheet. Residual interests (e.g.,	*Multiple minor clarifications*: ABS not subject to ratings based approach (RBA) will be risk-weighted at 100%; RMBS not subject to RBA and that include any nonqualifying mortgages will be risk-weighted at 100%; if corporate uses RBA on one security, must use RBA on all securities on that same call report;

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		retained, subordinated interests in a loan or loan participation transfer, or a retained credit enhancing interest-only strip) have different, more severe risk weighting calculations. The rule does not require a corporate to use Nationally Recognized Statistical Rating Organization (NRSRO) ratings when risk-weighting, but a corporate may employ a ratings-based approach (RBA) to risk weighting for certain investments that have an NRSRO rating. When there is more than one NRSRO rating, the corporate must use the lowest rating.	permit corporate to use RBA on short-term debt obligations issued by corporations; creates a series of "all others" conversion factors (CFs) for risk weighting derivatives not enumerated in rule; permits corporates to use Moving Monthly Average Net Risk-Weighted Assets (MMANRA) instead MDANRA in denominator of capital ratios.
New 704.4	A corporate that fails to meet its minimum 4% total capital ratio for more than 30 consecutive days, or fails to meet it during any three months out of 12, must submit a capital restoration plan. If it fails to submit and adequate plan, or fails to comply with the plan, NCUA may issue a capital directive to the corporate to cease or limit certain activities.	The new proposed PCA provisions for corporates are similar to those currently applicable to banks. Each corporate will be assigned to one of five capital categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. The potential consequences of failing to meet capital standards include prohibitions on dividend payments, restrictions on activities, restrictions on investments and asset growth, restrictions on executive compensation, requirements to elect new directors or dismiss management, and possible conservatorship or liquidation.	Remove NCUA authority in the proposal to apply certain discretionary PCA actions applicable to *significantly* undercapitalized corporates in the case of merely *undercapitalized* corporates; for state charters, permit state regulator first chance to carry out discretionary PCA actions at an undercapitalized corporate.
New Subpart L, Part 747	N/A.	The due process for credit unions and their employees associated with the new PCA provisions is set out in a new subpart to part 747 of NCUA's rules.	Provide corporates greater due process before NCUA takes certain

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			discretionary PCA actions.
Current 704.19	Wholesale corporate credit unions are only required to reserve earnings if their retained earnings ratio drops below one percent, unlike retail corporates, which must reserve if their ratio falls below two percent.	The proposal eliminates the special treatment that wholesale corporates receive with regard to retained earnings reserving requirements. Under the proposal, all corporates will be subject to the same requirements with regard to retained earnings.	No significant changes.
N/A	N/A	It will take some time for corporate credit unions to rebuild capital. Accordingly, the new capital and PCA provisions will be phased-in over time. Generally, the new PCA provisions and most of the new capital provisions will go into effect one year after the date of publication of the final rule. The effective date of the new, permanent leverage ratio, however, will be deferred for three years after publication of the final rule, and the retained earnings requirements will phase in from six to ten years after final rule publication as described above.	Permit NCAs to count without limit toward a corporate's interim leverage ratio (i.e., until the third anniversary of the final rule).
	Investments		
704.5; Appdx B to Part 704 (Parts I, II and IV).	The current Part 704 generally prohibits certain types of investments, including derivatives, stripped mortgage backed securities (MBS), mortgage servicing rights, and residual interests in asset backed securities (ABS). The rule specifies, for permissible investment types, that investments must be rated no lower than AA- by at least one Nationally Recognized Statistical Rating Organization (NRSRO) at time of purchase.	The proposal will prohibit investments in collateralized debt obligations (CDOs) and net interest margin (NIM) securities. CDOs and NIMs are complex and volatile investment types that have proven problematic for corporates. The proposal eliminates Part II expanded authority, thus limiting to "A-" the lowest possible rating for an NRSRO-rated investment purchased by a corporate with expanded investment authority. The proposal also requires that a corporate examine the NRSRO rating from every NRSRO that publicly rates a particular investment and only employ the lowest of those ratings. It further requires that at least 90 percent of a corporate's investments be rated by at least two NRSROs. Downgrades below the minimum rating threshold will continue to trigger investment action plans. The current Part III authority is renumbered as Part II. To qualify for Parts I and II expanded authorities, the proposal requires a corporate achieve and maintain higher capital levels, that is, a minimum six percent capital ratio.	Prohibit investments in private label residential MBS. Prohibits investments in subordinated securities. Permits corporates that qualify for derivatives authority to use counterparties rated down to A-; but also requires use of best practices with regard to bilateral netting agreements and collateral agreements.

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	Corporates that qualify for Part I expanded authority, however, have additional investment authority, including the purchase of investments rated down to A- Corporates that qualify for Part II expanded authority may purchase investments rated down to BBB(flat). Corporates that qualify for Part IV expanded authority may engage in derivatives transactions for certain specified purposes.	The proposal generally limits a corporate's Part III (renumbered from Part IV) derivatives activity to derivatives used for the purposes of reducing the corporate's overall risk, and limits counterparty credit ratings to those permissible for direct securities investment (e.g., base authority down to AA-).	
704.6	The current rule requires that corporates maintain an internal investment policy that includes "reasonable and supportable concentration limits" including limits by "investor type and sector." The current rule limits the aggregate of all investments in any single obligor to the greater of 50 percent of capital or $5 million, but includes no regulatory sector limits. The rule does not limit investments that are structured to be subordinate, in terms of potential credit losses, to other securities.	The proposal will reduce the single obligor limits from 50 percent of capital to 25 percent of capital, with slightly higher limits for mutual fund investments. The proposal will also impose new, specific concentration limits by investment sector. Investment sectors include residential mortgage backed securities, commercial mortgage backed securities, student loan asset backed securities, automobile loan/lease asset backed securities, credit card asset backed securities, other asset backed securities, corporate debt obligations, municipal securities, and money market mutual funds, and an "all others" category to account for the development of new investment types. The sector limits are, generally: • The lower of 500 percent of capital/25 percent of assets, or • The lower of 1000 percent of capital/50 percent of assets (for the less risky sectors). The proposal excludes certain assets entirely from both the proposed sector concentration limits and the single obligor concentration limit, including fixed assets, loans, investments in CUSOs, investments issued by the United States or its agencies or its government sponsored enterprises, and investments fully guaranteed or insured as to principal and interest by	Retain the 50% of capital single obligor limit where all investments with that obligor are short term (e.g., 30 days remaining maturity or less). Retain the 50% of capital single obligor limit for each credit card master trust, providing all securities are senior securities. Exempt settlement funds from single obligor limit. Establish additional subsector limitations, using

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		the United States or its agencies. Investments in other federally-insured credit unions, deposits in other depository institutions, and investment repurchase agreements are also excluded from the sector concentration limits but not the single obligor concentration limit. The proposal also limits subordinated positions in a structured security to the lesser of 100 percent of capital/5 percent of assets in any given sector class and the lesser of 400 percent of capital/20 percent of assets in the aggregate. This limit on subordinated securities will reduce a corporate's credit risk by limiting its ability to purchase "mezzanine" asset backed securities (as WesCorp did) or other subordinated structured securities that are not the most senior security in terms of credit risk.	the NAICS sectors, for the debt obligations of corporations.
704.2		The proposal adds, or modifies, the following definitions: *Derivative, Equity investment, Equity security, Residual interest, NRSRO,* and *Appropriate state regulator.* The proposal substitutes the term *Investment settlement* for *Regular way settlement*, and redefines that term.	Adds or modifies definitions of *Private label*, *Subordinated security*, and *Small business related security*.
704.5	Corporates may invest in certain registered investment companies (mutual funds).	The rule also adds *Collective investment funds* as a permissible investment under the same terms and conditions as investments in registered investment companies.	No changes.
	Asset Liability Management (ALM)		
704.8	The current Part 704 requires that corporates maintain an internal ALM policy. The rule requires that as part of that policy the corporate do Net Economic Value (NEV) modeling to measure the risk of interest rates changes of up to 300 basis points, but the rule does not have any other specific requirements relating to the	The proposal establishes two new limits on cash flow mismatches to ensure that the gap between the average life of assets and liabilities does not present excessive risk. • The first limit is in the form of an additional NEV stress test that applies a cash flow mismatch test to assets and liabilities. • The second limit is a cash flow mismatch test assuming a 50% slowdown in prepayment speeds. • These two tests are supplemented by prohibiting the weighted average life (WAL) of a corporate's assets from exceeding two years. • The corporate must calculate the effective and spread duration of individual assets and liabilities to support the NEV results above. • The proposal also requires every corporate	Removes the two proposed cash flow mismatch tests. Adds an additional prohibition on the WAL of a corporate's assets, assuming a 50% prepayment slowdown, exceeding 2.2 5 years.

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	matching of asset cash flows to liability cash flows.	conduct net interest income (NII) modeling.	
704.8	The current rule requires that any corporate permitting early withdrawals on share certificates "assess a market-based penalty sufficient to cover the estimated replacement cost of the certificate redeemed," but does not address the possibility of a corporate paying a member a premium for an early withdrawal.	The proposal limits a corporate's ability to pay a market-based redemption price to no more than its book value, thus eliminating the corporate's ability to pay a premium on early withdrawals and reducing the associated incentive for a natural person credit union (NPCU) to request a withdrawal.	Remove this proposed change.
704.8	N/A	The proposal also prohibits a corporate from accepting from a member or other entity any investment, including shares, loans, PIC (PCC), or MCAs (NCAs), if, following that investment, the aggregate of all investments from that member or entity in the corporate would exceed 10 percent of the corporate credit union's moving daily average net assets. This prohibition will reduce the risk to the corporate of any particular member moving its business elsewhere.	Modify proposed limit (i.e., 10% of assets) to 15% of assets. Limit applicability of this provision only to members and nonmember credit unions.
704.9	N/A	The proposal requires a corporate to keep a sufficient amount of cash and cash equivalents on hand to support its payment systems obligations.	No significant changes.
704.9	The current rule limits a corporate's borrowing to the greater of 10 times capital or 50 percent of shares and capital, but the rule does not place any additional limits on secured borrowings.	The proposal places limits on both aggregate borrowing and secured borrowing. The aggregate borrowing limit is reduced slightly, to the lower of 10 times capital or 50 percent of shares and capital. A corporate may borrow on a secured basis, but, generally, only for liquidity purposes and only with a maximum maturity of 30 days. A corporate may also borrow on a secured basis for nonliquidity purposes, but only if the corporate is well-capitalized and only in an amount equal to the corporate's excess capital. These borrowing limits will discourage a corporate from borrowing for investment arbitrage purposes.	No significant changes.
	CUSOs		
704.11	The current §704.11 does not specify the particular services	The proposal will retain the existing 704.11 requirements, including investment limitations, and further require that a corporate CUSO may only	Delay effective date of required NCUA

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	that corporate CUSOs may offer, but does provide that a CUSO must "primarily serve credit unions" and "restrict its services to those related to the normal course of business of credit unions." Corporate loans and investments in CUSOs are limited, in the aggregate, to 45% of capital, but may be less.	engage in brokerage services, investment advisory services, and other categories of services as approved by NCUA and published on the NCUA website. A CUSO must also agree with the corporate to permit NCUA to access the books, records, personnel, equipment, and facilities of the CUSO, thus strengthening NCUA's current access to corporate CUSOs.	preapproval of categories of services to 180 days following the publication of final rule; permit corporates 12 months to extricate themselves from CUSOs that are engaging in activities that are not approved; once NCUA has approved a category of service, require a rulemaking to remove or amend that category of service.
	Corporate Governance		
704.14	The current Part 704 places limitations on board representation, including limits on the number of trade organization representatives. The current rule does not, however, place any experience or knowledge requirements on individual corporate directors. The rule does not limit the representation of corporate managers and officials on the boards of other corporates.	The proposal requires that all corporate board members hold either a CEO, CFO, or COO position at their member credit union or other member entity. The proposal also requires that a majority of a corporate's board members be representatives of NPCU members and that individual board members, and the organizations they represent, be limited to no more than six consecutive years of board service. In addition, no person may sit on the boards of two or more corporates at the same time, nor may a single organizational member have more than one individual representative on the board of any given corporate. The proposal phases some of these new requirements in over time (e.g., 36 months for the majority NPCU director requirement).	Clarify that the position of Manager is equivalent to the CEO and Treasurer is equivalent to CFO. Removes the proposed term limits.
New 704.19	The current rule does not require any disclosure of senior executive	The proposal requires that each corporate prepare, on an annual basis, a document that discloses the compensation, in dollars, of each senior executive officer and director. Compensation is broadly defined,	Narrow the required compensation disclosure to the

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	compensation to the members of a corporate.[2]	and includes benefits, deferred payments, informal arrangements, and payments made to acquaintances and relatives. Any member of the corporate may obtain a copy of the disclosure upon request, and the corporate must also distribute the information to its members at least once a year, in the annual report or by some other means of its choosing. The credit union may include with the disclosure additional information if necessary to put the disclosure in context. With respect to any corporate merger, a merging federally-chartered corporate must affirmatively disclose to both NCUA and its members any material, merger-related increase in compensation (i.e., an increase of more than 15% or $10,000, whichever is greater) for any senior executive or director. A state-chartered corporate must also make the merger-related disclosure, but only to NCUA unless state law requires otherwise.	top five compensated employees, including always the CEO. Corporates with fewer than 41 employees need only disclose the top four compensated employees, and corporates with fewer than 31 employees need only disclose the top three.
New 704.20	The current rule does not place any particular limits on "golden parachute" severance packages or indemnification for senior executives and directors. Section 701.33 of NCUA's rules describes indemnification requirements generally applicable to FCUs.	The proposal prohibits golden parachutes, that is, payments made to an institution affiliated party (IAP) that are contingent on the termination of that person's employment and received when the corporate making the payment is either troubled, undercapitalized, or insolvent. The proposal also generally prohibits a corporate, regardless of its financial condition, from paying or reimbursing an IAP's legal and other professional expenses incurred in administrative or civil proceedings instituted by NCUA or a state regulatory authority where the IAP is ultimately found liable. For federal corporates, the proposed indemnification limits are in addition to the requirements of §701.33.	No changes.

[2] The Internal Revenue Code, and state law, may require some disclosure for state chartered corporates, but not for federal charters.