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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 741

RIN 3133-AD96

Liquidity and Contingency Funding Plans

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final Rule.

SUMMARY: The NCUA Board (Board) is issuing a final rule to require federally insured credit unions (FICUs) with less than \$50 million in assets to maintain a basic written policy that provides a credit union board-approved framework for managing liquidity and a list of contingent liquidity sources that can be employed under adverse circumstances. The rule requires FICUs with assets of \$50 million or more to have a contingency funding plan that clearly sets out strategies for addressing liquidity shortfalls in emergency situations. Finally, the rule requires FICUs with assets of \$250 million or more to have access to a backup federal liquidity source for emergency situations.

DATES: This rule is effective March 31, 2014.

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I. Background

A. Why is NCUA Adopting this Final Rule?

The recent financial crisis demonstrated the importance of good liquidity risk management to the safety and soundness of financial institutions. Many institutions experienced significant financial stress because they did not manage their liquidity in a prudent manner. In some cases, these institutions had difficulty meeting their obligations as they became due because sources of funding became severely restricted. In the financial crisis, even institutions that were healthy used emergency federal liquidity facilities when funding costs became prohibitively high. At the time, the borrowing authority of NCUA's Central Liquidity Facility (CLF) was more than \$40 billion, and it was able to play a significant role in making liquidity available to credit unions. Because of the 2012 closure of U.S. Central Credit Union and the redemption of most of its CLF stock, however, the CLF's borrowing authority has been reduced to just over \$2 billion.

These events followed several years of ample liquidity. The rapid reversal in market conditions and availability of liquidity during the crisis illustrated how quickly liquidity can evaporate. This illiquidity can last for an extended period, leading to an institution's inability to meet its financial obligations and possibly its insolvency. Many of the liquidity-related difficulties experienced by financial institutions were due to lapses in basic principles of liquidity risk management. This rule will strengthen FICU liquidity risk management, which

is crucial to ensuring the credit union system's resiliency during periods of financial market stress.

B. What Did the 2012 Proposed Rule Say?

The 2012 proposed liquidity rule required FICUs with less than \$10 million in assets to maintain a written liquidity policy, including a list of contingent liquidity sources.¹ It also required FICUs with assets of \$10 million or more to have a contingency funding plan (CFP) that clearly sets out strategies for addressing liquidity shortfalls in emergency situations. Finally, it required FICUs with assets of \$100 million or more to have access to either the CLF or the Federal Reserve Discount Window (Discount Window). The proposed rule also requested comment on the costs and benefits of applying Basel III liquidity measures to FICUs with assets over \$500 million.²

C. How Did the Commenters Respond to the 2012 Proposed Rule?

NCUA received 45 comments on the proposed rule. More than half of the commenters urged that the rule not go forward, stating that NCUA had not justified a need for a liquidity regulation and that the guidance provided by the 2010 Interagency Policy Statement on Funding and Liquidity Risk Management (Policy Statement)³ was sufficient to control liquidity risk. Twenty commenters stated that any emergency liquidity regulation should include the option of

¹ 77 FR 44503 (July 30, 2012).

² See Basel Committee on Banking Supervision, "Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring," Dec. 2010, available at <http://www.bis.org/publ/bcbs188.htm>.

³ 75 FR 13656 (Mar. 22, 2010).

membership in a Federal Home Loan Bank (FHLB), and ten stated that it should include the option of holding marketable securities.

A number of commenters praised the three-tiered approach, although 12 suggested that the lower threshold should be raised to match NCUA's then-proposed amendment to the definition of "small entity."⁴ Seven commenters suggested that the higher threshold should be raised. Six stated that asset size is a poor basis on which to determine whether liquidity requirements should be imposed.

Several commenters seemed confused about the proposed requirement that FICUs with assets of \$100 million or more have access to the CLF or Discount Window. Their comments suggested they believed the requirement meant that these larger credit unions would be prohibited from establishing other sources of liquidity. This is incorrect. As discussed in greater detail below, the Board encourages all FICUs to have multiple sources of liquidity.

Twenty-five commenters objected to the CLF's structure, specifically the required stock investment and the CLF's inability to guarantee same-day funding. The Board notes that the stock investment is required under the Federal Credit Union Act.⁵ The Board also notes that the CLF cannot guarantee same-day funding to credit unions because it borrows the funds it lends from the Federal Financing Bank under terms prescribed by the U.S. Treasury.

⁴ *See* 77 FR 59139 (Sept. 26, 2012).

⁵ *See generally* 12 U.S.C. 1795 – 1795k.

Eighteen commenters either opposed applying Basel III liquidity measures and monitoring tools to FICUs with assets over \$500 million or suggested that NCUA proceed very slowly in considering such application.

II. Final Rule

A. In General.

After careful consideration of the comments, the Board has concluded that a liquidity rule is necessary to ensure that FICUs remain resilient in times of economic stress. It, therefore, is adopting as final a modified version of the 2012 proposed rule. As discussed in greater detail below, this final rule addresses concerns raised by the commenters. Accordingly, the Board is adding a new §741.12 to part 741, titled “Liquidity and Contingency Funding Plans.” The Board believes that FICUs, relying on the guidance provided in the Policy Statement, generally have managed liquidity risk adequately. However, the financial crisis highlighted the importance for FICUs to have strong policies and programs explicitly addressing the credit union’s liquidity risk management. The Board believes it is critical to expand the credit union industry’s borrowing capacity after the liquidation of U.S. Central Credit Union.

The Board is retaining the tiered approach of the proposed rule and is continuing to base the tiers on asset size. The Board believes that, while there are exceptions, larger credit unions generally present greater exposure to the NCUSIF. The Board is, however, raising the triggering thresholds from those in the proposed rule.

Since the proposed rule was issued, the Board revised the definition of “small entity” from a credit union with less than \$10 million in assets to one with less than \$50 million in assets.⁶ The Board also amended two NCUA regulations that grant relief based on an asset threshold, raising that threshold from \$10 million to \$50 million.⁷ For regulatory relief and regulatory consistency, the Board is raising the lowest threshold in this rule – requiring a basic written policy – to include credit unions with less than \$50 million in assets.

In response to comments, and to reduce regulatory burden, the Board is raising the highest threshold – requiring established access to a federal liquidity provider – from \$100 million to \$250 million. While the Board encourages FICUs with assets between \$100 million and \$250 million to have this access, the Board is not requiring it at this time.

B. How Does the Final Rule Affect FICUs With Less Than \$50 Million in Assets?

The Board continues to believe that it is essential for every FICU, regardless of size and complexity, to have a management process for identifying, measuring, monitoring, and controlling liquidity risk that is commensurate with its respective needs. FICUs with less than \$50 million in assets present relatively limited liquidity concerns, as they tend to have lower loan-to-share ratios, shorter duration assets, and higher amounts of balance sheet liquidity than larger credit unions. Accordingly, §741.12(a) of the final rule requires these smaller FICUs to maintain a basic written policy that provides a credit union board-approved framework for

⁶ 78 FR 4032 (Jan. 18, 2013).

⁷ *Id.*

managing liquidity and a list of contingent liquidity sources that can be employed under adverse circumstances. Such a policy establishes liquidity measures and associated benchmarks, a reporting requirement to keep the board apprised of the institution's liquidity position, and a contingent source, or sources, of funding, such as a corporate credit union or correspondent bank.

C. How Does the Final Rule Affect FICUs With \$50 Million or More in Assets?

Section 741.12(b) requires any FICU with assets of at least \$50 million to have a fully developed, written CFP that clearly sets out strategies for addressing liquidity shortfalls in emergency situations. In addition to the policy items required for smaller FICUs, a fully developed CFP also provides for evaluation of adverse liquidity scenarios, outlines specific actions to be taken and specific sources of liquidity in emergency liquidity events, and provides for periodic testing of contingent liquidity sources. Section 741.12(d) of the final rule details all of the requirements of a CFP. The Board is imposing greater requirements on these larger FICUs because of the critical importance of a well-developed CFP to the viability of these institutions and, ultimately, the safety of the NCUSIF.

D. What Additional Requirements Apply to FICUs With \$250 Million or More in Assets?

In addition to the requirement to have a written CFP, §741.12(c) of the final rule requires any FICU with assets of \$250 million or more to ensure it has immediate, established access to either

the CLF or the Discount Window. These larger credit unions have a greater degree of interconnectedness with other market entities. When they experience unexpected or severe liquidity circumstances, they are more likely to adversely affect the credit union system, public perception, and the NCUSIF.

The Board determined not to include FHLB membership as a federal contingency source for purposes of meeting the requirements of this rule. As discussed in the preamble to the proposed rule, FHLBs can be valuable contingency funding sources. However, while government sponsored, FHLBs are not federal facilities and are not obligated to meet emergency liquidity demands in the same way that the CLF and Discount Window are designed to do. The Board also declines to allow large FICUs to meet the requirements of the rule by holding a portfolio of marketable securities. While it is prudent for every FICU to have a cushion of highly liquid assets on its balance sheet, these assets have proven to be insufficient in a crisis.

The Board emphasizes that all FICUs should have access to multiple sources of funding, from both their own balance sheets and through market funding sources. In requiring the largest FICUs to have established access to the CLF or the Discount Window, the Board is not suggesting that these sources are sufficient by themselves. FICUs with assets of \$250 million or more should have three distinct sources of liquidity readily available.

First, all FICUs should maintain a balance sheet cushion of highly liquid assets as a basic element of liquidity risk management. It is essential for FICUs of all sizes to hold an

adequate safeguard of cash and cash equivalents (such as short-term deposits and Treasury securities) on the balance sheet continuously. A balance-sheet cushion affords an institution time to avoid service disruptions and enter external funding arrangements if necessary.

A second element of liquidity management is borrowing from market counterparties, such as corporate credit unions, correspondent banks, FHLBs, and repurchase agreement counterparties. The ability to borrow from market sources requires having unencumbered assets that can be readily pledged against a loan. Larger FICUs with greater potential funding needs should have multiple stable borrowing sources and a clear understanding of which assets can be pledged.

The third element of protection is access to a federal emergency liquidity provider: the CLF or the Discount Window. These providers exist to provide backup liquidity in circumstances where on-balance sheet liquidity and market sources prove inadequate. Like the market funding sources, the CLF and Discount Window are both collateral-based lending facilities. The Board believes that, to protect the NCUSIF, it is essential for FICUs with assets of at least \$250 million to have this third element of liquidity in place.

The rule provides that a FICU may demonstrate access by becoming a regular member of the CLF, becoming a member of the CLF through an agent, or establishing borrowing access through the Discount Window. As discussed in the preamble to the proposed rule, corporate credit unions may facilitate natural person credit unions becoming regular CLF members by,

for example, assisting with applications of credit, serving as a collateral custodian and administrator, and assisting with credit reporting requirements.⁸

The Discount Window serves all depository institutions that meet eligibility requirements established by Federal Reserve regulations.⁹ To gain access to the Discount Window, the Federal Reserve requires specific agreements to be executed. Information regarding these agreements, as set forth in Operating Circular No. 10, and Discount Window operation can be found at www.frbdiscountwindow.org.

The Board notes that, while not required in the final rule, a FICU may wish to both become a member of the CLF and establish borrowing access at the Discount Window. The combination of the CLF and the Discount Window would provide the greatest protection in the event of a sudden and sustained liquidity emergency. The Discount Window is designed to handle sudden emergencies that require same-day access to liquidity. The CLF, on the other hand, is designed to handle sustained emergencies that require federal backup liquidity for several months.

The following table shows some of the similarities and differences between the CLF and the Discount Window.

⁸ A corporate acting as a CLF correspondent would not be an agent member of the CLF within the meaning of 12 U.S.C. 1795c(b) or 12 CFR 725.4, as it would not subscribe to CLF stock for its members. For a natural person credit union to be a regular member of the CLF, it must subscribe to CLF stock. 12 U.S.C. 1795c(a); 12 CFR 725.3.

⁹ Any depository institution holding liabilities potentially subject to reserve requirements under Federal Reserve regulations can establish access to the Discount Window. Such “reserveable liabilities” include transaction accounts and nonpersonal time deposits. For most credit unions, share draft accounts would be the principal reserveable liability. *See* 12 CFR part 204.

	Federal Reserve Discount Window	Central Liquidity Facility (CLF)
Similarities	Both the Discount Window and the CLF function as safety valves to relieve liquidity pressure on individual depository institutions and to stabilize broader liquidity systems.	
	Both are fully secured collateral-based lenders.	
	Both met emergency liquidity needs for individual institutions and for entire systems during the latest financial crisis.	
Differences	The Fed is able to advance <i>same-day funds</i> to qualifying credit unions (subject to collateral requirements).	CLF funding may take <i>1-10 business days</i> depending on the requested dollar amount (also subject to collateral requirements).
	The Fed's <i>overnight loans</i> may be renewable, but any series of rollovers is expected to be <i>brief</i> in duration.	The CLF makes <i>loans up to 90 days</i> , and these 90-day loans may be <i>renewed for an additional term</i> under certain circumstances.

With established access to both, in a liquidity crisis, when balance sheet and market sources are not enough, a FICU would have the ability to immediately obtain federal backup liquidity through the Discount Window. If the FICU's emergency liquidity needs persist for more than a few days, the FICU would have the flexibility to maintain federal backup liquidity through the CLF for several months at a time. The amount of liquidity advances available from either facility is a function of the eligible collateral available to pledge.

A FICU with \$250 million or more in assets will be in compliance with this final rule if, by the effective date of March 31, 2014, it has submitted either a completed application for access to the CLF or the necessary lending agreements and corporate resolutions to obtain credit from the Discount Window.

E. How Are a FICU's Assets Calculated for Purposes of the Final Rule?

Credit unions' assets can grow and shrink rapidly, and a particular FICU's assets may cross the \$50 million or \$250 million threshold repeatedly over a short period of time. In light of this fluctuation, §741.12(e) of the final rule provides that a FICU is subject to the requirements of a higher asset category when two consecutive Call Reports show its assets to be in that higher category. A FICU will then have 120 days from the effective date of that second Call Report to meet the higher triggered requirements.

F. Request for Comment Regarding Basel Liquidity

In the proposed rule, the Board requested comment on whether certain Basel III liquidity measures and monitoring tools should be incorporated into NCUA's supervisory expectations for the largest FICUs. In response to comments, the Board has determined not to take up the Basel measures at this time.

III. Regulatory Procedures

a. Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact any regulation may have on a substantial number of small entities (those under \$50 million in assets). The final rule requires small FICUs to establish a

basic liquidity policy, which is a best practice for every depository institution. Because the policy requires only modest effort, it will not have a significant economic impact on a substantial number of small credit unions.

b. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) applies to rulemakings in which an agency by rule creates a new paperwork burden on regulated entities or modifies an existing burden.¹⁰ For purposes of the PRA, a paperwork burden may take the form of a reporting, recordkeeping, or disclosure requirement, each referred to as an information collection.

NCUA has determined the requirement to maintain a basic written liquidity policy is an information collection requirement. NCUA estimates that all 4,444 credit unions under \$50 million in total assets may have to formalize their liquidity risk policies and that this task should take approximately 8 hours per credit union. The expected burden of the requirement is: $4,444 \text{ FICUs} \times 8 \text{ hours} = 35,552 \text{ hours}$.

NCUA has further determined the requirement to establish and document a CFP constitutes an information collection requirement but that, because of the Policy Statement, approximately 447 out of 2,237 (or 20%) of FICUs with assets of at least \$50 million will already have established such a plan. NCUA estimates that 1,790 FICUs will have to develop a written

¹⁰ 44 U.S.C. 3507(d); 5 CFR part 1320.

CFP and that the task should take a FICU approximately 24 hours. The expected burden of the requirement is: 1,790 FICUs x 24 hours = 42,960 hours.

NCUA has also determined the requirement to either become a member of the CLF or establish borrowing access through the Discount Window creates a new information collection requirement. There are 771 FICUs with assets of at least \$250 million, 374 of which are not currently regular members of CLF and/or do not report having established Discount Window access. NCUA estimates that it should take a FICU approximately 4 hours to complete the necessary paperwork to establish either CLF or Discount Window access. The expected burden of the requirement is: 374 FICUs x 4 hours = 1,496 hours.

While the regulation provides the option of establishing CLF membership through an agent, NCUA estimates that no corporates will opt to be agent members at this time and, therefore, no FICUs will establish membership in this manner.

As required by the PRA, NCUA submitted a copy of this final rule to OMB for its review and approval.

c. Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order to adhere to fundamental

federalism principles. This final rule does not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this rule does not constitute a policy that has federalism implications for purposes of the executive order.

d. The Treasury and General Government Appropriations Act, 1999 – Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this final rule will not affect family well-being within the meaning of § 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

e. Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104-121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by section 551 of the Administrative Procedure Act.¹¹ NCUA does not believe this final rule is a “major rule” within the meaning of the relevant sections of SBREFA and has submitted the rule to the Office of Management and Budget for its determination in that regard.

¹¹ 5 U.S.C. 551.

List of Subjects

12 CFR part 741

Credit, Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on October 24, 2013.

Gerard Poliquin

Secretary of the Board

For the reasons stated above, the National Credit Union Administration amends 12 CFR part 741 as follows:

PART 741—REQUIREMENTS FOR INSURANCE

1. The authority citation for part 741 continues to read as follows:

Authority: 12 U.S.C. 1757, 1766(a), 1781-1790, and 1790d; 31 U.S.C. 3717.

2. Amend part 741 by adding a new §741.12 to read as follows:

* * * * *

§741.12 Liquidity and Contingency Funding Plans

(a) Any credit union insured pursuant to Title II of the Act that has assets of less than \$50 million must maintain a basic written policy that provides a credit union board-approved framework for managing liquidity and a list of contingent liquidity sources that can be employed under adverse circumstances.

(b) Any credit union insured pursuant to Title II of the Act that has assets of \$50 million or more must establish and document a contingency funding plan (CFP) that meets the requirements of paragraph (d).

(c) In addition to the requirement specified in paragraph (b) to establish and maintain a CFP, any credit union insured pursuant to Title II of the Act that has assets of \$250 million or more must establish and document access to at least one contingent federal liquidity source for use in times of financial emergency and distressed economic circumstances. These credit unions must

conduct advance planning and periodic testing to ensure that contingent funding sources are readily available when needed. A credit union subject to this paragraph may demonstrate access to a contingent federal liquidity source by:

(1) Maintaining regular membership in the Central Liquidity Facility (Facility), as described in part 725 of this chapter;

(2) Maintaining membership in the Facility through an Agent, as described in part 725 of this chapter; or

(3) Establishing borrowing access at the Federal Reserve Discount Window by filing the necessary lending agreements and corporate resolutions to obtain credit from a Federal Reserve Bank pursuant to 12 CFR part 201.

(d) Contingency Funding Plan. A credit union must have a written CFP commensurate with its complexity, risk profile, and scope of operations that sets out strategies for addressing liquidity shortfalls in emergency situations. The CFP may be a separate policy or may be incorporated into an existing policy such as an asset/liability policy, a funds management policy, or a business continuity policy. The CFP must address, at a minimum, the following:

(1) The sufficiency of the institution's liquidity sources to meet normal operating requirements as well as contingent events;

(2) The identification of contingent liquidity sources;

(3) Policies to manage a range of stress environments, identification of some possible stress events, and identification of likely liquidity responses to such events;

(4) Lines of responsibility within the institution to respond to liquidity events;

(5) Management processes that include clear implementation and escalation procedures for liquidity events; and

(6) The frequency that the institution will test and update the plan.

(e) A credit union is subject to the requirements of paragraphs (b) or (c) of this section when two consecutive Call Reports show its assets to be at least \$50 million or \$250 million, respectively. A FICU then has 120 days from the effective date of that second Call Report to meet the greater requirements.

* * * * *