

7535-01-U

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 702

RIN 3133-AE27

Capital Planning and Stress Testing

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is issuing a rule requiring federally insured credit unions (FICUs) with assets of \$10 billion or more to develop and maintain capital plans. The rule also provides for annual stress tests of those credit unions.

DATES: This rule is effective [INSERT DATE 30 DAYS FROM DATE OF PUBLICATION IN FEDERAL REGISTER].

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SUPPLEMENTARY INFORMATION:

Table of Contents

- I. Background
 - A. Why is NCUA adopting this final rule?
 - B. What did the proposed rule say?
 - C. How did the commenters respond to the proposed rule?

- II. Final Rule
 - A. Capital planning.
 - B. Stress testing.
 - C. State coordination.
 - D. Public disclosure.
 - E. Process overview.
 - F. Effective date.

- III. Regulatory Procedures
 - A. Regulatory Flexibility Act.

- B. Paperwork Reduction Act.
- C. Executive Order 13132.
- D. Assessment of Federal Regulations and Policies on Families.
- E. Small Business Regulatory Enforcement Fairness Act.

I. Background

A. Why is NCUA adopting this final rule?

The NCUA Board (Board) believes that in order to ensure the safety and soundness of the credit union system and to protect the National Credit Union Share Insurance Fund (Share Insurance Fund), the largest FICUs should have in place systems and processes to monitor and maintain their capital adequacy. This rule achieves that by requiring FICUs with assets of at least \$10 billion (covered credit unions) to submit capital plans annually to NCUA. The rule establishes a supervisory tool for assessing covered credit union capital adequacy by also providing for annual stress tests of their balance sheets using baseline, adverse, and severely adverse scenarios.

B. What did the proposed rule say?

The proposed rule required covered credit unions to develop and maintain a capital plan and submit the plan to NCUA annually.¹ It applied to all FICUs that reported \$10 billion or more in

¹ 78 FR 65583 (Nov. 1, 2013).

assets on their March 31 Call Report. The proposed rule also provided for NCUA to conduct independent stress tests on all covered credit unions based on September 30 financial data.

C. How did the commenters respond to the proposed rule?

NCUA received 22 comments on the proposed rule. All of the commenters supported the concept of stress testing and capital planning for covered credit unions. However, eight were opposed to the issuance of a new regulation, urging that NCUA issue non-binding supervisory guidance instead. The remaining 14 commenters, including the four credit unions that are currently over \$10 billion in assets, did not object to a new regulation but suggested significant changes to the proposal.

The Board has determined that issuing guidance would not achieve the goals intended by this rule. The Board views stress tests and capital planning as common safety and soundness requirements for financial institutions, including credit unions, with \$10 billion or more in assets. This element of safety and soundness is broadly outlined in federal banking agency guidance, and NCUA intends to do the same. Also, in a manner similar to bank regulatory agencies, NCUA will issue guidance with greater details describing how covered credit unions can comply with the requirements for stress testing and capital planning.

Two commenters said that the proposal does not comply with the Administrative Procedure Act (APA). With respect to this type of rulemaking, the APA requires federal agencies to give the public advance notice of the contents of a proposed rule and to offer the public an opportunity to

express their views of the proposed rule before the agency.² The requirement to provide the public with adequate notice of a proposed rule is generally achieved through the publication of a notice of proposed rulemaking in the Federal Register.³ NCUA issued a proposed rule regarding capital planning and stress testing on October 24, 2013, which was published in the Federal Register on November 1, 2013.⁴ The public was given 60 days from that date to submit comments. The Board believes that the rulemaking procedures comply with APA requirements.

These commenters also stated that the legal authority cited for the proposed regulation, Sections 120(a) and 216 of the Federal Credit Union Act (the Act)⁵ do not specifically address capital planning and stress testing. This is correct, but the Act does not limit NCUA to issuing regulations only explicitly authorized by statute. Instead, it grants NCUA a broad mandate to “prescribe rules and regulations for the administration of this chapter.” “This chapter” means Chapter 14 of Title 12 of the United States Code, which is the Act itself.

Seven commenters argued that credit unions should be treated like banks, that is, NCUA should apply the supervisory stress testing and capital planning requirements only to credit unions with at least \$50 billion in assets. The Board disagrees. As of December 2013, the assets in the Share Insurance Fund totaled \$11.6 billion, and the assets of the four largest covered credit unions totaled \$111.4 billion – nearly 10 times the size of the Share Insurance Fund. The net worth of these credit unions was \$11.24 billion as a cushion against the risks of these assets. NCUA can

² 5 U.S.C. 553 (b) and (c).

³ 5 U.S.C. 553(b).

⁴ 78 FR 65583 (Nov. 1, 2013).

⁵ 12 U.S.C. 1766a and 1790d.

expect the exposure of the Share Insurance Fund will increase further as additional credit unions cross this \$10 billion threshold. The Board believes it is important to require capital planning and stress testing at the credit unions that, by virtue of their sheer size, could pose the greatest risk to the Share Insurance Fund, while limiting the regulatory burden.

After careful consideration of all of the comments, the Board has determined to issue this final capital planning and stress testing rule. In response to comments, the Board has reorganized the rule and made other changes from the proposal, as discussed below.

II. Final Rule

A. Capital planning.

The proposed rule contained mandatory elements of a capital plan. Some commenters objected that the requirements were too broad. Others said that the grounds for rejecting a capital plan should be specifically defined. The Board disagrees with these views. The risk exposure of a credit union depends on its marketplace, its individual business model, changes to its business plan, and the management of enterprise-wide risks specific to the credit union's strategies. The adequacy of capital planning must be commensurate with the risks and complexity of each credit union in the context of its own circumstances; these cannot be pre-defined.

The proposed rule required a covered credit union to perform specific capital analyses, including a requirement to test the impact of interest rate shocks of at least +/- 300 basis points on the net

economic value of the credit union, using final maturities of non-maturity shares not exceeding two years. A number of commenters opposed this test as arbitrary and unrealistic. The purpose of the requirement in the proposed rule was to address the extent to which an assumption of long maturities on non-maturity shares can mask a credit union's interest rate risk. However, the specificity of the rule as proposed may detract from other interest rate risk factors. Accordingly, the Board has removed that test from the final rule and substituted a requirement that covered credit unions perform reverse stress testing as part of their capital planning.

Reverse stress testing is a tool that allows a credit union to assume a known adverse outcome, such as suffering a credit loss that breaches regulatory capital ratios or suffering severe liquidity constraints that render it unable to meet its obligations, and then infer the types of events that could lead to such an outcome. This type of stress testing may help a credit union to consider scenarios beyond normal business expectations and see the impact of severe systemic effects on the credit union. It also allows a credit union to challenge common assumptions about its performance and expected mitigation strategies. NCUA expects that credit unions will address ranges of member behavior in regard to non-maturity share pricing in their sensitivity tests and reverse stress tests. The Board has added definitions of "sensitivity testing" and "reverse stress test" to the final rule.

Commenters objected to the requirement that capital plans must contain "at least" the elements enumerated in the proposal. They expressed concern that the phrase might lead examiners to require additional elements not listed in the rule. However, the point of the capital planning exercise is for a covered credit union to consider its specific risk exposures and to establish

capital goals and requirements to support these risks. Where a particular covered credit union's unique products, lines of business, and field of membership create a risk not captured by the enumerated elements, the credit union will be expected to conduct additional analyses.

The proposed rule required covered credit unions to conduct certain capital plan assessments over each quarter of a 3-year planning horizon. Some commenters suggested that the capital planning horizon should be only 9 quarters, like the stress test horizon. The Board disagrees. A covered credit union's capital planning should be part of long-term strategic planning. A 3-year capital planning horizon is longer than the stress test period and therefore allows a credit union to incorporate any stress testing as it formulates its capital plans. NCUA also encourages covered credit unions to incorporate factors longer than 3 years into their capital planning process.

B. Stress Testing.

The proposed rule provided that NCUA would conduct independent stress tests on all covered credit unions. Many commenters suggested stress testing should be performed by the covered credit unions themselves and that it would be simpler and less costly for NCUA to validate the models and assumptions of the credit unions than to conduct the stress testing independently. The Board considered the reasons for relying on independently performed stress testing, taking into account the costs. The primary objective of stress testing is for the Board to assess the ability of the largest credit unions to absorb the impact of significant economic stresses and to determine with a high degree of confidence when a covered credit union does not have sufficient capital to protect the Share Insurance Fund from losses that may threaten the credit union system.

The Board believes consistent processes and uniform application of stress test procedures and analysis are critical to achieving reliable results. As a result, the Board believes NCUA-run stress testing is necessary for the first three years of credit union stress testing.

After NCUA conducts stress tests on a credit union for three years, the credit union may apply to NCUA to conduct its own stress test in such a manner as approved and as supervised by NCUA.

This final rule is not the end of the process on stress testing, but just the beginning. The agency's objective is for stress testing to be a process of continuous improvement. For the first three years, NCUA will use external providers to assist in evaluating data and producing comparable results for the required stress test scenarios. In the following years, whether NCUA or the credit union conducts the stress test, NCUA will ensure the stress testing protocol maintains an independent and comparable assessment of capital plus the flexibility to address the demands of a changing environment.

In determining whether or not to approve a covered credit union's request to perform its own stress tests, NCUA may consider factors such as the credit union's previous stress test results, recent supervisory history, current financial condition, CAMEL codes, management continuity, and any operational changes, among other parameters.

The proposed rule established a minimum stress test capital ratio of 5 percent. Some commenters argued that the minimum ratio should be 4 percent, like the minimum bank leverage ratio. The Board disagrees. The stress test capital ratio must take into account the difference

between credit union and bank capital. Because credit unions do not have access to the capital markets to raise common stock, they must rely on retained earnings, which take time to accumulate. A minimum ratio of 5 percent provides a threshold below which a credit union may take timely action to enhance its stress test capital before reaching a 4 percent level, at which time the credit union would be considered significantly undercapitalized.

The proposed rule also excluded several items from the calculation of stress test capital, including the 1 percent Share Insurance Fund deposit. Some commenters argued that the 1 percent deposit should be included because the credit union has a claim on the deposit.

However, the deposit is not available to the credit union to cover losses it may incur. The Board therefore continues to believe it is appropriate to exclude the deposit from stress test capital for NCUA's stress testing.

C. State coordination.

The proposed rule provided that before taking any action against a federally insured, state-chartered credit union for capital planning or stress testing violations, NCUA would consult with the applicable state supervisory authority. Several commenters objected that consultation was insufficient and, therefore, that the proposal undermined state authority. The Board has added to the final rule a commitment that NCUA will also work cooperatively with the state authority.

D. Public Disclosure.

The Board noted that bank stress tests are publicly disclosed and sought comment on whether credit union tests should be similarly disclosed. The Board noted that public disclosure helps to provide valuable information to market participants, enhances transparency, and facilitates market discipline but also cautioned that stress test results can be misinterpreted and lead to inaccurate conclusions about the health of an institution. The majority of the commenters stated that stress test results should not be publicly disclosed. However, three of the four covered credit unions suggested that there should be public disclosure after an initial implementation period. The Board recognizes that the public policy goals of providing information to market participants and facilitating market discipline are of reduced importance in the case of credit unions, as credit unions are cooperatives and not publicly held institutions. The Board does, however, acknowledge that members are owners of credit unions and as such should be afforded as much information as possible about the credit union in which they invest and entrust to provide their financial services. To that end, NCUA provides full transparency of all federally insured credit unions' current and past financial information by posting quarterly Call Report data for all the public.

At the same time, the Board must consider whether publicizing stress test results could harm the credit union members that NCUA intends to protect. As some stakeholders cautioned, stress test results could be taken out of context or misreported in public media. This could lead members to faulty conclusions about their credit union's current health, and cause a run on deposits – one of the worst-case scenarios that stress testing is intended to avoid.

The same fundamental reasons why NCUA does not publicize CAMEL Codes would apply to publicizing stress test results: Both CAMEL Codes and stress tests are supervisory tools. Both are designed to require credit unions to take certain actions in order to strengthen safety and soundness. Similarly, NCUA does not require credit unions to publicly release results from asset-liability management modeling, liquidity planning, or interest rate risk shock tests. These tests are designed as internal exercises to ensure that credit unions are prepared for a wide variety of “what if” scenarios.

For credit unions that may be approved by NCUA to conduct their own stress tests after three years, publicizing the results could put even more pressure on the credit unions to make sure they always show positive results. In some cases, credit unions might choose to alter their assumptions rather than increase capital. Such an action would subvert the purpose of this rule: To ensure that the largest credit unions take proactive steps to increase capital in advance of the worst-case scenario.

Accordingly, the Board has determined that public disclosure is not appropriate during the first several years of stress test implementation. However, when NCUA next reviews Part 702 as part of its ongoing three-year rotation, the Board reserves the right to take a separate action on whether or not to publicly disclose the stress test results.

E. Process Overview.

The proposed rule contained a table setting out the timeframes of various requirements. Under the proposed rule, and as shown in that table, covered credit unions were required to submit their capital plans to NCUA by March 31 of each year. It provided that NCUA would notify the credit union of its acceptance or rejection of the plan by June 30 and, in the case of a rejection, allowed the credit union 30 days to resubmit its plan. Several commenters stated that 30 days was insufficient. The Board agrees, and the final rule provides 90 days for resubmission of a rejected plan. In order to accommodate this change, however, the final rule requires initial submission of the plan by February 28 and an NCUA response within 90 days. NCUA believes the slightly shorter time frame for initial submission will not be burdensome as capital planning is an ongoing process that occurs on an annual cycle.

The proposed rule provided that covered credit unions would be given the results of the NCUA stress tests by May 31. One commenter said that credit unions should be given the stress test results before the capital plan is due. The Board recognizes that credit unions would like to have the stress test results available for the development of their capital plans. However, supervisory stress testing and credit union capital planning have different purposes and are unique exercises. NCUA's supervisory stress test provides an independent assessment of the credit union's capital adequacy. A covered credit union's capital planning process is a sound practice that integrates strategic planning, risk management, and capital assessment.

Capital planning and supervisory stress testing are separate processes. Moreover, the final rule allows for stress testing to be performed by NCUA, or subsequently by the covered credit

unions. These processes have independent timelines, so the tables below now show each process separately.

Table 1	
Process Overview of Capital Planning Requirements when NCUA Performs Stress Tests Under this Final Rule	
Timeframe	Steps
September 30*	“As of” date for covered credit union’s capital plan.
by February 28 (of the following year)*	Covered credit union submits capital plan to NCUA.
within 90 days of submission of plan	NCUA accepts or rejects capital plan.
within 90 days of NCUA decision to reject plan	Affected covered credit union submits revised capital plan.

* The final rule allows NCUA to direct a covered credit union to formulate its capital plan based on financial data for a date other than the September 30 date in Table 1. NCUA anticipates there may be cases where September 30 data does not appropriately capture the risk of the covered credit union. In this instance, NCUA would specify the alternative capital plan date, and adjust the February 28 deadline for capital plan submissions on a schedule to reflect the change in the “as of” date.

Table 2	
Process Overview of NCUA-run Supervisory Stress Test Requirements Under this Final Rule	
Timeframe	Steps
September 30**	“As of” date for NCUA’s stress test data
by December 1	NCUA releases scenarios on which it will conduct independent stress tests.
by May 31***	NCUA provides stress test results to covered credit union.
within 90 days of receipt of stress test results (if below required minimum)	Affected covered credit union submits stress test capital enhancement plan.

**As with capital planning, NCUA may direct stress tests of a covered credit union to occur on an alternative “as of” date to the September 30 date in Tables 2 and 3, if the September 30 data does not accurately reflect the credit union’s risks or financial position. Any such change would prompt corresponding amendments in submission deadlines for NCUA and credit union-run stress tests.

*** NCUA recognizes the first year of stress test implementation poses unique challenges, such as selecting the NCUA-designated vendor, compiling data across multiple covered credit unions, and developing modeling processes that capture the risks within the covered credit unions. The

NCUA Board shares commenters’ thoughts that the quality of the results is of utmost importance. Therefore, NCUA reserves the right to adjust this date in the first year of implementation if necessary to ensure the accuracy of the results.

Table 3 Process Overview of Capital Planning and Supervisory Stress Test Requirements when the Credit Union Performs Stress Tests Under this Final Rule	
Timeframe	Steps
by July 31	Covered credit union requests authority to perform stress tests for coming annual cycle.
by August 31	NCUA approves or declines request by credit union to perform stress tests.
September 30**	“As of” date for NCUA’s stress test data
by December 1	NCUA releases scenarios on which CU will conduct stress tests.
by February 28 (of the following year)	Covered credit union submits capital plan, stress test results and, if applicable, stress test capital enhancement plan to NCUA.
Within 90 days of submission	NCUA accepts or rejects capital plan and, if applicable, stress test capital enhancement plan.
within 90 days of NCUA decision to	Affected covered credit union submits revised capital plan and, if applicable, stress test capital

reject plan	enhancement plan.
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A covered credit union with a stress test enhancement plan accepted by NCUA, following an NCUA-run supervisory stress test, must incorporate this enhancement plan into the credit union's capital plan for the following year.

F. Effective Date.

Some commenters urged NCUA to delay implementation of the regulation for a year to enable covered credit unions adequate time to develop and test assumptions, models, and processes and to collect the data. The Board believes that delayed implementation is unnecessary, as credit unions already employ many of the practices involved in stress testing and capital planning. The Board recognizes that implementation may include an element of continuous improvement and that practices will develop and be refined over time.

III. Regulatory Procedures

A. Regulatory Flexibility Act.

The Regulatory Flexibility Act requires NCUA to prepare an analysis of any significant economic impact any regulation may have on a substantial number of small entities (primarily

those under \$50 million in assets).⁶ Because the rule only applies to credit unions with \$10 billion or more in assets, it will not have any economic impact on 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 increases an existing burden.⁷ For purposes of the PRA, a paperwork burden may take the form of a reporting or recordkeeping requirement, both referred to as information collections. The information collection requirements are found in sections 702.503, 702.504, 702.505, and 702.506 of this final rule.

Section 702.503(b) provides a list of mandatory elements to be included in a covered credit union's capital policy.

Section 702.504(a) requires a covered credit union to develop and maintain a capital plan and to submit the plan to NCUA by February 28 of a given year. Section 702.504(a) further requires a covered credit union's board of directors or a designated committee to review and approve the covered credit union's capital plan prior to its submission to NCUA. Section 702.504(b) establishes a list of mandatory elements to be included in the capital plan.

⁶ 5 U.S.C. 603(a).

⁷ 44 U.S.C. 3507(d); 5 CFR part 1320.

Section 702.505(d) provides that within 90 calendar days of receipt of a notice of rejection by NCUA of a covered credit union's capital plan, under section 702.505(c), the covered credit union must update and re-submit its capital plan to NCUA.

Section 702.506(f) requires a covered credit union to provide any relevant qualitative or quantitative information requested by NCUA to conduct or analyze the stress test.

Section 702.506(h) provides that within 90 days of receipt of a notice that a covered credit union does not have the ability to maintain the required stress test capital ratio, the covered credit union must submit a stress test capital enhancement plan showing how it will meet that requirement.

In the proposed rule's PRA discussion, NCUA estimated that the initial paperwork burden for each covered credit union was 500 hours. One commenter stated that this estimate was low. The paperwork burdens of this final rule are substantially similar to those in the proposed rule. NCUA has reevaluated the initial paperwork burden, however, and determined it to be 750 hours.

Summary of Burden

As of December 31, 2013, there were four FICUs with assets of \$10 billion or more.

Number of respondents	Annual frequency	Hourly estimate	Total hours
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Initial Paperwork Burden:

Initial Report.....	4	1	750	3,000
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Ongoing Paperwork Burden:

Annual Report.....	4	1	250	1,000
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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. The final rule applies to federal credit unions and to two federally insured, state-chartered credit unions, each with assets over \$10 billion. By law, these state-chartered institutions are already subject to numerous provisions of NCUA's rules, based on the agency's role as the insurer of member share accounts and the significant interest NCUA has in the safety and soundness of their operations. Given the limited reach of the final rule on state-chartered credit unions, NCUA does not believe the rule will have a substantial direct effect 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, therefore, determined that this rule does not constitute a policy that has federalism implications for purposes of the executive order.

D. Assessment of Federal Regulations and Policies on Families.

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 (SBREFA)⁸ 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 APA.⁹ The Office of Management and Budget has determined that this rule is not a “major rule” for purposes of SBREFA.

List of Subjects

12 CFR Part 702

Credit unions, Reporting and recordkeeping requirements.

⁸ Public Law 104-121, 110 Stat. 857 (1996).

⁹ 5 U.S.C. 551.

By the National Credit Union Administration Board on April 24, 2014.

Gerard Poliquin
Secretary of the Board

For the reasons discussed above, the National Credit Union Administration amends part 702 as follows:

1. Rename part 702 as follows:

PART 702 – CAPITAL ADEQUACY

For the reasons discussed above, the National Credit Union Administration amends part 702 as follows:

1. Rename part 702 as follows:

PART 702 – CAPITAL ADEQUACY

2. The authority citation for part 702 continues to read as follows:

AUTHORITY: 12 U.S.C. 1766(a), 1790d.

3. Add subpart E to read as follows:

Subpart E –Capital Planning and Stress Testing

- 702.501 Authority, purpose, and reservation of authority.
- 702.502 Definitions.
- 702.503 Capital policy.
- 702.504 Capital planning.
- 702.505 NCUA action on capital plans.
- 702.506 Annual supervisory stress testing.

Subpart E —Capital Planning and Stress Testing

§ 702.501 Authority, purpose, and reservation of authority.

(a) *Authority.* This subpart is issued by the National Credit Union Administration (NCUA).

(b) *Purpose.* This subpart requires covered credit unions to develop and maintain capital plans and describes stress testing requirements and actions on covered credit union capital plans.

(c) *Reservation of authority.* Notwithstanding any other provisions of this subpart, NCUA may modify some or all of the requirements of this subpart. Any exercise of authority under this section by NCUA will be in writing and will consider the financial condition, size, complexity, risk profile, scope of operations, and level of capital of the covered credit union, in addition to any other relevant factors. Nothing in this subpart limits the authority of NCUA under any other provision of law or regulation to take supervisory or enforcement action, including action to address unsafe and unsound practices or conditions, or violations of law or regulation.

§ 702.502 Definitions.

For purposes of this subpart —

Adverse scenario means a scenario that is more adverse than that associated with the baseline scenario.

Baseline scenario means a scenario that reflects the consensus views of the economic and financial outlook.

Capital plan means a written presentation of a covered credit union's capital planning strategies and capital adequacy process that includes the mandatory elements set forth in this subpart.

Covered credit union means a federally insured credit union whose assets were \$10 billion or more on March 31 of the current calendar year.

Planning horizon means the period of 3 years over which capital planning projections extend.

Pre-provision net revenue means the sum of net interest income and non-interest income, less expenses, before adjusting for loss provisions.

Provision for loan and lease losses means the provision for loan and lease losses as reported by the covered credit union on its Call Report.

Reverse stress test means a test that defines severely unfavorable outcomes and then identifies events or scenarios that lead to these outcomes. Examples of severely unfavorable outcomes are breaching regulatory capital, failing to meet obligations, or being unable to continue independent operations.

Scenarios are those sets of conditions that affect the U.S. economy or the financial condition of a covered credit union that serve as the basis for stress testing, including, but not limited to, NCUA-established baseline, adverse, and severely adverse scenarios.

Sensitivity testing means testing the relationship between specific variables, parameters, and inputs and their impacts on analytical results.

Severely adverse scenario means a scenario that overall is more severe than that associated with the adverse scenario.

Stress test means the process to assess the potential impact of expected and stressed economic conditions on the consolidated earnings, losses, and capital of a covered credit union

over the planning horizon, taking into account the current state of the covered credit union and the covered credit union's risks, exposures, strategies, and activities.

Stress test capital means net worth (less assistance provided under Section 208 of the Federal Credit Union Act, subordinated debt included in net worth, and NCUSIF deposit) under stress test scenarios.

Stress test capital ratio means a covered credit union's stress test capital divided by its total consolidated assets less NCUSIF deposit.

702.503 Capital policy.

(a) *General requirements.* The extent and sophistication of a covered credit union's governance over its capital planning and analysis process must align with the extent and sophistication of that process. The process must be consistent with the financial condition, size, complexity, risk profile, scope of operations, and level of capital of the covered credit union. The ultimate responsibility for governance over a covered credit union's capital planning and analysis process rests with the credit union's board of directors. Senior management must establish a comprehensive, integrated, and effective process that fits into the broader risk management of the credit union. Senior management responsible for capital planning and analysis must provide regular reports on capital planning and analysis to the credit union's board of directors (or a designated committee of the board).

(b) *Mandatory elements.* A covered credit union's board of directors (or a designated committee of the board) must review and approve a capital policy, along with procedures to implement it. The capital policy must:

- (1) State goals and limits for capital levels and risk exposure.
- (2) Establish requirements for reviewing and reporting capital levels and breaches of capital limits, with contingency plans for remedying any breaches.
- (3) State the governance over the capital analysis process, including all the activities that contribute to the analysis;
- (4) Specify capital analysis roles and responsibilities, including controls over external resources used for any part of capital analysis (such as vendors and data providers);
- (5) Specify the internal controls that govern capital planning, including review by internal audit, control of changes in capital planning procedures, and required documentation;
- (6) Describe the frequency with which capital analyses will be conducted;
- (7) State how capital analysis results are used and by whom; and

(8) Be reviewed at least annually and updated as necessary to ensure that it remains current with changes in market conditions, credit union products and strategies, credit union risk exposures and activities, the credit union's established risk appetite, and industry practices.

702.504 Capital planning.

(a) *Annual capital planning.* (1) A covered credit union must develop and maintain a capital plan and submit this plan to NCUA each year by February 28, or such later date as directed by NCUA. The plan must be based on the credit union's financial data as of September 30 of the immediately preceding previous calendar year, or such other date as directed by NCUA. NCUA will assess whether the capital planning and analysis process is sufficiently robust in determining whether to accept a credit union's capital plan.

(2) A covered credit union's board of directors (or a designated committee of the board) must at least annually, and prior to submission of the capital plan under paragraph (a)(1) of this section:

- (i) Review the credit union's process for assessing capital adequacy;
- (ii) Ensure that any deficiencies in the credit union's process for assessing capital adequacy are appropriately remedied; and
- (iii) Approve the credit union's capital plan.

(b) *Mandatory elements.* A capital plan must contain at least the following elements:

(1) A quarterly assessment of the expected sources and levels of stress test capital over the planning horizon that reflects the covered credit union's financial state, size, complexity, risk profile, scope of operations, and existing level of capital, assuming both expected and unfavorable conditions, including:

(i) Estimates of projected revenues, losses, reserves, and pro forma capital levels, over each quarter of the planning horizon under expected and unfavorable conditions; and

(ii) A detailed description of the credit union's process for assessing capital adequacy;

(2) A discussion of how the credit union will, under expected and unfavorable conditions, maintain stress test capital commensurate with all of its risks, including reputational, strategic, legal, and compliance risks;

(3) A discussion of how the credit union will, under expected and unfavorable conditions, maintain ready access to funding, meet its obligations to all creditors and other counterparties, and continue to serve as an intermediary for its members;

(4) If the credit union conducts its own stress test under §702.506(c), a discussion of how the credit union will maintain a stress test capital ratio of 5 percent or more under baseline, adverse, and severely adverse conditions in each quarter of the 9-quarter horizon;

(5) A discussion of any expected changes to the credit union's business plan that are likely to have a material impact on the credit union's capital adequacy and liquidity; and

(6) A program to:

(i) Conduct sensitivity testing to analyze the effect on the credit union's stress test capital of changes in variables, parameters, and inputs used by the credit union in preparing its capital plan;

(ii) Conduct reverse stress testing to identify events and circumstances that cause severely unfavorable outcomes for the credit union; and

(iii) Analyze the impact of credit risk and interest rate risk to capital under unfavorable economic conditions, both separately and in combination with each other.

§702.505 NCUA action on capital plans.

(a) *Timing.* NCUA will notify the covered credit union of the acceptance or rejection of its capital plan within 90 calendar days of the date of the plan's submission.

(b) *Grounds for rejection of capital plan.* NCUA may reject a capital plan if it determines that:

(1) The covered credit union has material unresolved supervisory issues associated with its capital planning process;

(2) The capital analysis underlying the covered credit union's capital plan, or the covered credit union's methodologies for reviewing the robustness of its capital adequacy, are not reasonable or appropriate;

(3) Data utilized for the capital analysis is insufficiently detailed to capture the risks of the covered credit union, or the data lacks integrity;

(4) The plan does not meet all of the requirements of §702.504;

(5) NCUA finds unacceptable weakness in the capital plan, the capital planning analysis, or any critical system or process supporting capital analysis; or

(6) The covered credit union's capital planning process constitutes an unsafe or unsound practice, or would violate any law, regulation, NCUA order, directive, or any condition imposed by, or written agreement with, NCUA. In determining whether a capital plan would constitute an unsafe or unsound practice, NCUA considers whether the covered credit union is and would remain in sound financial condition after giving effect to the capital plan.

(c) *Notification in writing.* NCUA will notify the credit union in writing of the reasons for a decision to reject a capital plan.

(d) *Re-submission of a capital plan.* If NCUA rejects a credit union's capital plan, the credit union must update and resubmit an acceptable capital plan to NCUA within 90 calendar days of the rejection. The resubmitted capital plan must at a minimum address:

(1) NCUA-noted deficiencies in the credit union's original capital plan; and

(2) Remediation plans for unresolved supervisory issues contributing to the rejection of the credit union's original capital plan.

(e) *Supervisory actions.* Any covered credit union operating without a capital plan accepted by NCUA may be subject to supervisory actions on the part of NCUA.

(f) *Consultation on proposed action.* Before taking any action under this section on the capital plan of a federally insured, state-chartered credit union, NCUA will consult and work cooperatively with the appropriate State official.

§702.506 Annual supervisory stress testing.

(a) *General requirements.* The supervisory stress tests consist of baseline, adverse, and severely adverse scenarios, which NCUA will provide by December 1 of a calendar year. The tests will be based on the covered credit union's financial data as of September 30 of that year, or such other date as directed by NCUA. The tests will take into account all relevant exposures and activities of a credit union to evaluate its ability to absorb losses in specified scenarios over a 9-quarter horizon. The minimum stress test capital ratio is 5 percent.

(b) *NCUA-run tests.* Except as provided in paragraph (c) of this section, NCUA will conduct the tests described in this section.

(c) *Credit union-run tests under NCUA supervision.* After NCUA has completed three consecutive supervisory stress tests, a covered credit union may, with NCUA approval, conduct the tests described in this section. A covered credit union must submit its request to NCUA to conduct its own stress test by July 31 for the following annual cycle. NCUA will approve or decline the credit union's request by August 31. The credit union must include the results of the tests in the capital plan it submits under §702.504. NCUA reserves the ability to conduct the tests described in this section on any covered credit union at any time. Where both NCUA and a covered credit union have conducted the tests, the results of NCUA's tests will determine whether the covered credit union has met the requirements of this section.

(d) *Newly covered credit union.* A credit union that becomes a covered credit union after the effective date of this regulation must have three NCUA-run stress tests before it can seek NCUA approval to conduct credit union-run stress tests.

(e) *Potential impact on capital.* In conducting a stress test under this subpart, during each quarter of the stress test horizon, NCUA or the covered credit union will estimate the following for each scenario:

(1) Losses, pre-provision net revenues, loan and lease loss provisions, and net income;
and

(2) The potential impact on the stress test capital ratio, incorporating the effects of any capital action over the 9-quarter stress test horizon and maintenance of an allowance for loan losses appropriate for credit exposures throughout the horizon. NCUA or the covered credit union will conduct the stress test without assuming any risk mitigation actions on the part of the covered credit union, except those existing and identified as part of the covered credit union's balance sheet, or off-balance sheet positions, such as asset sales or derivatives positions, on the date of the stress test.

(f) *Information collection.* Upon request, the covered credit union must provide NCUA with any relevant qualitative or quantitative information requested by NCUA pertinent to the stress test under this section.

(g) *Stress test results.* NCUA will provide each covered credit union with the results of the stress test by May 31 of the year following the effective testing date. A credit union conducting its own stress test must provide NCUA the results of its stress test with its capital plan by February 28 of the year following the effective testing date.

(h) *Supervisory actions.* If NCUA-run stress tests show that a covered credit union does not have the ability to maintain a stress test capital ratio of 5 percent or more under expected and stressed conditions in each quarter of the 9-quarter horizon, the credit union must provide NCUA, within 90 days of receipt of the stress test results, a stress test capital enhancement plan showing how it will meet that target. If the credit union-run stress tests show that it does not have the ability to maintain a stress test capital ratio of 5 percent or more under expected and

stressed conditions in each quarter of the 9-quarter horizon, the credit union must incorporate a stress test capital enhancement plan into its capital plan. Any affected credit union operating without a stress test capital enhancement plan accepted by NCUA may be subject to supervisory actions on the part of NCUA.

(i) *Consultation on proposed action.* Before taking any action under this section against a federally insured, state-chartered credit union, NCUA will consult and work cooperatively with the appropriate State official.

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