Corporate Credit Unions, Technical Corrections

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: This final rule, which adopts technical amendments to NCUA’s corporate credit union rule, is identical to NCUA’s interim final rule published in the Federal Register of November 24, 2010. The amendments: (1) correct the definition of collateralized debt obligation (CDO) in §704.2; (2) correct the list of investments exempt from the single obligor limits and credit rating requirements in §704.6; and (3) correct a date contained in Model Form H of Appendix A to Part 704.

DATES: This rule was previously issued as an interim final rule, effective on January 18, 2011.
SUPPLEMENTARY INFORMATION:

A. Background

In September 2010, NCUA adopted a comprehensive overhaul to its corporate credit union rule, 12 C.F.R. part 704. 75 FR 64786 (Oct. 20, 2010). After adoption, NCUA discovered that three technical corrections were necessary and NCUA issued corrections in the form of an interim final rule with request for comment. 75 FR 71526 (Nov. 24, 2010). The Board issued the rule as an interim final because the corrections were technical in nature and it was in the public interest to have these corrections become effective on January 18, 2011, the same date as the corresponding revisions to the corporate rule. See 75 FR 64786 (Oct. 20, 2010).

The technical corrections are as follows:

§704.2 Definition of “collateralized debt obligation”

The September revisions to part 704 prohibited corporate credit unions (corporates) from purchasing certain overly complex or leveraged investments, including CDOs. 75 FR 64786, 64793 (October 20, 2010). These prohibitions were intended to protect the
corporates from the potential for excessive investment losses. 74 FR 65210, 65237 (December 9, 2009) (preamble to proposed part 704 revisions). The definition of CDO, however, was overly broad, in that it inadvertently included particular investments that did not -- when subject to the other credit risk and asset liability management limitations of part 704 -- present the risk of excessive losses.

This final rule amends the CDO definition to ensure the following are not prohibited: commercial mortgage backed securities; securities collateralized by Agency mortgage-backed securities (Agency MBS); and securities that are fully guaranteed as to principal and interest by the United States Government and its agencies and government sponsored enterprises.

Paragraph 704.6(b) Exemptions to §704.6

Section 704.6 generally requires corporate investments meet certain single obligor concentration limits, sector concentration limits, and credit rating requirements. Paragraph 704.6(b) exempts certain investments, including investments generally issued by or guaranteed by the U.S. Government or its agencies or sponsored enterprises, from the requirements of §704.6. As stated in the preamble to the September corporate rule revisions, however, the Board did not intend for this exemption to apply to agency MBS in the context of sector limits. 75 FR 64786, 64806 (Oct. 20, 2010) (discussing paragraph 704.6(d)(1)(i)). In the September rule text, however, not only the sector limits apply to agency MBS, but the other requirements,
including single obligor limits and credit rating requirements, inadvertently apply to agency MBS. This final correction makes clear that Agency MBS are subject to the sector concentration limits in 704.6(d) but not the other requirements of §704.6.

Appendix A, Model Form H

The rule as published included an incorrect date instruction on Model Form H in Appendix A. Id. at 64851. Model Form H included introductory text indicating that the form was for use before October 20, 2011. In fact, because Model Form H deals with perpetual contributed capital, the form should be used only on and after October 20, 2011. The correction replaces the phrase “before” with the phrase “on or after.”

B. Summary of Comments

NCUA received two comments on the interim final rule, both from credit union trade associations. Neither commenter suggested changes to the rule text, but one of the commenters sought additional clarification regarding NCUA’s treatment of commercial mortgage backed securities (CMBS) under the revised definition of CDO. The commenter requested that NCUA state its reasoning for the exclusion of CMBS from the definition of CDO and also state that if the structure of CMBS changes in a way that increases the corporates’ risk of loss on these investments, NCUA will remove this exclusion.
This commenter appears to have misunderstood the effect of the correction to the definition. The correction operates to make CMBS a permissible investment for corporate credit unions – that is, securities collateralized by commercial mortgage loans. Securities collateralized by mortgage securities, commercial or residential, remain prohibited under the definition of CDO.

Investments in plain-vanilla CMBS, which are collateralized by loans, do not pose the same risk as investments in securities collateralized by other securities where an investor cannot as easily determine the quality of the underlying loans. Also, as the commenter correctly noted, corporate credit union investments in CMBS are subject to the sector concentration limits imposed under §704.6(d). Finally, NCUA will continually monitor corporates’ investments and make adjustments to the corporates’ investment authorities where appropriate.

C. Regulatory Procedures

Section D of the Supplementary Information to the November 2010 interim final rule sets forth the Board’s analyses under the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR part 1320 Appendix A.1), the Small Business Regulatory Enforcement Fairness Act (Pub. L. 104-121), Executive Order 13132, and the Treasury and General Government Appropriations Act (Pub. L. 105-277, 112 Stat. 2681 1998). See 75 FR 71527-71528. Because the final rule is unchanged from the interim final rule, the Board continues to rely on those analyses and determinations for purposes of this rulemaking.
List of Subjects in 12 CFR Part 704
Credit unions, Corporate credit unions, Reporting and record keeping requirements.

Accordingly, the interim final rule amending 12 CFR part 704, which was published at 75 FR 47173 on November 24, 2010, is adopted as a final rule without change.

PART 704--CORPORATE CREDIT UNIONS

1. The authority citation for part 704 continues to read as follows:

Authority: 12 U.S.C. 1762, 1766(a), 1772a, 1781, 1789, and 1795e.

2. Revise the definition of “collateralized debt obligation” in §704.2 to read as follows:

§704.2 Definitions
Collateralized debt obligation (CDO) means a debt security collateralized by mortgage-backed securities, other asset-backed securities, or corporate obligations in the form of nonmortgage loans or debt. For purposes of Part 704, the term CDO does not include: (1) senior tranches of Re-REMIC’s consisting of senior mortgage- and asset-backed securities; (2) any security that is fully guaranteed as to principal and interest by the U.S. Government or its agencies or its sponsored enterprises; or (3) any security collateralized by other securities where all the underlying securities are fully guaranteed as to principal and interest by the U.S. Government or its agencies or its sponsored enterprises.

3. Effective October 20, 2011, revise the definition of “collateralized debt obligation” in §704.2 to read as follows:

§704.2 Definitions
Collateralized debt obligation (CDO) means a debt security collateralized by mortgage-backed securities, other asset-backed securities, or corporate obligations in the form of nonmortgage loans or debt. For purposes of Part 704, the term CDO does not include: (1) senior tranches of Re-REMIC’s consisting of senior mortgage-and asset-backed securities; (2) any security that is fully guaranteed as to principal and interest by the U.S. Government or its agencies or its sponsored enterprises; or (3) any security collateralized by other securities where all the underlying securities are fully guaranteed as to principal and interest by the U.S. Government or its agencies or its sponsored enterprises.

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4. Revise paragraph (b) in §704.6 to read as follows:

§704.6 Credit risk management.

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(b) Exemption. The limitations and requirements of this section do not apply to certain assets, whether or not considered investments under this part, including fixed assets, individual loans and loan participation interests, investments in CUSOs, investments that are issued or fully guaranteed as to principal and interest by the U.S. government or its agencies or its sponsored enterprises (but not exempting, for purposes of paragraph (d) of this section, mortgage backed securities), investments that are fully
insured or guaranteed (including accumulated dividends and interest) by the NCUSIF or the Federal Deposit Insurance Corporation, and settlement funds in federally insured depository institutions.

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5. Revise the introductory note in Model Form H, Appendix A, to read as follows:

APPENDIX A TO PART 704 – Capital Prioritization and Model Forms

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MODEL FORM H

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[NOTE: This form is for use on or after October 20, 2011 in the circumstances where the credit union has determined THAT IT WILL give newly issued capital priority over older capital as described in Part I of this Appendix. Also, capital previously issued under the nomenclature “paid-in capital” is considered perpetual contributed capital].

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