

Attachment 1

Important Points to Keep in Mind

1. Capital and Net Economic Value (“NEV”) Standards.

The final rule modifies the current corporate capital requirements to make them stronger and more consistent with the Basel I capital requirements imposed by banking regulators on banks. To be considered adequately capitalized, the rule replaces the 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).

On the one year anniversary of the rule, October 20, 2011, the 4% minimum leverage ratio is effective. Additionally, the current regulation maintains a minimum 2% NEV ratio.

What this means: CCUs that do not meet the minimum capital and NEV standards, must be analyzing and planning now for how they will meet minimum capital and NEV standards by October 20, 2011.

CCU Action Required: Revise previously submitted capital and/or NEV compliance plans or develop new plans that support the corporate’s new business model and strategies to ensure compliance with minimum regulatory standards. Capital compliance plans need to be submitted to OCCU by March 31, 2011.

Recommended Capital Compliance Plan Components. The capital compliance plan should include, but not be limited to, the following:

- Description of how the CCU will bring the capital and NEV ratios into compliance, to include expectations of capital conversions or additional capital contributions.
- Description of any capital subscription process. Indicate targeted capital subscription goals, timelines, and the process by which capital will be pledged and actually subscribed. Also describe how the corporate will return pledged capital to members if the targeted capital goals are not achieved.
- Tactical plans to achieve compliance, to include milestones for implementation, measurable goals, and discussion with members.

- Contingency plans for replacing services provided by U.S. Central Bridge Corporate Federal Credit Union.

Note: OCCU is not suggesting CCUs to move or switch service providers but rather encouraging them to be prepared should a long-term viable solution not arise.
- Balance sheet and income projections, including assumptions, for 2011 through 2013.
- Those CCUs with private label mortgage-backed securities (PLMBS) and/or commercial mortgage-backed securities (CMBS) must provide a plan to have an independent stress test of capital adequacy (see #2 below).
- New or revised business model or strategic direction.
- Options or contingency plans in case the CCU makes insufficient progress or is unable to comply with the new regulatory requirements. The plan must consider one or more of the following options prior to September 30, 2011:
 - Charter conversions or application for a new charter;
 - Mergers with or resulting in a well capitalized CCU; or
 - Self-liquidation.
- Investment portfolio changes to become compliant with Part 704. Plans requesting waivers to Part 704 not already approved should include the business reason for request, length of time waiver will be required, and how compliance with the waiver will be monitored.

Capital Priority and Conversion

Capital Priority

The new rule provides each CCU and its board of directors an optional right to determine capital prioritization of losses for capital contributed to the CCU after January 18, 2011.

What this means: On or before January 18, 2011, the board of directors of a CCU desiring to exercise this option must adopt a resolution implementing its determination. Failure to make a decision and act on this on or before January 18, 2011, causes the CCU to forfeit the option to give or assign priority to capital types. In addition to making this decision, CCUs will need to notify its members of the priority of capital. This is important as member credit unions will need this information for their decision on whether to recapitalize the CCU.

CCU Action Required: Analyze this optional right and discuss it with the CCU's board of directors to determine whether this option is appropriate for the corporate and will be exercised. If the CCU decides to exercise this option,

ensure this decision is adopted in a resolution at a board meeting on or before January 18, 2011.

Capital Conversion

Effective October 20, 2011, the final rule establishes new capital types that are different from the current Part 704. The term “perpetual contributed capital” (PCC) replaces “paid-in-capital” (PIC) and the term “nonperpetual capital account” (NCA) replaces the term “membership capital account” (MCA). On October 20, 2011, a CCU must have a combination of retained earnings, PCC, and NCA greater than or equal to 4 percent to be adequately capitalized. By October 20, 2013, a CCU must have a combination of retained earnings and PCC greater than or equal to 4 percent to be adequately capitalized. Under the new rule, MCAs that are not converted to NCAs or PCC by October 20, 2011, must be put on notice by the corporate and, to the extent not needed to cover operational losses, returned to the member at the end of the notice period.

What this means: CCUs need to analyze their existing capital account structure to determine the types of capital accounts it will offer. Additionally, CCUs need to consider how and if existing member capital will be converted to the new capital account types. CCUs also need to understand the impact of not converting existing MCAs to its capital position.

CCU Action Required: If a capital compliance plan is not needed or capital conversion is not addressed within the capital compliance plan, develop a capital conversion plan addressing how and if existing member capital will be converted to the new capital account types. If existing MCAs are not converted, this plan should address the amortization of these accounts and the impact on the CCUs capital position.

2. Additional Priority for CCUs with Legacy Assets

CCUs with remaining legacy assets on their balance sheets not only need to address and meet the requirements listed in the previous sections but also have the added challenge of convincing member credit unions to recapitalize when the potential exists for incurring additional losses from these legacy assets. NCUA generally will not dictate a course of action for CCUs to attain the capital levels. Some institutions may reduce assets, whereas others may increase efficiencies. Though it is likely others will have to attract new capital contributions.

What this means: The NCUA Board expects each institution to work with its members to develop a capital compliance plan. NCUA will not provide financial assistance (e.g., asset guarantees, capital injections) to institutions that are independent entities. While NCUA recognizes that members may be reluctant to contribute capital, that decision must be arrived at between the CCU and the membership. CCUs must determine the loss exposure from these assets, analyze capital needs, and disclose the results to the membership. Accordingly,

it may be feasible for such CCUs to raise capital from members that is subordinate to existing capital, thus protecting newly contributed capital from known existing credit risk.

CCU Action Required: *CCUs need to develop a comprehensive business plan, meet with members, and then pursue actions to meet the capital standards. To be transparent and allow full disclosure to their members, it is strongly recommended the capital plans for CCUs with legacy assets include:*

- *A Transparency Framework.* The capital compliance and strategic plans should include a transparency framework to be able to establish credibility and trust with members. This may include, but not be limited to:
 - The plan for management of legacy assets;
 - Security level data on all marketable securities;
 - Asset liability modeling results;
 - The strategic (business) plan documenting capital and NEV assumptions and projections;
 - Projected balance sheets and income statements with all assumptions; and
 - Specific requirements for periodically obtaining additional stress tests and disclosing the results to members going forward.

- *A Stress Test.* A stress test that identifies a range of potential losses (credit or other) from PLMBS and CMBS, and the impact of these potential losses to capital. The stress test should incorporate loss projections from an independent third party with appropriate experience in performing this function. This type of study will assist in developing a capitalization plan with a focus on isolating losses from new capital subscriptions. Including this type of study provides a transparency framework which allows members to assess potential continuing loss exposure and/or the ability for capital to absorb losses from legacy assets and deposits. The CCUs with PLMBS and CMBS should complete this study as soon as possible in order to provide the results to members by May 31, 2011 (see Attachment 2).

3. Charters and Mergers

Charters. NCUA published, on October 1, 2010, a proposed interpretive ruling and policy (IRPS) statement setting forth the requirements and process for chartering a new CCU. The comment period for this IRPS ended on November 1, 2010. Comments are currently under review. In the meantime, OCCU will process any new charter applications using the forms and processes outlined in

the proposed IRPS. Although the proposed IRPS allows for approximately six (6) months for processing and final approval of charter applications, the timeline is a guideline. OCCU may be able to expedite the application process if staff is kept informed throughout the process. Obviously OCCU's ability to expedite the charter application will be dependent upon receiving a complete package, as outlined in the IRPS, at the time of submission.

Mergers. OCCU is currently reviewing corporate merger application guidelines and procedures. OCCU will develop similarly expedited review/approval procedures as well as guidance for CCUs. In the meantime, please use the CCU merger guidelines and the current NCUA Merger Manual that are on the NCUA website for developing merger packages if this is an option or plan being considered.

4. Credit Union Service Organization (CUSOs) Activities

The current §704.11 does not specify the particular activities that a corporate CUSO may engage in 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.” The final rule retained these two requirements, but further requires that a corporate CUSO may only engage in activities preapproved by NCUA. Brokerage services and investment advisory services are preapproved in the rule, and NCUA will approve or disapprove additional categories of activities upon request. This requirement for NCUA approval is effective April 18, 2011. The delayed effective date of this rule change provides time for application to NCUA and NCUA review. In addition, the final rule requires that once NCUA has approved an activity and published its approval on NCUA's website NCUA can only reverse or modify its approval via a formal rulemaking.

OCCU has a team of staff dedicated to developing an expedited CUSO activity review process. Over the next weeks, we will be finalizing the list of submission requirements, the approval process, and guidance for credit unions and OCCU staff. **Just to clarify, OCCU will not be approving specific CUSO entities but only the activities or services that may be offered by a corporate CUSO.** Our primary focus during the review and approval process will be to evaluate the high level, systemic risks associated with the individual services or activities being offered by a CUSO. This may result in requesting or reviewing documents related to activity statistics on dollar amounts and transaction processing volumes.

In the meantime, if you already have an approval request package prepared, do not wait to submit your request. CUSO approval packages should include, but not be limited to, the following information; however please understand that we may need to request additional information at a later date.

- Submit a letter requesting approval of the specific CUSO activities, with supporting documentation to OCCU. Include all information

deemed important regarding or supporting the corporate CUSO activity (ies). This may include but not be limited to:

- Background information on the CUSO's activity.
- Detailed description of each product and/or service.
- Expected activity volume necessary for viability of the product or service.
- Description of necessary staff expertise and experience for managing these activities and services and the associated risks.
- Detailed description of any existing regulatory surveillance related to the activity or service. Include a description of any standard control structure(s) surrounding each activity or service.
- Detailed description of the risks associated with the activity and expected mitigating controls.
- A list or description of the users of each activity or service.

Organizations requesting approval of an activity to be offered in a CUSO will receive written notice the activities and/or services are approved. As required by the rule, OCCU will then post approved CUSO activities on the website.

Attachment 2

Reform Timeline for Compliance

The attached flowchart illustrates the timeline of milestones under which OCCU expects undercapitalized corporates to attain compliance.

