



Comparison of Current Rule 704 to Proposed Amendments 12 C.F.R.
Proposed Changes to Corporate Credit Union Rule 704

This guide compares NCUA's current Rule 704 with the proposed amendments (12 C.F.R.). For more details, please refer to NCUA's 12 C.F.R. in full at www.membersunited.org/ProposedRevisions_FINALPart704_11-17-2009.pdf. Page numbers included in the chart on the following pages indicate where the reader can find more specifics in the actual proposed rule.

Glossary of Terms

Below is a short list of commonly used terms that appear in this document.

CLF - Central Liquidity Facility
DANA - daily average net assets
DANRA - daily average net risk-based assets
FCUA - Federal Credit Union Act
FDIA - Federal Deposit Insurance Act
NRSRO - nationally recognized statistical ratings organization
PCA - prompt corrective action
PCC - perpetual contributed capital
RE - retained earnings
SMT - senior management team

More

A reference of additional terms can be found at: www.membersunited.org/Glossary.pdf.



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704.3 Corporate Credit Union Capital	<u>MCA</u> <ul style="list-style-type: none"> • Member capital accounts • Contributed by members • Adjustable balance with three-year notice • Available to cover losses that exceed retained earnings (RE) and paid in capital (PIC) • Not insured by NCUSIF • Cannot be pledged against borrowing 	<u>NCA</u> <ul style="list-style-type: none"> • Non-perpetual contributed capital (page 29) • Contributed by members or non-members • Indefinite term with 5-year notice (page 30) • Term certificates with 5-year term • Can cover losses that exceed retained earnings (RE) and perpetual contributed capital (PCC) • Not insured by NCUSIF • Cannot be pledged against borrowing • MCA can be subordinate to new NCA • NCA can only be called with permission of NCUA • Eliminates adjustable balance accounts
	<u>PIC</u> <ul style="list-style-type: none"> • Perpetual, non-cumulative dividend accounts • Available to cover losses that exceed RE • Not insured by NCUSIF • Cannot be pledged against borrowing 	<u>PCC</u> <ul style="list-style-type: none"> • No change from PIC definition • Losses must be distributed pro-rata at the time the loss is realized first among the holders of PCC and when PCC is exhausted, then pro-rata among all NCA • To extent contributed capital funds are used to cover losses, Corporate must not restore or replenish the affected capital accounts (page 31) • Capital can be stipulation/requirement of membership • PCC can only be called with permission of NCUA
	<u>CORE</u> <ul style="list-style-type: none"> • RE + PIC • Plus RE of any acquired CU if acquisition was mutual combination 	<u>T1RBCR/Tier1 CAPITAL (core capital) (page 32)</u> <ul style="list-style-type: none"> • RE +PCC • Plus RE of any acquired CU if acquisition was mutual combination • Plus Certain minority interests in the equity accounts of CUSO that are fully consolidated <u>TRBCR/Tier 2 CAPITAL (supplementary capital)</u> <ul style="list-style-type: none"> • Certain portions of NCA • The amount that can be considered supplemental is reduced monthly until amount reaches zero when 1 year left on account (704.3.(b)(3)) (page 32)

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		<ul style="list-style-type: none"> • GAAP allowance for loan and lease losses up to 1.25% of risk-weighted assets • Net unrealized gains on available-for-sale equity securities with readily determinable fair values up to 45% (page 33)
704.3(a)(1)	<p><u>CAPITAL REQUIREMENT</u></p> <p><u>One mandatory capital requirement:</u></p> <p>Capital Ratio = 4%</p> <p><u>Capital Ratio</u> = (RE + PIC + MCA)/moving daily average net assets (DANA)</p> <p><u>Core Capital</u> = RE + PIC</p> <p>If RE <2%, then must increase RE by a certain amount each quarter</p>	<p><u>CAPITAL REQUIREMENT</u></p> <p><u>Requires 3 minimum capital ratios at all times:</u></p> <ol style="list-style-type: none"> (1) Leverage ratio of 4% or greater (2) Tier 1 risk-based capital ratio (T1RBCR) 4% or greater (3) Total risk-based capital ratio (TRBCR) of 8% or greater <p><u>Leverage Ratio</u> = Adjusted Core Capital/moving DANA (effective after 3 years)</p> <ul style="list-style-type: none"> ▪ No leverage ratio requirements from regulation approval until 12 months ▪ From 12 through 36 months this will reflect current regulatory calculations <p><u>Adjusted Core Capital</u> = Core Capital with these changes:</p> <ol style="list-style-type: none"> (1) Deduct amount equal to the amount of the corporate intangible assets that exceed 0.5% of the corporate moving DANA. <ol style="list-style-type: none"> a. Intangibles <i>de minimus</i> (half of 1% of total assets) be treated just like other assets in the capital calculation b. Intangibles above this must be deducted from both core capital and assets c. NCUA may alter this based on overall condition of corporate (2) Deduct investments, both equity and debt, from consolidated CUSOs (3) If corporate (<u>on or after 12 months following publication of rule</u>) contributes new capital or renews existing capital to another corporate, the corporate MUST deduct an amount equal to the aggregate of such new or renewed capital. Discourages capital investment between corporates. Not effective for 12 months and will NOT apply to pre-existing capital accounts unless renewed in some fashion (page 36) <p><u>At 6 years after date of publication</u>, initial adjustment to core capital will require corporate to deduct from core capital any amount of PCC that causes (PCC-RE)/moving DANA to exceed 2% (§ 704.2)</p> <ul style="list-style-type: none"> • To achieve 4% leverage ratio must have 100 basis points of RE at year 6 <p><u>At 10 years after date of publication</u>, second adjustment will require corporate to deduct from core capital</p>

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		<p>any amount of PCC that causes PCC to exceed RE (§ 704.2)</p> <ul style="list-style-type: none"> • To achieve 4% leverage ratio must have 200bp of RE at year 10 <p>The combination of T1RBCR/Tier1 and TRBCR/Tier2 ensures that at least half of capital used for purposes of protecting against losses associated with credit risk is the more permanent capital. (page 39)</p> <p><u>T1RBCR (Tier 1 Risk Based Capital Ratio)</u> (p 39)</p> <ul style="list-style-type: none"> • Adjusted Core Capital/moving daily average net risk-based assets (DANRA) <ul style="list-style-type: none"> ○ Month being measured + prior 11 months ○ <u>DANRA</u> = average of net risk-weighted assets calculated for each day during the period (which would be the prior month) ○ <u>Net risk weighted assets</u> = risk-weighted assets less (see 704 Appendix C): <ul style="list-style-type: none"> ▪ Central Liquidity Facility (CLF) stock subscriptions ▪ CLF loans guaranteed by the NCUSIF ▪ US Central CLF certificates ▪ Member reverse repurchase transactions <p><u>TRBCR (Total Risk Based Capital Ratio)</u> (p 40)</p> <ul style="list-style-type: none"> • Total capital/moving DANRA <ul style="list-style-type: none"> ○ <u>Total Capital</u> = Adjusted Core Capital + Supplemental Capital – Corporate Equity Investments not otherwise deducted when calculating adjusted core capital ○ <u>Supplemental Capital (Tier 2)</u> = sum of NCA, except that at the beginning of each of last 5 years amount eligible to be included is reduced by 20% of original amount (net of redemptions)
704.3(a)(2)	Capital Plan	Keeps existing Capital Plan requirement in place (p 34)

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704.3(a)(3)	NCUA requires submission of capital plan if capital falls below current 4% requirement	<p>Starting with first call report submitted 3 years after date of rule:</p> <ul style="list-style-type: none"> • Corporate calculates and reports the ratio of its RE to its moving DANA <ul style="list-style-type: none"> ○ If less than 0.45%, within 30 days, submit retained earnings accumulation plan (REAP) to NCUA ○ Corporate subject to prompt corrective action (PCA) under §704.4 if fails to comply with any element of plan NCUA approved (discretionary). <p>Intent is to ensure corporate RE growth rates are adequate to achieve 100 basis points at year 6 and 200 basis points at year 10.</p>
704.3.(d)	NCUA requires submission of capital plan if capital falls below current 4% requirement	<p><u>MINIMUM CAPITAL REQUIREMENTS</u> (page 41)</p> <ul style="list-style-type: none"> • NCUA may establish increased individual minimum capital requirements for particular corporate • NCUA will notify corporate in writing along with schedule for compliance • Responses to NCUA/GDBF within 30 days • Failure to provide adequate response will result in PCA under §704.4
704.3(e)	Not part of previous regulation	<p><u>RESERVATION OF AUTHORITY</u> (page 42)</p> <ul style="list-style-type: none"> • Clarifies NCUA authority over corporate, on case-by-case basis, to determine the appropriate risk-weight for assets and credit equivalent amounts and the appropriate credit conversion factor for off-balance sheet items in these circumstances • Empowers NCUA, in appropriate cases, to direct that a Corporate use period-end assets in its capital ration calculations rather than moving DANA
704.4(d) PCA	Not part of previous regulation	<p><u>PROMPT CORRECTIVE ACTION</u> (p 64)</p> <ul style="list-style-type: none"> • Contains elements from Section 38 of Federal Deposit Insurance Act (FDIA) and Section 216 of Federal Credit Union Act (FCUA) • 5 categories of corporate classification (§704.4(d)): <ul style="list-style-type: none"> ○ <u>Well Capitalized</u>: <ul style="list-style-type: none"> ▪ corporate significantly exceeds the required minimum level for <u>each</u> relevant capital measure ▪ not subject to any written capital order or directive or prompt corrective action (PCA) ▪ TRBCR = 10% or more ▪ T1RBCR = 6% or more



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		<ul style="list-style-type: none"> ▪ Leverage Ratio = 5% or more ○ <u>Adequately Capitalized:</u> <ul style="list-style-type: none"> ▪ meets the required minimum level for <u>each</u> relevant capital measure ▪ TRBCR = 8% or more ▪ T1RBCR = 4% or more ▪ Leverage Ratio = 4% or more ○ <u>Undercapitalized:</u> <ul style="list-style-type: none"> ▪ fails to meet the required minimum level for <u>any</u> relevant capital measure ▪ TRBCR = less than 8% ▪ T1RBCR = less than 4% ▪ Leverage Ratio = less than 4% ○ <u>Significantly Undercapitalized:</u> <ul style="list-style-type: none"> ▪ significantly below the required minimum level for <u>any</u> relevant capital measure ▪ TRBCR = less than 6% ▪ T1RBCR = less than 3% ▪ Leverage Ratio = less than 3% ○ <u>Critically Undercapitalized:</u> <ul style="list-style-type: none"> ▪ critically below the required minimum level for <u>any</u> relevant capital measure ▪ TRBCR = less than 4% ▪ T1RBCR = less than 2% ▪ Leverage Ratio = less than 2% • NCUA has discretion to downgrade corporate by one category or to modify the minimum capital ratio percentages to determine the PCA capital category for any corporate (page 65) • NCUA continues to have all other non-PCA supervisory tools used to supervise corporate • Corporate PROHIBITED from disseminating to third parties its capital category, includes advertising (§704.4(b)) • Corporate to notify NCUA within 15 days of material event that would cause the capital category to be lowered. (§704.4(c))



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704.4(e)	NCUA requires submission of capital plan if capital falls below current 4% requirement	<p><u>CAPITAL RESTORATION PLANS</u> (page 68)</p> <p>Any corporate downgraded to undercapitalized or lower must file restoration plan within 45 days of notice Within 60 days of receipt, NCUA will provide written notice back to corporate; NCUA can extend time period</p>
704.4(k)	Not part of previous regulation	<p><u>SUPERVISORY ACTIONS</u> (page 69)</p> <p>If categorized as under, significantly under, or critically undercapitalized, restrictions are:</p> <ul style="list-style-type: none"> • Submit acceptable capital restoration plan to NCUA DANA cannot exceed moving DANA during any calendar month • No new ventures without NCUA approval • NCUA will ‘closely monitor’ corporate <p>If significantly under or critically undercapitalized and no plan approved by NCUA:</p> <ul style="list-style-type: none"> • No bonus or profit sharing for senior management team (SMT) • No increase in compensation for SMT (page 70) <p>And NCUA may restrict other corporate activities</p> <p>If critically undercapitalized, in addition to above: (page 71)</p> <ul style="list-style-type: none"> • After 60 days of categorization, NCUA further restricts activities

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704.6 CREDIT RISK MANAGEMENT	<p>Requires internal investment policy that includes limits, but does NOT prescribe standards for determining reasonableness of limits</p> <p>Prohibits certain investments (most derivatives, stripped MBS, mortgage servicing rights, residual interests in ABS)</p> <p>Requires aggregate investment in any single obligor limited to greater of 50% of capital or \$5 million</p> <p>Does not address investments that are structured to be subordinate, in terms of potential credit losses, to other securities</p> <p>Investments must be rated no lower than AA- by at least one nationally recognized statistical ratings agency (NRSRO) at purchase. Exempt: CUSO investments, USA securities</p>	<p>In addition to current limits on derivatives, imposes specific concentration limits by investment sector, including:</p> <ul style="list-style-type: none"> • Residential mortgage-backed securities • Commercial mortgage-backed securities • Student loan-backed securities • Auto loan/lease asset-backed securities • Credit card asset-backed securities • Other asset-backed securities • Corporate debt obligations • Municipal securities • Registered investment company • “All Others” category to account for development of new investment types <p>Restricts purchase of high-risk structured instruments that concentrate, and thus multiply, market risk exposures</p> <p>Limits subordinated positions in all sectors.</p> <ul style="list-style-type: none"> • Prohibit additional investment types that are problematic, such as: collateralized debt obligations (CDO) • Net interest margin securities (NIM) <p>Requires multiple ratings from different NRSRO and only use the lowest of the ratings. Ratings only used to EXCLUDE an investment, not authorize one.</p> <p>Eliminates current PART II EXPANDED INVESTMENT AUTHORITY</p> <p>Modifies current PART IV EXPANDED AUTHORITY ON DERIVATIVES</p> <p>Imposes increased capital requirements to qualify for PART 1 and PART II investment authorities</p>

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704.8 ASSET LIABILITY MANAGEMENT	<p>Maintain internal ALM policy</p> <p>Perform net economic value (NEV) modeling to measure interest risk rate</p> <p>Does not have specific requirements relating to the risks of MISMATCHES between assets/liability cash flows</p> <p>Early withdrawal - assess a market-based penalty sufficient to cover replacement costs of certificate redeemed</p> <p>Does not establish CASH on hand minimum for liquidity purposes</p> <p>Limits borrowing to greater of: 10 times capital or 50% of shares and capital</p> <p>No previous limitations</p>	<ul style="list-style-type: none"> • Establish maximum limit on weighted average life of aggregate assets • Require additional testing for spread widening and net interest income (NII) modeling, including testing standards • Establish limits on cash flow mismatches, so as to not exceed an acceptable gap between the average life of assets and liabilities • Further limit ability to pay a market-based redemption price to no more than par, thus eliminating ability to pay a premium on early withdrawals • Require minimum amount of cash (or cash equivalents) to ensure liquidity • Restrict use of secured borrowings for purposes other than liquidity needs <p>Limits borrowing to lower of: 10 times capital or 50% of shares and capital</p> <ul style="list-style-type: none"> • Restrict accepting from member investments (including shares, loans, PCC and NCA) to 10% of corporate’s moving daily average assets (DANA)



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704.11 CORPORATE CUSO	Substantially similar to previous regulation with the following changes	<u>CORPORATE CUSOs</u> <ul style="list-style-type: none"> • Corporate CUSO must agree to limit services to: <ul style="list-style-type: none"> ○ Brokerage services ○ Investment advisory services ○ Other categories preapproved by NCUA • Expanded access for auditors, corporate directors, NCUA • Agree to Abide by all parts of 704.11
704.14 REPRESENTATION	No previous limitations	<u>REPRESENTATION</u> <ul style="list-style-type: none"> • Qualification for Corporate Directorship <ul style="list-style-type: none"> ○ CEO, CFO or COO at member institution (and only one director per institution.) ○ Phase in: applies at re-election or election ○ 6 year limit on continuous service: not required to step down, but cannot serve if re-election puts them over 6 years ○ In 3 years, majority, including chairman, must be NPCU representatives ○ Director only serve on one corporate board ○ A majority of directors must not also serve on trade association board/subcommittee
704.19 & .20	No previous requirements	<u>DISCLOSURE OF EXECUTIVE COMPENSATION (page 114)</u> <ul style="list-style-type: none"> • Requires prepare/maintain annual disclosure of compensation for senior executive officer, director • Format is up to corporate (page 116) • Must identify name, job title, compensation • Encompasses all benefits received by senior executives/directors • Member can request in writing past 3 years' worth of disclosures • Corporate can include supplementary information (salary surveys, compensation discussions, etc.) <u>GOLDEN PARACHUTES</u> <ul style="list-style-type: none"> • Restricts "golden parachutes," does not include: <ul style="list-style-type: none"> ○ Qualified pension/retirement plan ○ Bonafide deferred compensation plan ○ Payments upon death, disability, nondiscriminatory severance plan <u>INDEMNIFICATION</u> <ul style="list-style-type: none"> • Indemnification prohibited for civil or administrative actions/judgments brought by NCUA or state regulators

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APPENDIX A		<p><u>CAPITAL PRIORITIZATION AND MODEL FORMS</u></p> <p>Part 1</p> <ul style="list-style-type: none"> • Optional Capital Prioritization <ul style="list-style-type: none"> ○ If implemented by BOD, will give priority to entities that contribute new capital starting 60 days after publication of rule (page 44) <p>Part II - Amends forms to include:</p> <ul style="list-style-type: none"> ○ changing the notice and term of NCAs from 3-year to 5-year ○ eliminating references to adjustable balance NCAs ○ describing phrase "available to cover losses"
APPENDIX B		Imposes increased capital requirements to qualify for PART 1 and PART II investment authorities
APPENDIX C		<p><u>RISK BASED CAPITAL RATIOS AND ASSET RISK-WEIGHTINGS</u> (page 45)</p> <p>Corporate risk-based capital requirement is based on the credit risk presented by on-balance sheet assets and off-balance sheet commitments/obligations</p> <p><u>On-balance sheet assets</u> (page 46)</p> <ul style="list-style-type: none"> • Assets will be assigned to four risk categories and are weighted 0%, 20%, 50% and 100%. • Risk-weighted assets are determined by multiplying the book value by the risk weight assigned to it. • The amount of total risk assets is the amount against which the minimum capital requirement is applied. <p><u>Off-balance sheet assets</u> (page 49)</p> <ul style="list-style-type: none"> • Face value multiplied by credit conversion factor to arrive at balance sheet "credit-equivalent amount" • Credit-equivalent amount is then assigned to risk category depending upon obligor. • Conversion Factors grouped: Group A = 100%; Group B = 50%; Group C=20%; Group D=10%; Group E=zero (page 50) <p>Certain asset backed securities can employ rating based approach versus general risk-weighting approach (page 59)</p>