

AuditLink

CU*ANSWERS Management Services

From DC to Michigan: A Compliance Update

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Agenda

- Little bit about AuditLink
 - <http://auditlink.cuanswers.com/>
- 2014/2013/2012 Significant Letters to Credit Unions
- 2012-2014 Significant Regulatory Changes
- Rules Promulgated by the CFPB
- IRR Risk Mitigation
- 2014 PCA Risk Based Capital

2014 Letters To Credit Unions NCUA

Number	Subject	Date	Status
14-CU-03	Civil Money Penalties to be Assessed for Late Call Report and Profile Submissions in 2014	January 2014	Active
14-CU-02	Supervisory Focus for 2014	January 2014	Active
14-CU-01	Supervisory Guidance on Qualified and non-Qualified Mortgages	January 2014	Active

2013 Letters To Credit Unions NCUA

Number	Subject	Date	Status
13-CU-15	Private Student Loans	December	2013
13-CU-14	Projected 2014 Stabilization Fund Assessment and Share Insurance Fund Premium Range	November	2013
13-CU-13	Changes to NCUA Regulations Related to Credit Union Service Organizations	November	2013
13-CU-12	Supervisory Guidance on Enterprise Risk Management	November	2013
13-CU-11	Electronic Filing of Call Reports and Extended Filing Dates for 2014	October	2013
13-CU-10	Guidance on How to Comply with NCUA Regulation §741.12 Liquidity and Contingency Funding Plans	October	2013
13-CU-09	Examination Report Modernization	October	2013
13-CU-08	Reporting Elder Abuse or Financial Exploitation	September	2013
13-CU-07	Loan Participation Waivers	September	2013
13-CU-06	2013 Corporate Stabilization Fund Assessment	August	2013
13-CU-05	Guidance: Investing in Securities without Reliance on Credit Ratings	June	2013
13-CU-04	Streamlined Process for Evaluating Low-Income Designation	April	2013
13-CU-03	Supervisory Guidance on Troubled Debt Restructuring	April	2013
13-CU-02	Member Business Loan Waivers	February	2013
13-CU-01	Supervisory Focus for 2013	January	2013

2012 Letters To Credit Unions NCUA

Number	Subject	Date	Status
12-CU-14	Scheduled Expiration of the Temporary Corporate Credit Union Share Guarantee and Unlimited Insurance on Noninterest-Bearing Transaction Accounts	December 2012	Active
12-CU-13	Projected 2013 NCUSIF Premium and Corporate Stabilization Fund Assessment Range	December 2012	Active
12-CU-12	Changes Planned for Upcoming Call Reports	October 2012	Active
12-CU-11	Interest Rate Risk Policy and Program Frequently Asked Questions	August 2012	Active
12-CU-10	Changes to Central Liquidity Facility Access and Emergency Liquidity Proposed Rule	August 2012	Active
12-CU-09	2012 Corporate Stabilization Fund Assessment	July 2012	Active
12-CU-08	State of the Credit Union Industry	June 2012	Active
12-CU-07	Mortgage Servicing Practices Impacting Military Homeowners	June 2012	Active
12-CU-06	Update on Transitioning U.S. Central Bridge Corporate Federal Credit Union Automated Clearing House (ACH) Services	June 2012	Active
12-CU-05	Interest Rate Risk Policy and Program Requirements	May 2012	Active

Regulations Promulgated Since 2012 NCUA

Regulation Part / Federal Register Notice	Description	Status	Date Board Issued
12 CFR Parts 721	Charitable Donation Accounts - Parts 703 and 721	Final Action	12/12/2013
12 CFR Parts 712 and 741	Credit Union Service Organizations	Final Action	11/21/2013
12 CFR Parts 741 and 748	Filing Financial and Other Reports	Final Action	10/24/2013
12 CFR Part 741	Liquidity and Contingency Funding Plans	Final Action	10/24/2013
12 CFR Parts 701 and 741	Loan Participations; Purchase, Sale and Pledge of Eligible Obligations; Purchase of Assets and Assumption of Liabilities; Extension of Effective Date	Final Action; Notice of Extension of Effective Date	07/02/2013
12 CFR Parts 701 and 741	Loan Participations; Purchase, Sale and Pledge of Eligible Obligations; Purchase of Assets and Assumption of Liabilities	Final Action	06/20/2013
12 CFR Part 701	Chartering and Field of Membership Manual for Federal Credit Unions	Final Action	02/21/2013
12 CFR Part 703	Investment and Deposit Activities	Final Action	02/21/2013
12 CFR Parts 700, 741, 747 and 750	Definition of Troubled Condition	Final Action	01/10/2013
12 CFR Parts 702, 741 and 791	Prompt Corrective Action; Requirements for Insurance and Promulgation of NCUA Rules and Regulations	Final Action	01/10/2013
12 CFR Parts 701 and 741	Designation of Low-Income Status; Acceptance of Secondary Capital Accounts by Low-Income Designated Credit Unions	Final Action	01/10/2013
12 CFR Parts 703, 704, 709 and 741	Alternatives to the Use of Credit Ratings	Final Action	12/06/2012
IRPS 12-1	Guidelines for the Supervisory Review Committee	Interim with Comments	05/24/2012
12 CFR Part 741	Correction - Interest Rate Risk Policy and Program	Correction	N/A
12 CFR Part 741	Loan Workouts and Nonaccrual Policy, and Regulatory Reporting of Troubled Debt Restructured Loans	Final Action	05/24/2012
12 CFR Part 741	Interest Rate Risk Policy and Program	Final Action	1/26/2012

Regulations Promulgated 2013-2014 CFPB

2014

February 10

[Equal Access to Justice Act Implementation Rule](#)

2013

December 30

[Truth in Lending \(Regulation Z\): Adjustment to Asset-Size Exemption Threshold](#)

[Home Mortgage Disclosure \(Regulation C\): Adjustment to Asset-Size Exemption Threshold](#)

December 12

[Appraisals for Higher-Priced Mortgage Loans – Supplemental Final Rule](#)

December 11

[Truth in Lending \(Regulation Z\) – Threshold Adjustments \(CARD, HOEPA\)](#)

December 3

[Defining Larger Participants of the Student Loan Servicing Market](#)

November 20

[Integrated Mortgage Disclosures under the Real Estate Settlement Procedures Act \(Regulation X\) and the Truth in Lending Act \(Regulation Z\)](#)

[Truth in Lending \(Regulation Z\) – Threshold Adjustments](#)

[Consumer Leasing \(Regulation M\)](#)

November 8

[Homeownership Counseling Organizations Lists Interpretive Rule](#)

October 15

[Amendments to the 2013 Mortgage Rules under the Real Estate Settlement Procedures Act \(Regulation X\) and the Truth in Lending Act \(Regulation Z\)](#)

September 26

[Rules of Practice for Issuance of Temporary Cease-and-Desist Orders](#)

September 13

[Amendments to the 2013 Mortgage Rules under the Equal Credit Opportunity Act \(Regulation B\), Real Estate Settlement Procedures Act \(Regulation X\), and the Truth in Lending Act \(Regulation Z\)](#)

August 7

[Electronic Fund Transfers \(Regulation E\); Correction](#)

August 5

[Claims under the Federal Tort Claims Act for Loss of or Damage to Property or for Personal Injury or Death](#)

July 11

[Bureau Procedures for Collection of Debts Owed to the United States](#)

Regulations Promulgated 2013 CFPB

July 10

[Amendments to the 2013 Mortgage Rules under the Real Estate Settlement Procedures Act \(Regulation X\) and the Truth in Lending Act \(Regulation Z\)](#)

June 26

[Procedural Rule to Establish Supervisory Authority over Certain Nonbank Covered Persons Based on Risk Determination](#)

May 29

[Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act \(Regulation Z\)](#)
[Loan Originator Compensation Requirements under the Truth in Lending Act \(Regulation Z\); Prohibition on Financing Credit Insurance Premiums; Delay of Effective Date](#)

May 16

[Amendments to the 2013 Escrows Final Rule under the Truth in Lending Act \(Regulation Z\)](#)

April 30

[Electronic Fund Transfers \(Regulation E\)](#)

April 29

[Truth in Lending \(Regulation Z\)](#)

April 26

[Consumer Financial Civil Penalty Fund Rule](#)

March 22

[Truth in Lending \(Regulation Z\)](#)

March 21

[Amendments to Disclosures at Automated Teller Machines \(Regulation E\)](#)

February 15

[Disclosure of Records and Information](#)

January 20

[Loan Originator Compensation Requirements under the Truth in Lending Act \(Regulation Z\)](#)

January 18

[Disclosure and Delivery Requirements for Copies of Appraisals and Other Written Valuations Under the Equal Credit Opportunity Act \(Regulation B\)](#)
[Appraisals for Higher-Priced Mortgage Loans](#)

January 17

[2013 Real Estate Settlement Procedures Act \(Regulation X\) and Truth in Lending Act \(Regulation Z\)](#)
[Mortgage Servicing Final Rules](#)

January 10

[Escrow Requirements under the Truth in Lending Act \(Regulation Z\)](#)
[High-Cost Mortgage and Homeownership Counseling Amendments to the Truth in Lending Act \(Regulation Z\) and Homeownership Counseling Amendments to the Real Estate Settlement Procedures](#)

Regulations Promulgated 2012 CFPB

[Procedure Relating to Rulemaking](#)

[Home Mortgage Disclosure \(Regulation C\) Adjustment to Asset-Size Exemption Threshold](#)

[Regulation M Exemption Threshold Adjustment](#)

[Regulation Z Exemption Threshold Adjustment](#)

[Regulation Z HOEPA Threshold Adjustment](#)

[Defining Larger Participants of the Consumer Reporting Market](#)

[Defining Larger Participants of the Consumer Debt Collection Market](#)

[Defining Larger Participants of the Consumer Debt Collection Market; Correction](#)

[Confidential Treatment of Privileged Information](#)

[Rules Relating to Investigations](#)

[Rules of Practice for Adjudication Proceedings](#)

[State Official Notification Rule](#)

[Equal Access to Justice Act Implementation Rule](#)

[Disclosure of Records and Information](#)

[Home Mortgage Disclosure \(Regulation C\)](#) asset threshold for 2012

[Fair Credit Reporting Act Disclosures](#) ceiling for allowable charges

[Correcting amendments to Regulation V \(fair credit reporting\)](#)

[Delayed Implementation of Certain New Mortgage Disclosures](#) required under Title XIV of the Dodd-Frank Act

[Supplemental Standards of Ethical Conduct](#) for Employees of the Bureau of Consumer Financial Protection

[Enforcement of Nondiscrimination on the Basis of Disability](#) in Programs and Activities Conducted by the Bureau of Consumer Financial Protection

Proposed Rules CFPB

- Defining Larger Participants of the International Money Transfer Market
- Appraisals for Higher-Priced Mortgage Loans – Supplemental Proposal
- Amendments to the 2013 Mortgage Rules under the Equal Credit Opportunity Act (Regulation B), Real Estate Settlement Procedures Act (Regulation X), and the Truth in Lending Act (Regulation Z)
- Amendments to the 2013 Mortgage Rules under the Real Estate Settlement Procedure Act (Regulation X) and the Truth In Lending Act (Regulation Z)
- Amendments to the 2013 Escrows Final Rule under the Truth in Lending Act (Regulation Z)
- Ability to Repay Standards Under the Truth in Lending Act (Regulation Z)
- »issued concurrent to the January 2013 Ability to Repay and Qualified Mortgage Standards final rule
- Remittance Rule (Regulation E)
- 2012 Truth in Lending Act (Regulation Z) Mortgage Servicing Proposal
- 2012 Real Estate Settlement Procedures Act (Regulation X) Mortgage Servicing Proposal
- Defining Larger Nonbank Participants in Certain Consumer Financial Products and Services Markets
- Truth in Lending Act (Regulation Z); Loan Originator Compensation
- Integrated Mortgage Disclosures Under the Real Estate Settlement Procedures Act (Regulation X) and the Truth In Lending Act (Regulation Z); notice of extended comment period
- High-Cost Mortgage and Homeownership Counseling Amendments to the Truth in Lending Act (Regulation Z) and Homeownership Counseling Amendments to the Real Estate Settlement Procedures Act (Regulation X); notice of extended comment period

IRR Risk Mitigation

- First Shot Across the Bow in Early 2012
 - [12 CFR Part 741](#) Interest Rate Risk Policy and Program
 - 741 is the regulation regarding the ongoing insurance of member accounts
 - Categorized by CU's > \$50 million and those below with SIRTT ratio's less than 100% (Supervisory Interest Rate Risk Threshold)
 - A few of the requirements
 - Risk Assessment based upon balance sheet structure
 - NEV and assumptions feeding the model
 - GAP analysis
 - Income simulations
 - Particular attention should be given to the section VII outlining the guidelines and responsibilities



IRR Risk Mitigation

- Second Shot Across the Bow in May 2012
 - [12-CU-05](#) Interest Rate Risk Policy and Program Requirements
 - Outlines the examiner checklist
 - Describes how examiners will use the checklist
 - Encourages credit unions to review the January rule
 - Describes the tools in the checklist
 - “The new questionnaire follows the steps of the guidance in the new rule and explains the focus of each question. It uses the scope determinant in the previous questionnaire but adds tests for exposures to short-term liabilities and complex assets. Our pricing tables will be an optional resource for examiners and you. The questionnaire accords with minimum scope requirements for all examinations. We will publish the new questionnaire on our website”.

IRR Risk Mitigation

- Third Shot Across the Bow in August 2012
 - [12-CU-11](#) Interest Rate Risk Policy and Program Frequently Asked Questions
 - Answers the question of “why is this a requirement of my insurance from NCUA perspective
 - Reiterates responsibilities of Board, Committee’s, and Management
 - For the first time discusses the validation
 - When should I consider my IRR management program as being effective?
 - *“Your program will be considered effective when it has a well-defined policy and it identifies, measures, monitors and controls interest rate risk, and you use these to guide decision making. Your program should be able to adjust as products are added or increased, interest rates shift, balance sheet changes and capital positions change. It is the FICU’s responsibility to effectively manage its potential IRR. NCUA expects credit unions to incorporate the program results and information obtained into the credit unions decision making”.*



IRR Risk Mitigation

- Fourth but not final.....
- [13-CU-01](#) Supervisory Focus for 2013
 - Clearly states that the main focus of the year will be evaluation of interest rate risk and other risks associated with the running of a financial institution
 - Re-introduces risk based examination focus.....leading to the change in examination reports as previously discussed.
- Other's include quarterly economic reports and town hall and event meeting speeches

Know let's did into some recent examination discussions

Interest Rate Risk in Investments

The #1 concern of examiners this cycle!!!

- Credit unions who are caught unaware of risk in the investment portfolio can expect to be on the receiving end of **very harsh** Safety and Soundness examinations!





What will Examiners be Looking For?

- The examiners will determine whether the credit union is in a position where **slow, gradual increases in interest rates** will create significant negative valuation in the investment portfolio.
- In addition, the examiners will also likely test at what point in a **rapidly rising interest rate environment** would a credit union expect to see substantial valuation loss.

Credit unions that fall into the first category can expect a rough time of it, but can alleviate pressure by **preparing a policy and a plan** that demonstrates to the examiners that credit union management is **aware of the risks** and is **prepared to take action** in the event that rising interest rates create significant loss scenarios for the credit union.

Step One: Understand SIRRT Ratio

- The SIRRT ratio is calculated by adding the Total First Mortgages Held to the, and dividing that total by the Total Net Worth of the Credit Union:

$$\frac{\textit{(Total First Mortgages Held + Total Investments with Maturities Greater than Five Years)}}{\textit{Total Net Worth of the Credit Union}}$$

- The NCUA looks very closely at any credit union where this ratio **exceeds 100%**.
- Also note that any federally insured credit union who has over \$50 million in assets or has a SIRRT ratio above 100% is **subject to the revised NCUA 741 interest rate risk regulations**. A summary of these revisions can be found on the NCUA site under the May 2012 Letter to Credit Unions.

Step Two: Understand Valuation Reserve Ratio

- The next step is to pool investments that meet the FASB definitions of AFS (“Available for Sale”) and Trading (i.e. held for near term sale) and calculate the ratio of that pool to the credit union’s Investment Valuation Reserve Account.

$$\frac{\textit{(Investments Available for Sale) + (Investments Held for Near Term Sale)}}{\textit{Investment Valuation Reserve Account}}$$

- Federally insured credit unions are required to have an Investment Valuation Reserve Account in an amount “**at least equal to the net excess of book value over current market value of the investments.**” See Chapter 26 of the NCUA Examiner’s Guide for more details.

Step Three: Provisions for Investment Loss Account Ratio

- In addition, federally insured credit unions should calculate the ratio between its Provisions for Investment Loss Account to Total Expenses. This information is useful in determining whether the credit union is adequately prepared for sudden devaluations in its investment portfolio.

$$\frac{\textit{Provisions for Investment Loss Account}}{\textit{Total Expenses}}$$

Consider Revisions to ALM and ALCO

- Once the credit union has a handle on its basic investment information, federally insured credit unions need to study the investment risk policy and compare it to the latest ALM and ALCO reports. Some of the key elements to update in the policy include:
- Adequate Price Research. Documentation of at least two price quotes for *every* investment.
- Adequate Understanding of the Security. Has management documented and understood when investments will have interrupted cash flows, especially with respect to prepayment? Management can help itself a great deal by having the ALCO calculate prepayment speed assumptions under multiple interest rate scenarios. For CMO's (Collateralized Mortgage Obligations), does management understand the relationships between deal structure, coupon rate, and collateral?
- Callable Securities. If the credit union has callable investments, all of these need to be reviewed. Management needs to have an understanding on the probability a security will be called, and how much damage a call will have on the credit union's yield. In the 2014 environment, management should be aware that callable securities are being called even in very small interest rate variations.
- Income Simulations. Credit unions should expand income simulations on the ALM model beyond 12 months to at least 36 months and understand earnings pressures on a longer time horizon. Occasionally credit unions will find that investment risk in the investment portfolio results in short-term pain but will end up profitable over a longer horizon.
- Liquidity Testing. Incorporate liquidity shock tests under multiple interest rate environments and include early warning measurements to proactively address potential future problems with earnings. What impact would rising interest rates have on the liquidity of the credit union? Examiners may want to see evidence of contingency plans in the event that in a +300bps shock there are deposit outflows with a reduction in asset cash flows. Include in this review the dependence on core deposits and analytics or non-term share accounts as well as the impact of prepayment speeds changing based upon the direction of shock.
- Price Risk. How does the amount of price risk compare to the net worth (capital) of the credit union? Credit unions will likely face examiner action if the price risk is greater than 50% of the credit union's net worth or if the resulting losses push the institution's net worth below 4%.
- Risk Limits. Calculate and compare the amount of market price loss in the investment portfolio to prior periods and compare the amount to overall net worth. Does the credit union have a price risk limit (limit as a percentage of net worth) for a +300bps shock for each investment regardless if they are held-to-maturity or available-for-sale? Depending on overall price riskiness of the portfolio, examiners may want limits to be set at no more than 35-40% of net worth for a +300bps shock.



Last Words on Investment Risk

- This sounds like a lot of work – and it is.
- However, credit union management should not underestimate the NCUA's fear of rising interest rates and the potential impact these increases might have on credit union earnings (and, ultimately, on the Share Insurance Fund).
- Remember, the **NCUA under 741 even has the right to remove your share insurance** if the NCUA has evidence that the federally insured credit union is inadequately managing interest rate risk.
- Your best defense against examiners will be the knowledge you have of your investment portfolio and how it operates, and your written and implemented contingency plans in the event of a rising interest rate environment.



Prompt Corrective Action and Risk Based Net Worth

<http://www.ncua.gov/Legal/Documents/Regulations/PR20140123PCA.pdf>

Risk Based Net Worth

- The NCUA is proposing revising its Risk Based Net Worth Calculations for federally insured credit unions
- If this Rule passes, the net effect will be **to increase** the number of credit unions who are subject to **PROMPT CORRECTIVE ACTION** because these financial institutions will **no longer be WELL CAPITALIZED**

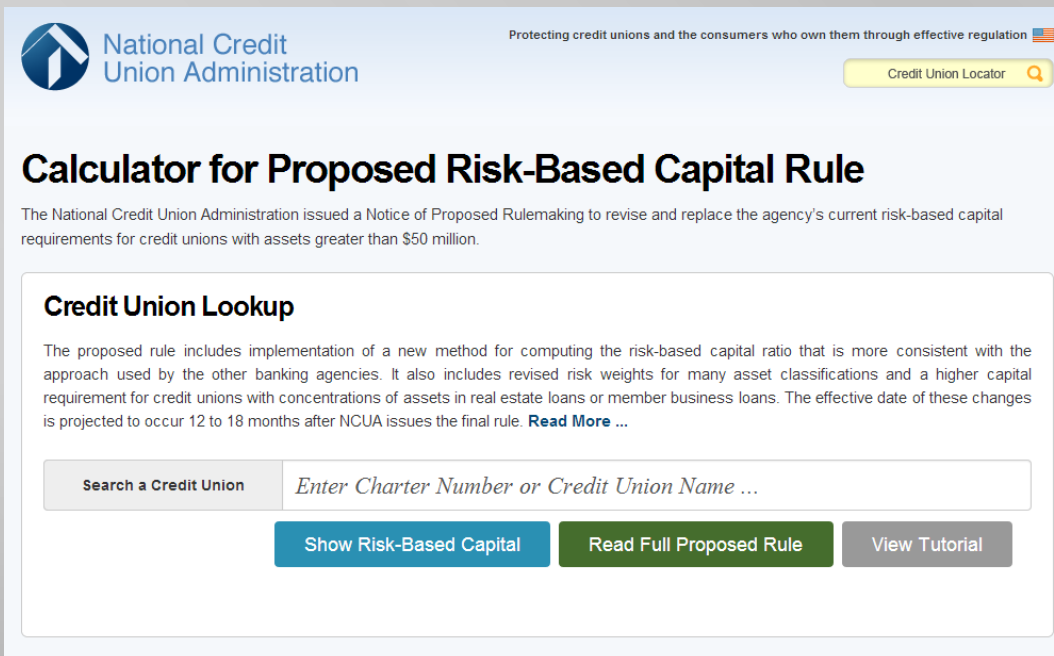


Even if you are well capitalized now, this Rule will serve to restrict your ability to engage in business, and also beware if you have a couple of bad years in a row!


NCUA Site


- If you haven't already, you should go to the NCUA site and see how you stack up (but remember, even if you are fine now think about what this might mean for your future):

<http://webapps2.ncua.gov/ncua.rbnw.web.ui/>



The screenshot displays the NCUA website interface. At the top left is the NCUA logo and the text 'National Credit Union Administration'. To the right is the tagline 'Protecting credit unions and the consumers who own them through effective regulation' and a 'Credit Union Locator' button. The main heading is 'Calculator for Proposed Risk-Based Capital Rule'. Below this is a paragraph explaining the proposed rulemaking. A 'Credit Union Lookup' section contains a search box with the placeholder text 'Enter Charter Number or Credit Union Name ...' and three buttons: 'Show Risk-Based Capital', 'Read Full Proposed Rule', and 'View Tutorial'.

National Credit Union Administration Protecting credit unions and the consumers who own them through effective regulation 

[Credit Union Locator](#) 

Calculator for Proposed Risk-Based Capital Rule

The National Credit Union Administration issued a Notice of Proposed Rulemaking to revise and replace the agency's current risk-based capital requirements for credit unions with assets greater than \$50 million.

Credit Union Lookup

The proposed rule includes implementation of a new method for computing the risk-based capital ratio that is more consistent with the approach used by the other banking agencies. It also includes revised risk weights for many asset classifications and a higher capital requirement for credit unions with concentrations of assets in real estate loans or member business loans. The effective date of these changes is projected to occur 12 to 18 months after NCUA issues the final rule. [Read More ...](#)

Search a Credit Union

[Show Risk-Based Capital](#) [Read Full Proposed Rule](#) [View Tutorial](#)

How the Rule Works

The NCUA rule will require you to add up the following as the **NUMERATOR**:

Additions	Deductions
Undivided earnings (includes any regular reserve) Appropriations for non-conforming investments Other reserves Equity acquired in merger	NCUSIF deposit. Goodwill. Other intangible assets. Identified losses not reflected as adjustments to components of the risk-based numerator.
Net income. ALLL (limited to 1.25% of risk assets). Secondary capital accounts included in net worth. Section 208 assistance included in net worth (as defined in § 702.2).	

How the Rule Works

The NCUA rule will require you add up a second set of assets as the **DENOMINATOR**. The trick is that some assets will have MUCH higher risk weights. Here is the low end:

TABLE 6—RISK-WEIGHT CATEGORIES AND ASSOCIATED RISK-WEIGHTS

Risk-weight category	Risk-weight	Items included
Category 1	0 percent	<ul style="list-style-type: none"> • Cash on hand, which includes the change fund (coin, currency, and cash items), vault cash, vault funds in transit, and currency supplied from automatic teller machines. • NCUSIF capitalization deposit. • Debt instruments unconditionally guaranteed by the NCUA or the FDIC. • U.S. Government obligations directly and unconditionally guaranteed by the full faith and credit of the U.S. Government, including U.S. Treasury bills, notes, bonds, zero coupon bonds, and separate trading of registered interest and principal securities (STRIPS).
Category 2	20 percent	<ul style="list-style-type: none"> • Non-delinquent student loans unconditionally guaranteed by a U.S. Government agency. • Cash on deposit, which includes balances on deposit in insured financial institutions and deposits in transit. These amounts may or may not be subject to withdrawal by check, and they may or may not bear interest. Examples include overnight accounts, corporate credit union daily accounts, money market accounts, and checking accounts. • Cash equivalents (investments with original maturities of three months or less). Cash equivalents are short-term, highly liquid non-security investments that have an original maturity of 3 months or less at the time of purchase, are readily convertible to known amounts of cash, and are used as part of the credit union's cash management activities. • The total amount of investments with a weighted-average life of one year or less. • Residential mortgages guaranteed by the federal government through the FHA or the VA.

How the Rule Works

Here are the rest of the categories. For example, your investments in a CUSO will need to be **multiplied by 250%** under this new rule!

TABLE 6—RISK-WEIGHT CATEGORIES AND ASSOCIATED RISK-WEIGHTS—Continued

Risk-weight category	Risk-weight	Items included
Category 3	50 percent	<ul style="list-style-type: none"> Loans guaranteed 75 percent or more by the SBA, U.S. Department of Agriculture, or other U.S. Government agency. The total amount of investments with a weighted-average life of greater than one year, but less than or equal to three years. The total amount of current and non-delinquent first mortgage real estate loans less than or equal to 25 percent of total assets.
Category 4	75 percent	<ul style="list-style-type: none"> The total amount of investments with a weighted-average life of greater than three years, but less than or equal to five years. Current and non-delinquent unsecured credit card loans, other unsecured loans and lines of credit, short-term, small amount loans (STS), new vehicle loans, used vehicle loans, leases receivable and all other loans. (Excluding loans reported as MBLs). Current and non-delinquent first mortgage real estate loans greater than 25 percent of total assets and less than or equal to 35 percent of assets.
Category 5	100 percent	<ul style="list-style-type: none"> Corporate credit union nonperpetual capital. The total outstanding principal amount loaned to CUSOs. Current and non-delinquent first mortgage real estate loans greater than 35 percent of total assets. Delinquent first mortgage real estate loans. Other real estate-secured loans less than or equal to 10 percent of assets. MBLs less than or equal to 15 percent of assets. Loans held for sale. The total amount of any foreclosures and repossessed assets. Land and building, less depreciation on building. Any other fixed assets, such as furniture and fixtures and leasehold improvements, less related depreciation. Current non-federally insured student loans. All other assets not specifically assigned a risk-weight but included in the balance sheet.
Category 6	125 percent	<ul style="list-style-type: none"> Total amount of all other real estate-secured loans greater than 10 percent of assets and less than or equal to 20 percent of assets.
Category 7	150 percent	<ul style="list-style-type: none"> The total amount of investments with a weighted-average life of greater than five years, but less than or equal to ten years. Any delinquent unsecured credit card loans; other unsecured loans and lines of credit; short-term, small amount loans; non-federally guaranteed student loans; new vehicle loans; used vehicle loans; leases receivable; and all other loans (excluding loans reported as MBLs). The total amount of all other real estate-secured loans greater than 20 percent of assets. Any MBLs greater than 15 percent of assets and less than or equal to 25 percent of assets.
Category 8	200 percent	<ul style="list-style-type: none"> Corporate credit union perpetual capital. The total amount of investments with a weighted-average life of greater than 10 years. The total amount of MBLs greater than 25 percent of assets, other than MBLs included in Category 3 above.
Category 9	250 percent	<ul style="list-style-type: none"> The total value of investments in CUSOs. The total value of mortgage servicing assets.
Category 10	1,250 percent	<ul style="list-style-type: none"> An asset-backed investment for which the credit union is unable to demonstrate, as required under § 702.104(d), a comprehensive understanding of the features of the asset-backed investment that would materially affect its performance.

How the Rule Works

- Now you divide the NUMERATOR by the DENOMINATOR. If the number is under 10.5%, your credit union is no longer Well Capitalized **even if** your Net Worth Ratio is above 7%.
- In other words, you have to pass **both** the Net Worth Ratio test of 7%+ and the Risk Based Net Worth Calculation of 10.5%+ to be Well Capitalized.
- If you do not pass both, you are now subject to **Prompt Corrective Action**.



A Flashback to the Investment Risk

- Remember how we said Investment Risk is a major worry of the NCUA? Take a close look at this:

Category 10	1,250 percent	<ul style="list-style-type: none">An asset-backed investment for which the credit union is unable to demonstrate, as required under § 702.104(d), a comprehensive understanding of the features of the asset-backed investment that would materially affect its performance.
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- If you have a large number of asset-backed investments, you absolutely need to understand **702.104(d)** and **document that you understand** these requirements, or the examiners are going to push you *hard* towards Prompt Corrective Action





What are the Biggest Pain Points?

If the rule passes, the credit unions that will have the most to worry about will be those that:

- Have asset-backed investments where the credit union cannot demonstrate sufficient understanding of its features
- Large amounts of Mortgage Servicing Assets
- Large amounts of MBLs
- Large investments in CUSOs
- Large amounts of investments with Weighted Average Life of 5+ years
- Large amounts of delinquent loans
- Large amounts of real estate loans

Dirty Pool

- In some respects, for all of its problems this new proposed rule wouldn't be so bad if it provided objective criteria for every credit union to follow. However, hidden in the rule is the highlighted clause seen here ---

In other words:

“Yeah you may pass both tests, but our ‘subjective judgment’ and ‘agency expertise’ tells us you still aren’t performing to our standards. Therefore, we are still going to tell you what to do!”

105(c) Standards for Determination of Appropriate Individual Minimum Capital Requirements

Proposed § 702.105(c) would provide that the appropriate minimum capital levels for an individual credit union cannot be determined solely through the application of a rigid mathematical formula or wholly objective criteria, and that the decision is necessarily based, in part, on a **subjective judgment grounded in agency expertise**. The proposed rule provides the following additional factors that may be considered by NCUA in making its determination:

- The conditions or circumstances leading to the determination that a higher minimum capital requirement is appropriate or necessary for the credit union.
- The urgency of those circumstances or potential problems.
- The overall condition, management strength, and future prospects of the credit union and, if applicable, its subsidiaries, affiliates, and business partners.
- The credit union's liquidity, capital, and other indicators of financial stability, particularly as compared with those of similarly situated credit unions.
- The policies and practices of the credit union's directors, officers, and senior management as well as the internal control and internal audit systems for implementation of such adopted policies and practices.

Next Steps

- Understand the Rule!
- If you don't like the Rule, organize and **fight now!**
- Start thinking about how your reports are going to need to look like in the future if the Rule passes
- Start thinking about how your strategic planning will need to change if the Rule passes

*Remember, the net effect of this Rule will be to provide the NCUA with more control over credit union operations both **now and in the future!***

By default, more credit unions will be subject to Prompt Corrective Action the moment this Rule passes!