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(3) Forty-five percent of unrealized gains on available-for-sale equity securities with readily determinable fair values. Unrealized gains are unrealized holding gains, net of unrealized holding losses, calculated as the amount, if any, by which fair value exceeds historical cost. The NCUA may disallow such inclusion in the calculation of supplementary capital if the NCUA determines that the securities are not prudently valued.

Tier 1 capital means adjusted core capital. *Tier 1 risk-based capital ratio* means the ratio of Tier 1 capital to the moving monthly average net risk-weighted assets.

Tier 2 capital means supplementary capital plus any perpetual contributed capital deducted from adjusted core capital.

Total assets means the sum of all a corporate credit union's assets as calculated under GAAP.

Total capital means the sum of a corporate credit union's adjusted core capital and its supplementary capital, less the corporate credit union's equity investments not otherwise deducted when calculating adjusted core capital.

Total risk-based capital ratio means the ratio of total capital to moving monthly average net risk-weighted assets.

Trade date means the date a corporate credit union originally agrees, whether orally or in writing, to enter into the purchase or sale of a security.

Trigger means an event in a securitization that will redirect cashflows if predefined thresholds are breached. Examples of triggers are delinquency and cumulative loss triggers.

Weighted average life means the weighted-average time to the return of a dollar of principal, calculated by multiplying each portion of principal received by the time at which it is expected to be received (based on a reasonable and supportable estimate of that time) and then summing and dividing by the total amount of principal. The calculation of weighted average life for interest only securities means the weighted-average time to the return of a dollar of interest, calculated by multiplying each portion of interest received by the time at which it is expected to be received (based on

a reasonable and supportable estimate of that time) and then summing and dividing by the total amount of interest to be received.

When-issued trading means the buying and selling of securities in the period between the announcement of an offering and the issuance and payment date of the securities.

[75 FR 64829, Oct. 20, 2010, as amended at 76 FR 23867, Apr. 29, 2011]

EFFECTIVE DATE NOTE: At 76 FR 79533, Dec. 22, 2011, §704.2 was amended by removing the definition of "daily average net risk-weighted assets" and revising the definition of "net assets", effective Jan. 23, 2012. For the convenience of the user, the revised text is set forth as follows:

§ 704.2 Definitions.

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Net assets means total assets less Central Liquidity Facility (CLF) stock subscriptions, loans guaranteed by the NCUSIF, and member reverse repurchase transactions. For its own account, a corporate credit union's payables under reverse repurchase agreements and receivables under repurchase agreements may be netted out if the GAAP conditions for offsetting are met. Also, any amounts deducted from core capital in calculating adjusted core capital are also deducted from net assets.

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§ 704.3 Corporate credit union capital.

(a) *Capital requirements.* (1) A corporate credit union must maintain at all times:

- (i) A leverage ratio of 4.0 percent or greater;
- (ii) A Tier 1 risk-based capital ratio of 4.0 percent or greater; and
- (iii) A total risk-based capital ratio of 8.0 percent or greater.

(2) To ensure it meets its capital requirements, a corporate credit union must develop and ensure implementation of written short- and long-term capital goals, objectives, and strategies which provide for the building of capital consistent with regulatory requirements, the maintenance of sufficient capital to support the risk exposures that may arise from current and projected activities, and the periodic review and reassessment of the capital position of the corporate credit union.

(3) Beginning with the first call report submitted on or after October 21, 2013, a corporate credit union must calculate and report to NCUA the ratio of its retained earnings to its moving daily average net assets. If this ratio is less than 0.45 percent, the corporate credit union must, within 30 days, submit a retained earnings accumulation plan to the NCUA for NCUA's approval. The plan must contain a detailed explanation of how the corporate credit union will accumulate earnings sufficient to meet all its future minimum leverage ratio requirements, including specific semiannual milestones for accumulating retained earnings. In the case of a state-chartered corporate credit union, the NCUA will consult with the appropriate state supervisory authority (SSA) before making a determination to approve or disapprove the plan, and will provide the SSA a copy of the completed plan. If the corporate credit union fails to submit a plan acceptable to NCUA, or fails to comply with any element of a plan approved by NCUA, the corporate will immediately be classified as significantly undercapitalized or, if already significantly undercapitalized, as critically undercapitalized for purposes of prompt corrective actions. The corporate credit union will be subject to all the associated actions under § 704.4.

(b) *Requirements for nonperpetual capital accounts (NCAs)*—(1) Form. NCA funds may be in the form of a term certificate or a no-maturity notice account.

(2) Disclosure. The terms and conditions of a nonperpetual capital account must be disclosed to the recorded owner of the account at the time the account is opened and at least annually thereafter.

(i) The initial NCA disclosure must be signed by either all of the directors of the member credit union or, if authorized by board resolution, the chair and secretary of the board; and

(ii) The annual disclosure notice must be signed by the chair of the corporate credit union. The chair must sign a statement that certifies that the notice has been sent to all entities with NCAs. The certification must be maintained in the corporate credit

union's files and be available for examiner review.

(3) Five-year remaining maturity. When a no-maturity NCA has been placed on notice, or a term account has a remaining maturity of less than five years, the corporate will reduce the amount of the account that can be considered as nonperpetual capital by a constant monthly amortization that ensures the capital is fully amortized one year before the date of maturity or one year before the end of the notice period. The full balance of an NCA being amortized, not just the remaining non-amortized portion, is available to absorb losses in excess of the sum of retained earnings and perpetual contributed capital until the funds are released by the corporate credit union at the time of maturity or the conclusion of the notice period.

(4) Release. Nonperpetual capital may not be released due solely to the merger, charter conversion, or liquidation of the account holder. In the event of a merger, the capital account transfers to the continuing entity. In the event of a charter conversion, the capital account transfers to the new institution. In the event of liquidation, the corporate may release a member capital account to facilitate the payout of shares, but only with the prior written approval of the NCUA.

(5) Redemption. A corporate credit union may redeem NCAs prior to maturity or prior to the end of the notice period only with the prior approval of the NCUA and, for state chartered corporate credit unions, the approval of the appropriate state regulator.

(6) Sale. A member may transfer its interest in a nonperpetual capital account to another member or to a non-member (other than a natural person). At least 14 days before consummating such a transfer, the member must notify the corporate credit union of the pending transfer. The corporate credit union must, within 10 days of such notice, provide the member and the potential transferee all financial information about the corporate credit union that is available to the public or that the corporate credit union has provided to its members, including any

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call report data submitted by the corporate credit union to NCUA but not yet posted on NCUA's Web site.

(7) Merger. In the event of a merger of a corporate credit union, nonperpetual capital will transfer to the continuing corporate credit union. The minimum five-year notice period for withdrawal of no-maturity capital remains in effect.

(c) *Requirements for perpetual contributed capital (PCC)*—(1) Disclosure. The terms and conditions of any perpetual contributed capital instrument must be disclosed to the recorded owner of the instrument at the time the instrument is created and must be signed by either all of the directors of the member credit union or, if authorized by board resolution, the chair and secretary of the board.

(2) Release. Perpetual contributed capital may not be released due solely to the merger, charter conversion or liquidation of a member credit union. In the event of a merger, the perpetual contributed capital transfers to the continuing credit union. In the event of a charter conversion, the perpetual contributed capital transfers to the new institution. In the event of liquidation, the perpetual contributed capital may be released to facilitate the payout of shares with NCUA's prior written approval.

(3) Callability. A corporate credit union may call perpetual contributed capital instruments only with the prior approval of the NCUA and, for state chartered corporate credit unions, the applicable state regulator. Perpetual contributed capital accounts are callable on a pro-rata basis across an issuance class.

(4) Perpetual contributed capital. A corporate credit union may issue perpetual contributed capital to both members and nonmembers.

(5) The holder of a PCC instrument may transfer its interests in the instrument to another member or to a nonmember (other than a natural person). At least 14 days before consummating such a transfer, the member must notify the corporate credit union of the pending transfer. The corporate credit union must, within 10 days of such notice, provide the member and the potential transferee all financial

information about the corporate credit union that is available to the public or that the corporate credit union has provided to its members, including any call report data submitted by the corporate credit union to NCUA but not yet posted on NCUA's Web site.

(6) A corporate credit union is permitted to condition membership, services, or prices for services on a member's ownership of PCC, provided the corporate credit union gives existing members at least six months written notice of:

(i) The requirement to purchase PCC, including specific amounts; and

(ii) The effects of a failure to purchase the requisite PCC on the pricing of services or on the member's access to membership or services.

(d) *Individual minimum capital requirements.*

(1) *General.* The rules and procedures specified in this paragraph apply to the establishment of an individual minimum capital requirement for a corporate credit union that varies from any of the risk-based capital requirement(s) or leverage ratio requirements that would otherwise apply to the corporate credit union under this part.

(2) *Appropriate considerations for establishing individual minimum capital requirements.* Minimum capital levels higher than the risk-based capital requirements or the leverage ratio requirement under this part may be appropriate for individual corporate credit unions. The NCUA may establish increased individual minimum capital requirements, including modification of the minimum capital requirements related to being either significantly and critically undercapitalized for purposes of § 704.4 of this part, upon a determination that the corporate credit union's capital is or may become inadequate in view of the credit union's circumstances. For example, higher capital levels may be appropriate when NCUA determines that:

(i) A corporate credit union is receiving special supervisory attention;

(ii) A corporate credit union has or is expected to have losses resulting in capital inadequacy;

(iii) A corporate credit union has a high degree of exposure to interest rate

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risk, prepayment risk, credit risk, concentration risk, certain risks arising from nontraditional activities or similar risks, or a high proportion of off-balance sheet risk including standby letters of credit;

(iv) A corporate credit union has poor liquidity or cash flow;

(v) A corporate credit union is growing, either internally or through acquisitions, at such a rate that supervisory problems are presented that are not dealt with adequately by other NCUA regulations or other guidance;

(vi) A corporate credit union may be adversely affected by the activities or condition of its CUSOs or other persons or entities with which it has significant business relationships, including concentrations of credit;

(vii) A corporate credit union with a portfolio reflecting weak credit quality or a significant likelihood of financial loss, or has loans or securities in nonperforming status or on which borrowers fail to comply with repayment terms;

(viii) A corporate credit union has inadequate underwriting policies, standards, or procedures for its loans and investments;

(ix) A corporate credit union has failed to properly plan for, or execute, necessary retained earnings growth, or

(ix) A corporate credit union has a record of operational losses that exceeds the average of other, similarly situated corporate credit unions; has management deficiencies, including failure to adequately monitor and control financial and operating risks, particularly the risks presented by concentrations of credit and nontraditional activities; or has a poor record of supervisory compliance.

(3) *Standards for determination of appropriate individual minimum capital requirements.* The appropriate minimum capital levels for an individual corporate credit union cannot be determined solely through the application of a rigid mathematical formula or wholly objective criteria. The decision is necessarily based, in part, on subjective judgment grounded in agency expertise. The factors to be considered in NCUA's determination will vary in each case and may include, for example:

(i) The conditions or circumstances leading to the determination that a higher minimum capital requirement is appropriate or necessary for the corporate credit union;

(ii) The exigency of those circumstances or potential problems;

(iii) The overall condition, management strength, and future prospects of the corporate credit union and, if applicable, its subsidiaries, affiliates, and business partners;

(iv) The corporate credit union's liquidity, capital and other indicators of financial stability, particularly as compared with those of similarly situated corporate credit unions; and

(v) The policies and practices of the corporate 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.

(4) Procedures—(i) In the case of a state chartered corporate credit union, NCUA will consult with the appropriate state regulator when considering imposing a new minimum capital requirement.

(ii) When the NCUA determines that a minimum capital requirement is necessary or appropriate for a particular corporate credit union, it will notify the corporate credit union in writing of its proposed individual minimum capital requirement; the schedule for compliance with the new requirement; and the specific causes for determining that the higher individual minimum capital requirement is necessary or appropriate for the corporate credit union. The NCUA shall forward the notifying letter to the appropriate state supervisory authority (SSA) if a state-chartered corporate credit union would be subject to an individual minimum capital requirement.

(iii) The corporate credit union's response must include any information that the credit union wants the NCUA to consider in deciding whether to establish or to amend an individual minimum capital requirement for the corporate credit union, what the individual capital requirement should be, and, if applicable, what compliance schedule is appropriate for achieving the required capital level. The responses of the corporate credit union

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and SSA must be in writing and must be delivered to the NCUA within 30 days after the date on which the notification was received. The NCUA may extend the time period for good cause, and the time period for response by the insured corporate credit union may be shortened for good cause:

(A) When, in the opinion of the NCUA, the condition of the corporate credit union so requires, and the NCUA informs the corporate credit union of the shortened response period in the notice;

(B) With the consent of the corporate credit union; or

(C) When the corporate credit union already has advised the NCUA that it cannot or will not achieve its applicable minimum capital requirement.

(iv) Failure by the corporate credit union to respond within 30 days, or such other time period as may be specified by the NCUA, may constitute a waiver of any objections to the proposed individual minimum capital requirement or to the schedule for complying with it, unless the NCUA has provided an extension of the response period for good cause.

(v) After expiration of the response period, the NCUA will decide whether or not the proposed individual minimum capital requirement should be established for the corporate credit union, or whether that proposed requirement should be adopted in modified form, based on a review of the corporate credit union's response and other relevant information. The NCUA's decision will address comments received within the response period from the corporate credit union and the appropriate state supervisory authority (SSA) (if a state-chartered corporate credit union is involved) and will state the level of capital required, the schedule for compliance with this requirement, and any specific remedial action the corporate credit union could take to eliminate the need for continued applicability of the individual minimum capital requirement. The NCUA will provide the corporate credit union and the appropriate SSA (if a state-chartered corporate credit union is involved) with a written decision on the individual minimum capital requirement, addressing the substantive com-

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ments made by the corporate credit union and setting forth the decision and the basis for that decision. Upon receipt of this decision by the corporate credit union, the individual minimum capital requirement becomes effective and binding upon the corporate credit union. This decision represents final agency action.

(vi) In lieu of the procedures established above, a corporate credit union may request an informal hearing. The corporate credit union must make the request for a hearing in writing, and NCUA must receive the request no later than 10 days following the date of the notice described in paragraph (d)(4)(ii) of this section. Upon receipt of the request for hearing, NCUA will conduct an informal hearing and render a decision using the procedures described in paragraphs (d), (e), and (f) of § 747.3003 of this chapter.

(5) *Failure to comply.* Failure to satisfy any individual minimum capital requirement, or to meet any required incremental additions to capital under a schedule for compliance with such an individual minimum capital requirement, will constitute a basis to take action as described in § 704.4.

(6) *Change in circumstances.* If, after a decision is made under paragraph (b)(3)(iv) of this section, there is a change in the circumstances affecting the corporate credit union's capital adequacy or its ability to reach its required minimum capital level by the specified date, the NCUA may amend the individual minimum capital requirement or the corporate credit union's schedule for such compliance. The NCUA may decline to consider a corporate credit union's request for such changes that are not based on a significant change in circumstances or that are repetitive or frivolous. Pending the NCUA's reexamination of the original decision, that original decision and any compliance schedule established in that decision will continue in full force and effect.

(e) *Reservation of authority.*

(1) *Transactions for purposes of evasion.* The NCUA may disregard any transaction entered into primarily for the purpose of reducing the minimum required amount of regulatory capital

or otherwise evading the requirements of this section.

(2) *Period-end versus average figures.* The NCUA reserves the right to require a corporate credit union to compute its capital ratios on the basis of period-end assets rather than average assets when the NCUA determines this requirement is appropriate to carry out the purposes of this part.

(3) *Reservation of authority.* (i) Notwithstanding the definitions of core and supplementary capital in paragraph (d) of this section, the NCUA may find that a particular asset or core or supplementary capital component has characteristics or terms that diminish its contribution to a corporate credit union's ability to absorb losses, and the NCUA may require the discounting or deduction of such asset or component from the computation of core, supplementary, or total capital.

(ii) Notwithstanding Appendix C to this Part, the NCUA will look to the substance of a transaction and may find that the assigned risk-weight for any asset, or credit equivalent amount or credit conversion factor for any off-balance sheet item does not appropriately reflect the risks imposed on the corporate credit union. The NCUA may require the corporate credit union to apply another risk-weight, credit equivalent amount, or credit conversion factor that NCUA deems appropriate.

(iii) If Appendix C to this part does not specifically assign a risk-weight, credit equivalent amount, or credit conversion factor to a particular asset or activity of the corporate credit union, the NCUA may assign any risk-weight, credit equivalent amount, or credit conversion factor that it deems appropriate. In making this determination, NCUA will consider the risks associated with the asset or off-balance sheet item as well as other relevant factors.

(4) Where practicable, the NCUA will consult with the appropriate state regulator before taking any action under this paragraph (e) that involves a state chartered corporate credit union.

(5) Before taking any action under this paragraph (e), NCUA will provide the corporate credit union with written notice of the intended action and the

reasons for such action. The corporate credit union will have seven days to provide the NCUA with a written response, and the NCUA will consider the response before taking the action. Upon the timely request of the corporate credit union, and for good cause, NCUA may extend the seven day response period.

(f) *Former capital accounts.* This paragraph addresses membership capital accounts (MCAs) that qualified as corporate capital prior to October 20, 2011 but which no longer satisfy the definitions of capital because the accounts have not been converted by the member to nonperpetual capital accounts (NCAs) or to perpetual contributed capital (PCC).

(1) For MCAs structured as adjustable balance accounts, the corporate will immediately place the account on notice of withdrawal if the member has not already done so. The corporate will continue to adjust the balance of the MCA account in accordance with the original terms of the account until the entire notice period has run and then return the remaining balance, less any losses, to the member. Until the expiration of the notice period the entire adjusted balance will be available to cover losses at the corporate credit union that exceed retained earnings and PCC (excluding, if a corporate credit union exercises the capital prioritization option under Part I of Appendix A to this Part, any PCC with priority under that option).

(2) For term MCAs, the corporate credit union will return the balance of the MCA account to the member at the expiration of the term. Until the expiration of term, the entire account balance will be available to cover losses that exceed retained earnings and PCC (excluding, if a corporate credit union exercises the capital prioritization option under part I of Appendix A to this part, any PCC with priority under that option).

(3) A corporate credit union may count a portion of unconverted MCAs as Tier 2 capital. Beginning on the date of issuance (for term MCAs) or the date of notice of withdrawal (for other MCAs), the corporate may count the entire account balance as Tier 2 capital, but will then reduce the amount

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of the account that can be considered as Tier 2 capital by a constant monthly amortization that ensures the capital is fully amortized one year before the date of maturity or one year before the end of the notice period. For adjustable balance account MCAs where the adjustment is determined based on some impermanent measure, such as shares on deposit with the corporate, the corporate credit union may not treat any part of the account as capital.

(4) A corporate credit union must, on or before December 20, 2011, provide any members that hold unconverted MCAs a one-time written disclosure about the status of their MCA accounts as described in this paragraph (f).

[75 FR 64829, Oct. 20, 2010]

§ 704.4. Prompt corrective action.

(a) *Purpose.* The principal purpose of this section is to define, for corporate credit unions that are not adequately capitalized, the capital measures and capital levels that are used for determining appropriate supervisory actions. This section establishes procedures for submission and review of capital restoration plans and for issuance and review of capital directives, orders, and other supervisory directives.

(b) *Scope.* This section applies to corporate credit unions, including officers, directors, and employees.

(1) This section does not limit the authority of NCUA in any way to take supervisory actions to address unsafe or unsound practices, deficient capital levels, violations of law, unsafe or unsound conditions, or other practices. The NCUA may take action under this section independently of, in conjunction with, or in addition to any other enforcement action available to the NCUA, including issuance of cease and desist orders, approval or denial of applications or notices, assessment of civil money penalties, or any other actions authorized by law.

(2) Unless permitted by the NCUA or otherwise required by law, no corporate credit union may state in any advertisement or promotional material its capital category under this part or that the NCUA has assigned the corporate credit union to a particular category.

(3) Any group of credit unions applying for a new corporate credit union charter will submit, as part of the charter application, a detailed draft plan for soliciting contributed capital and building retained earnings. The draft plan will include specific levels of contributed capital and retained earnings and the anticipated timeframes for achieving those levels. The Board will review the draft plan and modify it as necessary. If the Board approves the plan, the Board will include any necessary waivers of this section or part.

(c) *Notice of capital category.* (1) Effective date of determination of capital category. A corporate credit union will be deemed to be within a given capital category as of the most recent date:

(i) A 5310 Financial Report is required to be filed with the NCUA;

(ii) A final NCUA report of examination is delivered to the corporate credit union; or

(iii) Written notice is provided by the NCUA to the corporate credit union that its capital category has changed as provided in paragraphs (c)(2) or (d)(3) of this section.

(2) Adjustments to reported capital levels and category—

(i) Notice of adjustment by corporate credit union. A corporate credit union must provide the NCUA with written notice that an adjustment to the corporate credit union's capital category may have occurred no later than 15 calendar days following the date that any material event has occurred that would cause the corporate credit union to be placed in a lower capital category from the category assigned to the corporate credit union for purposes of this section on the basis of the corporate credit union's most recent call report or report of examination.

(ii) Determination by the NCUA to change capital category. After receiving notice pursuant to paragraph (c)(1) of this section, or on its own initiative, the NCUA will determine whether to change the capital category of the corporate credit union and will notify the corporate credit union of the NCUA's determination.

(d) *Capital measures and capital category definitions.* (1) Capital measures. For purposes of this section, the relevant capital measures are: