

## § 704.8

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union provided the corporate retains an interest of at least 5 percent of the face amount of the loan and a master participation loan agreement is in place before the purchase or the sale of a participation. A participating corporate credit union must exercise the same due diligence as if it were the originating corporate credit union.

(g) *Prepayment penalties.* If provided for in the loan contract, a corporate credit union is authorized to assess prepayment penalties on loans.

[62 FR 12938, Mar. 19, 1997, as amended at 64 FR 57365, Oct. 25, 1999; 67 FR 65655, Oct. 25, 2002; 68 FR 56550, Oct. 1, 2003; 75 FR 34621, June 18, 2010]

### § 704.8 Asset and liability management.

(a) *Policies.* A corporate credit union must operate according to a written asset and liability management policy which addresses, at a minimum:

(1) The purpose and objectives of the corporate credit union's asset and liability activities;

(2) The maximum allowable percentage decline in net economic value (NEV), compared to base case NEV;

(3) The minimum allowable NEV ratio;

(4) Policy limits and specific test parameters for the NEV sensitivity analysis requirements set forth in paragraphs (d), (e), and (f) of this section;

(5) The modeling of indexes that serve as references in financial instrument coupon formulas; and

(6) The tests that will be used, prior to purchase, to estimate the impact of investments on the percentage decline in NEV compared to base case NEV. The most recent NEV analysis, as determined under paragraph (d)(1)(i) of this section may be used as a basis of estimation.

(b) *Asset and liability management committee (ALCO).* A corporate credit union's ALCO must have at least one member who is also a member of the board of directors. The ALCO must review asset and liability management reports on at least a monthly basis. These reports must address compliance with Federal Credit Union Act, NCUA Rules and Regulations (12 CFR chapter VII), and all related risk management policies.

(c) *Penalty for early withdrawals.* A corporate credit union that permits early certificate/share withdrawals must assess market-based penalties sufficient to cover the estimated replacement cost of the certificate redeemed. This means the minimum penalty must be reasonably related to the rate that the corporate credit union would be required to offer to attract funds for a similar term with similar characteristics.

(d) *Interest rate sensitivity analysis.* (1) A corporate credit union must:

(i) Evaluate the risk in its balance sheet by measuring, at least quarterly, including once on the last day of the calendar quarter, the impact of an instantaneous, permanent, and parallel shock in the yield curve of plus and minus 100, 200, and 300 BP on its NEV and NEV ratio. If the base case NEV ratio falls below 3 percent at the last testing date, these tests must be calculated at least monthly, including once on the last day of the month, until the base case NEV ratio again exceeds 3 percent;

(ii) Limit its risk exposure to levels that do not result in a base case NEV ratio or any NEV ratio resulting from the tests set forth in paragraph (d)(1)(i) of this section below 2 percent; and

(iii) Limit its risk exposures to levels that do not result in a decline in NEV of more than 15 percent.

(2) A corporate credit union must assess annually if it should conduct periodic additional tests to address market factors that may materially impact that corporate credit union's NEV. These factors should include, but are not limited to, the following:

(i) Changes in the shape of the Treasury yield curve;

(ii) Adjustments to prepayment projections used for amortizing securities to consider the impact of significantly faster/slower prepayment speeds; and

(iii) Adjustments to volatility assumptions to consider the impact that changing volatilities have on embedded option values.

(e) *Net interest income modeling.* A corporate credit union must perform net interest income (NII) modeling to project earnings in multiple interest rate environments for a period of no less than 2 years. NII modeling must,

at minimum, be performed at least quarterly, including once on the last day of the calendar quarter.

(f) *Weighted average asset life.* The weighted average life (WAL) of a corporate credit union's loan and investment portfolio, excluding derivative contracts and equity investments, may not exceed 2 years. A corporate credit union must test its assets at least quarterly, including once on the last day of the calendar quarter, for compliance with this WAL limitation. When calculating its WAL, a corporate credit union must assume that no issuer or market options will be exercised. If the WAL of a corporate credit union's assets exceeds 2 years on the testing date, this test must be calculated at least monthly, including once on the last day of the month, until the WAL is below 2 years.

(g) *Weighted average asset life with 50 percent slowdown in prepayment speeds.* The weighted average life (WAL) of a corporate credit union's loan and investment portfolio, excluding derivative contracts and equity investments, may not exceed 2.25 years when prepayment speeds are reduced by 50 percent. A corporate credit union must test its investments at least quarterly, including once on the last day of the calendar quarter, for compliance with this WAL limitation. When calculating its WAL, a corporate credit union must assume that no issuer or market options will be exercised. If the WAL of a corporate credit union's assets exceeds 2.25 years, this test must be calculated at least monthly, including once on the last day of the month, until the WAL with the 50 slowdown in prepayment speeds is below 2.25 years.

(h) *Government issued or guaranteed securities.* The WAL of investments that are issued or fully guaranteed as to principal and interest by the U.S. government, its agencies or sponsored enterprises, including investments that are fully insured or guaranteed (including accumulated dividends and interest) by the NCUSIF or the Federal Deposit Insurance Corporation, will be multiplied by a factor of 0.50 for purposes of the WAL tests of paragraphs (f) and (g) of this section.

(i) *Effective and spread durations.* A corporate credit union must measure

at least once a quarter, including once on the last day of the calendar quarter, the effective duration and spread durations of each of its assets and liabilities, where the values of these are affected by changes in interest rates or credit spreads.

(j) *Regulatory violations.* (1)(i) If a corporate credit union's decline in NEV, base case NEV ratio or any NEV ratio resulting from the test set forth in paragraph (d) of this section violates the limits established in that paragraph, or the corporate credit union is unable to satisfy the tests in paragraphs (f) or (g) of this section; and

(ii) The corporate cannot adjust its balance sheet so as to satisfy the requirements of paragraphs (d), (f), or (g) of this section within 10 calendar days after detecting the violation, then:

(iii) The operating management of the corporate credit union must immediately report this information to its board of directors, supervisory committee, and the NCUA.

(2) If any violation described in paragraph (j)(1)(i) persists for 30 or more calendar days, the corporate credit union:

(i) Must immediately submit a detailed, written action plan to the NCUA that sets forth the time needed and means by which it intends to correct the violation and, if the NCUA determines that the plan is unacceptable, the corporate credit union must immediately restructure its balance sheet to bring the exposure back within compliance or adhere to an alternative course of action determined by the NCUA; and

(ii) If presently categorized as adequately capitalized or well capitalized for PCA purposes, immediately be recategorized as undercapitalized until the violation is corrected, and

(iii) If presently less than adequately capitalized, immediately be downgraded one additional capital category.

(k) *Overall limit on business generated from individual credit unions.* On or after April 22, 2013, a corporate credit union is prohibited from accepting from any member, or any nonmember credit union, any investment, including shares, loans, PCC, or NCAs if, following that investment, the aggregate of all investments from that entity in the corporate would exceed 15 percent

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of the corporate credit union's moving daily average net assets.

[75 FR 64842, Oct. 20, 2010]

EFFECTIVE DATE NOTE: At 76 FR 79533, Dec. 22, 2011, § 704.8 was amended by revising the first two sentences in paragraphs (f) and (g); and revising (j)(2)(ii) and (iii), effective Jan. 23, 2012. For the convenience of the user, the revised text is set forth as follows:

§ 704.8 Asset and liability management.

\* \* \* \* \*

(f) \* \* \* The weighted average life (WAL) of a corporate credit union's financial assets, consisting of cash, investments, and loans, but excluding derivative contracts and equity investments, may not exceed 2 years. A corporate credit union must test its financial assets at least quarterly, including once on the last day of the calendar quarter, for compliance with this WAL limitation. \* \* \*

(g) \* \* \* The weighted average life (WAL) of a corporate credit union's financial assets, consisting of cash, investments, and loans, but excluding derivative contracts and equity investments, may not exceed 2.25 years when prepayment speeds are reduced by 50 percent. A corporate credit union must test its financial assets at least quarterly, including once on the last day of the calendar quarter, for compliance with this WAL limitation. \* \* \*

\* \* \* \* \*

(j) \* \* \*

(2) \* \* \*

(ii) If presently categorized as adequately capitalized or well capitalized for prompt corrective action purposes, and the violation was of paragraph (d) of this section, immediately be recategorized as undercapitalized until the violation is corrected, and

(iii) If presently categorized as less than adequately capitalized, and the violation was of paragraph (d) of this section, immediately be downgraded one additional capital category.

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§ 704.9 Liquidity management.

(a) General. In the management of liquidity, a corporate credit union must:

(1) Evaluate the potential liquidity needs of its membership in a variety of economic scenarios;

(2) Regularly monitor and demonstrate accessibility to sources of internal and external liquidity;

(3) Keep a sufficient amount of cash and cash equivalents on hand to support its payment system obligations;

(4) Demonstrate that the accounting classification of investment securities is consistent with its ability to meet potential liquidity demands; and

(5) Develop a contingency funding plan that addresses alternative funding strategies in successively deteriorating liquidity scenarios. The plan must:

(i) List all sources of liquidity, by category and amount, that are available to service an immediate outflow of funds in various liquidity scenarios;

(ii) Analyze the impact that potential changes in fair value will have on the disposition of assets in a variety of interest rate scenarios; and

(iii) Be reviewed by the board or an appropriate committee no less frequently than annually or as market or business conditions dictate.

(b) Borrowing limits. A corporate credit union may borrow up to the lower of 10 times capital or 50 percent of capital and shares (excluding shares created by the use of member reverse repurchase agreements).

(1) Secured borrowings. A corporate credit union may borrow on a secured basis for liquidity purposes, but the maturity of the borrowing may not exceed 30 days. Only a credit union with core capital in excess of five percent of its moving DANA may borrow on a secured basis for nonliquidity purposes, and the outstanding amount of secured borrowing for nonliquidity purposes may not exceed an amount equal to the difference between core capital and five percent of moving DANA.

(2) Exclusions. CLF borrowings and borrowed funds created by the use of member reverse repurchase agreements are excluded from this limit.

[75 FR 64843, Oct. 20, 2010]

§ 704.10 Investment action plan.

(a) Any corporate credit union in possession of an investment, including a derivative, that fails to meet a requirement of this part must, within 30 calendar days of the failure, report the failed investment to its board of directors, supervisory committee and the OCCU Director. If the corporate credit union does not sell the failed investment, and the investment continues to