

APPENDIX 5

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[73 FR 73398, Dec. 2, 2008, as amended at 75 FR 36263, 36263, June 25, 2010; 78 FR 13463, Feb. 28, 2013; 78 FR 32544, May 31, 2013; 80 FR 25931, May 6, 2015]

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AUTHORITY: 12 U.S.C. 1766(a), 1790d.

SOURCE: 65 FR 8584, Feb. 18, 2000, unless otherwise noted.

§ 702.1 Authority, purpose, scope and other supervisory authority.

(a) *Authority.* Subparts A, B and C of this part and subpart L of part 747 of this chapter are issued by the National Credit Union Administration pursuant to section 216 of the Federal Credit Union Act (FCUA), 12 U.S.C. 1790d (section 1790d), as added by section 301 of the Credit Union Membership Access Act, Pub. L. No. 105–219, 112 Stat. 913 (1998). Subpart D of this part is issued pursuant to FCUA section 120, 12 U.S.C. 1766.

(b) *Purpose.* The express purpose of prompt corrective action under section 1790d is to resolve the problems of federally-insured credit unions at the least possible long-term loss to the National Credit Union Share Insurance Fund. This part carries out the purpose of prompt corrective action by establishing a framework of mandatory and discretionary supervisory actions, applicable according to a credit union’s net worth ratio, designed primarily to restore and improve the net worth of federally-insured credit unions.

(c) *Scope.* This part implements the provisions of section 1790d as they apply to federally-insured credit unions, whether federally- or state-chartered; to such credit unions defined as “new” pursuant to section 1790d(b)(2); and to such credit unions defined as “complex” pursuant to section 1790d(d). Certain of these provisions also apply to officers and directors of federally-insured credit unions. This part does not apply to corporate credit unions. Procedures for issuing, reviewing and enforcing orders and directives issued under this part are set forth in subpart L of part 747 of this chapter, 12 CFR 747.2001 *et seq.*

(d) *Other supervisory authority.* Neither § 1790d nor this part in any way limits the authority of the NCUA Board or appropriate State official under any other provision of law to take additional supervisory actions to address unsafe or unsound practices or

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conditions, or violations of applicable law or regulations. Action taken under this part may be taken independently of, in conjunction with, or in addition to any other enforcement action available to the NCUA Board or appropriate State official, including issuance of cease and desist orders, orders of prohibition, suspension and removal, or assessment of civil money penalties, or any other actions authorized by law.

EFFECTIVE DATE NOTE: At 80 FR 66706, Oct. 29, 2015, §702.1 was revised, effective January 1, 2019. For the convenience of the user, the revised text is set forth as follows:

§ 702.1 Authority, purpose, scope, and other supervisory authority.

(a) *Authority.* Subparts A and B of this part and subpart L of part 747 of this chapter are issued by the National Credit Union Administration (NCUA) pursuant to sections 120 and 216 of the Federal Credit Union Act (FCUA), 12 U.S.C. 1776 and 1790d (section 1790d), as revised by section 301 of the Credit Union Membership Access Act, Public Law 105-219, 112 Stat. 913 (1998).

(b) *Purpose.* The express purpose of prompt corrective action under section 1790d is to resolve the problems of federally insured credit unions at the least possible long-term loss to the National Credit Union Share Insurance Fund. Subparts A and B of this part carry out the purpose of prompt corrective action by establishing a framework of minimum capital requirements, and mandatory and discretionary supervisory actions applicable according to a credit union's capital classification, designed primarily to restore and improve the capital adequacy of federally insured credit unions.

(c) *Scope.* Subparts A and B of this part implement the provisions of section 1790d as they apply to federally insured credit unions, whether federally- or state-chartered; to such credit unions defined as "new" pursuant to section 1790d(b)(2); and to such credit unions defined as "complex" pursuant to section 1790d(d). Certain of these provisions also apply to officers and directors of federally insured credit unions. Subpart C applies capital planning and stress testing to credit unions with \$10 billion or more in total assets. This part does not apply to corporate credit unions. Unless otherwise provided, procedures for issuing, reviewing and enforcing orders and directives issued under this part are set forth in subpart L of part 747 of this chapter.

(d) *Other supervisory authority.* Neither section 1790d nor this part in any way limits the authority of the NCUA Board or appropriate state official under any other provision of law to take additional supervisory actions to address unsafe or unsound practices or condi-

tions, or violations of applicable law or regulations. Action taken under this part may be taken independently of, in conjunction with, or in addition to any other enforcement action available to the NCUA Board or appropriate state official, including issuance of cease and desist orders, orders of prohibition, suspension and removal, or assessment of civil money penalties, or any other actions authorized by law.

§ 702.2 Definitions.

Except as provided below, the terms used in this part have the same meanings as set forth in FCUA sections 101 and 216, 12 U.S.C. 1752, 1790d.

(a) *Appropriate Regional Director* means the director of the NCUA Regional Office having jurisdiction over federally insured credit unions in the state where the affected credit union is principally located or, for credit unions with \$10 billion or more in assets, the Director of the Office of National Examinations and Supervision.

(b) *Appropriate State official* means the commission, board or other supervisory authority having jurisdiction over credit unions chartered by the State which chartered the affected credit union.

(c) *Credit union* means a federally-insured, natural person credit union, whether federally- or State-chartered, as defined by 12 U.S.C. 1752(6).

(d) *CUSO* means a credit union service organization as described in 12 CFR 712 *et seq.* for federally-chartered credit unions, and as defined under State law for State-chartered credit unions.

(e) *NCUSIF* means the National Credit Union Share Insurance Fund as defined by 12 U.S.C. 1783.

(f) *Net Worth* means (1) The retained earnings balance of the credit union at quarter-end as determined under generally accepted accounting principles, subject to paragraph (f)(3) of this section. Retained earnings consists of undivided earnings, regular reserves, and any other appropriations designated by management or regulatory authorities;

(2) For a low income-designated credit union, net worth also includes secondary capital accounts that are uninsured and subordinate to all other claims, including claims of creditors, shareholders and the NCUSIF; and

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(3) For a credit union that acquires another credit union in a mutual combination, net worth includes the retained earnings of the acquired credit union, or of an integrated set of activities and assets, less any bargain purchase gain recognized in either case to the extent the difference between the two is greater than zero. The acquired retained earnings must be determined at the point of acquisition under generally accepted accounting principles. A mutual combination is a transaction in which a credit union acquires another credit union or acquires an integrated set of activities and assets that is capable of being conducted and managed as a credit union.

(4) The term “net worth” also includes loans to and accounts in an insured credit union established pursuant to section 208 of the Act [12 U.S.C. 1788], provided such loans and accounts:

- (i) Have a remaining maturity of more than 5 years;
- (ii) Are subordinate to all other claims including those of shareholders, creditors and the National Credit Union Share Insurance Fund;
- (iii) Are not pledged as security on a loan to, or other obligation of, any party;
- (iv) Are not insured by the National Credit Union Share Insurance Fund;
- (v) Have non-cumulative dividends;
- (vi) Are transferable; and
- (vii) Are available to cover operating losses realized by the insured credit union that exceed its available retained earnings.

(g) *Net worth ratio* means the ratio of the net worth of the credit union (as defined in paragraph (f) of this section) to the total assets of the credit union (as defined by a measure chosen under paragraph (j) of this section).

(h) *New credit union* means a federally-insured credit union which both has been in operation for less than ten (10) years and has \$10,000,000 or less in total assets.

(i) *Senior executive officer* means a senior executive officer as defined by 12 CFR 701.14(b)(2).

(j) *Shares* means deposits, shares, share certificates, share drafts, or any other depository account authorized by federal or state law.

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(k) *Total assets.* (1) Total assets means a credit union’s total assets as measured by either—

(i) *Average quarterly balance.* The average of quarter-end balances of the current and three preceding calendar quarters; or

(ii) *Average monthly balance.* The average of month-end balances over the three calendar months of the calendar quarter; or

(iii) *Average daily balance.* The average daily balance over the calendar quarter; or

(iv) *Quarter-end balance.* The quarter-end balance of the calendar quarter as reported on the credit union’s Call Report.

(2) For each quarter, a credit union must elect a measure of total assets from paragraph (k)(1) of this section to apply for all purposes under this part except §§ 702.103 through 702.108 [risk-based net worth requirement].

(1) *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.

[65 FR 8584, Feb. 18, 2000, as amended at 65 FR 44966, July 20, 2000; 67 FR 71087, Nov. 29, 2002; 73 FR 72691, Dec. 1, 2008; 75 FR 34620, June 18, 2010; 76 FR 60367, Sept. 29, 2011; 78 FR 32544, May 31, 2013]

EFFECTIVE DATE NOTE: At 80 FR 66706, Oct. 29, 2015, § 702.2 was revised, effective January 1, 2019. For the convenience of the user, the revised text is set forth as follows:

§ 702.2 Definitions.

Unless otherwise provided in this part, the terms used in this part have the same meanings as set forth in FCUA sections 101 and 216, 12 U.S.C. 1752, 1790d. The following definitions apply to this part:

Allowances for loan and lease losses (ALLL) means valuation allowances that have been established through a charge against earnings to cover estimated credit losses on loans, lease financing receivables or other extensions of credit as determined in accordance with GAAP.

Amortized cost means the purchase price of a security adjusted for amortizations of premium or accretion of discount if the security

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was purchased at other than par or face value.

Appropriate state official means the state commission, board or other supervisory authority that chartered the affected credit union.

Call Report means the Call Report required to be filed by all credit unions under §741.6(a)(2) of this chapter.

Carrying value means the value of the asset or liability on the statement of financial condition of the credit union, determined in accordance with GAAP.

Central counterparty (CCP) means a counterparty (for example, a clearing house) that facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts.

Charitable donation account means an account that satisfies all of the conditions in §721.3(b)(2)(i), (b)(2)(ii), and (b)(2)(v) of this chapter.

Commercial loan means any loan, line of credit, or letter of credit (including any unfunded commitments) for commercial, industrial, and professional purposes, but not for investment or personal expenditure purposes. Commercial loan excludes loans to CUSOs, first- or junior-lien residential real estate loans, and consumer loans.

Commitment means any legally binding arrangement that obligates the credit union to extend credit, purchase or sell assets, enter into a borrowing agreement, or enter into a financial transaction.

Consumer loan means a loan for household, family, or other personal expenditures, including any loans that, at origination, are wholly or substantially secured by vehicles generally manufactured for personal, family, or household use regardless of the purpose of the loan. Consumer loan excludes commercial loans, loans to CUSOs, first- and junior-lien residential real estate loans, and loans for the purchase of one or more vehicles to be part of a fleet of vehicles.

Contractual compensating balance means the funds a commercial loan borrower must maintain on deposit at the lender credit union as security for the loan in accordance with the loan agreement, subject to a proper account hold and on deposit as of the measurement date.

Credit conversion factor (CCF) means the percentage used to assign a credit exposure equivalent amount for selected off-balance sheet accounts.

Credit union means a federally insured, natural person credit union, whether federally- or state-chartered.

Current means, with respect to any loan, that the loan is less than 90 days past due, not placed on non-accrual status, and not restructured.

CUSO means a credit union service organization as defined in part 712 and 741 of this chapter.

Custodian means a financial institution that has legal custody of collateral as part of a qualifying master netting agreement, clearing agreement, or other financial agreement.

Depository institution means a financial institution that engages in the business of providing financial services; that is recognized as a bank or a credit union by the supervisory or monetary authorities of the country of its incorporation and the country of its principal banking operations; that receives deposits to a substantial extent in the regular course of business; and that has the power to accept demand deposits. Depository institution includes all federally insured offices of commercial banks, mutual and stock savings banks, savings or building and loan associations (stock and mutual), cooperative banks, credit unions and international banking facilities of domestic depository institutions, and all privately insured state chartered credit unions.

Derivatives Clearing Organization (DCO) means the same as defined by the Commodity Futures Trading Commission in 17 CFR 1.3(d).

Derivative contract means a financial contract whose value is derived from the values of one or more underlying assets, reference rates, or indices of asset values or reference rates. Derivative contracts include interest rate derivative contracts, exchange rate derivative contracts, equity derivative contracts, commodity derivative contracts, and credit derivative contracts. Derivative contracts also include unsettled securities, commodities, and foreign exchange transactions with a contractual settlement or delivery lag that is longer than the lesser of the market standard for the particular instrument or five business days.

Equity investment means investments in equity securities and any other ownership interests, including, for example, investments in partnerships and limited liability companies.

Equity investment in CUSOs means the unimpaired value of the credit union's equity investments in a CUSO as recorded on the statement of financial condition in accordance with GAAP.

Exchange means a central financial clearing market where end users can enter into derivative transactions.

Excluded goodwill means the outstanding balance, maintained in accordance with GAAP, of any goodwill originating from a supervisory merger or combination that was completed on or before December 28, 2015. This term and definition expire on January 1, 2029.

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Excluded other intangible assets means the outstanding balance, maintained in accordance with GAAP, of any other intangible assets such as core deposit intangible, member relationship intangible, or trade name intangible originating from a supervisory merger or combination that was completed on or before December 28, 2015. This term and definition expire on January 1, 2029.

Exposure amount means:

(1) The amortized cost for investments classified as held-to-maturity and available-for-sale, and the fair value for trading securities.

(2) The outstanding balance for Federal Reserve Bank Stock, Central Liquidity Facility Stock, Federal Home Loan Bank Stock, non-perpetual capital and perpetual contributed capital at corporate credit unions, and equity investments in CUSOs.

(3) The carrying value for non-CUSO equity investments, and investment funds.

(4) The carrying value for the credit union's holdings of general account permanent insurance, and separate account insurance.

(5) The amount calculated under § 702.105 of this part for derivative contracts.

Fair value has the same meaning as provided in GAAP.

Financial collateral means collateral approved by both the credit union and the counterparty as part of the collateral agreement in recognition of credit risk mitigation for derivative contracts.

First-lien residential real estate loan means a loan or line of credit primarily secured by a first-lien on a one-to-four family residential property where:

(1) The credit union made a reasonable and good faith determination at or before consummation of the loan that the member will have a reasonable ability to repay the loan according to its terms; and

(2) In transactions where the credit union holds the first-lien and junior lien(s), and no other party holds an intervening lien, for purposes of this part the combined balance will be treated as a single first-lien residential real estate loan.

GAAP means generally accepted accounting principles in the United States as set forth in the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC).

General account permanent insurance means an account into which all premiums, except those designated for separate accounts are deposited, including premiums for life insurance and fixed annuities and the fixed portfolio of variable annuities, whereby the general assets of the insurance company support the policy.

General obligation means a bond or similar obligation that is backed by the full faith and credit of a public sector entity.

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Goodwill means an intangible asset, maintained in accordance with GAAP, representing the future economic benefits arising from other assets acquired in a business combination (e.g., merger) that are not individually identified and separately recognized. Goodwill does not include excluded goodwill.

Government guarantee means a guarantee provided by the U.S. Government, FDIC, NCUA or other U.S. Government agency, or a public sector entity.

Government-sponsored enterprise (GSE) means an entity established or chartered by the U.S. Government to serve public purposes specified by the U.S. Congress, but whose debt obligations are not explicitly guaranteed by the full faith and credit of the U.S. Government.

Guarantee means a financial guarantee, letter of credit, insurance, or similar financial instrument that allows one party to transfer the credit risk of one or more specific exposures to another party.

Identified losses means those items that have been determined by an evaluation made by NCUA, or in the case of a state chartered credit union the appropriate state official, as measured on the date of examination in accordance with GAAP, to be chargeable against income, equity or valuation allowances such as the allowances for loan and lease losses. Examples of identified losses would be assets classified as losses, off-balance sheet items classified as losses, any provision expenses that are necessary to replenish valuation allowances to an adequate level, liabilities not shown on the books, estimated losses in contingent liabilities, and differences in accounts that represent shortages.

Industrial development bond means a security issued under the auspices of a state or other political subdivision for the benefit of a private party or enterprise where that party or enterprise, rather than the government entity, is obligated to pay the principal and interest on the obligation.

Intangible assets mean assets, maintained in accordance with GAAP, other than financial assets, that lack physical substance.

Investment fund means an investment with a pool of underlying investment assets. Investment fund includes an investment company that is registered under section 8 of the Investment Company Act of 1940, and collective investment funds or common trust investments that are unregistered investment products that pool fiduciary client assets to invest in a diversified pool of investments.

Junior-lien residential real estate loan means a loan or line of credit secured by a subordinate lien on a one-to-four family residential property.

Loan secured by real estate means a loan that, at origination, is secured wholly or substantially by a lien(s) on real property for

which the lien(s) is central to the extension of the credit. A lien is "central" to the extension of credit if the borrowers would not have been extended credit in the same amount or on terms as favorable without the liens on real property. For a loan to be "secured wholly or substantially by a lien(s) on real property," the estimated value of the real estate collateral at origination (after deducting any more senior liens held by others) must be greater than 50 percent of the principal amount of the loan at origination.

Loan to a CUSO means the outstanding balance of any loan from a credit union to a CUSO as recorded on the statement of financial condition in accordance with GAAP.

Loans transferred with limited recourse means the total principal balance outstanding of loans transferred, including participations, for which the transfer qualified for true sale accounting treatment under GAAP, and for which the transferor credit union retained some limited recourse (*i.e.*, insufficient recourse to preclude true sale accounting treatment). Loans transferred with limited recourse excludes transfers that qualify for true sale accounting treatment but contain only routine representation and warranty clauses that are standard for sales on the secondary market, provided the credit union is in compliance with all other related requirements, such as capital requirements.

Mortgage-backed security (MBS) means a security backed by first- or junior-lien mortgages secured by real estate upon which is located a dwelling, mixed residential and commercial structure, residential manufactured home, or commercial structure.

Mortgage partnership finance program means a Federal Home Loan Bank program through which loans are originated by a depository institution that are purchased or funded by the Federal Home Loan Banks, where the depository institution receives fees for managing the credit risk of the loans. The credit risk must be shared between the depository institution and the Federal Home Loan Banks.

Mortgage servicing assets mean those assets, maintained in accordance with GAAP, resulting from contracts to service loans secured by real estate (that have been securitized or owned by others) for which the benefits of servicing are expected to more than adequately compensate the servicer for performing the servicing.

NCUSIF means the National Credit Union Share Insurance Fund as defined by 12 U.S.C. 1783.

Net worth means:

(1) The retained earnings balance of the credit union at quarter-end as determined under GAAP, subject to paragraph (3) of this definition.

(2) For a low income-designated credit union, net worth also includes secondary capital accounts that are uninsured and sub-

ordinate to all other claims, including claims of creditors, shareholders, and the NCUSIF.

(3) For a credit union that acquires another credit union in a mutual combination, net worth also includes the retained earnings of the acquired credit union, or of an integrated set of activities and assets, less any bargain purchase gain recognized in either case to the extent the difference between the two is greater than zero. The acquired retained earnings must be determined at the point of acquisition under GAAP. A mutual combination, including a supervisory combination, is a transaction in which a credit union acquires another credit union or acquires an integrated set of activities and assets that is capable of being conducted and managed as a credit union.

(4) The term "net worth" also includes loans to and accounts in an insured credit union, established pursuant to section 208 of the Act [12 U.S.C. 1788], provided such loans and accounts:

(i) Have a remaining maturity of more than 5 years;

(ii) Are subordinate to all other claims including those of shareholders, creditors, and the NCUSIF;

(iii) Are not pledged as security on a loan to, or other obligation of, any party;

(iv) Are not insured by the NCUSIF;

(v) Have non-cumulative dividends;

(vi) Are transferable; and

(vii) Are available to cover operating losses realized by the insured credit union that exceed its available retained earnings.

Net worth ratio means the ratio of the net worth of the credit union to the total assets of the credit union rounded to two decimal places.

New credit union has the same meaning as in § 702.201.

Nonperpetual capital has the same meaning as in § 704.2 of this chapter.

Off-balance sheet exposure means:

(1) For loans transferred under the Federal Home Loan Bank mortgage partnership finance program, the outstanding loan balance as of the reporting date, net of any related valuation allowance.

(2) For all other loans transferred with limited recourse or other seller-provided credit enhancements and that qualify for true sales accounting, the maximum contractual amount the credit union is exposed to according to the agreement, net of any related valuation allowance.

(3) For unfunded commitments, the remaining unfunded portion of the contractual agreement.

Off-balance sheet items means items such as commitments, contingent items, guarantees, certain repo-style transactions, financial

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standby letters of credit, and forward agreements that are not included on the statement of financial condition, but are normally reported in the financial statement footnotes.

On-balance sheet means a credit union's assets, liabilities, and equity, as disclosed on the statement of financial condition at a specific point in time.

Other intangible assets means intangible assets, other than servicing assets and goodwill, maintained in accordance with GAAP. Other intangible assets does not include excluded other intangible assets.

Over-the-counter (OTC) interest rate derivative contract means a derivative contract that is not cleared on an exchange.

Part 703 compliant investment fund means an investment fund that is restricted to holding only investments that are permissible under § 703.14(c) of this chapter.

Perpetual contributed capital has the same meaning as in § 704.2 of this chapter.

Public sector entity (PSE) means a state, local authority, or other governmental subdivision of the United States below the sovereign level.

Qualifying master netting agreement means a written, legally enforceable agreement, provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default, including upon an event of conservatorship, receivership, insolvency, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides the credit union the right to accelerate, terminate, and close out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of default, including upon an event of conservatorship, receivership, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, or under any similar insolvency law applicable to GSEs;

(3) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate is a net creditor under the agreement); and

(4) In order to recognize an agreement as a qualifying master netting agreement for purposes of this part, a credit union must conduct sufficient legal review, at origination

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and in response to any changes in applicable law, to conclude with a well-founded basis (and maintain sufficient written documentation of that legal review) that:

(i) The agreement meets the requirements of paragraph (2) of this definition; and

(ii) In the event of a legal challenge (including one resulting from default or from conservatorship, receivership, insolvency, liquidation, or similar proceeding), the relevant court and administrative authorities would find the agreement to be legal, valid, binding, and enforceable under the law of relevant jurisdictions.

Recourse means a credit union's retention, in form or in substance, of any credit risk directly or indirectly associated with an asset it has transferred that exceeds a *pro rata* share of that credit union's claim on the asset and disclosed in accordance with GAAP. If a credit union has no claim on an asset it has transferred, then the retention of any credit risk is recourse. A recourse obligation typically arises when a credit union transfers assets in a sale and retains an explicit obligation to repurchase assets or to absorb losses due to a default on the payment of principal or interest or any other deficiency in the performance of the underlying obligor or some other party. Recourse may also exist implicitly if the credit union provides credit enhancement beyond any contractual obligation to support assets it has transferred.

Residential mortgage-backed security means a mortgage-backed security backed by loans secured by a first-lien on residential property.

Residential property means a house, condominium unit, cooperative unit, manufactured home, or the construction thereof, and unimproved land zoned for one-to-four family residential use. Residential property excludes boats or motor homes, even if used as a primary residence, or timeshare property.

Restructured means, with respect to any loan, a restructuring of the loan in which a credit union, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. Restructured excludes loans modified or restructured solely pursuant to the U.S. Treasury's Home Affordable Mortgage Program.

Revenue obligation means a bond or similar obligation that is an obligation of a PSE, but which the PSE is committed to repay with revenues from the specific project financed rather than general tax funds.

Risk-based capital ratio means the percentage, rounded to two decimal places, of the risk-based capital ratio numerator to risk-weighted assets, as calculated in accordance with § 702.104(a).

Risk-weighted assets means the total risk-weighted assets as calculated in accordance with § 702.104(c).

Secured consumer loan means a consumer loan associated with collateral or other item of value to protect against loss where the creditor has a perfected security interest in the collateral or other item of value.

Senior executive officer means a senior executive officer as defined by § 701.14(b)(2) of this chapter.

Separate account insurance means an account into which a policyholder's cash surrender value is supported by assets segregated from the general assets of the carrier.

Shares means deposits, shares, share certificates, share drafts, or any other depository account authorized by federal or state law.

Share-secured loan means a loan fully secured by shares, and does not include the imposition of a statutory lien under § 701.39 of this chapter.

STRIPS means a separately traded registered interest and principal security.

Structured product means an investment that is linked, via return or loss allocation, to another investment or reference pool.

Subordinated means, with respect to an investment, that the investment has a junior claim on the underlying collateral or assets to other investments in the same issuance. An investment that does not have a junior claim to other investments in the same issuance on the underlying collateral or assets is non-subordinated. A Security that is junior only to money market eligible securities in the same issuance is also non-subordinated.

Supervisory merger or combination means a transaction that involved the following:

(1) An assisted merger or purchase and assumption where funds from the NCUSIF were provided to the continuing credit union;

(2) A merger or purchase and assumption classified by NCUA as an "emergency merger" where the acquired credit union is either insolvent or "in danger of insolvency" as defined under appendix B to Part 701 of this chapter; or

(3) A merger or purchase and assumption that included NCUA's or the appropriate state official's identification and selection of the continuing credit union.

Swap dealer has the meaning as defined by the Commodity Futures Trading Commission in 17 CFT 1.3(ggg).

Total assets means a credit union's total assets as measured¹ by either:

(1) *Average quarterly balance.* The credit union's total assets measured by the average

of quarter-end balances of the current and three preceding calendar quarters;

(2) *Average monthly balance.* The credit union's total assets measured by the average of month-end balances over the three calendar months of the applicable calendar quarter;

(3) *Average daily balance.* The credit union's total assets measured by the average daily balance over the applicable calendar quarter; or

(4) *Quarter-end balance.* The credit union's total assets measured by the quarter-end balance of the applicable calendar quarter as reported on the credit union's Call Report.

Tranche means one of a number of related securities offered as part of the same transaction. Tranche includes a structured product if it has a loss allocation based off of an investment or reference pool.

Unsecured consumer loan means a consumer loan not secured by collateral.

U.S. Government agency means an instrumentality of the U.S. Government whose obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. Government. U.S. Government agency includes NCUA.

Subpart A—Net Worth Classification

EFFECTIVE DATE NOTE: At 80 FR 66706, Oct. 29, 2015, subpart A to part 702 was revised, effective January 1, 2019. For the convenience of the user, the revised text is set forth at the end of this subpart.

§ 702.101 Measures and effective date of net worth classification.

(a) *Net worth measures.* For purposes of this part, a credit union must determine its net worth category classification at the end of each calendar quarter using two measures:

(1) The net worth ratio as defined in § 702.2(g); and

(2) If determined to be applicable under § 702.103, a risk-based net worth requirement.

(b) *Effective date of net worth classification.* For purposes of this part, the effective date of a federally-insured credit union's net worth category classification shall be the most recent to occur of:

(1) *Quarter-end effective date.* The last day of the calendar month following the end of the calendar quarter; or

¹For each quarter, a credit union must elect one of the measures of total assets listed in paragraph (2) of this definition to apply for all purposes under this part except §§ 702.103 through 702.106 (risk-based capital requirement).

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(2) *Corrected net worth category.* The date the credit union received subsequent written notice from NCUA or, if State-chartered, from the appropriate State official, of a decline in net worth category due to correction of an error or misstatement in the credit union's most recent Call Report; or

(3) *Reclassification to lower category.* The date the credit union received written notice from NCUA or, if State-chartered, the appropriate State official, of reclassification on safety and soundness grounds as provided under § 702.102(b) or § 702.302(d).

(c) *Notice to NCUA by filing Call Report.* (1) Other than by filing a Call Report, a federally-insured credit union need not notify the NCUA Board of a change in its net worth ratio that places the credit union in a lower net worth category;

(2) Failure to timely file a Call Report as required under this section in no way alters the effective date of a change in net worth classification under this paragraph (b) of this section, or the affected credit union's corresponding legal obligations under this part.

[65 FR 8584, Feb. 18, 2000; 65 FR 55439, Sept. 14, 2000, as amended at 67 FR 12464, Mar. 19, 2002; 67 FR 71087, Nov. 29, 2002]

§ 702.102 Statutory net worth categories.

(a) *Net worth categories.* Except for credit unions defined as "new" under

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subpart B of this part, a federally-insured credit union shall be classified (Table 1)—

(1) *Well capitalized* if it has a net worth ratio of seven percent (7%) or greater and also meets any applicable risk-based net worth requirement under §§ 702.103 through 702.108; or

(2) *Adequately capitalized* if it has a net worth ratio of six percent (6%) or more but less than seven percent (7%), and also meets any applicable risk-based net worth requirement under §§ 702.103 through 702.108 below; or

(3) *Undercapitalized* if it has a net worth ratio of four percent (4%) or more but less than six percent (6%), or fails to meet any applicable risk-based net worth requirement under §§ 702.103 through 702.108; or

(4) *Significantly undercapitalized* if it

(i) Has a net worth ratio of two percent (2%) or more but less than four percent (4%); or

(ii) Has a net worth ratio of four percent (4%) or more but less than five percent (5%), and either—

(A) Fails to submit an acceptable net worth restoration plan within the time prescribed in § 702.206; or

(B) Materially fails to implement a net worth restoration plan approved by the NCUA Board; or

(5) *Critically undercapitalized* if it has a net worth ratio of less than two percent (2%).

TABLE 1 – STATUTORY NET WORTH CATEGORY CLASSIFICATION

<i>A credit union's net worth category is . . .</i>	<i>if its net worth ratio is . . .</i>	<i>and subject to the following condition(s) . . .</i>
"Well Capitalized"	7% or above	Meets applicable risk-based net worth (RBNW) requirement
"Adequately Capitalized"	6% to 6.99%	Meets applicable RBNW requirement
"Undercapitalized"	4% to 5.99%	Or fails applicable RBNW requirement
"Significantly Undercapitalized"	2% to 3.99%	Or if "undercapitalized" at <5% net worth ratio and fails to timely submit or materially implement Net Worth Restoration Plan
"Critically Undercapitalized"	Less than 2%	None

(b) *Reclassification based on supervisory criteria other than net worth.* The NCUA Board may reclassify a "well capitalized" credit union as "adequately capitalized" and may require an "adequately capitalized" or "undercapitalized" credit union to comply with certain mandatory or discretionary supervisory actions as if it were in the next lower net worth category (each of such actions hereinafter referred to generally as "reclassification") in the following circumstances:

(1) *Unsafe or unsound condition.* The NCUA Board has determined, after notice and opportunity for hearing pursuant to §747.2003 of this chapter, that the credit union is in an unsafe or unsound condition; or

(2) *Unsafe or unsound practice.* The NCUA Board has determined, after notice and opportunity for hearing pursuant to §747.2003 of this chapter, that the credit union has not corrected a material unsafe or unsound practice of which it was, or should have been, aware.

(c) *Non-delegation.* The NCUA Board may not delegate its authority to reclassify a credit union under paragraph (b) of this section.

(d) *Consultation with State officials.* The NCUA Board shall consult and seek to work cooperatively with the appropriate State official before reclassifying a federally-insured State-chartered credit union under paragraph (b)

of this section, and shall promptly notify the appropriate State official of its decision to reclassify.

[65 FR 8584, Feb. 18, 2000, as amended at 65 FR 44966, July 20, 2000; 67 FR 71087, Nov. 29, 2002]

§ 702.103 Applicability of risk-based net worth requirement.

For purposes of §702.102, a credit union is defined as "complex" and a risk-based net worth requirement is applicable only if the credit union meets both of the following criteria as reflected in its most recent Call Report:

(a) *Minimum asset size.* Its quarter-end total assets exceed fifty million dollars (\$50,000,000); and

(b) *Minimum RBNW calculation.* Its risk-based net worth requirement as calculated under §702.106 exceeds six percent (6%).

[65 FR 44966, July 20, 2000, as amended at 67 FR 13464, Mar. 19, 2002; 67 FR 71088, Nov. 29, 2002; 75 FR 34620, June 18, 2010; 78 FR 4037, Jan. 18, 2013]

§ 702.104 Risk portfolios defined.

A risk portfolio is a portfolio of assets, liabilities, or contingent liabilities as specified below, each expressed as a percentage of the credit union's quarter-end total assets reflected in its most recent Call Report, rounded to two decimal places (Table 2):

(a) *Long-term real estate loans.* Total real estate loans and real estate lines

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of credit outstanding, exclusive of those outstanding that will contractually refinance, reprice or mature within the next five (5) years, and exclusive of all member business loans (as defined in 12 CFR 723.1 or as approved under 12 CFR 723.20);

(b) *Member business loans outstanding.* All member business loans as defined in 12 CFR 723.1 or as approved under 12 CFR 723.20;

(c) *Investments.* Investments as defined by 12 CFR 703.2 or applicable State law, including investments in CUSOs (as defined by § 702.2(d));

(d) *Low-risk assets.* Cash on hand (*e.g.*, coin and currency, including vault, ATM and teller cash), the NCUSIF deposit, and debt instruments unconditionally guaranteed by the National Credit Union Administration;

(e) *Average-risk assets.* One hundred percent (100%) of total assets minus the sum of the risk portfolios in paragraphs (a) through (d) of this section;

(f) *Loans sold with recourse.* Outstanding balance of loans sold or swapped with recourse, excluding loans sold to the secondary mortgage market that have representations and warranties consistent with those customarily required by the U.S. Government and government sponsored enterprises;

(g) *Unused member business loan commitments.* Unused commitments for member business loans as defined in 12 CFR 723.1 or as approved under 12 CFR 723.20; and

(h) *Allowance.* The Allowance for Loan and Lease Losses not to exceed the equivalent of one and one-half percent (1.5%) of total loans outstanding.

TABLE 2 -- § 702.104 RISK PORTFOLIOS DEFINED

<i>Risk portfolio</i>	<i>Assets, liabilities or contingent liabilities</i>
(a) Long-term real estate loans	Total real estate loans and real estate lines of credit (excluding MBLs) with a maturity (and next rate adjustment period if variable rate) greater than 5 years
(b) MBLs outstanding	Member business loans outstanding
(c) Investments	As defined by federal regulation or applicable State law.
(d) Low-risk assets	Cash on hand and NCUSIF deposit.
(e) Average-risk assets	100% of total assets minus sum of risk portfolios above
(f) Loans sold with recourse	Outstanding balance of loans sold or swapped with recourse, except for loans sold to the secondary mortgage market with a recourse period of 1 year or less.
(g) Unused MBL commitments	Unused commitments for MBLs
(h) Allowance	Allowance for Loan and Lease Losses limited to equivalent of 1.50 percent of total loans

[65 FR 44966, July 20, 2000, as amended at 67 FR 71088, Nov. 29, 2002; 75 FR 66300, Oct. 28, 2010; 78 FR 32544, May 31, 2013]

§ 702.105 Weighted-average life of investments.

Except as provided below (Table 3), the weighted-average life of an investment for purposes of §§ 702.106(c) and 702.107(c) is defined pursuant to § 702.2(m):

(a) *Registered investment companies and collective investment funds.* (1) For

investments in registered investment companies (*e.g.*, mutual funds) and collective investment funds, the weighted-average life is defined as the maximum weighted-average life disclosed, directly or indirectly, in the prospectus or trust instrument;

(2) For investments in money market funds, as defined in 17 CFR 270.2a–7, and

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collective investment funds operated in accordance with short-term investment fund rules set forth in 12 CFR 9.18(b)(4)(ii)(B)(1)–(3), the weighted-average life is defined as one (1) year or less; and

(3) For other investments in registered investment companies or collective investment funds, the weighted-average life is defined as greater than five (5) years, but less than or equal to seven (7) years;

(b) *Callable fixed-rate debt obligations and deposits.* For fixed-rate debt obligations and deposits that are callable in whole, the weighted-average life is defined as the period remaining to the maturity date;

(c) *Variable-rate debt obligations and deposits.* For variable-rate debt obligations and deposits, the weighted-average

life is defined as the period remaining to the next rate adjustment date;

(d) *Capital in mixed-ownership Government corporations and corporate credit unions.* For capital stock in mixed-ownership Government corporations, as defined in 31 U.S.C. 9101(2), and perpetual and nonperpetual capital in corporate credit unions, as defined in 12 CFR 704.2, the weighted-average life is defined as greater than one (1) year, but less than or equal to three years;

(e) *Investments in CUSOs.* For investments in CUSOs (as defined in § 702.2(d)), the weighted-average life is defined as greater than one (1) year, but less than or equal to three (3) years; and

(f) *Other equity securities.* For other equity securities, the weighted average life is defined as greater than ten (10) years.

TABLE 3 -- § 702.106 WEIGHTED-AVERAGE LIFE OF INVESTMENTS

<i>Investment</i>	<i>Weighted-average life</i>
(a) Registered investment companies and collective investment funds	i. <i>Registered investment companies and collective investment funds:</i> As disclosed in prospectus or trust instrument, but if not disclosed, greater than five (5) years, but less than or equal to seven (7) years. ii. <i>Money market funds and STIFs:</i> One (1) year or less.
(b) Callable fixed-rate debt obligations and deposits	Period remaining to maturity date.
(c) Variable-rate debt obligations and deposits	Period remaining to next rate adjustment date.
(d) Capital in mixed-ownership Government corporations and corporate credit unions	Greater than one (1) year, but less than or equal to three (3) years.
(e) Investments in CUSOs	Greater than one (1) year, but less than or equal to three (3) years.
(f) Other equity securities	Greater than ten (10) years.

[65 FR 44966, July 20, 2000, as amended at 67 FR 71088, Nov. 29, 2002; 75 FR 64826, Oct. 20, 2010]

§ 702.106 Standard calculation of risk-based net worth requirement.

A credit union's risk-based net worth requirement is the aggregate of the following standard component amounts, each expressed as a percentage of the credit union's quarter-end total assets as reflected in its most recent Call Re-

port, rounded to two decimal places (Table 4):

(a) *Long-term real estate loans.* The sum of:

(1) Six percent (6%) of the amount of long-term real estate loans less than or equal to twenty-five percent (25%) of total assets; and

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(2) Fourteen percent (14%) of the amount in excess of twenty-five percent

(25%) of total assets;

(b) *Member business loans outstanding.* The sum of:

(1) Six percent (6%) of the amount of member business loans outstanding less than or equal to fifteen percent (15%) of total assets;

(2) Eight percent (8%) of the amount of member business loans outstanding greater than fifteen percent (15%), but less than or equal to twenty-five percent (25%), of total assets; and

(3) Fourteen percent (14%) of the amount in excess of twenty-five percent (25%) of total assets;

(c) *Investments.* The sum of:

(1) Three percent (3%) of the amount of investments with a weighted-average life (as specified in § 702.105 above) of one (1) year or less;

(2) Six percent (6%) of the amount of investments with a weighted-average life greater than one (1) year, but less than or equal to three (3) years;

(3) Twelve percent (12%) of the amount of investments with a weighted-average life greater than three (3) years, but less than or equal to ten (10) years; and

(4) Twenty percent (20%) of the amount of investments with a weighted-average life greater than ten (10) years;

(d) *Low-risk assets.* Zero percent (0%) of the entire portfolio of low-risk assets;

(e) *Average-risk assets.* Six percent (6%) of the entire portfolio of average-risk assets;

(f) *Loans sold with recourse.* Six percent (6%) of the entire portfolio of loans sold with recourse;

(g) *Unused member business loan commitments.* Six percent (6%) of the entire portfolio of unused member business loan commitments; and

(h) *Allowance.* Negative one hundred percent (-100%) of the balance of the Allowance for Loan and Lease Losses account, not to exceed the equivalent of one and one-half percent (1.5%) of total loans outstanding.

TABLE 4 -- §702.106 STANDARD CALCULATION OF RBNW REQUIREMENT

<i>Risk portfolio</i>	<i>Amount of risk portfolio (as percent of quarter-end total assets) to be multiplied by risk weighting</i>	<i>Risk weighting</i>
(a) Long-term real estate loans	0 to 25.00% over 25.00%	.06 .14
(b) MBLs outstanding	0 to 15.00% >15.00% to 25.00% over 25.00%	.06 .08 .14
(c) Investments	<i>By weighted-average life:</i> 0 to 1 year >1 year to 3 years >3 years to 10 years >10 years	.03 .06 .12 .20
(d) Low-risk assets	All %	.00
(e) Average-risk assets	All %	.06
(f) Loans sold with recourse	All %	.06
(g) Unused MBL commitments	All %	.06
(h) Allowance	Limited to equivalent of 1.50% of total loans (expressed as a percent of total assets)	(1.00)
A credit union's RBNW requirement is the sum of eight standard components. A standard component is calculated for each of the eight risk portfolios, equal to the sum of each amount of a risk portfolio times its risk weighting. A credit union is classified "undercapitalized" if its net worth ratio is less than its applicable RBNW requirement.		

[65 FR 44966, July 20, 2000, as amended at 67 FR 71088, Nov. 29, 2002; 68 FR 56547, Oct. 1, 2003]

§702.107 Alternative components for standard calculation.

A credit union may substitute one or more alternative components below, in place of the corresponding standard components in §702.106 above, when any alternative component amount, expressed as a percentage of the credit union's quarter-end total assets as reflected in its most recent Call Report, rounded to two decimal places, is smaller (Table 5):

(a) *Long-term real estate loans.* The sum of:

(1) *Non-callable.* Non-callable long-term real estate loans as follows:

(i) Eight percent (8%) of the amount of such loans with a remaining maturity of greater than 5 years, but less than or equal to 12 years;

(ii) Twelve percent (12%) of the amount of such loans with a remaining maturity of greater than 12 years, but less than or equal to 20 years; and

(iii) Fourteen percent (14%) of the amount of such loans with a remaining maturity greater than 20 years;

(2) *Callable.* Long-term real estate loans callable in 5 years or less as follows:

(i) Six percent (6%) of the amount of such loans with a documented call provision of 5 years or less and with a remaining maturity of greater than 5 years, but less than or equal to 12 years;

(ii) Ten percent (10%) of the amount of such loans with a documented call provision of 5 years or less and with a remaining maturity of greater than 12 years, but less than or equal to 20 years; and

(iii) Twelve percent (12%) of the amount of such loans with a documented call provision of 5 years or less and with a remaining maturity of greater than 20 years;

(b) *Member business loans outstanding.* The sum of:

(1) *Fixed rate.* Fixed-rate member business loans outstanding as follows:

(i) Six percent (6%) of the amount of such loans with a remaining maturity of 3 or fewer years;

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(ii) Nine percent (9%) of the amount of such loans with a remaining maturity greater than 3 years, but less than or equal to 5 years;

(iii) Twelve percent (12%) of the amount of such loans with a remaining maturity greater than 5 years, but less than or equal to 7 years;

(iv) Fourteen percent (14%) of the amount of such loans with a remaining maturity greater than 7 years, but less than or equal to 12 years; and

(v) Sixteen percent (16%) of the amount of such loans with a remaining maturity greater than 12 years; and

(2) *Variable-rate*. Variable-rate member business loans outstanding as follows:

(i) Six percent (6%) of the amount of such loans with a remaining maturity of 3 or fewer years;

(ii) Eight percent (8%) of the amount of such loans with a remaining maturity greater than 3 years, but less than or equal to 5 years;

(iii) Ten percent (10%) of the amount of such loans with a remaining maturity greater than 5 years, but less than or equal to 7 years;

(iv) Twelve percent (12%) of the amount of such loans with a remaining maturity greater than 7 years, but less than or equal to 12 years; and

(v) Fourteen percent (14%) of the amount of such loans with a remaining maturity greater than 12 years.

(c) *Investments*. The sum of:

(1) Three percent (3%) of the amount of investments with a weighted-average life (as specified in § 702.105 above) of one (1) year or less;

(2) Six percent (6%) of the amount of investments with a weighted-average life greater than one (1) year, but less than or equal to three (3) years;

(3) Eight percent (8%) of the amount of investments with a weighted-average life greater than three (3) years, but less than or equal to five (5) years;

(4) Twelve percent (12%) of the amount of investments with a weighted-average life greater than five (5) years, but less than or equal to seven (7) years;

(5) Sixteen percent (16%) of the amount of investments with a weighted-average life greater than seven (7) years, but less than or equal to ten (10) years; and

(6) Twenty percent (20%) of the amount of investments with a weighted-average life greater than ten (10) years.

(d) *Loans sold with recourse*. The alternative component is the sum of:

(1) Six percent (6%) of the amount of loans sold with contractual recourse obligations of six percent (6%) or greater; and

(2) The weighted average recourse percent of the amount of loans sold with contractual recourse obligations of less than six percent (6%), as computed by the credit union.

TABLE 5—§ 702.107 ALTERNATIVE COMPONENTS FOR STANDARD CALCULATION

(a) LONG-TERM REAL ESTATE LOANS

<i>Amount of long-term real estate loans by remaining maturity</i>	<i>Alternative risk weighting</i>
<i>Non-callable long-term real estate loans</i>	
<i>Remaining maturity:</i>	
<i>> 5 years to 12 years</i>	.08
<i>> 12 years to 20 years</i>	.12
<i>> 20 years</i>	.14
<i>Long-term real estate loans callable in 5 years or less</i>	
<i>Remaining maturity:</i>	
<i>> 5 years to 12 years</i>	.06
<i>> 12 years to 20 years</i>	.10
<i>> 20 years</i>	.12
The "alternative component" is the sum of each amount of the "long-term real estate loans" risk portfolio by non-"callable" and "callable" characteristic and by remaining maturity (as a percent of quarter-end total assets) times its alternative factor. Substitute for corresponding standard component if smaller.	

(b) MEMBER BUSINESS LOANS

<i>Amount of member business loans by remaining maturity</i>	<i>Alternative risk weighting</i>
<i>Fixed-rate MBLs</i>	
<i>0 to 3 years</i>	.06
<i>> 3 years to 5 years</i>	.09
<i>> 5 years to 7 years</i>	.12
<i>> 7 years to 12 years</i>	.14
<i>> 12 years</i>	.16
<i>Variable-rate MBLs</i>	
<i>0 to 3 years</i>	.06
<i>> 3 years to 5 years</i>	.08
<i>> 5 years to 7 years</i>	.10
<i>> 7 years to 12 years</i>	.12
<i>> 12 years</i>	.14
The "alternative component" is the sum of each amount of the member business loans risk portfolio by fixed and variable rate and by remaining maturity (as a percent of quarter-end total assets) times its alternative factor. Substitute for corresponding standard component if smaller.	

(c) INVESTMENTS

<i>Amount of investments by weighted-average life</i>	<i>Alternative risk weighting</i>
<i>0 to 1 year</i>	.03
<i>>1 year to 3 years</i>	.06
<i>>3 years to 5 years</i>	.08
<i>>5 years to 7 years</i>	.12
<i>>7 years to 10 years</i>	.16
<i>> 10 years</i>	.20
The "alternative component" is the sum of each amount of the Investments risk portfolio by weighted-average life (as a percent of quarter-end total assets) times its alternative factor. Substitute for corresponding standard component if smaller.	

(d) LOANS SOLD WITH RECOURSE

Amount of loans by recourse	Alternative risk weighting
Recourse 6% or greater	.06
Recourse <6%	Weighted average recourse percent

The "alternative component" is the sum of each amount of the "loans sold with recourse" risk portfolio by level of recourse (as a percent of quarter-end total assets) times its alternative factor. The alternative factor for loans sold with recourse of less than 6% is equal to the weighted average recourse percent on such loans. A credit union must compute the weighted average recourse percent for its loans sold with recourse of less than six percent (6%). Substitute for corresponding standard component if smaller.

[65 FR 44966, July 20, 2000, as amended at 67 FR 71088, Nov. 29, 2002]

§ 702.108 Risk mitigation credit.

(a) *Who may apply.* A credit union may apply for a risk mitigation credit if on any of the current or three preceding effective dates of classification it either failed an applicable RBNW requirement or met it by less than 100 basis points.

(b) *Application for credit.* Upon application pursuant to guidelines duly adopted by the NCUA Board, the NCUA Board may in its discretion grant a credit to reduce a risk-based net worth requirement under §§ 702.106 and 702.107 upon proof of mitigation of:

- (1) Credit risk; or
- (2) Interest rate risk as demonstrated by economic value exposure measures.

(c) *Application by FISCU.* In the case of a FISCU seeking a risk mitigation credit—

(1) Before an application under paragraph (a) above may be submitted to the NCUA Board, it must be submitted in duplicate to the appropriate State official and the appropriate Regional Director; and

(2) The NCUA Board, when evaluating the application of a FISCU, shall consult and seek to work cooperatively with the appropriate State official, and shall provide prompt notice of its decision to the appropriate State official.

[65 FR 44971, July 20, 2000, as amended at 67 FR 71089, Nov. 29, 2002]

APPENDIXES A–H TO SUBPART A OF PART 702

APPENDIX A – EXAMPLE STANDARD COMPONENTS FOR RBNW REQUIREMENT, §702.106
(EXAMPLE CALCULATION IN BOLD)

<i>Risk portfolio</i>	<i>Dollar balance</i>	<i>Amount as percent of quarter-end total assets</i>	<i>Risk weighting</i>	<i>Amount times risk weighting</i>	<i>Standard component</i>
Quarter-end total assets	200,000,000	100.0000 %			
(a) Long-term real estate loans Threshold amount: 0 to 25% Excess amount: over 25%	60,000,000	30.0000 % = 25.0000 % 5.0000 %	 .06 .14	 1.5000 % 0.7000 %	2.20 %
(b) MBLs outstanding Threshold amount: 0 to 15% Intermediate tier: >15% to 25% Excess amount: over 25%	35,000,000	17.5000 % = 15.0000 % 2.5000 % 0.0 %	 .06 .08 .14	 0.9000 % 0.2000 % 0.0 %	1.10 %
(c) Investments <i>Weighted-average life:</i> 0 to 1 year >1 year to 3 years >3 years to 10 years >10 years	50,000,000 = 24,000,000 15,000,000 10,000,000 1,000,000	25.0000 % = 12.0000 % 7.5000 % 5.0000 % 0.5000 %	 .03 .06 .12 .20	 0.3600 % 0.4500 % 0.6000 % 0.1000 %	1.51 %
(d) Low-risk assets	4,000,000	2.0000 %	.00		0 %
Sum of risk portfolios (a) through (d) above	149,000,000	74.5000%			
(e) Average-risk assets	51,000,000	25.5000 %^{a/}	.06		1.53 %
(f) Loans sold with recourse	40,000,000	20.0000 %	.06		1.20 %
(g) Unused MBL commitments	5,000,000	2.5000 %	.06		0.15 %
(h) Allowance	2,040,000.00 ^{b/}	1.0200 %	(1.00)		(1.02) %
Sum of standard components: RBNW requirement ^{c/}					6.67 %

^{a/} The Average-risk assets risk portfolio percent of quarter-end total assets equals 100 percent minus the sum of the percentages in the four risk portfolios above (i.e., Long-term real estate loans, MBLs outstanding, Investments, and Low-risk assets).

^{b/} The Allowance risk portfolio is limited to the equivalent of 1.50 percent of total loans. For an example computation of the permitted dollar balance of Allowance, see worksheet in Appendix B below.

^{c/} A credit union is classified "undercapitalized" if its net worth ratio is less than its applicable RBNW requirement. The dollar equivalent of RBNW requirement may be computed for informational purposes as the RBNW requirement percent of total assets.

APPENDIX B – ALLOWANCE RISK PORTFOLIO DOLLAR BALANCE WORKSHEET
(EXAMPLE CALCULATION IN BOLD)

<i>Balance sheet account</i>	<i>Dollar balance</i>	<i>Percent of total loans</i>	<i>Range of ALL permitted</i>	<i>Permitted ALL percent of total loans</i>	<i>Permitted dollar balance of Allowance</i>
Allowance for Loan and Lease Losses (ALL)	2,400,000	1.7647%	0 to 1.50%	1.50%	2,040,000
Total loans	136,000,000				

APPENDIX C – EXAMPLE LONG-TERM REAL ESTATE LOANS
ALTERNATIVE COMPONENT, §702.107(a)
(EXAMPLE CALCULATION IN BOLD)

<i>Remaining maturity</i>	<i>Dollar balance of Long-term real estate loans by remaining maturity</i>	<i>Percent of total assets by remaining maturity</i>	<i>Alternative risk weighting</i>	<i>Alternative component</i>
<i>Non-callable long-term real estate loans</i>				
> 5 years to 12 years	15,000,000	7.5000 %	.08	0.6000 %
> 12 years to 20 years	2,500,000	1.2500 %	.12	0.1500 %
> 20 years	2,500,000	1.2500 %	.14	0.1750 %
<i>Long-term real estate loans callable in 5 years or less</i>				
> 5 years to 12 years	35,000,000	17.5000 %	.06	1.0500 %
> 12 years to 20 years	5,000,000	2.5000 %	.10	0.2500 %
> 20 years	0	0.000 %	.12	0.000 %
Sum of above equals Alternative Component*				2.23 %

*Substitute for standard component if lower.

APPENDIX D – EXAMPLE OF MEMBER BUSINESS LOANS
ALTERNATIVE COMPONENT, §702.107(b)
(EXAMPLE CALCULATION IN BOLD)

<i>Remaining maturity</i>	<i>Dollar balance of MBLs by remaining maturity</i>	<i>Percent of total assets by remaining maturity</i>	<i>Alternative risk weighting</i>	<i>Alternative component</i>
<i>Fixed-rate MBLs</i>				
0 to 3 years	6,000,000	3.0000 %	.06	0.1800 %
> 3 years to 5 years	4,000,000	2.0000 %	.09	0.1800 %
> 5 years to 7 years	2,000,000	1.0000 %	.12	0.1200 %
> 7 years to 12 years	0	0.0000 %	.14	0.0000 %
> 12 years	0	0.0000 %	.16	0.0000 %
<i>Variable-rate MBLs</i>				
0 to 3 years	17,000,000	8.5000 %	.06	0.5100 %
> 3 years to 5 years	4,000,000	2.0000 %	.08	0.1600 %
> 5 years to 7 years	2,000,000	1.0000 %	.10	0.1000 %
> 7 years to 12 years	0	0.0000 %	.12	0.0000 %
>12 years	0	0.0000 %	.14	0.0000 %
Sum of above equals Alternative component*				1.25 %

* Substitute for standard component if lower.

APPENDIX E -- EXAMPLE OF INVESTMENTS ALTERNATIVE COMPONENT, §702.107(c)
(EXAMPLE CALCULATION IN BOLD)

<i>Weighted-average life</i>	<i>Dollar balance of investments by weighted-average life</i>	<i>Percent of total assets by weighted-average life</i>	<i>Alternative risk weighting</i>	<i>Alternative component</i>
0 to 1 year	24,000,000	12.0000 %	.03	0.3600 %
> 1 year to 3 years	15,000,000	7.5000 %	.06	0.4500 %
> 3 years to 5 years	8,000,000	4.0000 %	.08	0.3200 %
> 5 years to 7 years	1,000,000	0.5000 %	.12	0.0600 %
> 7 years to 10 years	1,000,000	0.5000 %	.16	0.0800 %
> 10 years	1,000,000	0.5000 %	.20	0.1000 %
Sum of above equals Alternative component*				1.37 %

* Substitute for standard component if lower.

APPENDIX F -- EXAMPLE LOANS SOLD WITH RECOURSE
ALTERNATIVE COMPONENT, §702.107(d)
(EXAMPLE CALCULATION IN BOLD)

<i>Percent of contractual recourse obligation</i>	<i>Dollar balance of Loans sold with recourse</i>	<i>Percent of total assets</i>	<i>Alternative risk weighting</i>	<i>Alternative component</i>
Recourse 6 % or greater	5,000,000	2.5000 %	.06	0.1500 %
Recourse < 6 %	35,000,000	17.5000 %	.0500 *	0.8750 %
Sum of above equals Alternative component*				1.03 %

* Substitute for corresponding standard component if lower.

* The credit union must calculate this alternative risk weighting for loans sold with recourse of less than 6 %. For an example computation, see worksheet in Appendix G below.

APPENDIX G --WORKSHEET FOR ALTERNATIVE RISK WEIGHTING OF
LOANS SOLD WITH CONTRACTUAL RECOURSE OBLIGATIONS OF LESS THAN 6 %
(EXAMPLE CALCULATION IN BOLD)

<i>Percent of contractual recourse obligation less than 6%</i>	<i>Dollar balance of loans sold with recourse</i>	<i>Dollars of recourse</i>	<i>Alternative risk weighting</i>
5.50 %	5,000,000	275,000	
5.00 %	25,000,000	1,250,000	
4.50 %	5,000,000	225,000	
Sum of above equals	35,000,000	1,750,000	
Dollar of recourse divided by dollar balance equals (expressed as %)			5.00 %

APPENDIX H -- EXAMPLE RBNW REQUIREMENT USING ALTERNATIVE COMPONENTS
(EXAMPLE CALCULATION IN BOLD)

<i>Risk portfolio</i>	Standard component	Alternative component	Lower of standard or alternative component
(a) Long-term real estate loans	2.20 %	2.85 %	2.20 %
(b) MBLs outstanding	1.10 %	1.25 %	1.10 %
(c) Investments	1.51 %	1.37 %	1.37 %
(f) Loans sold with recourse	1.20%	1.03%	1.03%
			Standard component
(d) Low-risk assets			0 %
(e) Average-risk assets			1.53 %
(g) Unused MBL commitments			0.15 %
(h) Allowance			(1.02) %
RBNW requirement* Compare to Net Worth Ratio			6.53 %

* A credit union is "undercapitalized" if its net worth ratio is less than its applicable RBNW requirement

[65 FR 44971, July 20, 2000, as amended at 67 FR 71089, 71090, 71091, Nov. 29, 2002; 68 FR 56548, 56549, 56550, Oct. 1, 2003]

EFFECTIVE DATE NOTE: At 80 FR 66706, Oct. 29, 2015, subpart A to part 702 was revised, effective January 1, 2019. For the convenience of the user, the revised text is set forth as follows:

Subpart A—Prompt Corrective Action

§ 702.101 Capital measures, capital adequacy, effective date of classification, and notice to NCUA.

(a) *Capital measures.* For purposes of this part, a credit union must determine its capital classification at the end of each calendar quarter using the following measures:

- (1) The net worth ratio; and
- (2) If determined to be applicable under § 702.103, the risk-based capital ratio.

(b) *Capital adequacy.* (1) Notwithstanding the minimum requirements in this part, a credit union defined as complex must maintain capital commensurate with the level and nature of all risks to which the institution is exposed.

(2) A credit union defined as complex must have a process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive written strategy for maintaining an appropriate level of capital.

(c) *Effective date of capital classification.* For purposes of this part, the effective date of a federally insured credit union's capital classification shall be the most recent to occur of:

(1) *Quarter-end effective date.* The last day of the calendar month following the end of the calendar quarter;

(2) *Corrected capital classification.* The date the credit union received subsequent written notice from NCUA or, if state-chartered, from the appropriate state official, of a decline in capital classification due to correction of an error or misstatement in the credit union's most recent Call Report; or

(3) *Reclassification to lower category.* The date the credit union received written notice from NCUA or, if state-chartered, the appropriate state official, of reclassification on safety and soundness grounds as provided under §§ 702.102(b) or 702. 202(d).

(d) *Notice to NCUA by filing Call Report.* (1) Other than by filing a Call Report, a federally insured credit union need not notify the NCUA Board of a change in its capital measures that places the credit union in a lower capital category;

(2) Failure to timely file a Call Report as required under this section in no way alters the effective date of a change in capital classification under paragraph (b) of this section, or the affected credit union's corresponding legal obligations under this part.

§ 702.102 Capital classification.

(a) *Capital categories.* Except for credit unions defined as "new" under subpart B of this part, a credit union shall be deemed to be classified (Table 1 of this section)—

- (1) *Well capitalized* if:

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- (i) *Net worth ratio.* The credit union has a net worth ratio of 7.0 percent or greater; and
 - (ii) *Risk-based capital ratio.* The credit union, if complex, has a risk-based capital ratio of 10 percent or greater.
- (2) *Adequately capitalized if:*
- (i) *Net worth ratio.* The credit union has a net worth ratio of 6.0 percent or greater; and
 - (ii) *Risk-based capital ratio.* The credit union, if complex, has a risk-based capital ratio of 8.0 percent or greater; and
 - (iii) Does not meet the definition of a well capitalized credit union.
- (3) *Undercapitalized if:*
- (i) *Net worth ratio.* The credit union has a net worth ratio of 4.0 percent or more but less than 6.0 percent; or
 - (ii) *Risk-based capital ratio.* The credit union, if complex, has a risk-based capital ratio of less than 8.0 percent.

- (4) *Significantly undercapitalized if:*
- (i) The credit union has a net worth ratio of 2.0 percent or more but less than 4.0 percent; or
 - (ii) The credit union has a net worth ratio of 4.0 percent or more but less than 5.0 percent, and either—
 - (A) Fails to submit an acceptable net worth restoration plan within the time prescribed in §702.110;
 - (B) Materially fails to implement a net worth restoration plan approved by the NCUA Board; or
 - (C) Receives notice that a submitted net worth restoration plan has not been approved.
- (5) *Critically undercapitalized* if it has a net worth ratio of less than 2.0 percent.

TABLE 1 TO § 702.102—CAPITAL CATEGORIES

A credit union's capital classification is . . .	Net worth ratio		Risk-based capital ratio also applicable if complex	And subject to following condition(s) . . .
Well Capitalized	7% or greater	And	10.0% or greater	And does not meet the criteria to be classified as well capitalized.
Adequately Capitalized	6% or greater	And	8% or greater	
Undercapitalized	4% to 5.99%	Or	Less than 8%.	Or if "undercapitalized at <5% net worth and (a) fails to timely submit, (b) fails to materially implement, or (c) receives notice of the rejection of a net worth restoration plan.
Significantly Under-capitalized.	2% to 3.99%	N/A	
Critically Undercapitalized.	Less than 2%	N/A	

(b) *Reclassification based on supervisory criteria other than net worth.* The NCUA Board may reclassify a well capitalized credit union as adequately capitalized and may require an adequately capitalized or undercapitalized credit union to comply with certain mandatory or discretionary supervisory actions as if it were classified in the next lower capital category (each of such actions hereinafter referred to generally as "reclassification") in the following circumstances:

- (1) *Unsafe or unsound condition.* The NCUA Board has determined, after providing the credit union with notice and opportunity for hearing pursuant to §747.2003 of this chapter, that the credit union is in an unsafe or unsound condition; or
- (2) *Unsafe or unsound practice.* The NCUA Board has determined, after providing the credit union with notice and opportunity for hearing pursuant to §747.2003 of this chapter, that the credit union has not corrected a material unsafe or unsound practice of which it was, or should have been, aware.

(c) *Non-delegation.* The NCUA Board may not delegate its authority to reclassify a credit union under paragraph (b) of this section.

(d) *Consultation with state officials.* The NCUA Board shall consult and seek to work cooperatively with the appropriate state official before reclassifying a federally insured state-chartered credit union under paragraph (b) of this section, and shall promptly notify the appropriate state official of its decision to reclassify.

§ 702.103 Applicability of the risk-based capital ratio measure.

For purposes of §702.102, a credit union is defined as "complex" and the risk-based capital ratio measure is applicable only if the credit union's quarter-end total assets exceed one hundred million dollars (\$100,000,000), as reflected in its most recent Call Report.

§ 702.104 Risk-based capital ratio.

A complex credit union must calculate its risk-based capital ratio in accordance with this section.

(a) *Calculation of the risk-based capital ratio.* To determine its risk-based capital ratio, a complex credit union must calculate the percentage, rounded to two decimal places, of its risk-based capital ratio numerator as described in paragraph (b) of this section, to its

total risk-weighted assets as described in paragraph (c) of this section.

(b) *Risk-based capital ratio numerator.* The risk-based capital ratio numerator is the sum of the specific capital elements in paragraph (b)(1) of this section, minus the regulatory adjustments in paragraph (b)(2) of this section.

(1) *Capital elements of the risk-based capital ratio numerator.* The capital elements of the risk-based capital numerator are:

- (i) Undivided earnings;
- (ii) Appropriation for non-conforming investments;
- (iii) Other reserves;
- (iv) Equity acquired in merger;
- (v) Net income
- (vi) ALLL, maintained in accordance with GAAP;
- (vii) Secondary capital accounts included in net worth (as defined in §702.2); and
- (viii) Section 208 assistance included in net worth (as defined in §702.2).

(2) *Risk-based capital ratio numerator deductions.* The elements deducted from the sum of the capital elements of the risk-based capital ratio numerator are:

- (i) NCUSIF Capitalization Deposit;
- (ii) Goodwill;
- (iii) Other intangible assets; and
- (iv) Identified losses not reflected in the risk-based capital ratio numerator.

(c) *Risk-weighted assets*—(1) *General.* Risk-weighted assets includes risk-weighted on-balance sheet assets as described in paragraphs (c)(2) and (3) of this section, plus the risk-weighted off-balance sheet assets in paragraph (c)(4) of this section, plus the risk-weighted derivatives in paragraph (c)(5) of this section, less the risk-based capital ratio numerator deductions in paragraph (b)(2) of this section. If a particular asset, derivative contract, or off balance sheet item has features or characteristics that suggest it could potentially fit into more than one risk weight category, then a credit union shall assign the asset, derivative contract, or off balance sheet item to the risk weight category that most accurately and appropriately reflects its associated credit risk.

(2) *Risk weights for on-balance sheet assets.* The risk categories and weights for assets of a complex credit union are as follows:

(i) *Category 1—zero percent risk weight.* A credit union must assign a zero percent risk weight to:

- (A) The balance of:
 - (1) Cash, currency and coin, including vault, automatic teller machine, and teller cash.
 - (2) share-secured loans, where the shares securing the loan are on deposit with the credit union.

(B) The exposure amount of:

(1) An obligation of the U.S. Government, its central bank, or a U.S. Government agency that is directly and unconditionally guar-

anteed, excluding detached security coupons, ex-coupon securities, and interest-only mortgage-backed-security STRIPS.

(2) Federal Reserve Bank stock and Central Liquidity Facility stock.

(C) Insured balances due from FDIC-insured depositories or federally insured credit unions.

(ii) *Category 2—20 percent risk weight.* A credit union must assign a 20 percent risk weight to:

(A) The uninsured balances due from FDIC-insured depositories, federally insured credit unions, and all balances due from privately-insured credit unions.

(B) The exposure amount of:

(1) A non-subordinated obligation of the U.S. Government, its central bank, or a U.S. Government agency that is conditionally guaranteed, excluding interest-only mortgage-backed-security STRIPS.

(2) A non-subordinated obligation of a GSE other than an equity exposure or preferred stock, excluding interest-only GSE mortgage-backed-security STRIPS.

(3) Securities issued by PSEs that represent general obligation securities.

(4) Part 703 compliant investment funds that are restricted to holding only investments that qualify for a zero or 20 percent risk-weight under this section.

(5) Federal Home Loan Bank stock.

(C) The balances due from Federal Home Loan Banks.

(D) The balance of share-secured loans, where the shares securing the loan are on deposit with another depository institution.

(E) The portions of outstanding loans with a government guarantee.

(F) The portions of commercial loans secured with contractual compensating balances.

(iii) *Category 3—50 percent risk weight.* A credit union must assign a 50 percent risk weight to:

(A) The outstanding balance (net of government guarantees), including loans held for sale, of current first-lien residential real estate loans less than or equal to 35 percent of assets.

(B) The exposure amount of:

(1) Securities issued by PSEs in the U.S. that represent non-subordinated revenue obligation securities.

(2) Other non-subordinated, non-U.S. Government agency or non-GSE guaranteed, residential mortgage-backed security, excluding interest-only mortgage-backed security STRIPS.

(iv) *Category 4—75 percent risk weight.* A credit union must assign a 75 percent risk weight to the outstanding balance (net of government guarantees), including loans held for sale, of:

(A) Current first-lien residential real estate loans greater than 35 percent of assets.

(B) Current secured consumer loans.

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(v) *Category 5—100 percent risk weight.* A credit union must assign a 100 percent risk weight to:

(A) The outstanding balance (net of government guarantees), including loans held for sale, of:

(1) First-lien residential real estate loans that are not current.

(2) Current junior-lien residential real estate loans less than or equal to 20 percent of assets.

(3) Current unsecured consumer loans.

(4) Current commercial loans, less contractual compensating balances that comprise less than 50 percent of assets.

(5) Loans to CUSOs.

(B) The exposure amount of:

(1) Industrial development bonds.

(2) Interest-only mortgage-backed security STRIPS.

(3) Part 703 compliant investment funds, with the option to use the look-through approaches in paragraph (c)(3)(iii)(B) of this section.

(4) Corporate debentures and commercial paper.

(5) Nonperpetual capital at corporate credit unions.

(6) General account permanent insurance.

(7) GSE equity exposure or preferred stock.

(8) Non-subordinated tranches of any investment, with the option to use the gross-up approach in paragraph (c)(3)(iii)(A) of this section.

(C) All other assets listed on the statement of financial condition not specifically assigned a different risk weight under this subpart.

(vi) *Category 6—150 percent risk weight.* A credit union must assign a 150 percent risk weight to:

(A) The outstanding balance, net of government guarantees and including loans held for sale, of:

(1) Current junior-lien residential real estate loans that comprise more than 20 percent of assets.

(2) Junior-lien residential real estate loans that are not current.

(3) Consumer loans that are not current.

(4) Current commercial loans (net of contractual compensating balances), which comprise more than 50 percent of assets.

(5) Commercial loans (net of contractual compensating balances), which are not current.

(B) The exposure amount of:

(1) Perpetual contributed capital at corporate credit unions.

(2) Equity investments in CUSOs.

(vii) *Category 7—250 percent risk weight.* A credit union must assign a 250 percent risk weight to the carrying value of mortgage servicing assets.

(viii) *Category 8—300 percent risk weight.* A credit union must assign a 300 percent risk weight to the exposure amount of:

(A) Publicly traded equity investments, other than a CUSO investment.

(B) Investment funds that do not meet the requirements under §703.14(c) of this chapter, with the option to use the look-through approaches in paragraph (c)(3)(iii)(B) of this section.

(C) Separate account insurance, with the option to use the look-through approaches in paragraph (c)(3)(iii)(B) of this section.

(ix) *Category 9—400 percent risk weight.* A credit union must assign a 400 percent risk weight to the exposure amount of non-publicly traded equity investments, other than equity investments in CUSOs.

(x) *Category 10—1,250 percent risk weight.* A credit union must assign a 1,250 percent risk weight to the exposure amount of any subordinated tranche of any investment, with the option to use the gross-up approach in paragraph (c)(3)(iii)(A) of this section.

(3) *Alternative risk weights for certain on-balance sheet assets—(i) Non-significant equity exposures—(A) General.* Notwithstanding the risk weights assigned in paragraph (c)(2) of this section, a credit union must assign a 100 percent risk weight to non-significant equity exposures.

(B) *Determination of non-significant equity exposures.* A credit union has non-significant equity exposures if the aggregate amount of its equity exposures does not exceed 10 percent of the sum of the credit union's capital elements of the risk-based capital ratio numerator (as defined under paragraph (b)(1) of this section).

(C) *Determination of the aggregate amount of equity exposures.* When determining the aggregate amount of its equity exposures, a credit union must include the total amounts (as recorded on the statement of financial condition in accordance with GAAP) of the following:

(1) Equity investments in CUSOs,

(2) Perpetual contributed capital at corporate credit unions,

(3) Nonperpetual capital at corporate credit unions, and

(4) Equity investments subject to a risk weight in excess of 100 percent.

(ii) *Charitable donation accounts.* Notwithstanding the risk weights assigned in paragraph (c)(2) of this section, a credit union may assign a 100 percent risk weight to a charitable donation account.

(iii) *Alternative approaches.* Notwithstanding the risk weights assigned in paragraph (c)(2) of this section, a credit union may determine the risk weight of investment funds, and non-subordinated or subordinated tranches of any investment as follows:

(A) *Gross-up approach.* A credit union may use the gross-up approach under appendix A of this part to determine the risk weight of the carrying value of non-subordinated or subordinated tranches of any investment.

(B) *Look-through approaches.* A credit union may use one of the look-through approaches under appendix A of this part to determine the risk weight of the exposure amount of any investment funds, the holdings of separate account insurance, or both.

(4) *Risk weights for off-balance sheet activities.* The risk weighted amounts for all off-balance sheet items are determined by multiplying the off-balance sheet exposure amount by the appropriate CCF and the assigned risk weight as follows:

(i) For the outstanding balance of loans transferred to a Federal Home Loan Bank under the mortgage partnership finance program, a 20 percent CCF and a 50 percent risk weight.

(ii) For other loans transferred with limited recourse, a 100 percent CCF applied to the off-balance sheet exposure and:

(A) For commercial loans, a 100 percent risk weight.

(B) For first-lien residential real estate loans, a 50 percent risk weight.

(C) For junior-lien residential real estate loans, a 100 percent risk weight.

(D) For all secured consumer loans, a 75 percent risk weight.

(E) For all unsecured consumer loans, a 100 percent risk weight.

(iii) For unfunded commitments:

(A) For commercial loans, a 50 percent CCF with a 100 percent risk weight.

(B) For first-lien residential real estate loans, a 10 percent CCF with a 50 percent risk weight.

(C) For junior-lien residential real estate loans, a 10 percent CCF with a 100 percent risk weight.

(D) For all secured consumer loans, a 10 percent CCF with a 75 percent risk weight.

(E) For all unsecured consumer loans, a 10 percent CCF with a 100 percent risk weight.

(5) *Derivative contracts.* A complex credit union must assign a risk-weighted amount to any derivative contracts as determined under § 702.105.

§ 702.105 Derivative contracts.

(a) *OTC interest rate derivative contracts—(1) Exposure amount—(i) Single OTC interest rate derivative contract.* Except as modified by paragraph (a)(2) of this section, the exposure amount for a single OTC interest rate derivative contract that is not subject to a qualifying master netting agreement is equal to the sum of the credit union's current credit exposure and potential future credit exposure (PFE) on the OTC interest rate derivative contract.

(A) *Current credit exposure.* The current credit exposure for a single OTC interest rate derivative contract is the greater of the fair value of the OTC interest rate derivative contract or zero.

(B) *PFE.* (1) The PFE for a single OTC interest rate derivative contract, including an

OTC interest rate derivative contract with a negative fair value, is calculated by multiplying the notional principal amount of the OTC interest rate derivative contract by the appropriate conversion factor in Table 1 of this section.

(2) A credit union must use an OTC interest rate derivative contract's effective notional principal amount (that is, the apparent or stated notional principal amount multiplied by any multiplier in the OTC interest rate derivative contract) rather than the apparent or stated notional principal amount in calculating PFE.

TABLE 1 TO § 702.105—CONVERSION FACTOR MATRIX FOR INTEREST RATE DERIVATIVE CONTRACTS²

Remaining maturity	Conversion factor
One year or less	0.00
Greater than one year and less than or equal to five years	0.005
Greater than five years	0.015

(ii) *Multiple OTC interest rate derivative contracts subject to a qualifying master netting agreement.* Except as modified by paragraph (a)(2) of this section, the exposure amount for multiple OTC interest rate derivative contracts subject to a qualifying master netting agreement is equal to the sum of the net current credit exposure and the adjusted sum of the PFE amounts for all OTC interest rate derivative contracts subject to the qualifying master netting agreement.

(A) *Net current credit exposure.* The net current credit exposure is the greater of the net sum of all positive and negative fair value of the individual OTC interest rate derivative contracts subject to the qualifying master netting agreement or zero.

(B) *Adjusted sum of the PFE amounts (Anet).* The adjusted sum of the PFE amounts is calculated as $Anet = (0.4 \times Agross) + (0.6 \times NGR \times Agross)$, where:

(1) *Agross* equals the gross PFE (that is, the sum of the PFE amounts as determined under paragraph (a)(1)(i)(B) of this section for each individual derivative contract subject to the qualifying master netting agreement); and

(2) *Net-to-gross Ratio (NGR)* equals the ratio of the net current credit exposure to the gross current credit exposure. In calculating the NGR, the gross current credit exposure equals the sum of the positive current credit exposures (as determined under paragraph (a)(1)(i) of this section) of all individual derivative contracts subject to the qualifying master netting agreement.

²Non-interest rate derivative contracts are addressed in paragraph (d) of this section.

(2) *Recognition of credit risk mitigation of collateralized OTC derivative contracts.* A credit union may recognize credit risk mitigation benefits of financial collateral that secures an OTC derivative contract or multiple OTC derivative contracts subject to a qualifying master netting agreement (netting set) by following the requirements of paragraph (c) of this section.

(b) *Cleared transactions for interest rate derivatives—(1) General requirements.* A credit union must use the methodologies described in paragraph (b) of this section to calculate risk-weighted assets for a cleared transaction.

(2) *Risk-weighted assets for cleared transactions.* (i) To determine the risk weighted asset amount for a cleared transaction, a credit union must multiply the trade exposure amount for the cleared transaction, calculated in accordance with paragraph (b)(3) of this section, by the risk weight appropriate for the cleared transaction, determined in accordance with paragraph (b)(4) of this section.

(ii) A credit union's total risk-weighted assets for cleared transactions is the sum of the risk-weighted asset amounts for all its cleared transactions.

(3) *Trade exposure amount.* For a cleared transaction the trade exposure amount equals:

(i) The exposure amount for the derivative contract or netting set of derivative contracts, calculated using the methodology used to calculate exposure amount for OTC interest rate derivative contracts under paragraph (a) of this section; plus

(ii) The fair value of the collateral posted by the credit union and held by the, clearing member, or custodian.

(4) *Cleared transaction risk weights.* A credit union must apply a risk weight of:

(i) Two percent if the collateral posted by the credit union to the DCO or clearing member is subject to an arrangement that prevents any losses to the credit union due to the joint default or a concurrent insolvency, liquidation, or receivership proceeding of the clearing member and any other clearing member clients of the clearing member; and the clearing member credit union has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that in the event of a legal challenge (including one resulting from an event of default or from liquidation, insolvency, or receivership proceedings) the relevant court and administrative authorities would find the arrangements to be legal, valid, binding and enforceable under the law of the relevant jurisdictions; or

(ii) Four percent if the requirements of paragraph (b)(4)(i) are not met.

(5) *Recognition of credit risk mitigation of collateralized OTC derivative contracts.* A cred-

it union may recognize the credit risk mitigation benefits of financial collateral that secures a cleared derivative contract by following the requirements of paragraph (c) of this section.

(c) *Recognition of credit risk mitigation of collateralized interest rate derivative contracts.*

(1) A credit union may recognize the credit risk mitigation benefits of financial collateral that secures an OTC interest rate derivative contract or multiple interest rate derivative contracts subject to a qualifying master netting agreement (netting set) or clearing arrangement by using the simple approach in paragraph (c)(3) of this section.

(2) As an alternative to the simple approach, a credit union may recognize the credit risk mitigation benefits of financial collateral that secures such a contract or netting set if the financial collateral is marked-to-fair value on a daily basis and subject to a daily margin maintenance requirement by applying a risk weight to the exposure as if it were uncollateralized and adjusting the exposure amount calculated under paragraph (a) or (b) of this section using the collateral approach in paragraph (c)(3) of this section. The credit union must substitute the exposure amount calculated under paragraphs (b) or (c) of this section in the equation in paragraph (c)(3) of this section.

(3) *Collateralized transactions—(i) General.* A credit union may use the approach in paragraph (c)(3)(ii) of this section to recognize the risk-mitigating effects of financial collateral.

(ii) *Simple collateralized derivatives approach.* To qualify for the simple approach, the financial collateral must meet the following requirements:

(A) The collateral must be subject to a collateral agreement for at least the life of the exposure;

(B) The collateral must be revalued at least every six months; and

(C) The collateral and the exposure must be denominated in the same currency.

(iii) *Risk weight substitution.* (A) A credit union may apply a risk weight to the portion of an exposure that is secured by the fair value of financial collateral (that meets the requirements for the simple collateralized approach of this section) based on the risk weight assigned to the collateral as established under §702.104(c).

(B) A credit union must apply a risk weight to the unsecured portion of the exposure based on the risk weight applicable to the exposure under this subpart.

(iv) *Exceptions to the 20 percent risk weight floor and other requirements.* Notwithstanding the simple collateralized derivatives approach in paragraph (c)(3)(ii) of this section:

(A) A credit union may assign a zero percent risk weight to an exposure to a derivatives contract that is marked-to-market on a

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daily basis and subject to a daily margin maintenance requirement, to the extent the contract is collateralized by cash on deposit.

(B) A credit union may assign a 10 percent risk weight to an exposure to a derivatives contract that is marked-to-market daily and subject to a daily margin maintenance requirement, to the extent that the contract is collateralized by an exposure that qualifies for a zero percent risk weight under § 702.104(c)(2)(i).

(v) A credit union may assign a zero percent risk weight to the collateralized portion of an exposure where:

(A) The financial collateral is cash on deposit; or

(B) The financial collateral is an exposure that qualifies for a zero percent risk weight under § 702.104(c)(2)(i), and the credit union has discounted the fair value of the collateral by 20 percent.

(4) *Collateral haircut approach.* (i) A credit union may recognize the credit risk mitigation benefits of financial collateral that secures a collateralized derivative contract by using the standard supervisory haircuts in paragraph (c)(3) of this section.

(ii) The collateral haircut approach applies to both OTC and cleared interest rate derivatives contracts discussed in this section.

(iii) A credit union must determine the exposure amount for a collateralized derivative contracts by setting the exposure amount equal to the max {0,[(exposure amount – value of collateral) + (sum of current fair value of collateral instruments * market price volatility haircut of the collateral instruments)]}, where:

(A) The value of the exposure equals the exposure amount for OTC interest rate derivative contracts (or netting set) calculated under paragraphs (a)(1)(i) and (ii) of this section.

(B) The value of the exposure equals the exposure amount for cleared interest rate derivative contracts (or netting set) calculated under paragraph (b)(3) of this section.

(C) The value of the collateral is the sum of cash and all instruments under the transaction (or netting set).

(D) The sum of current fair value of collateral instruments as of the measurement date.

(E) A credit union must use the standard supervisory haircuts for market price volatility in Table 2 to this section.

TABLE 2 TO § 702.105—STANDARD SUPERVISORY MARKET PRICE VOLATILITY HAIRCUTS
[Based on a 10 business-day holding period]

Residual maturity	Haircut (in percent) assigned based on:	
	Collateral risk weight (in percent)	
	Zero	20 or 50
Less than or equal to 1 year	0.5	1.0
Greater than 1 year and less than or equal to 5 years	2.0	3.0
Greater than 5 years	4.0	6.0
Cash collateral held	Zero	
Other exposure types	25.0	

(d) *All other derivative contracts and transactions.* Credit unions must follow the requirements of the applicable provisions of 12 CFR part 324, when assigning risk weights to exposure amounts for derivatives contracts not addressed in paragraphs (a) or (b) of this section.

§ 702.106 Prompt corrective action for adequately capitalized credit unions.

(a) *Earnings retention.* Beginning on the effective date of classification as adequately capitalized or lower, a federally insured credit union must increase the dollar amount of its net worth quarterly either in the current quarter, or on average over the current and three preceding quarters, by an amount equivalent to at least 1/10th percent (0.1%) of its total assets (or more by choice), until it is well capitalized.

(b) *Decrease in retention.* Upon written application received no later than 14 days before the quarter end, the NCUA Board, on a case-by-case basis, may permit a credit union to increase the dollar amount of its net worth by an amount that is less than the amount required under paragraph (a) of this section, to the extent the NCUA Board determines that such lesser amount:

(1) Is necessary to avoid a significant redemption of shares; and

(2) Would further the purpose of this part.

(c) *Decrease by FISCO.* The NCUA Board shall consult and seek to work cooperatively with the appropriate state official before permitting a federally insured state-chartered credit union to decrease its earnings retention under paragraph (b) of this section.

(d) *Periodic review.* A decision under paragraph (b) of this section to permit a credit union to decrease its earnings retention is subject to quarterly review and revocation except when the credit union is operating under an approved net worth restoration plan that provides for decreasing its earnings retention as provided under paragraph (b) of this section.

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§ 702.107 Prompt corrective action for undercapitalized credit unions.

(a) *Mandatory supervisory actions by credit union.* A credit union which is undercapitalized must—

(1) *Earnings retention.* Increase net worth in accordance with § 702.106;

(2) *Submit net worth restoration plan.* Submit a net worth restoration plan pursuant to § 702.111, *provided however*, that a credit union in this category having a net worth ratio of less than five percent (5%) which fails to timely submit such a plan, or which materially fails to implement an approved plan, is classified significantly undercapitalized pursuant to § 702.102(a)(4)(i);

(3) *Restrict increase in assets.* Beginning the effective date of classification as undercapitalized or lower, not permit the credit union's assets to increase beyond its total assets for the preceding quarter unless—

(i) *Plan approved.* The NCUA Board has approved a net worth restoration plan which provides for an increase in total assets and—

(A) The assets of the credit union are increasing consistent with the approved plan; and

(B) The credit union is implementing steps to increase the net worth ratio consistent with the approved plan;

(ii) *Plan not approved.* The NCUA Board has not approved a net worth restoration plan and total assets of the credit union are increasing because of increases since quarter-end in balances of:

(A) Total accounts receivable and accrued income on loans and investments; or

(B) Total cash and cash equivalents; or

(C) Total loans outstanding, not to exceed the sum of total assets plus the quarter-end balance of unused commitments to lend and unused lines of credit provided however that a credit union which increases a balance as permitted under paragraphs (a)(3)(ii)(A), (B) or (C) of this section cannot offer rates on shares in excess of prevailing rates on shares in its relevant market area, and cannot open new branches;

(4) *Restrict member business loans.* Beginning the effective date of classification as undercapitalized or lower, not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as of the preceding quarter-end unless it is granted an exception under 12 U.S.C. 1757a(b).

(b) *Second tier discretionary supervisory actions by NCUA.* Subject to the applicable procedures for issuing, reviewing and enforcing directives set forth in subpart L of part 747 of this chapter, the NCUA Board may, by directive, take one or more of the following actions with respect to an undercapitalized credit union having a net worth ratio of less than five percent (5%), or a director, officer or employee of such a credit union, if it de-

termines that those actions are necessary to carry out the purpose of this part:

(1) *Requiring prior approval for acquisitions, branching, new lines of business.* Prohibit a credit union from, directly or indirectly, acquiring any interest in any business entity or financial institution, establishing or acquiring any additional branch office, or engaging in any new line of business, unless the NCUA Board has approved the credit union's net worth restoration plan, the credit union is implementing its plan, and the NCUA Board determines that the proposed action is consistent with and will further the objectives of that plan;

(2) *Restricting transactions with and ownership of a CUSO.* Restrict the credit union's transactions with a CUSO, or require the credit union to reduce or divest its ownership interest in a CUSO;

(3) *Restricting dividends paid.* Restrict the dividend rates the credit union pays on shares to the prevailing rates paid on comparable accounts and maturities in the relevant market area, as determined by the NCUA Board, except that dividend rates already declared on shares acquired before imposing a restriction under this paragraph may not be retroactively restricted;

(4) *Prohibiting or reducing asset growth.* Prohibit any growth in the credit union's assets or in a category of assets, or require the credit union to reduce its assets or a category of assets;

(5) *Alter, reduce or terminate activity.* Require the credit union or its CUSO to alter, reduce, or terminate any activity which poses excessive risk to the credit union;

(6) *Prohibiting nonmember deposits.* Prohibit the credit union from accepting all or certain nonmember deposits;

(7) *Dismissing director or senior executive officer.* Require the credit union to dismiss from office any director or senior executive officer, *provided however*, that a dismissal under this clause shall not be construed to be a formal administrative action for removal under 12 U.S.C. 1786(g);

(8) *Employing qualified senior executive officer.* Require the credit union to employ qualified senior executive officers (who, if the NCUA Board so specifies, shall be subject to its approval); and

(9) *Other action to carry out prompt corrective action.* Restrict or require such other action by the credit union as the NCUA Board determines will carry out the purpose of this part better than any of the actions prescribed in paragraphs (b)(1) through (8) of this section.

(c) *First tier application of discretionary supervisory actions.* An undercapitalized credit union having a net worth ratio of five percent (5%) or more, or which is classified undercapitalized by reason of failing to maintain a risk-based capital ratio equal to or greater than 8 percent under § 702.104, is

subject to the discretionary supervisory actions in paragraph (b) of this section if it fails to comply with any mandatory supervisory action in paragraph (a) of this section or fails to timely implement an approved net worth restoration plan under §702.111, including meeting its prescribed steps to increase its net worth ratio.

§702.108 Prompt corrective action for significantly undercapitalized credit unions.

(a) *Mandatory supervisory actions by credit union.* A credit union which is significantly undercapitalized must—

(1) *Earnings retention.* Increase net worth in accordance with §702.106;

(2) *Submit net worth restoration plan.* Submit a net worth restoration plan pursuant to §702.111;

(3) *Restrict increase in assets.* Not permit the credit union's total assets to increase except as provided in §702.107(a)(3); and

(4) *Restrict member business loans.* Not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as provided in §702.107(a)(4).

(b) *Discretionary supervisory actions by NCUA.* Subject to the applicable procedures for issuing, reviewing and enforcing directives set forth in subpart L of part 747 of this chapter, the NCUA Board may, by directive, take one or more of the following actions with respect to any significantly undercapitalized credit union, or a director, officer or employee of such credit union, if it determines that those actions are necessary to carry out the purpose of this part:

(1) *Requiring prior approval for acquisitions, branching, new lines of business.* Prohibit a credit union from, directly or indirectly, acquiring any interest in any business entity or financial institution, establishing or acquiring any additional branch office, or engaging in any new line of business, except as provided in §702.107(b)(1);

(2) *Restricting transactions with and ownership of CUSO.* Restrict the credit union's transactions with a CUSO, or require the credit union to divest or reduce its ownership interest in a CUSO;

(3) *Restricting dividends paid.* Restrict the dividend rates that the credit union pays on shares as provided in §702.107(b)(3);

(4) *Prohibiting or reducing asset growth.* Prohibit any growth in the credit union's assets or in a category of assets, or require the credit union to reduce assets or a category of assets;

(5) *Alter, reduce or terminate activity.* Require the credit union or its CUSO(s) to alter, reduce, or terminate any activity which poses excessive risk to the credit union;

(6) *Prohibiting nonmember deposits.* Prohibit the credit union from accepting all or certain nonmember deposits;

(7) *New election of directors.* Order a new election of the credit union's board of directors;

(8) *Dismissing director or senior executive officer.* Require the credit union to dismiss from office any director or senior executive officer, *provided however*, that a dismissal under this clause shall not be construed to be a formal administrative action for removal under 12 U.S.C. 1786(g);

(9) *Employing qualified senior executive officer.* Require the credit union to employ qualified senior executive officers (who, if the NCUA Board so specifies, shall be subject to its approval);

(10) *Restricting senior executive officers' compensation.* Except with the prior written approval of the NCUA Board, limit compensation to any senior executive officer to that officer's average rate of compensation (excluding bonuses and profit sharing) during the four (4) calendar quarters preceding the effective date of classification of the credit union as significantly undercapitalized, and prohibit payment of a bonus or profit share to such officer;

(11) *Other actions to carry out prompt corrective action.* Restrict or require such other action by the credit union as the NCUA Board determines will carry out the purpose of this part better than any of the actions prescribed in paragraphs (b)(1) through (10) of this section; and

(12) *Requiring merger.* Require the credit union to merge with another financial institution if one or more grounds exist for placing the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i).

(c) *Discretionary conservatorship or liquidation if no prospect of becoming adequately capitalized.* Notwithstanding any other actions required or permitted to be taken under this section, when a credit union becomes significantly undercapitalized (including by reclassification under §702.102(b)), the NCUA Board may place the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i), provided that the credit union has no reasonable prospect of becoming adequately capitalized.

§702.109 Prompt corrective action for critically undercapitalized credit unions.

(a) *Mandatory supervisory actions by credit union.* A credit union which is critically undercapitalized must—

(1) *Earnings retention.* Increase net worth in accordance with §702.106;

(2) *Submit net worth restoration plan.* Submit a net worth restoration plan pursuant to §702.111;

(3) *Restrict increase in assets.* Not permit the credit union's total assets to increase except as provided in §702.107(a)(3); and

(4) *Restrict member business loans.* Not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as provided in §702.107(a)(4).

(b) *Discretionary supervisory actions by NCUA.* Subject to the applicable procedures for issuing, reviewing and enforcing directives set forth in subpart L of part 747 of this chapter, the NCUA Board may, by directive, take one or more of the following actions with respect to any critically undercapitalized credit union, or a director, officer or employee of such credit union, if it determines that those actions are necessary to carry out the purpose of this part:

(1) *Requiring prior approval for acquisitions, branching, new lines of business.* Prohibit a credit union from, directly or indirectly, acquiring any interest in any business entity or financial institution, establishing or acquiring any additional branch office, or engaging in any new line of business, except as provided by §702.107(b)(1);

(2) *Restricting transactions with and ownership of CUSO.* Restrict the credit union's transactions with a CUSO, or require the credit union to divest or reduce its ownership interest in a CUSO;

(3) *Restricting dividends paid.* Restrict the dividend rates that the credit union pays on shares as provided in §702.107(b)(3);

(4) *Prohibiting or reducing asset growth.* Prohibit any growth in the credit union's assets or in a category of assets, or require the credit union to reduce assets or a category of assets;

(5) *Alter, reduce or terminate activity.* Require the credit union or its CUSO(s) to alter, reduce, or terminate any activity which poses excessive risk to the credit union;

(6) *Prohibiting nonmember deposits.* Prohibit the credit union from accepting all or certain nonmember deposits;

(7) *New election of directors.* Order a new election of the credit union's board of directors;

(8) *Dismissing director or senior executive officer.* Require the credit union to dismiss from office any director or senior executive officer, *provided however*, that a dismissal under this clause shall not be construed to be a formal administrative action for removal under 12 U.S.C. 1786(g);

(9) *Employing qualified senior executive officer.* Require the credit union to employ qualified senior executive officers (who, if the NCUA Board so specifies, shall be subject to its approval);

(10) *Restricting senior executive officers' compensation.* Reduce or, with the prior written approval of the NCUA Board, limit compensation to any senior executive officer to that officer's average rate of compensation (excluding bonuses and profit sharing) during the four (4) calendar quarters preceding the

effective date of classification of the credit union as critically undercapitalized, and prohibit payment of a bonus or profit share to such officer;

(11) *Restrictions on payments on uninsured secondary capital.* Beginning 60 days after the effective date of classification of a credit union as critically undercapitalized, prohibit payments of principal, dividends or interest on the credit union's uninsured secondary capital accounts established after August 7, 2000, except that unpaid dividends or interest shall continue to accrue under the terms of the account to the extent permitted by law;

(12) *Requiring prior approval.* Require a critically undercapitalized credit union to obtain the NCUA Board's prior written approval before doing any of the following:

(i) Entering into any material transaction not within the scope of an approved net worth restoration plan (or approved revised business plan under subpart C of this part);

(ii) Extending credit for transactions deemed highly leveraged by the NCUA Board or, if state-chartered, by the appropriate state official;

(iii) Amending the credit union's charter or bylaws, except to the extent necessary to comply with any law, regulation, or order;

(iv) Making any material change in accounting methods; and

(v) Paying dividends or interest on new share accounts at a rate exceeding the prevailing rates of interest on insured deposits in its relevant market area;

(13) *Other action to carry out prompt corrective action.* Restrict or require such other action by the credit union as the NCUA Board determines will carry out the purpose of this part better than any of the actions prescribed in paragraphs (b)(1) through (12) of this section; and

(14) *Requiring merger.* Require the credit union to merge with another financial institution if one or more grounds exist for placing the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i).

(c) *Mandatory conservatorship, liquidation or action in lieu thereof—(1) Action within 90 days.* Notwithstanding any other actions required or permitted to be taken under this section (and regardless of a credit union's prospect of becoming adequately capitalized), the NCUA Board must, within 90 calendar days after the effective date of classification of a credit union as critically undercapitalized—

(i) *Conservatorship.* Place the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(G); or

(ii) *Liquidation.* Liquidate the credit union pursuant to 12 U.S.C. 1787(a)(3)(A)(ii); or

(iii) *Other corrective action.* Take other corrective action, in lieu of conservatorship or liquidation, to better achieve the purpose of

this part, provided that the NCUA Board documents why such action in lieu of conservatorship or liquidation would do so, *provided however*, that other corrective action may consist, in whole or in part, of complying with the quarterly timetable of steps and meeting the quarterly net worth targets prescribed in an approved net worth restoration plan.

(2) *Renewal of other corrective action.* A determination by the NCUA Board to take other corrective action in lieu of conservatorship or liquidation under paragraph (c)(1)(iii) of this section shall expire after an effective period ending no later than 180 calendar days after the determination is made, and the credit union shall be immediately placed into conservatorship or liquidation under paragraphs (c)(1)(i) and (ii) of this section, unless the NCUA Board makes a new determination under paragraph (c)(1)(iii) of this section before the end of the effective period of the prior determination;

(3) *Mandatory liquidation after 18 months—*
(i) *Generally.* Notwithstanding paragraphs (c)(1) and (2) of this section, the NCUA Board must place a credit union into liquidation if it remains critically undercapitalized for a full calendar quarter, on a monthly average basis, following a period of 18 months from the effective date the credit union was first classified critically undercapitalized.

(ii) *Exception.* Notwithstanding paragraph (c)(3)(i) of this section, the NCUA Board may continue to take other corrective action in lieu of liquidation if it certifies that the credit union—

(A) Has been in substantial compliance with an approved net worth restoration plan requiring consistent improvement in net worth since the date the net worth restoration plan was approved;

(B) Has positive net income or has an upward trend in earnings that the NCUA Board projects as sustainable; and

(C) Is viable and not expected to fail.

(iii) *Review of exception.* The NCUA Board shall, at least quarterly, review the certification of an exception to liquidation under paragraph (c)(3)(i) of this section and shall either—

(A) Recertify the credit union if it continues to satisfy the criteria of paragraph (c)(3)(ii) of this section; or

(B) Promptly place the credit union into liquidation, pursuant to 12 U.S.C. 1787(a)(3)(A)(ii), if it fails to satisfy the criteria of paragraph (c)(3)(ii) of this section.

(4) *Nondelegation.* The NCUA Board may not delegate its authority under paragraph (c) of this section, unless the credit union has less than \$5,000,000 in total assets. A credit union shall have a right of direct appeal to the NCUA Board of any decision made by delegated authority under this section within ten (10) calendar days of the date of that decision.

(d) *Mandatory liquidation of insolvent federal credit union.* In lieu of paragraph (c) of this section, a critically undercapitalized federal credit union that has a net worth ratio of less than zero percent (0%) may be placed into liquidation on grounds of insolvency pursuant to 12 U.S.C. 1787(a)(1)(A).

§ 702.110 Consultation with state officials on proposed prompt corrective action.

(a) *Consultation on proposed conservatorship or liquidation.* Before placing a federally insured state-chartered credit union into conservatorship (pursuant to 12 U.S.C. 1786(h)(1)(F) or (G)) or liquidation (pursuant to 12 U.S.C. 1787(a)(3)) as permitted or required under subparts A or B of this part to facilitate prompt corrective action—

(1) The NCUA Board shall seek the views of the appropriate state official (as defined in § 702.2), and give him or her an opportunity to take the proposed action;

(2) The NCUA Board shall, upon timely request of the appropriate state official, promptly provide him or her with a written statement of the reasons for the proposed conservatorship or liquidation, and reasonable time to respond to that statement; and

(3) If the appropriate state official makes a timely written response that disagrees with the proposed conservatorship or liquidation and gives reasons for that disagreement, the NCUA Board shall not place the credit union into conservatorship or liquidation unless it first considers the views of the appropriate state official and determines that—

(i) The NCUSIF faces a significant risk of loss if the credit union is not placed into conservatorship or liquidation; and

(ii) Conservatorship or liquidation is necessary either to reduce the risk of loss, or to reduce the expected loss, to the NCUSIF with respect to the credit union.

(b) *Nondelegation.* The NCUA Board may not delegate any determination under paragraph (a)(3) of this section.

(c) *Consultation on proposed discretionary action.* The NCUA Board shall consult and seek to work cooperatively with the appropriate state official before taking any discretionary supervisory action under §§ 702.107(b), 702.108(b), 702.109(b), 702.204(b) and 702.205(b) with respect to a federally insured state-chartered credit union; shall provide prompt notice of its decision to the appropriate state official; and shall allow the appropriate state official to take the proposed action independently or jointly with NCUA.

§ 702.111 Net worth restoration plans (NWRP).

(a) *Schedule for filing—*(1) *Generally.* A credit union shall file a written net worth restoration plan (NWRP) with the appropriate Regional Director and, if state-chartered,

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the appropriate state official, within 45 calendar days of the effective date of classification as either undercapitalized, significantly undercapitalized or critically undercapitalized, unless the NCUA Board notifies the credit union in writing that its NWRP is to be filed within a different period.

(2) *Exception.* An otherwise adequately capitalized credit union that is reclassified undercapitalized on safety and soundness grounds under §702.102(b) is not required to submit a NWRP solely due to the reclassification, unless the NCUA Board notifies the credit union that it must submit an NWRP.

(3) *Filing of additional plan.* Notwithstanding paragraph (a)(1) of this section, a credit union that has already submitted and is operating under a NWRP approved under this section is not required to submit an additional NWRP due to a change in net worth category (including by reclassification under §702.102(b)), unless the NCUA Board notifies the credit union that it must submit a new NWRP. A credit union that is notified to submit a new or revised NWRP shall file the NWRP in writing with the appropriate Regional Director within 30 calendar days of receiving such notice, unless the NCUA Board notifies the credit union in writing that the NWRP is to be filed within a different period.

(4) *Failure to timely file plan.* When a credit union fails to timely file an NWRP pursuant to this paragraph, the NCUA Board shall promptly notify the credit union that it has failed to file an NWRP and that it has 15 calendar days from receipt of that notice within which to file an NWRP.

(b) *Assistance to small credit unions.* Upon timely request by a credit union having total assets of less than \$10 million (regardless how long it has been in operation), the NCUA Board shall provide assistance in preparing an NWRP required to be filed under paragraph (a) of this section.

(c) *Contents of NWRP.* An NWRP must—

(1) Specify—

(i) A quarterly timetable of steps the credit union will take to increase its net worth ratio, and risk-based capital ratio if applicable, so that it becomes adequately capitalized by the end of the term of the NWRP, and to remain so for four (4) consecutive calendar quarters;

(ii) The projected amount of net worth increases in each quarter of the term of the NWRP as required under §702.106(a), or as permitted under §702.106(b);

(iii) How the credit union will comply with the mandatory and any discretionary supervisory actions imposed on it by the NCUA Board under this subpart;

(iv) The types and levels of activities in which the credit union will engage; and

(v) If reclassified to a lower category under §702.102(b), the steps the credit union will take to correct the unsafe or unsound practice(s) or condition(s);

(2) Include pro forma financial statements, including any off-balance sheet items, covering a minimum of the next two years; and

(3) Contain such other information as the NCUA Board has required.

(d) *Criteria for approval of NWRP.* The NCUA Board shall not accept a NWRP plan unless it—

(1) Complies with paragraph (c) of this section;

(2) Is based on realistic assumptions, and is likely to succeed in restoring the credit union's net worth; and

(3) Would not unreasonably increase the credit union's exposure to risk (including credit risk, interest-rate risk, and other types of risk).

(e) *Consideration of regulatory capital.* To minimize possible long-term losses to the NCUSIF while the credit union takes steps to become adequately capitalized, the NCUA Board shall, in evaluating an NWRP under this section, consider the type and amount of any form of regulatory capital which may become established by NCUA regulation, or authorized by state law and recognized by NCUA, which the credit union holds, but which is not included in its net worth.

(f) *Review of NWRP—(1) Notice of decision.* Within 45 calendar days after receiving an NWRP under this part, the NCUA Board shall notify the credit union in writing whether the NWRP has been approved, and shall provide reasons for its decision in the event of disapproval.

(2) *Delayed decision.* If no decision is made within the time prescribed in paragraph (f)(1) of this section, the NWRP is deemed approved.

(3) *Consultation with state officials.* In the case of an NWRP submitted by a federally insured state-chartered credit union (whether an original, new, additional, revised or amended NWRP), the NCUA Board shall, when evaluating the NWRP, seek and consider the views of the appropriate state official, and provide prompt notice of its decision to the appropriate state official.

(g) *NWRP not approved—(1) Submission of revised NWRP.* If an NWRP is rejected by the NCUA Board, the credit union shall submit a revised NWRP within 30 calendar days of receiving notice of disapproval, unless it is notified in writing by the NCUA Board that the revised NWRP is to be filed within a different period.

(2) *Notice of decision on revised NWRP.* Within 30 calendar days after receiving a revised NWRP under paragraph (g)(1) of this section, the NCUA Board shall notify the credit union in writing whether the revised NWRP is approved. The Board may extend the time within which notice of its decision shall be provided.

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(3) *Disapproval of reclassified credit union's NWRP.* A credit union which has been classified significantly undercapitalized shall remain so classified pending NCUA Board approval of a new or revised NWRP.

(4) *Submission of multiple unapproved NWRPs.* The submission of more than two NWRPs that are not approved is considered an unsafe and unsound condition and may subject the credit union to administrative enforcement actions under section 206 of the FCUA, 12 U.S.C. 1786 and 1790d.

(h) *Amendment of NWRP.* A credit union that is operating under an approved NWRP may, after prior written notice to, and approval by the NCUA Board, amend its NWRP to reflect a change in circumstance. Pending approval of an amended NWRP, the credit union shall implement the NWRP as originally approved.

(i) *Publication.* An NWRP need not be published to be enforceable because publication would be contrary to the public interest.

(j) *Termination of NWRP.* For purposes of this part, an NWRP terminates once the credit union is classified as adequately capitalized and remains so for four consecutive quarters. For example, if a credit union with an active NWRP attains the classification as adequately classified on December 31, 2015 this would be quarter one and the fourth consecutive quarter would end September 30, 2016.

§ 702.112 Reserves.

Each credit union shall establish and maintain such reserves as may be required by the FCUA, by state law, by regulation, or in special cases by the NCUA Board or appropriate state official.

§ 702.113 Full and fair disclosure of financial condition.

(a) *Full and fair disclosure defined.* "Full and fair disclosure" is the level of disclosure which a prudent person would provide to a member of a credit union, to NCUA, or, at the discretion of the board of directors, to creditors to fairly inform them of the financial condition and the results of operations of the credit union.

(b) *Full and fair disclosure implemented.* The financial statements of a credit union shall provide for full and fair disclosure of all assets, liabilities, and members' equity, including such valuation (allowance) accounts as may be necessary to present fairly the financial condition; and all income and expenses necessary to present fairly the statement of income for the reporting period.

(c) *Declaration of officials.* The Statement of Financial Condition, when presented to members, to creditors or to NCUA, shall contain a dual declaration by the treasurer and the chief executive officer, or in the latter's absence, by any other officer designated by the board of directors of the reporting credit

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union to make such declaration, that the report and related financial statements are true and correct to the best of their knowledge and belief and present fairly the financial condition and the statement of income for the period covered.

(d) *Charges for loan and lease losses.* Full and fair disclosure demands that a credit union properly address charges for loan losses as follows:

(1) Charges for loan and lease losses shall be made timely and in accordance with GAAP;

(2) The ALLL must be maintained in accordance with GAAP; and

(3) At a minimum, adjustments to the ALLL shall be made prior to the distribution or posting of any dividend to the accounts of members.

§ 702.114 Payment of dividends.

(a) *Restriction on dividends.* Dividends shall be available only from net worth, net of any special reserves established under § 702.112, if any.

(b) *Payment of dividends and interest refunds.* The board of directors must not pay a dividend or interest refund that will cause the credit union's capital classification to fall below adequately capitalized under this subpart unless the appropriate Regional Director and, if state-chartered, the appropriate state official, have given prior written approval (in an NWRP or otherwise). The request for written approval must include the plan for eliminating any negative retained earnings balance.

Subpart B—Mandatory and Discretionary Supervisory Actions

EFFECTIVE DATE NOTE: At 80 FR 66706, Oct. 29, 2015, subpart B to part 702 was revised, effective January 1, 2019. For the convenience of the user, the revised text is set forth at the end of this subpart.

§ 702.201 Prompt corrective action for "adequately capitalized" credit unions.

(a) *Earnings retention.* Beginning the effective date of classification as "adequately capitalized" or lower, a federally-insured credit union must increase the dollar amount of its net worth quarterly either in the current quarter, or on average over the current and three preceding quarters, by an amount equivalent to at least 1/10th percent (0.1%) of its total assets, and must quarterly transfer that amount (or

more by choice) from undivided earnings to its regular reserve account until it is “well capitalized.”

(b) *Decrease in retention.* Upon written application received no later than 14 days before the quarter end, the NCUA Board, on a case-by-case basis, may permit a credit union to increase the dollar amount of its net worth and quarterly transfer an amount that is less than the amount required under paragraph (a) of this section, to the extent the NCUA Board determines that such lesser amount—

(1) Is necessary to avoid a significant redemption of shares; and

(2) Would further the purpose of this part.

(c) *Decrease by FISCU.* The NCUA Board shall consult and seek to work cooperatively with the appropriate State official before permitting a federally-insured State-chartered credit union to decrease its earnings retention under paragraph (b) of this section.

(d) *Periodic review.* A decision under paragraph (b) of this section to permit a credit union to decrease its earnings retention is subject to quarterly review and revocation except when the credit union is operating under an approved net worth restoration plan that provides for decreasing its earnings retention as provided under paragraph (b).

[67 FR 71091, Nov. 29, 2002]

§ 702.202 Prompt corrective action for “undercapitalized” credit unions.

(a) *Mandatory supervisory actions by credit union.* A federally-insured credit union which is “undercapitalized” must—

(1) *Earnings retention.* Increase net worth and transfer earnings to its regular reserve account in accordance with § 702.201;

(2) *Submit net worth restoration plan.* Pursuant to § 702.206, provided however, that a credit union in this category having a net worth ratio of less than five percent (5%) which fails to timely submit such a plan, or which materially fails to implement an approved plan, is classified “significantly undercapitalized” pursuant to § 702.102(a)(4)(ii) above;

(3) *Restrict increase in assets.* Beginning the effective date of classification as “undercapitalized” or lower, not permit the credit union’s assets to increase beyond its total assets (per § 702.2(j)) for the preceding quarter unless—

(i) *Plan approved.* The NCUA Board has approved a net worth restoration plan which provides for an increase in total assets and—

(A) The assets of the credit union are increasing consistent with the approved plan; and

(B) The credit union is implementing steps to increase the net worth ratio consistent with the approved plan;

(ii) *Plan not approved.* The NCUA Board has not approved a net worth restoration plan and total assets of the credit union are increasing because of increases since quarter-end in balances of:

(A) Total accounts receivable and accrued income on loans and investments; or

(B) Total cash and cash equivalents; or

(C) Total loans outstanding, not to exceed the sum of total assets (per § 702.2(j)) plus the quarter-end balance of unused commitments to lend and unused lines of credit provided however that a credit union which increases a balance as permitted under paragraphs (A), (B) or (C) cannot offer rates on shares in excess of prevailing rates on shares in its relevant market area, and cannot open new branches;

(4) *Restrict member business loans.* Beginning the effective date of classification as “undercapitalized” or lower, not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as of the preceding quarter-end unless it is granted an exception under 12 U.S.C. 1757a(b).

(b) *“Second tier” discretionary supervisory actions by NCUA.* Subject to the applicable procedures for issuing, reviewing and enforcing directives set forth in subpart L of part 747 of this chapter, the NCUA Board may, by directive, take one or more of the following actions with respect to an “undercapitalized” credit union having

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a net worth ratio of less than five percent (5%), or a director, officer or employee of such a credit union, if it determines that those actions are necessary to carry out the purpose of this part:

(1) *Requiring prior approval for acquisitions, branching, new lines of business.* Prohibit a credit union from, directly or indirectly, acquiring any interest in any business entity or financial institution, establishing or acquiring any additional branch office, or engaging in any new line of business, unless the NCUA Board has approved the credit union's net worth restoration plan, the credit union is implementing its plan, and the NCUA Board determines that the proposed action is consistent with and will further the objectives of that plan;

(2) *Restricting transactions with and ownership of CUSO.* Restrict the credit union's transactions with a CUSO, or require the credit union to reduce or divest its ownership interest in a CUSO;

(3) *Restricting dividends paid.* Restrict the dividend rates the credit union pays on shares to the prevailing rates paid on comparable accounts and maturities in the relevant market area, as determined by the NCUA Board, except that dividend rates already declared on shares acquired before imposing a restriction under this paragraph may not be retroactively restricted;

(4) *Prohibiting or reducing asset growth.* Prohibit any growth in the credit union's assets or in a category of assets, or require the credit union to reduce its assets or a category of assets;

(5) *Alter, reduce or terminate activity.* Require the credit union or its CUSO to alter, reduce, or terminate any activity which poses excessive risk to the credit union;

(6) *Prohibiting nonmember deposits.* Prohibit the credit union from accepting all or certain nonmember deposits;

(7) *Dismissing director or senior executive officer.* Require the credit union to dismiss from office any director or senior executive officer, *provided however*, that a dismissal under this clause shall not be construed to be a formal administrative action for removal under 12 U.S.C. 1786(g);

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(8) *Employing qualified senior executive officer.* Require the credit union to employ qualified senior executive officers (who, if the NCUA Board so specifies, shall be subject to its approval); and

(9) *Other action to carry out prompt corrective action.* Restrict or require such other action by the credit union as the NCUA Board determines will carry out the purpose of this part better than any of the actions prescribed in paragraphs (b)(1) through (8) of this section.

(c) *“First tier” application of discretionary supervisory actions.* An “undercapitalized” credit union having a net worth ratio of five percent (5%) or more, or which is classified “undercapitalized” by reason of failing to satisfy a risk-based net worth requirement under § 702.105 or 702.106, is subject to the discretionary supervisory actions in paragraph (b) of this section if it fails to comply with any mandatory supervisory action in paragraph (a) of this section or fails to timely implement an approved net worth restoration plan under § 702.206, including meeting its prescribed steps to increase its net worth ratio.

[65 FR 8584, Feb. 18, 2000, as amended at 67 FR 71092, Nov. 29, 2002]

§ 702.203 Prompt corrective action for “significantly undercapitalized” credit unions.

(a) *Mandatory supervisory actions by credit union.* A federally-insured credit union which is “significantly undercapitalized” must—

(1) *Earnings retention.* Increase net worth and transfer earnings to its regular reserve account in accordance with § 702.201;

(2) *Submit net worth restoration plan.* Submit a net worth restoration plan pursuant to § 702.206;

(3) *Restrict increase in assets.* Not permit the credit union's total assets to increase except as provided in § 702.202(a)(3) and

(4) *Restrict member business loans.* Not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as provided in § 702.202(a)(4).

(b) *Discretionary supervisory actions by NCUA.* Subject to the applicable procedures for issuing, reviewing and enforcing directives set forth in subpart L of part 747 of this chapter, the NCUA Board may, by directive, take one or more of the following actions with respect to any “significantly undercapitalized” credit union, or a director, officer or employee of such credit union, if it determines that those actions are necessary to carry out the purpose of this part:

(1) *Requiring prior approval for acquisitions, branching, new lines of business.*

Prohibit a credit union from, directly or indirectly, acquiring any interest in any business entity or financial institution, establishing or acquiring any additional branch office, or engaging in any new line of business, except as provided in § 702.202(b)(1);

(2) *Restricting transactions with and ownership of CUSO.* Restrict the credit union’s transactions with a CUSO, or require the credit union to divest or reduce its ownership interest in a CUSO;

(3) *Restricting dividends paid.* Restrict the dividend rates that the credit union pays on shares as provided in § 702.202(b)(3);

(4) *Prohibiting or reducing asset growth.* Prohibit any growth in the credit union’s assets or in a category of assets, or require the credit union to reduce assets or a category of assets;

(5) *Alter, reduce or terminate activity.* Require the credit union or its CUSO(s) to alter, reduce, or terminate any activity which poses excessive risk to the credit union;

(6) *Prohibiting nonmember deposits.* Prohibit the credit union from accepting all or certain nonmember deposits;

(7) *New election of directors.* Order a new election of the credit union’s board of directors;

(8) *Dismissing director or senior executive officer.* Require the credit union to dismiss from office any director or senior executive officer, *provided however*, that a dismissal under this clause shall not be construed to be a formal administrative action for removal under 12 U.S.C. 1786(g);

(9) *Employing qualified senior executive officer.* Require the credit union to employ qualified senior executive officers

(who, if the NCUA Board so specifies, shall be subject to its approval);

(10) *Restricting senior executive officers’ compensation.* Except with the prior written approval of the NCUA Board, limit compensation to any senior executive officer to that officer’s average rate of compensation (excluding bonuses and profit sharing) during the four (4) calendar quarters preceding the effective date of classification of the credit union as “significantly undercapitalized,” and prohibit payment of a bonus or profit share to such officer;

(11) *Other actions to carry out prompt corrective action.* Restrict or require such other action by the credit union as the NCUA Board determines will carry out the purpose of this part better than any of the actions prescribed in paragraphs (b)(1) through (10) of this section; and

(12) *Requiring merger.* Require the credit union to merge with another financial institution if one or more grounds exist for placing the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i).

(c) *Discretionary conservatorship or liquidation if no prospect of becoming “adequately capitalized.”* Notwithstanding any other actions required or permitted to be taken under this section, when a credit union becomes “significantly undercapitalized” (including by reclassification under section 702.102(b) above), the NCUA Board may place the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i), provided that the credit union has no reasonable prospect of becoming “adequately capitalized.”

[65 FR 8584, Feb. 18, 2000, as amended at 67 FR 71092, Nov. 29, 2002]

§ 702.204 Prompt corrective action for “critically undercapitalized” credit unions

(a) *Mandatory supervisory actions by credit union.* A federally-insured credit union which is “critically undercapitalized” must—

(1) *Earnings retention.* Increase net worth and transfer earnings to its regular reserve account in accordance with § 702.201;

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(2) *Submit net worth restoration plan.* Submit a net worth restoration plan pursuant to § 702.206;

(3) *Restrict increase in assets.* Not permit the credit union's total assets to increase except as provided in § 702.202(a)(3); and

(4) *Restrict member business loans.* Not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as provided in § 702.202(a)(4).

(b) *Discretionary supervisory actions by NCUA.* Subject to the applicable procedures for issuing, reviewing and enforcing directives set forth in subpart L of part 747 of this chapter, the NCUA Board may, by directive, take one or more of the following actions with respect to any "critically undercapitalized" credit union, or a director, officer or employee of such credit union, if it determines that those actions are necessary to carry out the purpose of this part:

(1) *Requiring prior approval for acquisitions, branching, new lines of business.* Prohibit a credit union from, directly or indirectly, acquiring any interest in any business entity or financial institution, establishing or acquiring any additional branch office, or engaging in any new line of business, except as provided by § 702.202(b)(1);

(2) *Restricting transactions with and ownership of CUSO.* Restrict the credit union's transactions with a CUSO, or require the credit union to divest or reduce its ownership interest in a CUSO;

(3) *Restricting dividends paid.* Restrict the dividend rates that the credit union pays on shares as provided in § 702.202(b)(3);

(4) *Prohibiting or reducing asset growth.* Prohibit any growth in the credit union's assets or in a category of assets, or require the credit union to reduce assets or a category of assets;

(5) *Alter, reduce or terminate activity.* Require the credit union or its CUSO(s) to alter, reduce, or terminate any activity which poses excessive risk to the credit union;

(6) *Prohibiting nonmember deposits.* Prohibit the credit union from accepting all or certain nonmember deposits;

(7) *New election of directors.* Order a new election of the credit union's board of directors;

(8) *Dismissing director or senior executive officer.* Require the credit union to dismiss from office any director or senior executive officer, *provided however*, that a dismissal under this clause shall not be construed to be a formal administrative action for removal under 12 U.S.C. 1786(g);

(9) *Employing qualified senior executive officer.* Require the credit union to employ qualified senior executive officers (who, if the NCUA Board so specifies, shall be subject to its approval);

(10) *Restricting senior executive officers' compensation.* Reduce or, with the prior written approval of the NCUA Board, limit compensation to any senior executive officer to that officer's average rate of compensation (excluding bonuses and profit sharing) during the four (4) calendar quarters preceding the effective date of classification of the credit union as "critically undercapitalized," and prohibit payment of a bonus or profit share to such officer;

(11) *Restrictions on payments on uninsured secondary capital.* Beginning 60 days after the effective date of classification of a credit union as "critically undercapitalized," prohibit payments of principal, dividends or interest on the credit union's uninsured secondary capital accounts established after August 7, 2000, except that unpaid dividends or interest shall continue to accrue under the terms of the account to the extent permitted by law;

(12) *Requiring prior approval.* Require a "critically undercapitalized" credit union to obtain the NCUA Board's prior written approval before doing any of the following:

(i) Entering into any material transaction not within the scope of an approved net worth restoration plan (or approved revised business plan under subpart C of this part);

(ii) Extending credit for transactions deemed highly leveraged by the NCUA Board or, if State-chartered, by the appropriate State official;

(iii) Amending the credit union's charter or bylaws, except to the extent necessary to comply with any law, regulation, or order;

(iv) Making any material change in accounting methods; and

(v) Paying dividends or interest on new share accounts at a rate exceeding the prevailing rates of interest on insured deposits in its relevant market area;

(13) *Other action to carry out prompt corrective action.* Restrict or require such other action by the credit union as the NCUA Board determines will carry out the purpose of this part better than any of the actions prescribed in paragraphs (b)(1) through (12) of this section; and

(14) *Requiring merger.* Require the credit union to merge with another financial institution if one or more grounds exist for placing the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i).

(c) *Mandatory conservatorship, liquidation or action in lieu thereof—(1) Action within 90 days.* Notwithstanding any other actions required or permitted to be taken under this section (and regardless of a credit union's prospect of becoming "adequately capitalized"), the NCUA Board must, within 90 calendar days after the effective date of classification of a credit union as "critically undercapitalized"—

(i) *Conservatorship.* Place the credit union into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(G); or

(ii) *Liquidation.* Liquidate the credit union pursuant to 12 U.S.C. 1787(a)(3)(A)(ii); or

(iii) *Other corrective action.* Take other corrective action, in lieu of conservatorship or liquidation, to better achieve the purpose of this part, provided that the NCUA Board documents why such action in lieu of conservatorship or liquidation would do so, *provided however*, that other corrective action may consist, in whole or in part, of complying with the quarterly timetable of steps and meeting the quarterly net worth targets prescribed in an approved net worth restoration plan.

(2) *Renewal of other corrective action.* A determination by the NCUA Board to take other corrective action in lieu of conservatorship or liquidation under paragraph (c)(1)(iii) of this section

shall expire after an effective period ending no later than 180 calendar days after the determination is made, and the credit union shall be immediately placed into conservatorship or liquidation under paragraphs (c)(1)(i) and (ii), unless the NCUA Board makes a new determination under paragraph (c)(1)(iii) of this section before the end of the effective period of the prior determination;

(3) *Mandatory liquidation after 18 months—(i) Generally.* Notwithstanding paragraphs (c)(1) and (2) of this section, the NCUA Board must place a credit union into liquidation if it remains "critically undercapitalized" for a full calendar quarter, on a monthly average basis, following a period of 18 months from the effective date the credit union was first classified "critically undercapitalized."

(ii) *Exception.* Notwithstanding paragraph (c)(3)(i) of this section, the NCUA Board may continue to take other corrective action in lieu of liquidation if it certifies that the credit union—

(A) Has been in substantial compliance with an approved net worth restoration plan requiring consistent improvement in net worth since the date the net worth restoration plan was approved;

(B) Has positive net income or has an upward trend in earnings that the NCUA Board projects as sustainable; and

(C) Is viable and not expected to fail.

(iii) *Review of exception.* The NCUA Board shall, at least quarterly, review the certification of an exception to liquidation under paragraph (c)(3)(ii) of this section and shall either—

(A) Recertify the credit union if it continues to satisfy the criteria of paragraph (c)(3)(ii) of this section; or

(B) Promptly place the credit union into liquidation, pursuant to 12 U.S.C. 1787(a)(3)(A)(ii), if it fails to satisfy the criteria of paragraph (c)(3)(ii) of this section.

(4) *Nondelegation.* The NCUA Board may not delegate its authority under paragraph (c) of this section, unless the credit union has less than \$5,000,000 in total assets. A credit union shall have a right of direct appeal to the NCUA Board of any decision made by delegated authority under this section

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within ten (10) calendar days of the date of that decision.

(d) *Mandatory liquidation of insolvent federal credit union.* In lieu of paragraph (c) of this section, a “critically undercapitalized” federal credit union that has a net worth ratio of less than zero percent (0%) may be placed into liquidation on grounds of insolvency pursuant to 12 U.S.C. 1787(a)(1)(A).

[65 FR 8584, Feb. 18, 2000, as amended at 67 FR 71092, Nov. 29, 2002; 75 FR 34620, June 18, 2010]

§ 702.205 Consultation with State officials on proposed prompt corrective action.

(a) *Consultation on proposed conservatorship or liquidation.* Before placing a federally-insured State-chartered credit union into conservatorship (pursuant to 12 U.S.C. 1786(h)(1)(F) or (G)) or liquidation (pursuant to 12 U.S.C. 1787(a)(3)) as permitted or required under subparts B or C of this part to facilitate prompt corrective action—

(1) The NCUA Board shall seek the views of the appropriate State official (as defined in § 702.2(b)), and give him or her an opportunity to take the proposed action;

(2) The NCUA Board shall, upon timely request of the appropriate State official, promptly provide him or her with a written statement of the reasons for the proposed conservatorship or liquidation, and reasonable time to respond to that statement; and

(3) If the appropriate State official makes a timely written response that disagrees with the proposed conservatorship or liquidation and gives reasons for that disagreement, the NCUA Board shall not place the credit union into conservatorship or liquidation unless it first considers the views of the appropriate State official and determines that—

(i) The NCUSIF faces a significant risk of loss if the credit union is not placed into conservatorship or liquidation; and

(ii) Conservatorship or liquidation is necessary either to reduce the risk of loss, or to reduce the expected loss, to the NCUSIF with respect to the credit union.

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(b) *Nondelegation.* The NCUA Board may not delegate any determination under paragraph (a)(3) of this section.

(c) *Consultation on proposed discretionary action.* The NCUA Board shall consult and seek to work cooperatively with the appropriate State official before taking any discretionary supervisory action under §§ 702.202(b), 702.203(b), 702.204(b), 702.304(b) and 702.305(b) with respect to a federally-insured State-chartered credit union; shall provide prompt notice of its decision to the appropriate State official; and shall allow the appropriate State official to take the proposed action independently or jointly with NCUA.

[65 FR 8584, Feb. 18, 2000, as amended at 67 FR 71092, Nov. 29, 2002; 75 FR 34620, June 18, 2010]

§ 702.206 Net worth restoration plans.

(a) *Schedule for filing—(1) Generally.* A federally-insured credit union shall file a written net worth restoration plan (NWRP) with the appropriate Regional Director and, if State-chartered, the appropriate State official, within 45 calendar days of the effective date of classification as either “undercapitalized,” “significantly undercapitalized” or “critically undercapitalized,” unless the NCUA Board notifies the credit union in writing that its NWRP is to be filed within a different period.

(2) *Exception.* An otherwise “adequately capitalized” credit union that is reclassified “undercapitalized” on safety and soundness grounds under § 702.102(b) is not required to submit a NWRP solely due to the reclassification, unless the NCUA Board notifies the credit union that it must submit an NWRP.

(3) *Filing of additional plan.* Notwithstanding paragraph (a)(1) of this section, a credit union that has already submitted and is operating under a NWRP approved under this section is not required to submit an additional NWRP due to a change in net worth category (including by reclassification under § 702.102(b)), unless the NCUA Board notifies the credit union that it must submit a new NWRP. A credit union that is notified to submit a new or revised NWRP shall file the NWRP in writing with the appropriate Regional Director within 30 calendar days

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of receiving such notice, unless the NCUA Board notifies the credit union in writing that the NWRP is to be filed within a different period.

(4) *Failure to timely file plan.* When a credit union fails to timely file an NWRP pursuant to this paragraph, the NCUA Board shall promptly notify the credit union that it has failed to file an NWRP and that it has 15 calendar days from receipt of that notice within which to file an NWRP.

(b) *Assistance to small credit unions.* Upon timely request by a credit union having total assets of less than \$10 million (regardless how long it has been in operation), the NCUA Board shall provide assistance in preparing an NWRP required to be filed under paragraph (a) of this section.

(c) *Contents of NWRP.* An NWRP must—

(1) Specify—

(i) A quarterly timetable of steps the credit union will take to increase its net worth ratio so that it becomes “adequately capitalized” by the end of the term of the NWRP, and to remain so for four (4) consecutive calendar quarters. If “complex,” the credit union is subject to a risk-based net worth requirement that may require a net worth ratio higher than six percent (6%) to become “adequately capitalized”;

(ii) The projected amount of earnings to be transferred to the regular reserve account in each quarter of the term of the NWRP as required under § 702.201(a), or as permitted under § 702.201(b);

(iii) How the credit union will comply with the mandatory and any discretionary supervisory actions imposed on it by the NCUA Board under this subpart;

(iv) The types and levels of activities in which the credit union will engage; and

(v) If reclassified to a lower category under § 702.102(b), the steps the credit union will take to correct the unsafe or unsound practice(s) or condition(s);

(2) Include pro forma financial statements, including any off-balance sheet items, covering a minimum of the next two years; and

(3) Contain such other information as the NCUA Board has required.

(d) *Criteria for approval of NWRP.* The NCUA Board shall not accept a NWRP plan unless it—

(1) Complies with paragraph (c) of this section;

(2) Is based on realistic assumptions, and is likely to succeed in restoring the credit union’s net worth; and (3) Would not unreasonably increase the credit union’s exposure to risk (including credit risk, interest-rate risk, and other types of risk).

(e) *Consideration of regulatory capital.* To minimize possible long-term losses to the NCUSIF while the credit union takes steps to become “adequately capitalized,” the NCUA Board shall, in evaluating an NWRP under this section, consider the type and amount of any form of regulatory capital which may become established by NCUA regulation, or authorized by State law and recognized by NCUA, which the credit union holds, but which is not included in its net worth.

(f) *Review of NWRP*—(1) *Notice of decision.* Within 45 calendar days after receiving an NWRP under this part, the NCUA Board shall notify the credit union in writing whether the NWRP has been approved, and shall provide reasons for its decision in the event of disapproval.

(2) *Delayed decision.* If no decision is made within the time prescribed in paragraph (f)(1) of this section, the NWRP is deemed approved.

(3) *Consultation with State officials.* In the case of an NWRP submitted by a federally-insured State-chartered credit union (whether an original, new, additional, revised or amended NWRP), the NCUA Board shall, when evaluating the NWRP, seek and consider the views of the appropriate State official, and provide prompt notice of its decision to the appropriate State official.

(g) *NWRP not approved*—(1) *Submission of revised NWRP.* If an NWRP is rejected by the NCUA Board, the credit union shall submit a revised NWRP within 30 calendar days of receiving notice of disapproval, unless it is notified in writing by the NCUA Board that the revised NWRP is to be filed within a different period.

(2) *Notice of decision on revised NWRP.* Within 30 calendar days after receiving a revised NWRP under paragraph (g)(1)

of this section, the NCUA Board shall notify the credit union in writing whether the revised NWRP is approved. The Board may extend the time within which notice of its decision shall be provided.

(3) *Disapproval of reclassified credit union's NWRP.* A credit union which has been classified “significantly undercapitalized” under §702.102(a)(4)(ii) shall remain so classified pending NCUA Board approval of a new or revised NWRP.

(h) *Amendment of NWRP.* A credit union that is operating under an approved NWRP may, after prior written notice to, and approval by the NCUA Board, amend its NWRP to reflect a change in circumstance. Pending approval of an amended NWRP, the credit union shall implement the NWRP as originally approved.

(i) *Publication.* An NWRP need not be published to be enforceable because publication would be contrary to the public interest.

[65 FR 8584, Feb. 18, 2000, as amended at 67 FR 71092, Nov. 29, 2002]

EFFECTIVE DATE NOTE: At 80 FR 66706, Oct. 29, 2015, subpart B to part 702 was revised, effective January 1, 2019. For the convenience of the user, the revised text is set forth as follows:

Subpart B—Alternative Prompt Corrective Action for New Credit Unions

§ 702.201 Scope and definition.

(a) *Scope.* This subpart B applies in lieu of subpart A of this part exclusively to credit unions defined in paragraph (b) of this section as “new” pursuant to section 216(b)(2) of the FCUA, 12 U.S.C. 1790d(b)(2).

(b) *New credit union defined.* A “new” credit union for purposes of this subpart is a credit union that both has been in operation for less than ten (10) years and has total assets of not more than \$10 million. Once a credit union reports total assets of more than \$10 million on a Call Report, the credit union is no longer new, even if its assets subsequently decline below \$10 million.

(c) *Effect of spin-offs.* A credit union formed as the result of a “spin-off” of a group from the field of membership of an existing credit union is deemed to be in operation since the effective date of the spin-off. A credit union whose total assets decline below \$10 million because a group within its field of membership has been spun-off is deemed “new” if it has been in operation less than 10 years.

(d) *Actions to evade prompt corrective action.* If the NCUA Board determines that a credit union was formed, or was reduced in asset size as a result of a spin-off, or was merged, primarily to qualify as “new” under this subpart, the credit union shall be deemed subject to prompt corrective action under subpart A of this part.

§ 702.202 Net worth categories for new credit unions.

(a) *Net worth measures.* For purposes of this part, a new credit union must determine its capital classification quarterly according to its net worth ratio.

(b) *Effective date of net worth classification of new credit union.* For purposes of subpart B of this part, the effective date of a new credit union’s classification within a capital category in paragraph (c) of this section shall be determined as provided in §702.101(c); and written notice of a decline in net worth classification in paragraph (c) of this section shall be given as required by §702.101(c).

(c) *Net worth categories.* A credit union defined as “new” under this section shall be classified—

(1) *Well capitalized* if it has a net worth ratio of seven percent (7%) or greater;

(2) *Adequately capitalized* if it has a net worth ratio of six percent (6%) or more but less than seven percent (7%);

(3) *Moderately capitalized* if it has a net worth ratio of three and one-half percent (3.5%) or more but less than six percent (6%);

(4) *Marginally capitalized* if it has a net worth ratio of two percent (2%) or more but less than three and one-half percent (3.5%);

(5) *Minimally capitalized* if it has a net worth ratio of zero percent (0%) or greater but less than two percent (2%); and

(6) *Uncapitalized* if it has a net worth ratio of less than zero percent (0%).

TABLE 1 TO § 702.202—CAPITAL CATEGORIES FOR NEW CREDIT UNIONS

A new credit union's capital classification is	If it's net worth ratio is
Well Capitalized	7% or above.
Adequately Capitalized	6 to 7%.
Moderately Capitalized	3.5% to 5.99%.
Marginally Capitalized	2% to 3.49%.
Minimally Capitalized	0% to 1.99%.
Uncapitalized	Less than 0%.

(d) *Reclassification based on supervisory criteria other than net worth.* Subject to §702.102(b), the NCUA Board may reclassify a well capitalized, adequately capitalized or moderately capitalized new credit union to the next lower capital category (each of such actions is hereinafter referred to generally as “reclassification”) in either of the circumstances prescribed in §702.102(b).

(e) *Consultation with state officials.* The NCUA Board shall consult and seek to work

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cooperatively with the appropriate state official before reclassifying a federally insured state-chartered credit union under paragraph (d) of this section, and shall promptly notify the appropriate state official of its decision to reclassify.

§ 702.203 Prompt corrective action for adequately capitalized new credit unions.

Beginning on the effective date of classification, an adequately capitalized new credit union must increase the dollar amount of its net worth by the amount reflected in its approved initial or revised business plan in accordance with § 702.204(a)(2), or in the absence of such a plan, in accordance with § 702.106 until it is well capitalized.

§ 702.204 Prompt corrective action for moderately capitalized, marginally capitalized, or minimally capitalized new credit unions.

(a) *Mandatory supervisory actions by new credit union.* Beginning on the date of classification as moderately capitalized, marginally capitalized or minimally capitalized (including by reclassification under § 702.202(d)), a new credit union must—

(1) *Earnings retention.* Increase the dollar amount of its net worth by the amount reflected in its approved initial or revised business plan;

(2) *Submit revised business plan.* Submit a revised business plan within the time provided by § 702.206 if the credit union either:

(i) Has not increased its net worth ratio consistent with its then-present approved business plan;

(ii) Has no then-present approved business plan; or

(iii) Has failed to comply with paragraph (a)(3) of this section; and

(3) *Restrict member business loans.* Not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as of the preceding quarter-end unless it is granted an exception under 12 U.S.C. 1757a(b).

(b) *Discretionary supervisory actions by NCUA.* Subject to the applicable procedures set forth in subpart L of part 747 of this chapter for issuing, reviewing and enforcing directives, the NCUA Board may, by directive, take one or more of the actions prescribed in § 702.109(b) if the credit union's net worth ratio has not increased consistent with its then-present business plan, or the credit union has failed to undertake any mandatory supervisory action prescribed in paragraph (a) of this section.

(c) *Discretionary conservatorship or liquidation.* Notwithstanding any other actions required or permitted to be taken under this section, the NCUA Board may place a new credit union which is moderately capitalized, marginally capitalized or minimally capitalized (including by reclassification under

§ 702.202(d)) into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i), provided that the credit union has no reasonable prospect of becoming adequately capitalized.

§ 702.205 Prompt corrective action for uncapped new credit unions.

(a) *Mandatory supervisory actions by new credit union.* Beginning on the effective date of classification as uncapped, a new credit union must—

(1) *Earnings retention.* Increase the dollar amount of its net worth by the amount reflected in the credit union's approved initial or revised business plan;

(2) *Submit revised business plan.* Submit a revised business plan within the time provided by § 702.206, providing for alternative means of funding the credit union's earnings deficit, if the credit union either:

(i) Has not increased its net worth ratio consistent with its then-present approved business plan;

(ii) Has no then-present approved business plan; or

(iii) Has failed to comply with paragraph (a)(3) of this section; and

(3) *Restrict member business loans.* Not increase the total dollar amount of member business loans as provided in § 702.204(a)(3).

(b) *Discretionary supervisory actions by NCUA.* Subject to the procedures set forth in subpart L of part 747 of this chapter for issuing, reviewing and enforcing directives, the NCUA Board may, by directive, take one or more of the actions prescribed in § 702.109(b) if the credit union's net worth ratio has not increased consistent with its then-present business plan, or the credit union has failed to undertake any mandatory supervisory action prescribed in paragraph (a) of this section.

(c) *Mandatory liquidation or conservatorship.* Notwithstanding any other actions required or permitted to be taken under this section, the NCUA Board—

(1) *Plan not submitted.* May place into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(ii), or conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), an uncapped new credit union which fails to submit a revised business plan within the time provided under paragraph (a)(2) of this section; or

(2) *Plan rejected, approved, implemented.* Except as provided in paragraph (c)(3) of this section, must place into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(ii), or conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), an uncapped new credit union that remains uncapped one hundred twenty (120) calendar days after the later of:

(i) The effective date of classification as uncapped; or

(ii) The last day of the calendar month following expiration of the time period provided in the credit union's initial business

plan (approved at the time its charter was granted) to remain uncanceled, regardless whether a revised business plan was rejected, approved or implemented.

(3) *Exception.* The NCUA Board may decline to place a new credit union into liquidation or conservatorship as provided in paragraph (c)(2) of this section if the credit union documents to the NCUA Board why it is viable and has a reasonable prospect of becoming adequately capitalized.

(d) *Mandatory liquidation of uncanceled federal credit union.* In lieu of paragraph (c) of this section, an uncanceled federal credit union may be placed into liquidation on grounds of insolvency pursuant to 12 U.S.C. 1787(a)(1)(A).

§ 702.206 Revised business plans (RBP) for new credit unions.

(a) *Schedule for filing—(1) Generally.* Except as provided in paragraph (a)(2) of this section, a new credit union classified moderately capitalized or lower must file a written revised business plan (RBP) with the appropriate Regional Director and, if state-chartered, with the appropriate state official, within 30 calendar days of either:

(i) The last of the calendar month following the end of the calendar quarter that the credit union's net worth ratio has not increased consistent with the present approved business plan;

(ii) The effective date of classification as less than adequately capitalized if the credit union has no then-present approved business plan; or

(iii) The effective date of classification as less than adequately capitalized if the credit union has increased the total amount of member business loans in violation of § 702.204(a)(3).

(2) *Exception.* The NCUA Board may notify the credit union in writing that its RBP is to be filed within a different period or that it is not necessary to file an RBP.

(3) *Failure to timely file plan.* When a new credit union fails to file an RBP as provided under paragraphs (a)(1) or (a)(2) of this section, the NCUA Board shall promptly notify the credit union that it has failed to file an RBP and that it has 15 calendar days from receipt of that notice within which to do so.

(b) *Contents of revised business plan.* A new credit union's RBP must, at a minimum—

(1) Address changes, since the new credit union's current business plan was approved, in any of the business plan elements required for charter approval under chapter 1, section IV.D. of appendix B to part 701 of this chapter, or for state-chartered credit unions under applicable state law;

(2) Establish a timetable of quarterly targets for net worth during each year in which the RBP is in effect so that the credit union becomes adequately capitalized by the time it no longer qualifies as "new" per § 702.201;

(3) Specify the projected amount of earnings of net worth increases as provided under § 702.204(a)(1) or 702.205(a)(1);

(4) Explain how the new credit union will comply with the mandatory and discretionary supervisory actions imposed on it by the NCUA Board under this subpart;

(5) Specify the types and levels of activities in which the new credit union will engage;

(6) In the case of a new credit union reclassified to a lower category under § 702.202(d), specify the steps the credit union will take to correct the unsafe or unsound condition or practice; and

(7) Include such other information as the NCUA Board may require.

(c) *Criteria for approval.* The NCUA Board shall not approve a new credit union's RBP unless it—

(1) Addresses the items enumerated in paragraph (b) of this section;

(2) Is based on realistic assumptions, and is likely to succeed in building the credit union's net worth; and

(3) Would not unreasonably increase the credit union's exposure to risk (including credit risk, interest-rate risk, and other types of risk).

(d) *Consideration of regulatory capital.* To minimize possible long-term losses to the NCUSIF while the credit union takes steps to become adequately capitalized, the NCUA Board shall, in evaluating an RBP under this section, consider the type and amount of any form of regulatory capital which may become established by NCUA regulation, or authorized by state law and recognized by NCUA, which the credit union holds, but which is not included in its net worth.

(e) *Review of revised business plan—(1) Notice of decision.* Within 30 calendar days after receiving an RBP under this section, the NCUA Board shall notify the credit union in writing whether its RBP is approved, and shall provide reasons for its decision in the event of disapproval. The NCUA Board may extend the time within which notice of its decision shall be provided.

(2) *Delayed decision.* If no decision is made within the time prescribed in paragraph (e)(1) of this section, the RBP is deemed approved.

(3) *Consultation with state officials.* When evaluating an RBP submitted by a federally insured state-chartered new credit union (whether an original, new or additional RBP), the NCUA Board shall seek and consider the views of the appropriate state official, and provide prompt notice of its decision to the appropriate state official.

(f) *Plan not approved—(1) Submission of new revised plan.* If an RBP is rejected by the NCUA Board, the new credit union shall submit a new RBP within 30 calendar days of receiving notice of disapproval of its initial RBP, unless it is notified in writing by the

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NCUA Board that the new RBP is to be filed within a different period.

(2) *Notice of decision on revised plan.* Within 30 calendar days after receiving an RBP under paragraph (f)(1) of this section, the NCUA Board shall notify the credit union in writing whether the new RBP is approved. The Board may extend the time within which notice of its decision shall be provided.

(3) *Submission of multiple unapproved RBPs.* The submission of more than two RBPs that are not approved is considered an unsafe and unsound condition and may subject the credit union to administrative enforcement action pursuant to section 206 of the FCUA, 12 U.S.C. 1786 and 1790d.

(g) *Amendment of plan.* A credit union that has filed an approved RBP may, after prior written notice to and approval by the NCUA Board, amend it to reflect a change in circumstance. Pending approval of an amended RBP, the new credit union shall implement its existing RBP as originally approved.

(h) *Publication.* An RBP need not be published to be enforceable because publication would be contrary to the public interest.

§ 702.207 Incentives for new credit unions.

(a) *Assistance in revising business plans.* Upon timely request by a credit union having total assets of less than \$10 million (regardless how long it has been in operation), the NCUA Board shall provide assistance in preparing a revised business plan required to be filed under § 702.206.

(b) *Assistance.* Management training and other assistance to new credit unions will be provided in accordance with policies approved by the NCUA Board.

(c) *Small credit union program.* A new credit union is eligible to join and receive comprehensive benefits and assistance under NCUA's Small Credit Union Program.

§ 702.208 Reserves.

Each new credit union shall establish and maintain such reserves as may be required by the FCUA, by state law, by regulation, or in special cases by the NCUA Board or appropriate state official.

§ 702.209 Full and fair disclosure of financial condition.

(a) *Full and fair disclosure defined.* "Full and fair disclosure" is the level of disclosure which a prudent person would provide to a member of a new credit union, to NCUA, or, at the discretion of the board of directors, to creditors to fairly inform them of the financial condition and the results of operations of the credit union.

(b) *Full and fair disclosure implemented.* The financial statements of a new credit union shall provide for full and fair disclosure of all assets, liabilities, and members' equity, including such valuation (allowance) ac-

counts as may be necessary to present fairly the financial condition; and all income and expenses necessary to present fairly the statement of income for the reporting period.

(c) *Declaration of officials.* The Statement of Financial Condition, when presented to members, to creditors or to NCUA, shall contain a dual declaration by the treasurer and the chief executive officer, or in the latter's absence, by any other officer designated by the board of directors of the reporting credit union to make such declaration, that the report and related financial statements are true and correct to the best of their knowledge and belief and present fairly the financial condition and the statement of income for the period covered.

(d) *Charges for loan and lease losses.* Full and fair disclosure demands that a new credit union properly address charges for loan losses as follows:

(1) Charges for loan and lease losses shall be made timely in accordance with generally accepted accounting principles (GAAP);

(2) The ALLL must be maintained in accordance with GAAP; and

(3) At a minimum, adjustments to the ALLL shall be made prior to the distribution or posting of any dividend to the accounts of members.

§ 702.210 Payment of dividends.

(a) *Restriction on dividends.* Dividends shall be available only from net worth, net of any special reserves established under § 702.208, if any.

(b) *Payment of dividends and interest refunds.* The board of directors may not pay a dividend or interest refund that will cause the credit union's capital classification to fall below adequately capitalized under subpart A of this part unless the appropriate regional director and, if state-chartered, the appropriate state official, have given prior written approval (in an RBP or otherwise). The request for written approval must include the plan for eliminating any negative retained earnings balance.

Subpart C—Alternative Prompt Corrective Action for New Credit Unions

EFFECTIVE DATE NOTE: At 80 FR 66722, Oct. 29, 2015, subpart C to part 702 was removed, effective January 1, 2019.

§ 702.301 Scope and definition.

(a) *Scope.* This subpart C applies in lieu of subpart B of this part exclusively to credit unions defined in paragraph (b) of this section as "new" pursuant to 12 U.S.C. 1790d(b)(2).

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(b) *New credit union defined.* A “new” credit union for purposes of this subpart is a federally-insured credit union that both has been in operation for less than ten (10) years and has total assets of not more than \$10 million. A credit union which exceeds \$10 million in total assets may become “new” if its total assets subsequently decline below \$10 million while it is still in operation for less than 10 years.

(c) *Effect of spin-offs.* A credit union formed as the result of a “spin-off” of a group from the field of membership of an existing credit union is deemed to be in operation since the effective date of the “spin-off.” A credit union whose total assets decline below \$10 million because a group within its field of membership has been “spun-off” is deemed “new” if it has been in operation less than 10 years.

(d) *Actions to evade prompt corrective action.* If the NCUA Board determines that a credit union was formed, or was reduced in asset size as a result of a “spin-off,” or was merged, primarily to qualify as “new” under this subpart, the credit union shall be deemed subject to prompt corrective action under subpart A of this part.

§ 702.302 Net worth categories for new credit unions.

(a) *Net worth measures.* For purposes of this part, a new credit union must determine its net worth category classification quarterly according to its net worth ratio as defined in §702.2(g).

(b) *Effective date of net worth classification of new credit union.* For purposes of subpart C, the effective date of a new federally-insured credit union’s classification within a net worth category in paragraph (c) of this section shall be determined as provided in §702.101(b); and written notice to the NCUA Board of a decline in net worth category in paragraph (c) of this section shall be given as required by section 702.101(c).

(c) *Net worth categories.* A federally-insured credit union defined as “new” under this section shall be classified (Table 6)—

(1) *Well capitalized* if it has a net worth ratio of seven percent (7%) or greater;

(2) *Adequately capitalized* if it has a net worth ratio of six percent (6%) or more but less than seven percent (7%);

(3) *Moderately capitalized* if it has a net worth ratio of three and one-half percent (3.5%) or more but less than six percent (6%);

(4) *Marginally capitalized* if it has a net worth ratio of two percent (2%) or more but less than three and one-half percent (3.5%);

(5) *Minimally capitalized* if it has a net worth ratio of zero percent (0%) or greater but less than two percent (2%); and

(6) *Uncapitalized* if it has a net worth ratio of less than zero percent (0%) (*e.g.*, a deficit in retained earnings).

TABLE 6 -- NET WORTH CATEGORY CLASSIFICATION FOR “NEW” CREDIT UNIONS

A “new” credit union’s net worth category is . . .	if its net worth ratio is . . .
“Well Capitalized”	7% or above
“Adequately Capitalized”	6% to 6.99%
“Moderately Capitalized”	3.5% to 5.99%
“Marginally Capitalized”	2% to 3.49%
“Minimally Capitalized”	0% to 1.99%
“Uncapitalized”	Less than 0%

(d) *Reclassification based on supervisory criteria other than net worth.* Subject to §702.102(b) and (c), the NCUA Board may reclassify a “well capital-

ized,” “adequately capitalized” or “moderately capitalized” new credit

union to the next lower net worth category (each of such actions is hereinafter referred to generally as “reclassification”) in either of the circumstances prescribed in §702.102(b).

(e) *Consultation with State officials.* The NCUA Board shall consult and seek to work cooperatively with the appropriate State official before reclassifying a federally-insured State-chartered credit union under paragraph (d) of this section, and shall promptly notify the appropriate State official of its decision to reclassify.

[65 FR 8584, Feb. 18, 2000, as amended at 65 FR 44974, July 20, 2000; 65 FR 55439, Sept. 14, 2000; 67 FR 71092, Nov. 29, 2002]

§ 702.303 Prompt corrective action for “adequately capitalized” new credit unions.

Beginning on the effective date of classification, an “adequately capitalized” new credit union must increase the dollar amount of its net worth by the amount reflected in its approved initial or revised business plan in accordance with §702.304(a)(2), or in the absence of such a plan, in accordance with §702.201, and quarterly transfer that amount from undivided earnings to its regular reserve account, until it is “well capitalized.”

[67 FR 71092, Nov. 29, 2002]

§ 702.304 Prompt corrective action for “moderately capitalized,” “marginally capitalized” or “minimally capitalized” new credit unions.

(a) *Mandatory supervisory actions by new credit union.* Beginning on the date of classification as “moderately capitalized,” “marginally capitalized” or “minimally capitalized” (including by reclassification under §702.302(d)), a new credit union must—

(1) *Earnings retention.* Increase the dollar amount of its net worth by the amount reflected in its approved initial or revised business plan and quarterly transfer that amount from undivided earnings to its regular reserve account;

(2) *Submit revised business plan.* Submit a revised business plan within the time provided by §702.306 if the credit union either:

(i) Has not increased its net worth ratio consistent with its then-present approved business plan;

(ii) Has no then-present approved business plan; or

(iii) Has failed to comply with paragraph (a)(3) of this section; and

(3) *Restrict member business loans.* Not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as of the preceding quarter-end unless it is granted an exception under 12 U.S.C. 1757a(b).

(b) *Discretionary supervisory actions by NCUA.* Subject to the applicable procedures set forth in subpart L of part 747 of this chapter for issuing, reviewing and enforcing directives, the NCUA Board may, by directive, take one or more of the actions prescribed in §702.204(b) if the credit union’s net worth ratio has not increased consistent with its then-present business plan, or the credit union has failed to undertake any mandatory supervisory action prescribed in paragraph (a) of this section.

(c) *Discretionary conservatorship or liquidation.* Notwithstanding any other actions required or permitted to be taken under this section, the NCUA Board may place a new credit union which is “moderately capitalized,” “marginally capitalized” or “minimally capitalized” (including by reclassification under §702.302(d)) into conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(i), provided that the credit union has no reasonable prospect of becoming “adequately capitalized.”

[65 FR 8584, Feb. 18, 2000, as amended at 67 FR 71093, Nov. 29, 2002]

§ 702.305 Prompt corrective action for “uncapitalized” new credit unions.

(a) *Mandatory supervisory actions by new credit union.* Beginning on the effective date of classification as “uncapitalized,” a new credit union must—

(1) *Earnings retention.* Increase the dollar amount of its net worth by the amount reflected in the credit union’s approved initial or revised business plan;

(2) *Submit revised business plan.* Submit a revised business plan within the time provided by § 702.306, providing for alternative means of funding the credit

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union's earnings deficit, if the credit union either:

(i) Has not increased its net worth ratio consistent with its then-present approved business plan;

(ii) Has no then-present approved business plan; or

(iii) Has failed to comply with paragraph (a)(3) of this section; and

(3) *Restrict member business loans.* Not increase the total dollar amount of member business loans as provided in § 702.304(a)(3).

(b) *Discretionary supervisory actions by NCUA.* Subject to the procedures set forth in subpart L of part 747 of this chapter for issuing, reviewing and enforcing directives, the NCUA Board may, by directive, take one or more of the actions prescribed in § 702.204(b) if the credit union's net worth ratio has not increased consistent with its then-present business plan, or the credit union has failed to undertake any mandatory supervisory action prescribed in paragraph (a) of this section.

(c) *Mandatory liquidation or conservatorship.* Notwithstanding any other actions required or permitted to be taken under this section, the NCUA Board—

(1) *Plan not submitted.* May place into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(ii), or conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), an “uncapitalized” new credit union which fails to submit a revised business plan within the time provided under paragraph (a)(2) of this section; or

(2) *Plan rejected, approved, implemented.* Except as provided in paragraph (c)(3) of this section, must place into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A)(ii), or conservatorship pursuant to 12 U.S.C. 1786(h)(1)(F), an “uncapitalized” new credit union that remains “uncapitalized” one hundred twenty (120) calendar days after the later of:

(i) The effective date of classification as “uncapitalized”; or

(ii) The last day of the calendar month following expiration of the time period provided in the credit union's initial business plan (approved at the time its charter was granted) to remain “uncapitalized,” regardless whether a revised business plan was rejected, approved or implemented.

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(3) *Exception.* The NCUA Board may decline to place a new credit union into liquidation or conservatorship as provided in paragraph (c)(2) of this section if the credit union documents to the NCUA Board why it is viable and has a reasonable prospect of becoming “adequately capitalized.”

(d) *Mandatory liquidation of “uncapitalized” federal credit union.* In lieu of paragraph (c) of this section, an “uncapitalized” federal credit union may be placed into liquidation on grounds of insolvency pursuant to 12 U.S.C. 1787(a)(1)(A).

[65 FR 8584, Feb. 18, 2000, as amended at 67 FR 71093, Nov. 29, 2002]

§ 702.306 Revised business plans for new credit unions.

(a) *Schedule for filing—(1) Generally.* Except as provided in paragraph (a)(2) of this section, a new credit union classified “moderately capitalized” or lower must file a written revised business plan (RBP) with the appropriate Regional Director and, if State-chartered, with the appropriate State official, within 30 calendar days of either:

(i) The last of the calendar month following the end of the calendar quarter that the credit union's net worth ratio has not increased consistent with its then-present approved business plan;

(ii) The effective date of classification as less than “adequately capitalized” if the credit union has no then-present approved business plan; or

(iii) The effective date of classification as less than “adequately capitalized” if the credit union has increased the total amount of member business loans in violation of § 702.304(a)(3).

(2) *Exception.* The NCUA Board may notify the credit union in writing that its RBP is to be filed within a different period or that it is not necessary to file an RBP.

(3) *Failure to timely file plan.* When a new credit union fails to file an RBP as provided under paragraphs (a)(1) or (a)(2) of this section, the NCUA Board shall promptly notify the credit union that it has failed to file an RBP and that it has 15 calendar days from receipt of that notice within which to do so.

(b) *Contents of revised business plan.* A new credit union's RBP must, at a minimum—

(1) Address changes, since the new credit union's current business plan was approved, in any of the business plan elements required for charter approval under Chapter 1, section IV.D. of NCUA's *Chartering and Field of Membership Manual* (IRPS 99-1), 63 FR 71998, 72019 (Dec. 30, 1998), or its successor(s), or for State-chartered credit unions under applicable State law;

(2) Establish a timetable of quarterly targets for net worth during each year in which the RBP is in effect so that the credit union becomes "adequately capitalized" by the time it no longer qualifies as "new" per § 702.301(b);

(3) Specify the projected amount of earnings to be transferred quarterly to its regular reserve as provided under § 702.304(a)(1) or 702.305(a)(1);

(4) Explain how the new credit union will comply with the mandatory and discretionary supervisory actions imposed on it by the NCUA Board under this subpart;

(5) Specify the types and levels of activities in which the new credit union will engage;

(6) In the case of a new credit union reclassified to a lower category under § 702.302(d), specify the steps the credit union will take to correct the unsafe or unsound condition or practice; and

(7) Include such other information as the NCUA Board may require.

(c) *Criteria for approval.* The NCUA Board shall not approve a new credit union's RBP unless it—

(1) Addresses the items enumerated in paragraph (b) of this section;

(2) Is based on realistic assumptions, and is likely to succeed in building the credit union's net worth; and

(3) Would not unreasonably increase the credit union's exposure to risk (including credit risk, interest-rate risk, and other types of risk).

(d) *Consideration of regulatory capital.* To minimize possible long-term losses to the NCUSIF while the credit union takes steps to become "adequately capitalized," the NCUA Board shall, in evaluating an RBP under this section, consider the type and amount of any form of regulatory capital which may become established by NCUA regula-

tion, or authorized by State law and recognized by NCUA, which the credit union holds, but which is not included in its net worth.

(e) *Review of revised business plan—(1) Notice of decision.* Within 30 calendar days after receiving an RBP under this section, the NCUA Board shall notify the credit union in writing whether its RBP is approved, and shall provide reasons for its decision in the event of disapproval. The NCUA Board may extend the time within which notice of its decision shall be provided.

(2) *Delayed decision.* If no decision is made within the time prescribed in paragraph (e)(1) of this section, the RBP is deemed approved.

(3) *Consultation with State officials.* When evaluating an RBP submitted by a federally-insured State-chartered new credit union (whether an original, new or additional RBP), the NCUA Board shall seek and consider the views of the appropriate State official, and provide prompt notice of its decision to the appropriate State official.

(f) *Plan not approved—(1) Submission of new revised plan.* If an RBP is rejected by the NCUA Board, the new credit union shall submit a new RBP within 30 calendar days of receiving notice of disapproval of its initial RBP, unless it is notified in writing by the NCUA Board that the new RBP is to be filed within a different period.

(2) *Notice of decision on revised plan.* Within 30 calendar days after receiving an RBP under paragraph (f)(1) of this section, the NCUA Board shall notify the credit union in writing whether the new RBP is approved. The Board may extend the time within which notice of its decision shall be provided.

(g) *Amendment of plan.* A credit union that has filed an approved RBP may, after prior written notice to and approval by the NCUA Board, amend it to reflect a change in circumstance. Pending approval of an amended RBP, the new credit union shall implement its existing RBP as originally approved.

(h) *Publication.* An RBP need not be published to be enforceable because publication would be contrary to the public interest.

[65 FR 8584, Feb. 18, 2000, as amended at 67 FR 71093, Nov. 29, 2002]

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§ 702.307 Incentives for new credit unions.

(a) *Assistance in revising business plans.* Upon timely request by a credit union having total assets of less than \$10 million (regardless how long it has been in operation), the NCUA Board shall provide assistance in preparing a revised business plan required to be filed under § 702.306.

(b) *Assistance.* Management training and other assistance to new credit unions will be provided in accordance with policies approved by the NCUA Board.

(c) *Small credit union program.* A new credit union is eligible to join and receive comprehensive benefits and assistance under NCUA's Small Credit Union Program.

Subpart D—Reserves

EFFECTIVE DATE NOTE: At 80 FR 66722, Oct. 29, 2015, subpart D to part 702 was removed, effective January 1, 2019.

§ 702.401 Reserves.

(a) *Special reserve.* Each federally-insured credit union shall establish and maintain such reserves as may be required by the FCUA, by state law, by regulation, or in special cases by the NCUA Board or appropriate State official.

(b) *Regular reserve.* Each federally-insured credit union shall establish and maintain a regular reserve account for the purpose of absorbing losses that exceed undivided earnings and other appropriations of undivided earnings, subject to paragraph (c) of this section. Earnings required to be transferred annually to a credit union's regular reserve under subparts B or C of this part shall be held in this account.

(c) *Charges to regular reserve after depleting undivided earnings.* The board of directors of a federally-insured credit union may authorize losses to be charged to the regular reserve after first depleting the balance of the undivided earnings account and other reserves, provided that the authorization states the amount and provides an explanation of the need for the charge, and either—

(1) The charge will not cause the credit union's net worth classification

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to fall below “adequately capitalized” under subparts B or C of this part; or

(2) If the charge will cause the net worth classification to fall below “adequately capitalized,” the appropriate Regional Director and, if State-chartered, the appropriate State official, have given written approval (in an NWRP or otherwise) for the charge.

(d) *Transfers to regular reserve.* The transfer of earnings to a federally-insured credit union's regular reserve account when required under subparts B or C of this part must occur after charges for loan or other losses are addressed as provided in paragraph (c) of this section and § 702.402(d), but before payment of any dividends to members.

[65 FR 8584, Feb. 18, 2000, as amended at 67 FR 71093, Nov. 29, 2002]

§ 702.402 Full and fair disclosure of financial condition.

(a) *Full and fair disclosure defined.* “Full and fair disclosure” is the level of disclosure which a prudent person would provide to a member of a federally-insured credit union, to NCUA, or, at the discretion of the board of directors, to creditors to fairly inform them of the financial condition and the results of operations of the credit union.

(b) *Full and fair disclosure implemented.* The financial statements of a federally-insured credit union shall provide for full and fair disclosure of all assets, liabilities, and members' equity, including such valuation (allowance) accounts as may be necessary to present fairly the financial condition; and all income and expenses necessary to present fairly the statement of income for the reporting period.

(c) *Declaration of officials.* The Statement of Financial Condition, when presented to members, to creditors or to the NCUA, shall contain a dual declaration by the treasurer and the chief executive officer, or in the latter's absence, by any other officer designated by the board of directors of the reporting credit union to make such declaration, that the report and related financial statements are true and correct to the best of their knowledge and belief and present fairly the financial condition and the statement of income for the period covered.

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(d) *Charges for loan losses.* Full and fair disclosure demands that a credit union properly address charges for loan losses as follows:

(1) Charges for loan losses shall be made in accordance with generally accepted accounting principles (GAAP);

(2) The allowance for loan and lease losses (ALL) established for loans must fairly present the probable losses for all categories of loans and the proper valuation of loans. The valuation allowance must encompass specifically identified loans, as well as estimated losses inherent in the loan portfolio, such as loans and pools of loans for which losses have been incurred but are not identifiable on a specific loan-by-loan basis;

(3) Adjustments to the valuation ALL will be recorded in the expense account "Provision for Loan and Lease Losses";

(4) The maintenance of an ALL shall not affect the requirement to transfer earnings to a credit union's regular reserve when required under subparts B or C of this part; and

(5) At a minimum, adjustments to the ALL shall be made prior to the distribution or posting of any dividend to the accounts of members.

§ 702.403 Payment of dividends.

(a) *Restriction on dividends.* Dividends shall be available only from undivided earnings, if any.

(b) *Payment of dividends if undivided earnings depleted.* The board of directors of a "well capitalized" federally-insured credit union that has depleted the balance of its undivided earnings account may authorize a transfer of funds from the credit union's regular reserve account to undivided earnings to pay dividends, provided that either—

(1) The payment of dividends will not cause the credit union's net worth classification to fall below "adequately capitalized" under subpart B or C of this part; or

(2) If the payment of dividends will cause the net worth classification to fall below "adequately capitalized," the appropriate Regional Director and, if State-chartered, the appropriate State official, have given prior written

approval (in an NWRP or otherwise) to pay a dividend.

[65 FR 8584, Feb. 18, 2000, as amended at 67 FR 71093, Nov. 29, 2002]

Subpart E—Capital Planning and Stress Testing

SOURCE: 79 FR 24315, Apr. 30, 2014, unless otherwise noted.

EFFECTIVE DATE NOTE: At 80 FR 66722, Oct. 29, 2015, subpart E to part 702 was redesignated as subpart C, effective January 1, 2019.

§ 702.501 Authority, purpose, and reservation of authority.

(a) *Authority.* This subpart is issued by the National Credit Union Administration (NCUA).

(b) *Purpose.* This subpart requires covered credit unions to develop and maintain capital plans and describes stress testing requirements and actions on covered credit union capital plans.

(c) *Reservation of authority.* Notwithstanding any other provisions of this subpart, NCUA may modify some or all of the requirements of this subpart. Any exercise of authority under this section by NCUA will be in writing and will consider the financial condition, size, complexity, risk profile, scope of operations, and level of capital of the covered credit union, in addition to any other relevant factors. Nothing in this subpart limits the authority of NCUA under any other provision of law or regulation to take supervisory or enforcement action, including action to address unsafe and unsound practices or conditions, or violations of law or regulation.

§ 702.502 Definitions.

For purposes of this subpart—

Adverse scenario means a scenario that is more adverse than that associated with the baseline scenario.

Baseline scenario means a scenario that reflects the consensus views of the economic and financial outlook.

Capital plan means a written presentation of a covered credit union's capital planning strategies and capital adequacy process that includes the mandatory elements set forth in this subpart.

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Capital planning process means development of a capital policy and formulation of a capital plan that conforms to this part.

Covered credit union means a federally insured credit union whose assets are \$10 billion or more. A credit union that crosses the asset threshold as of March 31 of a given calendar year is subject to the capital planning and stress testing requirements of this subpart in the following calendar year.

Planning horizon means the period of 3 years over which capital planning projections extend.

Pre-provision net revenue means the sum of net interest income and non-interest income, less expenses, before adjusting for loss provisions.

Provision for loan and lease losses means the provision for loan and lease losses as reported by the covered credit union on its Call Report.

Reverse stress test means a test that defines severely unfavorable outcomes and then identifies events or scenarios that lead to these outcomes. Examples of severely unfavorable outcomes are breaching regulatory capital, failing to meet obligations, or being unable to continue independent operations.

Scenarios are those sets of conditions that affect the U.S. economy or the financial condition of a covered credit union that serve as the basis for stress testing, including, but not limited to, NCUA-established baseline, adverse, and severely adverse scenarios.

Sensitivity testing means testing the relationship between specific variables, parameters, and inputs and their impacts on analytical results.

Severely adverse scenario means a scenario that overall is more severe than that associated with the adverse scenario.

Stress test means the process to assess the potential impact of expected and stressed economic conditions on the consolidated earnings, losses, and capital of a covered credit union over the planning horizon, taking into account the current state of the covered credit union and the covered credit union's risks, exposures, strategies, and activities.

Stress test capital means net worth (less assistance provided under Section 208 of the Federal Credit Union Act,

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subordinated debt included in net worth, and NCUSIF deposit) under stress test scenarios.

Stress test capital ratio means a covered credit union's stress test capital divided by its total consolidated assets less NCUSIF deposit.

[79 FR 24315, Apr. 30, 2014, as amended at 80 FR 48012, Aug. 11, 2015]

§ 702.503 Capital policy.

(a) *General requirements.* The extent and sophistication of a covered credit union's governance over its capital planning and analysis process must align with the extent and sophistication of that process. The process must be consistent with the financial condition, size, complexity, risk profile, scope of operations, and level of capital of the covered credit union. The ultimate responsibility for governance over a covered credit union's capital planning and analysis process rests with the credit union's board of directors. Senior management must establish a comprehensive, integrated, and effective process that fits into the broader risk management of the credit union. Senior management responsible for capital planning and analysis must provide regular reports on capital planning and analysis to the credit union's board of directors (or a designated committee of the board).

(b) *Mandatory elements.* A covered credit union's board of directors (or a designated committee of the board) must review and approve a capital policy, along with procedures to implement it. The capital policy must:

(1) State goals and limits for capital levels and risk exposure.

(2) Establish requirements for reviewing and reporting capital levels and breaches of capital limits, with contingency plans for remedying any breaches.

(3) State the governance over the capital analysis process, including all the activities that contribute to the analysis;

(4) Specify capital analysis roles and responsibilities, including controls over external resources used for any part of capital analysis (such as vendors and data providers);

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(5) Specify the internal controls that govern capital planning, including review by internal audit, control of changes in capital planning procedures, and required documentation;

(6) Describe the frequency with which capital analyses will be conducted;

(7) State how capital analysis results are used and by whom; and

(8) Be reviewed at least annually and updated as necessary to ensure that it remains current with changes in market conditions, credit union products and strategies, credit union risk exposures and activities, the credit union's established risk appetite, and industry practices.

§ 702.504 Capital planning.

(a) *Annual capital planning.* (1) A covered credit union must develop and maintain a capital plan. It must submit this plan and its capital policy to NCUA by May 31 each year, or such later date as directed by NCUA. The plan must be based on the credit union's financial data as of December 31 of the preceding calendar year, or such other date as directed by NCUA. NCUA will assess whether the capital planning and analysis process is sufficiently robust in determining whether to accept a credit union's capital plan.

(2) [Reserved]

(b) *Mandatory elements.* A capital plan must contain at least the following elements:

(1) A quarterly assessment of the expected sources and levels of stress test capital over the planning horizon that reflects the covered credit union's financial state, size, complexity, risk profile, scope of operations, and existing level of capital, assuming both expected and unfavorable conditions, including:

(i) Estimates of projected revenues, losses, reserves, and pro forma capital levels, over each quarter of the planning horizon under expected and unfavorable conditions; and

(ii) A detailed description of the credit union's process for assessing capital adequacy;

(2) A discussion of how the credit union will, under expected and unfavorable conditions, maintain stress test capital commensurate with all of its

risks, including reputational, strategic, legal, and compliance risks;

(3) A discussion of how the credit union will, under expected and unfavorable conditions, maintain ready access to funding, meet its obligations to all creditors and other counterparties, and continue to serve as an intermediary for its members;

(4) If the credit union conducts its own stress test under § 702.506(c), a discussion of how the credit union will maintain a stress test capital ratio of 5 percent or more under baseline, adverse, and severely adverse conditions in each quarter of the 9-quarter horizon;

(5) A discussion of any expected changes to the credit union's business plan that are likely to have a material impact on the credit union's capital adequacy and liquidity; and

(6) A program to:

(i) Conduct sensitivity testing to analyze the effect on the credit union's stress test capital of changes in variables, parameters, and inputs used by the credit union in preparing its capital plan;

(ii) Conduct reverse stress testing to identify events and circumstances that cause severely unfavorable outcomes for the credit union; and

(iii) Analyze the impact of credit risk and interest rate risk to capital under unfavorable economic conditions, both separately and in combination with each other.

[79 FR 24315, Apr. 30, 2014, as amended at 80 FR 48012, Aug. 11, 2015]

EFFECTIVE DATE NOTE: At 80 FR 66722, Oct. 29, 2015, § 702.504 was amended in paragraph (b)(4) by removing the citation “§ 702.506(c)” and adding in its place “§ 702.306(c)”, effective January 1, 2019.

§ 702.505 NCUA action on capital plans.

(a) *Timing.* NCUA will notify the covered credit union of the acceptance or rejection of its capital plan by August 31 of the year in which the credit union submitted its plan.

(b) *Grounds for rejection of capital plan.* NCUA may reject a capital plan if it determines that:

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(1) The covered credit union has material unresolved supervisory issues associated with its capital planning process;

(2) The capital analysis underlying the covered credit union's capital plan, or the covered credit union's methodologies for reviewing the robustness of its capital adequacy, are not reasonable or appropriate;

(3) Data utilized for the capital analysis is insufficiently detailed to capture the risks of the covered credit union, or the data lacks integrity;

(4) The plan does not meet all of the requirements of § 702.504;

(5) Unacceptable weakness in the capital plan or policy, the capital planning analysis, or any critical system or process supporting capital analysis;

(6) The covered credit union's capital planning process constitutes an unsafe or unsound practice, or would violate any law, regulation, NCUA order, directive, or any condition imposed by, or written agreement with, NCUA. In determining whether a capital plan would constitute an unsafe or unsound practice, NCUA considers whether the covered credit union is and would remain in sound financial condition after giving effect to the capital plan.

(c) *Notification in writing.* NCUA will notify the credit union in writing of the reasons for a decision to reject a capital plan.

(d) *Resubmission of a capital plan.* If NCUA rejects a credit union's capital plan, the credit union must update and resubmit an acceptable capital plan to NCUA by November 30 of the year in which the credit union submitted its plan. The resubmitted capital plan must, at a minimum, address:

(1) NCUA-noted deficiencies in the credit union's original capital plan or policy; and

(2) Remediation plans for unresolved supervisory issues contributing to the rejection of the credit union's original capital plan.

(e) *Supervisory actions.* Any covered credit union operating without a capital plan accepted by NCUA may be subject to supervisory actions on the part of NCUA.

(f) *Consultation on proposed action.* Before taking any action under this section on the capital plan of a federally

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insured, state-chartered credit union, NCUA will consult and work cooperatively with the appropriate State official.

[79 FR 24315, Apr. 30, 2014, as amended at 80 FR 48012, Aug. 11, 2015]

EFFECTIVE DATE NOTE: At 80 FR 66722, Oct. 29, 2015, § 702.505 was amended in paragraph (b)(4) by removing the citation “§ 702.504” and adding in its place “§ 702.304”, effective January 1, 2019.

§ 702.506 Annual supervisory stress testing.

(a) *General requirements.* The supervisory stress tests consist of baseline, adverse, and severely adverse scenarios, which NCUA will provide by February 28 of each year. The tests will be based on the credit union's financial data as of December 31 of the preceding calendar year, or such other date as directed by NCUA. The tests will take into account all relevant exposures and activities of a credit union to evaluate its ability to absorb losses in specified scenarios over a 9-quarter horizon. The minimum stress test capital ratio is 5 percent.

(b) *NCUA-run tests.* Except as provided in paragraph (c) of this section, NCUA will conduct the tests described in this section.

(c) *Credit union-run tests under NCUA supervision.* After NCUA has completed three consecutive supervisory stress tests of a covered credit union, the covered credit union may, with NCUA approval, conduct the tests described in this subpart. A covered credit union must submit its request to NCUA to conduct its own stress test by November 30 for the following annual cycle. NCUA will approve or decline the credit union's request by December 31 of the year in which the credit union submitted its request. NCUA reserves the right to conduct the tests described in this section on any covered credit union at any time. Where both NCUA and a covered credit union have conducted the tests, the results of NCUA's tests will determine whether the covered credit union has met the requirements of this subpart.

(d) *Potential impact on capital.* In conducting stress tests under this subpart, NCUA or the covered credit union will

estimate the following for each scenario during each quarter of the stress test horizon:

(1) Losses, pre-provision net revenues, loan and lease loss provisions, and net income; and

(2) The potential impact on the stress test capital ratio, incorporating the effects of any capital action over the 9-quarter stress test horizon and maintenance of an allowance for loan losses appropriate for credit exposures throughout the horizon. NCUA or the covered credit union will conduct the stress tests without assuming any risk mitigation actions on the part of the covered credit union, except those existing and identified as part of the covered credit union's balance sheet, or off-balance sheet positions, such as asset sales or derivatives positions, on the date of the stress test.

(e) *Information collection.* Upon request, the covered credit union must provide NCUA with any relevant qualitative or quantitative information requested by NCUA pertinent to the stress tests under this subpart.

(f) *Stress test results.* NCUA will provide each covered credit union with the results of the stress tests by August 31 of the year in which it conducted the tests. A credit union conducting its own stress tests must incorporate the test results in its capital plan.

(g) *Supervisory actions.* If NCUA-run stress tests show that a covered credit union does not have the ability to maintain a stress test capital ratio of 5 percent or more under expected and stressed conditions in each quarter of the 9-quarter horizon, the credit union must provide NCUA, by November 30 of the calendar year in which NCUA conducted the tests, a stress test capital enhancement plan showing how it will meet that target. If credit union-run stress tests show that a covered credit union does not have the ability to maintain a stress test capital ratio of 5 percent or more under expected and stressed conditions in each quarter of the 9-quarter horizon, the credit union must incorporate a stress test capital enhancement plan into its capital plan. Any affected credit union operating without a stress test capital enhancement plan accepted by NCUA may be subject to supervisory actions.

(h) *Consultation on proposed action.* Before taking any action under this section against a federally insured, state-chartered credit union, NCUA will consult and work cooperatively with the appropriate State official.

[79 FR 24315, Apr. 30, 2014, as amended at 80 FR 48012, Aug. 11, 2015]

APPENDIX A TO PART 702—GROSS-UP APPROACH, AND LOOK-THROUGH APPROACHES

Instead of using the risk weights assigned in §702.104(c)(2) a credit union may determine the risk weight of certain investment funds, and the risk weight of a non-subordinated or subordinated tranche of any investment as follows:

(a) *Gross-up approach*—(1) *Applicability.* Section 702.104(c)(3)(iii)(A) of this part provides that, a credit union may use the gross-up approach in this appendix to determine the risk weight of the carrying value of non-subordinated or subordinated tranches of any investment.

(2) *Calculation.* To use the gross-up approach, a credit union must calculate the following four inputs:

(i) Pro rata share, which is the par value of the credit union's exposure as a percent of the par value of the tranche in which the securitization exposure resides;

(ii) Enhanced amount, which is the par value of tranches that are more senior to the tranche in which the credit union's securitization resides;

(iii) Exposure amount, which is the amortized cost for investments classified as held-to-maturity and available-for-sale, and the fair value for trading securities; and

(iv) Risk weight, which is the weighted-average risk weight of underlying exposures of the securitization as calculated under this appendix.

(3) *Credit equivalent amount.* The "credit equivalent amount" of a securitization exposure under this part equals the sum of:

(i) The exposure amount of the credit union's exposure; and

(ii) The pro rata share multiplied by the enhanced amount, each calculated in accordance with paragraph (a)(2) of this appendix.

(4) *Risk-weighted assets.* To calculate risk-weighted assets for a securitization exposure under the gross-up approach, a credit union must apply the risk weight required under paragraph (a)(2) of this appendix to the credit equivalent amount calculated in paragraph (a)(3) of this appendix.

(5) *Securitization exposure defined.* For purposes of this this paragraph (a), "securitization exposure" means:

(i) A credit exposure that arises from a securitization; or

(ii) An exposure that directly or indirectly references a securitization exposure described in paragraph (a)(5)(i) of this appendix.

(6) *Securitization defined.* For purposes of this paragraph (a), “securitization” means a transaction in which:

(i) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;

(ii) Performance of the securitization exposures depends upon the performance of the underlying exposures; and

(iii) All or substantially all of the underlying exposures are financial exposures (such as loans, receivables, asset-backed securities, mortgage-backed securities, or other debt securities).

(b) *Look-through approaches.*—(1) *Applicability.* Section 702.104(c)(3)(iii)(B) provides that, a credit union may use one of the look-through approaches in this appendix to determine the risk weight of the exposure amount of any investment fund, or the holding of separate account insurance.

(2) *Full look-through approach.* (i) *General.* A credit union that is able to calculate a risk-weighted asset amount for its proportional ownership share of each exposure held by the investment fund may set the risk-weighted asset amount of the credit union’s exposure to the fund equal to the product of:

(A) The aggregate risk-weighted asset amounts of the exposures held by the fund as if they were held directly by the credit union; and

(B) The credit union’s proportional ownership share of the fund.

(ii) *Holding report.* To calculate the risk-weighted amount under paragraph (b)(2)(i) of this appendix, a credit union should:

(A) Use the most recently issued investment fund holding report; and

(B) Use an investment fund holding report that reflects holding that are not older than 6-months from the quarter-end effective date (as defined in § 702.101(c)(1)).

(3) *Simple modified look-through approach.* Under the simple modified look-through approach, the risk-weighted asset amount for a credit union’s exposure to an investment fund equals the exposure amount multiplied by the highest risk weight that applies to any exposure the fund is permitted to hold under the prospectus, partnership agreement, or similar agreement that defines the fund’s permissible investments (excluding derivative contracts that are used for hedging rather than speculative purposes and that do not constitute a material portion of the fund’s exposures).

(4) *Alternative modified look-through approach.* Under the alternative look-through approach, a credit union may assign the credit union’s exposure amount to an investment fund on a pro rata basis to dif-

ferent risk weight categories under subpart A of this part based on the investment limits in the fund’s prospectus, partnership agreement, or similar contract that defines the fund’s permissible investments. The risk-weighted asset amount for the credit union’s exposure to the investment fund equals the sum of each portion of the exposure amount assigned to an exposure type multiplied by the applicable risk weight under subpart A of this part. If the sum of the investment limits for all exposure types within the fund exceeds 100 percent, the credit union must assume that the fund invests to the maximum extent permitted under its investment limits in the exposure type with the highest applicable risk weight under subpart A of this part and continues to make investments in order of the exposure type with the next highest applicable risk weight under subpart A of this part until the maximum total investment level is reached. If more than one exposure type applies to an exposure, the credit union must use the highest applicable risk weight. A credit union may exclude derivative contracts held by the fund that are used for hedging rather than for speculative purposes and do not constitute a material portion of the fund’s exposures.

EFFECTIVE DATE NOTE: At 80 FR 66722, Oct. 29, 2015, appendix A to part 702 was added, effective January 1, 2019.

PART 703—INVESTMENT AND DEPOSIT ACTIVITIES

Subpart A—General Investment and Deposit Activities

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Subpart B—Derivatives Authority

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