Chapter 2

V.A.2—Definition of Well-Defined Local Community and Rural District

* * * * *

The rural district requirement is met if:

• Rural District—
• The district has well-defined, contiguous geographic boundaries;
• More than 50% of the district’s population resides in census blocks or other geographic areas that are designated as rural by the United State Census Bureau; and
• The total population of the district does not exceed the greater of 200,000 people or three percent of the population of the state in which the majority of the district is located; or

• The district has well-defined, contiguous geographic boundaries;
• The district does not have a population density in excess of 100 people per square mile; and
• The total population of the district does not exceed the greater of 200,000 people or three percent of the population of the state in which the majority of the district is located.

* * * * *

[FR Doc. 2012–23643 Filed 9–25–12; 8:45 am]
BILLING CODE 7535–01–P

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 702, 741 and 791

RIN 3133–AE07

Prompt Corrective Action, Requirements for Insurance, and Promulgation of NCUA Rules and Regulations

AGENCY: National Credit Union Administration (NCUA).

ACTION: Proposed rule and Interpretive Ruling and Policy Statement 12–2 with request for comments.

SUMMARY: The NCUA Board (Board) proposes to amend Interpretive Ruling and Policy Statement 12–2 as amended by IRPS 03–2, and two NCUA regulations that apply asset thresholds to grant relief from risk-based net worth and interest rate risk requirements. The amended IRPS would result in more robust consideration of regulatory relief for more small credit unions in future rulemakings. The amended regulations would grant immediate and prospective relief from regulatory burden to a larger group of small credit unions.

DATES: Send your comments to reach us on or before October 26, 2012. We may not consider comments received after the above date in making our decision on the proposed rule.

ADDRESSES: You may submit comments by any of the following methods (Please send comments by one method only):

• Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
• NCUA Web Site: http://www.ncua.gov/Legal/Regs/Pages/PropRegs.aspx. Follow the instructions for submitting comments.
• Email: Address to regcomments@ncua.gov. Include “[Your name]—Comments on Proposed Rule 702, 741, 791 and IRPS 12–2” in the email subject line.
• Fax: (703) 519–6319. Use the subject line described above for email.
• Mail: Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.
• Hand Delivery/Courier: Same as mail address.

Public Inspection: You can view all public comments on NCUA’s Web site at http://www.ncua.gov/Legal/Regs/Pages/PropRegs.aspx as submitted, except for those we cannot post for technical reasons. NCUA will not edit or remove any identifying or contact information from the public comments submitted. You may inspect paper copies of comments in NCUA’s law library at 1775 Duke Street, Alexandria, Virginia 22314, by appointment weekdays between 9 a.m. and 3 p.m. To make an appointment, call (703) 518–6546 or send an email to OGCMail@ncua.gov.

FOR FURTHER INFORMATION CONTACT: Kevin Tuininga, Trial Attorney, Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428 or telephone: (703) 518–6543.

SUPPLEMENTARY INFORMATION:

I. Background

II. The Rule as Proposed

III. Regulatory Procedures

I. Background

A. What changes does this proposed rule make?

The Regulatory Flexibility Act, Public Law 96–354, as amended (RFA), generally requires federal agencies to determine whether a proposed rule will have a significant economic impact on a substantial number of small entities. If so, agencies must prepare an analysis that describes the proposed rule’s impact on small entities. The analysis must include descriptions of any significant alternatives that minimize the impact. This requirement encourages federal agencies to give special consideration to the ability of smaller entities to absorb compliance burden imposed by new rules.

In 1981, the Board initially defined “small entity” for purposes of the RFA as any credit union with less than $1 million in assets. IRPS 81–4 superseded IRPS 81–4 but retained the definition of “small entity” as a credit union with less than $1 million in assets. The Board then amended IRPS 81–4 to redefine “small entity” as a credit union with less than $1 million in assets. This proposed rule and IRPS 12–2 redefine “small entity” as a credit union with less than $10 million in assets.

B. Why is the Board proposing this rule?

The Board is proposing this rule and IRPS to implement an updated measure of immediate and prospective regulatory relief for small credit unions across multiple applications, while avoiding undue risk to the National Credit Union Share Insurance Fund (NCUSIF). The Board believes the $10 million asset threshold used to define “small entity” for purposes of the RFA and for other provisions in NCUA’s regulations where the Board has discretion to set asset thresholds is outdated. Increasing these thresholds will account for industry asset growth, consolidation, and inflation. It will provide an updated, reasonable, and historically consistent threshold for credit unions with respect to RFA coverage, regulatory compliance relief, and risk to the NCUSIF.

C. What is the history and purpose of the RFA?

Congress enacted the RFA in 1980 and amended it with the Small Business Regulatory Enforcement Fairness Act of 1996, Public Law 104–121. The RFA in part requires federal agencies to determine whether a proposed rule will have a significant economic impact on a substantial number of small entities. If so, agencies must prepare an analysis that describes the proposed rule’s impact on small entities. The analysis must include descriptions of any significant alternatives that minimize the impact. This requirement encourages federal agencies to give special consideration to the ability of smaller entities to absorb compliance burden imposed by new rules.

In 1981, the Board initially defined “small entity” for purposes of the RFA as any credit union with less than $1 million in assets. IRPS 81–2 superseded IRPS 81–4 but retained the definition of “small entity” as a credit union with less than $1 million in assets. IRPS 81–4, 46 FR 29248 (June 1, 1981).
assets. The Board updated the definition in 2003 to include credit unions with less than $10 million in assets. IRPS 87–2 and 03–2 are incorporated by reference into NCUA’s rule governing the promulgation of regulations.

When the Board updated its RFA threshold to $10 million, it noted that amendments to the Federal Credit Union Act (FCU Act) in 1998 employed a $10 million threshold for multiple new provisions. These new provisions addressed the use of generally accepted accounting principles and voluntary audits; prompt corrective action for new credit unions; and assistance for small credit unions in filing net worth restoration plans. IRPS 03–2 made the threshold in NCUA’s RFA definition consistent with the $10 million threshold in the new FCU Act provisions. The Board has not increased its RFA threshold since 2003.

II. Rule as Proposed

This proposed rule and IRPS 12–2 will amend IRPS 87–2 and partially supersede IRPS 03–2 by changing the definition of “small entity” to include credit unions with less than $30 million in assets. The increased threshold will cause NCUA to give special consideration to the economic impact of proposed and final regulations on an additional 1,603 small credit unions, bringing the total covered by the RFA to 4,041. IRPS 12–2 will also commit the Board to review and consider adjusting the RFA threshold every three years and will be incorporated by reference into 12 CFR 791.8(a).

The asset threshold used as part of the definition of “complex” credit union in 12 CFR 702.103(a) will be increased to $30 million. This increase will benefit 1,603, to a total of 4,041, the number of FICUs removed from the definition of “complex” based on asset size alone. This increase eliminates the possibility that these FICUs could become subject to PCA provisions, despite having at least six percent net worth.

Finally, the proposed rule amends the asset range in 12 CFR 741.3(b)(5)(i), NCUA’s interest rate risk rule. In 12 CFR 741.3(b)(5)(i)(B) and (C), the minimum asset threshold will be changed from $10 million to $30 million for the asset range governing whether a FICU must adopt a written interest rate risk policy and program based on its first mortgage loans and investment maturities. The asset threshold of $10 million in 12 CFR 741.3(b)(5)(i)(D), which determines whether a FICU is categorically excluded from interest rate risk policy and program requirements, will be changed to $30 million. This change will increase by 1,603, to a total of 4,041, the number of FICUs that are categorically exempt, based on asset size alone, from adopting an interest rate risk policy and program.

As with IRPS 12–2, the Board intends to review and consider adjusting the RFA thresholds in 12 CFR 702.103(a) and 741.3(b)(5)(i) at least once every three years.

A. Why is the period for public comment thirty days?

As a matter of policy, the Board believes the public should be given at least sixty days to comment on a proposed rule and IRPS with a thirty-day comment period to expedite regulatory relief for an additional group of small FICUs. Given the relatively narrow subject addressed in the proposed rule and IRPS, the Board believes thirty days appropriately balances the need for public comment and the collective interest in implementing near-term regulatory relief.

B. How did the board identify $30 million as an appropriate asset threshold for this proposed rule and IRPS?

The Board accounted for the following indicators in determining an appropriate threshold for the proposed rule and IRPS: (i) Industry percentages represented by FICUs with less than $10 million in assets at the time Congress implemented that threshold in various FCU Act provisions in 1998; (ii) the correlation of NCUSIF losses and FICU asset size; and (iii) FICU complexity and relative risk.

(i) Industry Percentages

When Congress enacted a $10 million threshold in various provisions of the FCU Act in 1998, FICUs below that threshold represented 60.4 percent of all FICUs and 5.5 percent of total system assets. In 2003, when the Board increased its RFA threshold to $10 million, these credit unions represented approximately 52 percent of all FICUs. As of June 30, 2012, credit unions with less than $10 million in assets represented only 35.0 percent of FICUs and accounted for one percent of total system assets. The table below compares the 1998 characteristics to the 2012 characteristics of FICUs with less than $10 million in assets.

<table>
<thead>
<tr>
<th></th>
<th>December 1998</th>
<th>June 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of FICUs with &lt; $10mm in assets</td>
<td>6,636</td>
<td>2,438</td>
</tr>
<tr>
<td>Percent of Total FICUs</td>
<td>60.4</td>
<td>35.0</td>
</tr>
<tr>
<td>Total Assets</td>
<td>$21,376,801,396</td>
<td>$7,935,413,650</td>
</tr>
<tr>
<td>Percent of Total System Assets</td>
<td>5.5</td>
<td>1.0</td>
</tr>
<tr>
<td>Total Net Worth</td>
<td>$2,911,019,491</td>
<td>$1,396,317,929</td>
</tr>
<tr>
<td>Percent of System Net Worth</td>
<td>6.9</td>
<td>1.4</td>
</tr>
<tr>
<td>Percent of NCUSIF</td>
<td>561.0</td>
<td>86.7</td>
</tr>
</tbody>
</table>

From 1998 to 2012, the number of FICUs with less than $10 million in assets declined by 63 percent and their total assets declined by over 54 percent. Shifting industry characteristics resulted in fewer credit unions with fewer collective assets receiving regulatory relief as credit unions grew in size and smaller FICUs merged at a faster rate than large FICUs.

As a principal reference point for determining a new asset threshold, the percentages of FICUs, assets, net worth, and NCUSIF equity that apply to a range of asset thresholds in 2012 are shown below, shaded where they most closely correspond to the 1998 percentages for FICUs with less than $10 million in assets.

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52 FR 35231 (September 18, 1987).
68 FR 31949 (May 29, 2003).
12 U.S.C. 1782(a)(6); 1790d.
68 FR 31949, 31950 (May 29, 2003).
6 IRPS 87–2, as amended by IRPS 03–2.
In addition to the percentages in this table, the Board notes that, assuming average industry asset growth, the average FICU with $10 million in assets in 1998 had $25.9 million in assets as of June 30, 2012.

Raising the RFA threshold to $30 million in assets will cause the percentage of FICUs under that threshold to be just over two percentage points less than the 1998 ratio. A $30 million threshold will also cause the percentage of system assets and net worth at FICUs under the threshold to be within two percentage points of the comparable 1998 ratios. Although raising the threshold to $40 million would also approximate asset size and net worth percentages from 1998, it would cause the percentage of FICUs included to exceed the 1998 percentage. The Board believes more incremental increases are appropriate and prudent, especially in light of the scheduled three-year review period.

(ii) NCUSIF Loss History

The following table shows the history of failures among credit unions of various asset sizes that caused NCUSIF losses from 1998 through 2012.

<table>
<thead>
<tr>
<th>Assets ($mm)</th>
<th>Number of failures</th>
<th>NCUSIF loss ($mm)</th>
<th>Percentage of total NCUSIF losses</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Failures for asset range</td>
<td>Cumulative</td>
<td>Loss for asset range</td>
</tr>
<tr>
<td>&lt; $10</td>
<td>202</td>
<td>202</td>
<td>$116.1</td>
</tr>
<tr>
<td>$10 to &lt; $20</td>
<td>12</td>
<td>214</td>
<td>31.2</td>
</tr>
<tr>
<td>$20 to &lt; $30</td>
<td>8</td>
<td>222</td>
<td>12.8</td>
</tr>
<tr>
<td>$30 to &lt; $40</td>
<td>9</td>
<td>231</td>
<td>36.2</td>
</tr>
<tr>
<td>$40 to &lt; $50</td>
<td>4</td>
<td>235</td>
<td>11.3</td>
</tr>
<tr>
<td>$50 to &lt; $60</td>
<td>1</td>
<td>236</td>
<td>3.6</td>
</tr>
<tr>
<td>$60 to &lt; $70</td>
<td>0</td>
<td>236</td>
<td>0.0</td>
</tr>
<tr>
<td>$70 to &lt; $80</td>
<td>2</td>
<td>238</td>
<td>11.3</td>
</tr>
<tr>
<td>$80 to &lt; $90</td>
<td>4</td>
<td>242</td>
<td>22.5</td>
</tr>
<tr>
<td>$90 to &lt; $100</td>
<td>3</td>
<td>243</td>
<td>64.9</td>
</tr>
<tr>
<td>$100 to &lt; $200</td>
<td>9</td>
<td>254</td>
<td>76.2</td>
</tr>
<tr>
<td>$200 to &lt; $500</td>
<td>7</td>
<td>261</td>
<td>513.2</td>
</tr>
<tr>
<td>≥ $500</td>
<td>1</td>
<td>262</td>
<td>36.1</td>
</tr>
</tbody>
</table>

Since 1998, 202 FICUs with less than $10 million in assets failed, costing the NCUSIF $116 million, which represents only 12.3 percent of total period losses. Over the same period, FICUs with less than $30 million in assets accounted for only 18 percent of losses, although accounting for 22%, or over 84 percent, of period failures. In comparison, 40 FICUs with more than $30 million in assets failed, costing the NCUSIF $775.3 million or 82 percent of period losses. Thus, despite the higher number of failures among smaller FICUs, the NCUSIF experienced immensely greater losses from the far fewer FICUs with more than $30 million in assets that have failed. While the same general conclusion could be drawn for some thresholds higher than $30 million, the complexity index discussed below weighs against adjusting the threshold higher than $30 million based on loss history alone. These loss figures confirm that a $30 million threshold would likely not pose undue risk to the NCUSIF based on recent trends.

(iii) Credit Union Complexity and NCUSIF Risk

The Board also evaluated asset thresholds in terms of credit union complexity. As an approximate measuring tool, NCUA generated a complexity index for FICUs by assigning points based on factors such as a FICU’s cash and liquidity positions, whether it holds real estate or member business loans, and whether it invests in credit union service organizations. FICUs with a higher index tend to engage in a greater range of complex activities, which generally decreases the justification for regulatory relief. Using the complexity index, the $25 million to $30 million asset size approximates the point below which, on average, FICU complexity begins to decrease at the fastest rate. FICUs above $30 million in assets have a median complexity index value of 14, which is twice the median complexity index value of FICUs below $30 million in assets.
Based on industry percentage data, NCUSIF loss history data, and FICU complexity data, a $30 million threshold is reasonable and historically consistent. A $30 million threshold provides roughly the same percentage today of FICUs defined as small in 1998, representing a slightly lower proportion of total system assets and net worth. A $30 million threshold also provides a significant degree of assurance that the NCUSIF would not be subject to undue risk based on loss history and credit union complexity. Finally, the three-year review period this proposed rule and IRPS requires will provide opportunity for more routine evaluation and supports increasing the threshold moderately at this time.

C. How did the Board decide on a three-year review period?

The Board believes a scheduled review period is advisable to account for evolving industry characteristics. A three-year threshold provides a reasonable time within which to discern new trends in percentage, loss, and complexity data. In addition, a three-year period is consistent with the long-standing review period NCUA uses for all its regulations. It provides sufficient time to avoid the uncertainty of a continuous cycle of rulemakings and policy adjustments that a shorter period could create.

The Board acknowledges the proposed amendments and potential adjustments every three years would reestablish the variation that previously existed between the asset thresholds in multiple sections of the FCU Act and the asset thresholds in certain regulatory provisions and in NCUA’s RFA definition of “small entity.” Unless the Board leaves the adjustable asset thresholds at $10 million, this variation is unavoidable. The Board does not have authority to amend the FCU Act or numerous NCUA regulations where the FCU Act specifies an applicable asset threshold or range. The Board believes the proposed updates and review period will provide immediate and prospective relief that outweighs concerns about threshold variation.

D. How will the proposed rule and IRPS affect credit unions?

The change to the RFA threshold will ensure that regulatory relief will be more consistently and robustly considered for an additional 1,603 FICUs. A total of 4,041 FICUs with less than $30 million in total assets would come within the RFA’s mandates. Future regulations, including the proposed emergency liquidity regulation, 77 FR 44503 (July 30, 2012), will be more thoroughly evaluated to determine whether FICUs below $30 million in assets should be exempted from some provisions or separately considered. The Board also intends to use the $30 million threshold when considering adjustments to examination schedules and developing policies and programs.

The proposed $30 million threshold for defining “complex” credit unions would categorically exclude 1,603 more FICUs from the definition of “complex” based on asset size alone, bringing the total FICUs excluded to 4,041. NCUA currently defines a “complex” credit union in 12 CFR 702.103 as one with more than $10 million in assets and with a risk-based net worth requirement of more than six percent. If a “complex” credit union fails its risk-based net worth requirement despite having at least six percent net worth, the credit union is subject to mandatory prompt corrective action (PCA) requirements.13 These requirements govern earnings retention, net worth restoration plans, asset increases, and member business loans. Of the additional 1,603 credit unions that would be excluded, 230 FICUs with at least six percent net worth that currently must meet a risk-based net worth requirement would no longer be subject to the requirement. These FICUs will be removed one step further from the possibility of PCA requirements.

By increasing the lower threshold in NCUA’s interest rate risk rule to $30

With respect to additional credit unions that would be covered by the RFA, a significant component of the rule will provide prospective relief in the form of special and more robust consideration of their ability to handle compliance burden. This prospective relief is not yet quantifiable. Further, the proposed rule will reduce compliance burden for these credit unions and, therefore, will not raise costs in a manner that requires a regulatory flexibility analysis or a discussion of alternatives for minimizing the proposed rule’s compliance burden.

Accordingly, NCUA has determined and certifies that the proposed rule and IRPS will not have a significant economic impact on a substantial number of small entities. No regulatory flexibility analysis is required.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) applies to rulemakings in which an agency creates a new paperwork burden on regulated entities or modifies an existing burden.14 For purposes of the PRA, a paperwork burden may take the form of either a reporting or a recordkeeping requirement, both referred to as information collections. The proposed changes to 12 CFR 702.103 and 741.3(b)(5)(i) will cause an immediate and prospective reduction in paperwork burden related to PCA requirements and interest rate risk policies for FICUs between $10 million and $30 million in assets. The proposed changes to IRPS 87–2, as amended by IRPS 03–2, will not create any new paperwork burden for credit unions.

Thus, NCUA has determined that the requirements of this proposed rule and IRPS do not increase the paperwork requirements under the PRA and regulations of the Office of Management and Budget.

C. Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order to adhere to fundamental federalism principles. This proposed rule and IRPS would not have a substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this proposed rule does not constitute a policy that has federalism implications for purposes of the executive order.

D. Assessment of Federal Regulations and Policies on Families

NCUA has determined that this proposed rule and IRPS will not affect family well-being within the meaning of Section 654 of the Treasury and General Government Appropriations Act, 1999, Public Law 105–277, 112 Stat. 2681 (1998).

E. Agency Regulatory Goal

The Board’s goal is to promulgate clear and understandable regulations that impose minimal regulatory burden. We request your comments on whether the proposed rule and IRPS is understandable and minimally intrusive if implemented as proposed.

List of Subjects

12 CFR Part 702

Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 741

Credit unions, Requirements for insurance.

12 CFR Part 791

Administrative practice and procedure, Sunshine Act.

By the National Credit Union Administration Board on September 20, 2012.

Mary Rupp.
Secretary of the Board.

Interpreting Rule and Policy Statement 87–2

For the reasons stated above, IRPS 12–2 amends IRPS 87–2 (52 FR 35231, September 18, 1987) and partially supersedes IRPS 03–2 (68 FR 31949, May 29, 2003) by revising the second sentence in Section II, paragraph 2 of IRPS 87–2 and adding a sentence to the end of Section II, paragraph 2 of IRPS 87–2 to read as follows:

II. Procedures for the Development of Regulations

1. * * * * * * * * * * * *

2. * * * NCUA will designate credit unions with less than $30 million in assets as small entities. * * * Every three years, the NCUA Board will review and consider adjusting the asset threshold it uses to define small entities for purposes of analyzing whether a regulation will have a significant economic impact on a substantial number of small entities.

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For the reasons discussed above, the Board proposes to amend 12 CFR parts 702, 741 and 791 as follows:

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15 Id.
16 44 U.S.C. 3507(d).
PART 702—PROMPT CORRECTIVE ACTION

1. The authority citation for part 702 continues to read as follows:
   Authority: 12 U.S.C. 1766(a), 1790d.

2. Section 702.103 is amended by:
   a. Removing “ten” in paragraph (a) and replacing it with “thirty”.
   b. Removing “($10,000,000)” in paragraph (a) and replacing it with “($30,000,000)”.

PART 741—REQUIREMENTS FOR INSURANCE

3. The authority for part 741 continues to read as follows:

§ 741.3 [Amended]

4. Section 741.3 is amended by removing the number “10” and replacing it with “30” wherever it appears in paragraph (b)(5)(i).

PART 791—RULES OF NCUA BOARD MEETINGS; PROMULGATION OF NCUA RULES AND REGULATIONS; PUBLIC OBSERVATION OF NCUA BOARD MEETINGS

5. The authority for part 791 continues to read as follows:

§ 791.8 [Amended]

6. Section 791.8 paragraph (a) is revised to read as follows:

SUMMARY: The NCUA Board (Board) proposes to amend its investment regulation to allow federal credit unions (FCUs) to purchase Treasury Inflation Protected Securities (TIPS). This proposed amendment adds TIPS to the list of permissible investments for FCUs in part 703. The Board believes TIPS will provide FCUs with an additional investment portfolio risk management tool that can be useful in an inflationary economic environment.

DATES: Comments must be received on or before November 26, 2012.

ADDRESSES: You may submit comments by any of the following methods (Please send comments by one method only):
   - NCUA Web Site: http://www.ncua.gov/Legal/Regs/Pages/PropRegs.aspx.
   - Email: Address to regcomments@ncua.gov. Include “[Your name] Comments on Proposed Rule 703, Investment and Deposit Activities” in the email subject line.
   - Fax: (703) 518–6319. Use the subject line described above for email.
   - Mail: Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.
   - Hand Delivery/Courier: Same as mail address.

Public Inspection: You may view all public comments on NCUA’s Web site at http://www.ncua.gov/Legal/Regs/Pages/PropRegs.aspx as submitted, except for those we cannot post for technical reasons. NCUA will not edit or remove any identifying or contact information from the public comments submitted. You may inspect paper copies of comments in NCUA’s law library at 1775 Duke Street, Alexandria, Virginia 22314, by appointment weekdays between 9:00 a.m. and 3:00 p.m. To make an appointment, call (703) 518–6546 or send an email to OCMail@ncua.gov.

FOR FURTHER INFORMATION CONTACT: Frank Kressman, Associate General Counsel, Office of General Counsel, at the above address or telephone (703) 518–6540, or J. Owen Cole, Jr., Director, Division of Capital Markets, Office of Examination and Insurance, at the above address or telephone (703) 518–6360.

I. Background

A. Why is the NCUA Board proposing this rule?

The Board is proposing this rule because, after extensive research and analysis as discussed more fully below, it believes TIPS can be a valuable risk management tool for FCUs. The Board also believes FCUs have the ability to manage the risks associated with TIPS and can benefit from including them in their overall investment portfolio. In addition to analyzing the nature and performance of TIPS in the marketplace, NCUA has monitored FCU usage of TIPS through a long-term investment pilot program. The results of the pilot program are consistent with the Board’s opinion that TIPS are an appropriate investment for FCUs and can be a valuable portfolio management tool when there are inflationary risks in the economy.

Accordingly, for the reasons discussed above, NCUA proposes to make TIPS permissible under part 703.

B. What is a TIPS?

TIPS 1 is a security issued by the U.S. Department of the Treasury, Bureau of Public Debt, which is readily available to investors. TIPS differ from other securities by providing protection against inflation. The principal of a TIPS increases with inflation and decreases with deflation, as measured by the Bureau of Labor Statistics’s Consumer Price Index (CPI). 2 When a TIPS matures, the holder is paid the adjusted principal or original principal, whichever is greater. TIPS pay interest twice a year at a fixed rate. The rate is applied to the adjusted principal, so, like the principal, interest payments rise with inflation and fall with deflation. In a deflationary period, it is possible to experience a contractual decline in the principal balance, which is not an event of default.

C. Analysis of TIPS and Part 703

Overview

TIPS are currently a prohibited investment under part 703 because they reprice their value in response to changes in the CPI, and the CPI is a prohibited index for variable rate

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1 To learn more about TIPS, see the U.S. Department of the Treasury, Bureau of Public Debt Web site at: http://www.treasurydirect.gov/indiv/research/indepth/tips/res_tips.htm. 2 The CPI program produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services. To learn more about how the CPI is produced, see the Department of the Treasury, Bureau of Public Debt Web site at: http://www.bls.gov/cpi/cpsfaq.htm.