NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 702

Prompt Corrective Action; Risk-Based Net Worth Requirement

AGENCY: National Credit Union Administration (NCUA).

ACTION: Proposed rule.

SUMMARY: NCUA proposes to supplement its system of prompt corrective action for federally-insured credit unions with a risk-based net worth requirement for credit unions defined as ''complex.'' In 1998, the Federal Credit Union Act was amended to require NCUA to adopt a system of prompt corrective action to commence when a federally-insured credit union becomes undercapitalized. In a separate component of that system, NCUA is required to define credit unions which are ''complex'' by reason of their portfolio of assets and liabilities and to develop a risk-based net worth requirement to apply to complex credit unions in the ''well capitalized'' or ''adequately capitalized'' statutory net worth categories. The statute classifies complex credit unions in those categories to the ''undercapitalized'' category if their net worth ratios do not meet their risk-based net worth requirement. NCUA seeks public comment on its proposed criteria for defining a ''complex'' credit union and on its proposed Call Report data-based formula for determining a complex credit union's risk-based net worth requirement.

DATES: Comments must be received on or before April 18, 2000.

ADDRESSES: Direct comments to Becky Baker, Secretary of the Board. Mail or hand-deliver comments to: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428. Fax comments to (703) 518–6319. *Please send comments by one method only.*

FOR FURTHER INFORMATION CONTACT: *Technical:* Herbert S. Yolles, Deputy Director, Office of Examination and Insurance, at the above address or telephone (703) 518–6360. *Legal:* Steven W. Widerman, Trial Attorney, Office of General Counsel, at the above address or telephone (703) 518–6557.

SUPPLEMENTARY INFORMATION:

A. Background

1. The Credit Union Membership Access Act

On August 7, 1998, Congress enacted the Credit Union Membership Access Act, Pub. L. No. 105–219, 112 State. 913 (1998). Section 301 of the statute added a new section 216 to the Federal Credit Union Act, 12 U.S.C. 1790d (hereinafter referred to as ''CUMAA'' or ''the statute'' and cited as ''§ 1790d''). Section 1790d requires the NCUA Board to adopt by regulation a system of ''prompt corrective action'' (sometimes referred to as ''PCA'') to commence when a federally-insured ''natural person'' credit union becomes undercapitalized. The purpose of PCA is to ''resolve the problems of insured credit unions at the least possible long-term loss to the [National Credit Union Share Insurance Fund (NCUSIF)].'' § 1790d(a)(1). The statute designates three principal components of PCA: (1) a framework of mandatory actions prescribed by statute, § 1790d(c), (e), (f) and (g), and discretionary actions developed by NCUA, which are indexed to five statutory net worth categories and their corresponding net worth ratios, § 1790d(c); (2) an alternative system of PCA to be developed by NCUA for credit unions which CUMAA defines as ''new,'' § 1790d(a)(2); and (3) a risk-based net worth ratio to apply to credit unions which NCUA defines as ''complex.'' § 1790d(d). The third component alone is the subject of this proposed rule.

2. Part 702 Final Rule

Following the statutory mandate, the NCUA Board proposed a comprehensive system of PCA consisting of a framework of mandatory and discretionary supervisory actions and an alternative system of PCA to apply to ''new'' credit unions. 64 FR 27090 (May 18, 1999). Following a 120-day comment period which generated 86 comment letters, the NCUA Board adopted a final rule, 12 CFR 702 *et seq.* (2000) (''part 702 final rule''), to take effect on August 7, 2000. (The final rule is found elsewhere in this issue of the **Federal Register**). The first quarter to which the part 702 final rule will apply is the fourth quarter of 2000, based on data reflected in the Call Report due to be filed January 22, 2001. The part 702 final rule is the product of consultation with the Department of the Treasury, comments from the Federal banking agencies, and extensive collaboration with a committee of representative State credit union supervisors. *See* CUMAA § 301(c).

For credit unions which do not meet the statutory definition of a ''new'' credit union, the part 702 final rule establishes a framework of mandatory and discretionary supervisory actions, indexed to the five net worth categories, and implements statutory conditions triggering conservatorship and liquidation. 12 CFR 702.210–702.206.

For credit unions which CUMAA defines as ''new''—those having been in operation less than ten years and having $10 million or less in assets, § 1790d(o)(4)—the part 702 final rule establishes a similarly-structured alternative system of PCA which recognizes that ''new'' credit unions initially have no net worth and must have reasonable time to accumulate net worth and incentives to ultimately become ''adequately capitalized.'' § 1790d(b)(2)(B). To that end, the system for ''new'' credit unions is modeled on the net worth category structure, but has six categories (including ''uncapitalized'') which differ from the five statutory net worth categories. 12 CFR 702.301–702.307. The net worth ratio and category of a credit union, whether ''new'' or not, is determined quarterly. 12 CFR 702.101(a)(1), 702.302(a).

In addition to the substantive components of PCA, the part 702 final rule implements an independent appeal process by which affected credit unions and officials can appeal decisions by NCUA staff imposing certain prompt corrective actions on a discretionary basis, and decisions by the NCUA Board reclassifying a credit union to a lower net worth category on safety and soundness grounds. 12 CFR 747.2001 *et seq.* Finally, the final rule retains certain of NCUA's current reserve and dividend payment requirements in modified form to reflect repeal of FCUA § 116, 12 U.S.C. 1762, and to conform to CUMAA's earnings retention requirement. § 1790d(e). 12 CFR 702.401 *et seq.*

3. Risk-Based Net Worth Requirement for ''Complex'' Credit Unions

Independently of the general system of PCA in the part 702 final rule, CUMAA requires NCUA to develop the definition of a ''complex'' credit union based on the risk level of a credit union's portfolio of assets and liabilities, § 1790d(d)(1), and to formulate a risk-based net worth (''RBNW'') requirement to apply to credit unions which meet that definition. The RBNW requirement must ''take account of any material risks against which the net worth ratio required for an insured credit union to be adequately capitalized [6%] may not provide adequate protection.'' § 1790d(d)(2). NCUA must, ''for example, consider whether the 6 percent requirement provides adequate protection against interest-rate risk and other market risks, credit risk, and the risks posed by contingent liabilities, as well as other relevant risks. The design of the [RBNW] requirement should reflect a reasoned judgment about the actual risks involved.'' S. Rep. No. 193, 105th Cong., 2d Sess. 13 (1998) (S. Rep.).

CUMAA demands that a credit union which qualifies as ''complex,'' and whose net worth ratio initially places it in either of the ''adequately capitalized'' or ''well capitalized'' net worth categories, must satisfy a separate RBNW requirement, which may exceed the minimum net worth ratio corresponding to its initial category (6% and 7%, respectively), in order to remain classified in that category. § 1790d(c)(1)(A)(ii) and (c)(1)(B)(ii). A ''well capitalized'' or ''adequately capitalized'' complex credit union which fails to meet its RBNW requirement is reclassified to the ''undercapitalized'' net worth category, and will be subject to certain mandatory and discretionary supervisory actions applicable to that category. § 1790d(c)(1)(c)(ii).

The RBNW requirement also has an indirect impact on the ''undercapitalized'' and lower net worth categories. All credit unions which fall into those categories are required to operate under an approved net worth restoration plan. The plan must provide the means and a timetable for the credit union to reach the 6% net worth ratio ''gate'' to the ''adequately capitalized'' category. § 1790d(f)(5); 12 CFR 702.206(c). However, for credit unions in the ''undercapitalized'' or lower net worth categories which qualify as ''complex,'' the net worth ratio ''gate'' to that category will be the credit union's RBNW requirement, which may be higher than 6%. Thus, to become ''adequately capitalized'' and to remain so, a complex credit union's net worth restoration plan will have to prescribe the steps a credit union will take to reach a higher net worth ratio ''gate'' to that category. *See* 12 CFR 702.206(c)(1)(i)(A).

As directed by CUMAA, NCUA commenced rulemaking by issuing an Advance Notice of Proposed Rulemaking (ANPR) which, among other things, both suggested and invited concepts for an RBNW requirement and criteria for defining a ''complex'' credit union. CUMAA § 301(d)(2)(A). 63 FR 57938 (October 29, 1998). Although there is no deadline for issuing NCUA's proposed rule implementing the RBNW requirement for ''complex'' credit unions, CUMAA set August 7, 2000, as the deadline for issuing the final rule, and January 1, 2001, as its effective date. CUMAA § 301(d)(2)(B) and (e)(2). The first quarter to which the RBNW requirement for ''complex'' credit unions will apply is the first quarter of 2001, based on data reflected in the Call Report due to be filed in April 2001.

4. Advance Notice of Proposed Rulemaking

By the comment deadline of January 27, 1999, NCUA received 34 comment letters from 32 commenters in response to its ANPR soliciting concepts and criteria for a ''risk-based net worth requirement'' for ''complex'' credit unions. The commenters consisted of 13 Federal credit unions, 3 State-chartered credit unions, 8 state credit union leagues, 2 credit union trade associations, 3 banking trade associations, a single State supervisory authority, a single State credit union supervisors association, and a single credit union consulting firm.

The comments in response to the ANPR generally fall into three categories: (1) those which dwell on the four considerations NCUA had raised in the ANPR, two of which were abandoned as arbitrary even before the comment period expired; [1] (2) those which suggest approaches that are contrary to CUMAA's express mandate and, thus, are outside NCUA's authority to adopt; [2] and (3) those which suggest a genuinely new or different approach not at odds with the statutory mandate. Accordingly, this proposed rule addresses neither the considerations NCUA already has abandoned, nor the suggestions which are contrary to CUMAA. Other comments in response to the ANPR are addressed below.

Three commenters urged NCUA to base the RBNW requirement on a credit union's market value of portfolio equity (MVPE) or net economic value (NEV). One of these went further to recommend establishing assumptions for these measures, and to deem a credit union ''complex'' if the after-shock value of its capital is six percent or less. The NCUA Board declines to adopt these suggestions for two reasons. First, MVPE and NEV typically address only one type of risk—interest rate risk-not the range of relevant risks the statute contemplates. Second, relying on general assumptions to calculate MVPE or NEV may produce an inaccurate result; however, institution-specific assumptions may be costly and burdensome to formulate.

Responding to the concept of establishing a threshold ratio of fixed-rate real estate mortgages as a criterion for defining a ''complex'' credit union, one commenter suggested using fixed rate loans with maturities greater than 5 years in excess of 50 percent of assets. The proposed rule adopts this concept with a more inclusive asset threshold than the commenter urged and a 3-year remaining maturity criterion. Another commenter recommended excluding ''conforming'' real estate loans which may be sold on the secondary market—a proposal that has been rejected because it addresses only liquidity risks, while ignoring interest rate, credit and other risks. Two commenters suggested using non-consumer, off-balance sheet commitments and contingencies exceeding 10 percent of assets. This recommendation has been adopted in part in the proposed rule through establishment of a risk portfolio consisting of unused commitments for member business loans.

Four commenters urged using only ''unmatched'' fixed-rate mortgages (*i.e.,* not matched against a like funding source such as Federal Home Loan Bank borrowings or long-term share deposits) in excess of 25 to 35 percent of assets with terms greater than 12 to 15 years. NCUA concludes that the suggested matching criteria are unsuitable either because they cannot be applied on a consistent basis, or because they fail to sufficiently mitigate risk. As with MVPE or NEV calculations, the process of analyzing and monitoring a credit union's ''matched'' versus ''unmatched'' positions would be subject to inconsistent application because the process depends on individual, institution-specific assumptions. The issue of how to treat ''non-maturity'' shares similarly invites inconsistency in maturity matching because it is open to various interpretations. Further, the maturity match proposed by the commenters, particularly in the absence of a market-based penalty for early withdrawal, would not fully mitigate interest rate risk. NCUA believes that longer term real estate loans inherently pose greater risks and therefore are an

[1] The four considerations raised in the ANPAR were: (i) Whether the credit union's securities portfolio is subject to NCUA's 300-basis-point ''shock test,'' 12 CFR 703.90(b)–(c); (ii) Whether the credit union's portfolio exceeds a certain threshold ratio of fixed-rate real estate mortgages; (iii) Whether the credit union has exceeded a certain threshold ratio of borrowed funds; and (iv) Whether the credit union's ''Capital'' and/or ''Asset'' CAMEL components are rated ''4'' or ''5.'' 63 FR at 57940. NCUA abandoned CAMEL components as a criterion because they are not readily accessible to credit unions to use in determining for themselves whether they are ''complex,'' and abandoned the 300-basis point ''shock test'' because the purpose of the investment regulation fundamentally differs from that of a minimum capital requirement.

[2] For example, seven commenters advocated measuring risk by means other than a credit union's portfolio of assets and liabilities (*e.g.,* asset size in relation to size of NCUSIF) and determining complexity according to the lack of diversification of products, geographic distribution of certain portfolios of assets, and lack of diversification of the field of membership (single employer).

appropriate indicator of the complexity of a credit union.

Commenters advocated other criteria for defining a ''complex'' credit union—a defined segment of a credit union's investment portfolio and member business lending. NCUA agrees and has included in the proposed rule a risk portfolio combining three types of long-term investments, and a risk portfolio consisting of member business loans. Both risk portfolios are subject to a threshold percentage of the credit union's total assets.

The commenters were divided as to whether credit union borrowing beyond a certain threshold of assets should be a criterion of ''complexity.'' The opponents argued that using borrowed funds as a criterion could inhibit prudent cash management or risk reduction. The NCUA Board seriously considered, but ultimately rejected, borrowed funds as a criterion because management may use borrowed funds to accomplish different objectives. Properly structured, borrowed funds may be a risk-reducing measure taken by the credit union to improve its asset liability structure.

Addressing the structure of the RBNW requirement, thirteen commenters advocated various basis point ceilings on the net worth ratio ''add on'' proposed in the ANPR. Three commenters favored a 100-basis-point ceiling; another three favored that ceiling if it incorporates intermediate tiers or steps based on a credit union's complexity; one preferred a 50-basis-point maximum; another characterized a ceiling of 100 basis points as excessive; and the final commenter indicated that 100 basis points was not enough to capture all the risks. NCUA concurs with the final commenter because CUMAA sets no limit in directing NCUA to take into account ''any material risks against which [the 6% net worth ratio to be ''adequately capitalized''] may not provide adequate protection.'' § 1790d(d)(2).

Two commenters urged NCUA to model the RBNW requirement for complex credit unions on the risk-based system that has applied to banks since 1992. To do so would not take account of the cooperative character and other unique features of credit unions, 12 U.S.C. 1790d((b)(1)(B), and would not ''reflect a reasoned judgment about the actual risks involved'' in credit unions. S. Rep. at 14. Embracing its mandate, NCUA is determined to develop an RBNW requirement that is tailored to each credit union's individual risk profile and thereby provides ''real protection against real risks.''

Finally, commenters suggested three standards for the definition of a ''complex'' credit union: that size alone should not determine complexity; that a credit union should be able to determine for itself whether it is ''complex''; and that PCA rules should provide ''real protection against real risks.'' NCUA concurs and has incorporated the substance of these standards in its four goals described in section 5 below.

5. Proposed Rule

The proposed rule reflects four goals in developing an RBNW for ''complex'' credit unions. First, to allow a credit union to determine for itself at any point whether it qualifies as ''complex,'' and if so, to ascertain its RBNW requirement on its own. Second, to rely on objective numerical standards to ensure uniformity, rather than on subjective determinations that allow unequal treatment. Third, to rely primarily on already-existing data such as Call Report data, rather than to impose a new additional recordkeeping burden. Fourth, to tailor the RBNW requirement to a credit union's individual risk profile, rather than to impose a ''one size fits all'' requirement.

Through this notice, NCUA invites public comment on all aspects of its proposed rule. As with the final rule implementing the general system of PCA, broad public input addressing the proposed rule will assist the NCUA Board in tailoring an RBNW requirement that is workable, fair and effective in light of the cooperative character of credit unions. *See* S. Rep. at 14. However, commenters are urged to recognize that NCUA lacks discretion to modify the statutory basis for defining a ''complex'' credit union (*e.g.,* the risk level of its portfolio of assets and liabilities) and the impact of failing to meet an RBNW requirement (classification in the ''undercapitalized'' category). Within those limitations, public comments suggesting and justifying modifications to the proposed rule will be most beneficial.

To facilitate consideration of public comments on the proposed rule, the NCUA Board urges commenters to organize their comment letters on a section-by-section basis to correspond to the sections of the proposed rule, and to include general comments, if any, in a separate section.

B. Section-by-Section Analysis of Proposed Rule

While all credit unions determine their net worth ratio quarterly, 12 CFR 702.101(a), the determination whether a credit union is ''complex'' and, if so, the determination of its RBNW requirement, is made on a quarterly basis by credit unions which file Call Reports quarterly, and on a semiannual basis by credit unions which file Call Reports semiannually. Both determinations rely on month-end account balances, including the balance of total assets, as reflected in the Call Report. *See* n. 7 *infra.* Coupling both determinations with the Call Report filing will relieve semiannual filers of the burden of making and reporting those determinations separately for the first and third quarters. However, this may cause semiannual filers either to remain ''complex,'' or to be subject to a higher RBNW requirement than would otherwise be the case.

The proposed rule implements a three-step process involving eight ''risk portfolios'' which are defined in section 702.103. The process applies to all federally-insured credit unions including those defined as ''new.'' [3] 702.302(c)(1)–(2). The first step, reflected in proposed section 702.104, is to determine whether a credit union qualifies as ''complex'' based on whether any of four specific threshold percentages of total assets is exceeded by corresponding ''risk portfolios.'' The second step, reflected in section 702.105, uses eight ''RBNW components'' (derived from the ''risk portfolios'') to calculate the individual RBNW requirement that applies to a credit union which meets section 702.104's definition of ''complex.'' The third and final step, reflected in section 702.106, gives a ''complex'' credit union the opportunity to substitute any of three specific ''RBNW components'' in section 702.105 with a corresponding ''alternative component'' that may reduce the RBNW requirement against which the credit union's net worth ratio is measured.

NCUA relied on several resources to construct the proposed process for identifying ''complex'' credit unions and formulating an RBNW requirement for each. First, NCUA assembled a ''complex'' credit union committee to analyze field staff experience in dealing with risk exposure and capital deficiencies of credit unions. Among the members of the committee is a combined 74 years of regulatory and private sector depository institution and related experience. The committee collaborated extensively with representative state credit union

[3] Throughout the proposed rule, including the tables in the preamble and the rule text, and the appendices which follow the rule text, the terms ''credit union'' and ''CU'' refer to federally-insured credit unions, wherther federal- or State-chartered. 12 CFR 702.2(c).

supervisors. Second, the committee compared its findings against the results of interest rate risk measurement models incorporating Securities Industry Association standard calculation formulas. Finally, the committee consulted historical data from Call Reports identifying the relationship between specific asset and liability portfolios, which the committee identified as having higher than average risk, and capital deficiency. This process was used to construct the ''risk portfolios'' and derivative ''RBNW components'' and ''alternative components,'' as well as to establish the tiers, thresholds and RBNW factors incorporated in each.

1. Section 702.2(k)—Definition of Weighted-Average Life

The proposed rule defines the term ''weighted-average life'' for use in identifying the contents of the ''Long-term investments'' risk portfolio, § 702.103(c)(1), and the contents of the ''Long-term investments'' alternative component for calculating the RBNW requirement, § 702.106(c). The definition is adopted in modified form from Fabozzi, Frank and T. Dessa, eds., *The Handbook of Fixed Income Securities* (4th ed. 1995) at 518, and reflects the method by which credit unions report investments in Schedule C of the Call Report.

The definition treats investments in registered investment companies and collective investment funds differently because their weighted-average lives generally are not disclosed. In the current Call Report, these investments all are combined in a single weighted-average life category—less than or equal to one year. When the Call Report is revised to conform to this part, investments in registered investment companies and collective investment funds will be reported separately. Whereas money market funds will continue to be categorized as having a weighted-average life of less than or equal to one year, investments in a registered investment company or collective investment fund will be categorized as having a weighted-average life of greater than 5 years, but less than or equal to 7 years. That category reflects the interest rate risk of typical mutual funds. The final sentence of the ''weighted-average life'' definition anticipates this revision to the Call Report.

2. Section 702.103—Risk Portfolios Defined

Section 702.103 of the proposed rule identifies eight ''risk portfolios'' which are used in subsequent sections. Five portfolios are used to determine whether a credit union is ''complex.'' *See* Table 1 in § 702.103. If so, all eight are used to calculate what that credit union's risk-based net worth requirement will be. The portfolios consist of assets, liabilities and contingent liabilities, and are based entirely upon Call Report data integrated in a ''PCA Worksheet'' planned for introduction on a trial basis in the Call Report for the last quarter of 2000 (the quarter preceding the first quarter in which the final rule will apply).

(a) *Long-term real estate loans.* This risk portfolio contains loans with above average economic value exposure to interest rate changes.[4] Examination experience indicates the vast majority of member loans with above average exposure to interest rate changes are real estate related. In contrast, short-term fixed-rate and frequently repricing adjustable-rate real estate loans typically do not have above average exposure to interest rate changes. Thus, this portfolio combines all fixed-rate real estate loans and lines of credit with a maturity greater than 3 years, with variable-rate real estate loans that will not reprice within 3 years. NCUA research indicates that a balloon real estate loan with a 5-year original maturity, 30-year amortization schedule, and 3-year remaining maturity, would have less than a 6 percent decline in market value on a 200-basis-point increase in interest rates. This risk portfolio may be expanded when examination experience indicates significant new sources of long-term loans.

(b) *Member business loans outstanding.* This risk portfolio is comprised of all member business loans (MBLs) outstanding, exclusive of unused MBL commitments.[5] Examination experience indicates credit risk of MBLs generally is greater than credit risk of member non-business loans. This portfolio also includes real-estate-related MBLs that generally have above average exposure to interest rate risk.

(c) *Long-term investments.* Long-term investments generally have greater economic value exposure to interest rate changes than investments with shorter terms. This portfolio contains all fixed-rate investments with a weighted-average life greater than 3 years. NCUA research indicates fixed-rate investments with a shorter weighted-average life generally have less than a 6 percent decline in market value for a 200 basis-point increase in interest rates. This risk portfolio also contains infrequently reset variable-rate investments. While no distinction is made between investments of different credit quality, most credit union investments are of high credit quality. The examination process permits NCUA to monitor trends in credit quality of investments on a continuing basis.

(d) *Low-risk assets.* This risk portfolio is comprised of cash and cash equivalents[6] that typically have below average interest rate and credit risk. Such assets also contribute significantly to a credit union's liquidity position. Credit unions generally have well controlled processes for securing cash. Cash equivalents generally are maintained in low-risk investment instruments, which still have some level of credit risk.

(e) *Average-risk assets.* Average-risk assets primarily consist of consumer loans, real estate loans that will contractually refinance, reprice or mature within 3 years, most investments with a weighted-average life or repricing interval of less than 3 years, and land, building and fixed assets. This risk portfolio is calculated by subtracting the preceding four risk portfolios from Call Report month-end total assets. Assets assigned to one of the preceding portfolios (''Long-term real estate loans,'' ''MBLs,'' ''Long-term investments'' and ''Low-risk assets'')

[4] ''Economic value exposure to interest rate changes'' refers to price sensitivity of a credit union's assets (changes in the value of the assets over different interest rate/yield curve scenarios). Interpretive Ruling and Policy Statement No. 98–2, ''Supervisory Policy Statement on Investment Securities and End-User Derivatives,'' 65 FR 20191 at 20195 (April 23, 1998).

[5] In NCUA's rule on member business loans, 12 CFR 723.1(a), and elsewhere in part 702, the term ''Member Business Loan'' [MBL] combines MBLs outstanding and unused MBL commitments. *E.g.*, 12 CFR 702.202(a)(4), 702.304(a)(3). For purposes of sections 702.103 through 702.106, however, MBLs outstanding and unused MBL commitments each constitute a separate risk portfolio, 12 CFR 702.103 (b) and (g), as well as a separate RBNW component. 12 CFR 702.105 (b) and (g). The two risk portfolios are combined into a single portfolio only for the purpose of applying a threshold to define a complex credit union. 12 CFR 702.104(b).

[6] ''Cash'' includes currency on hand, demand deposits with banks or other financial institutions, and other accounts which have the characteristics of demand deposits in that the customer may deposit additional funds at any time and also effectively may withdraw funds at any time without prior notice of penalty. All charges to those accounts are cash receipts or payments to both entity owning the account and the financial institution holding it. Statement of Financial Accounting Standards No. 95 at ¶7, n.1. ''Cash equivalents'' are short-term highly liquid investments that are both readily convertible to known amounts of cash, and so near to maturity that there is an insignificant risk of change in value because of changes in interest rates. *Id.* ¶8. Generally Accepted Accounting Principles often interpret ''so near to maturity'' to mean within 3 months.

have either above or below average risk. All other assets are grouped into this portfolio because they typically are average-risk assets.

(f) *Loans sold with recourse*. Loans sold with recourse are an off-balance sheet account and, therefore, are not included in any of the above portfolios of assets. Credit unions retain credit risk exposure on these contingent liabilities.

(g) *Unused member business loan commitments.* Unused MBL commitments also are an off balance-sheet account. Large draws on unused MBL commitments may cause liquidity problems for credit unions with high levels of commitments. Unused commitments also represent contingent exposure to credit risk.

(h) *Allowance*. This risk portfolio will reduce a credit union's RBNW requirement. The Allowance for Loan and Lease Losses (ALL) reflects provisions made for potential credit losses. Increases in the ALL account result in decreases in net worth, since provisions for ALL represent expense items. As of the June 1999 Call Report, about two-thirds of all credit unions had an ALL of 1.50 percent or less of total loans outstanding. Thus, an ALL account of 1.50 percent or less is fairly typically observed. When the level of potential credit losses increases, the ALL account also should be increased. High levels of ALL accounts therefore reflect high levels of credit exposure. Because the Call Report does not make fine distinctions among loans by credit quality measures, its data cannot be used to finely distinguish different components of the RBNW requirement. Accordingly, the RBNW requirement is designed to reflect average credit risk exposures. Thus, the Allowance risk portfolio (expressed as a percentage of total assets) is limited to the ALL account up to the equivalent of 1.50 percent of total loans. However, a credit union's ALL account will continue to be reviewed during the examination process to ensure its adequacy.

3. Section 702.104—Thresholds to Define Complex Credit Unions

The first step of the proposed process, reflected in proposed section 702.104, is to determine whether a credit union is ''complex.'' A credit union is ''complex'' if any of four specific threshold percentages of total assets is exceeded by corresponding ''risk portfolios.''[7] *See* Table 2 in § 702.104, and Appendix B. In that case, the credit union is ''complex'' and must proceed to calculate its RBNW requirement under section 702.105. Conversely, a credit union which does not exceed any of the four thresholds is not ''complex'' and may disregard the subsequent steps of the process.

NCUA proposes four thresholds only for the following five ''risk portfolios'' because they were designed to reflect above average risk, whereas each of the remaining three ''risk portfolios'' either reflects average or below average risk (''Average-risk assets'' and ''Low-risk assets'') or represents a cushion against loss (''Allowance'').

(a) *Long-term real estate loans.* For long-term real estate loans, NCUA proposes a threshold of 25 percent of total assets. This proposal is based on NCUA's examination of interest rate risk data for a variety of typical loans. For example, a June 1998 analysis by the Office of Thrift Supervision estimates the industry aggregate present value of all thrifts' fixed-rate single-family first-mortgage loans and mortgage-backed securities would decline by about 8 percent for a 200-basis-point increase in interest rates, and decline by about 12 percent for a 300-basis-point increase in interest rates. Office of Thrift Supervision, Division of Risk Management, ''Interest Rate Risk Exposure Report for All Reporting CMR'' as of June 1998. A credit union with a long-term real estate loan portfolio of 25 percent of total assets similar in composition to that of the average thrift institution would have an interest rate risk exposure of 2 percent of total assets for a rate increase of 200 basis points, and 3 percent of total assets for a rate increase of 300 basis points. Increased credit risk in such a higher interest rate environment would result in further declining present value of the long-term real estate loans. In this analysis, the risk of 25 percent of a credit union's assets would absorb half of the minimum net worth required to be ''adequately capitalized'' (*i.e.,* a 6 percent net worth ratio). Accordingly, NCUA concludes that a credit union having greater levels of long-term real estate loans needs additional net worth to adequately protect the NCUSIF.

(b) *Combined member business loans outstanding and unused commitments.* NCUA proposes a threshold of 12.25 percent of total assets for the combined risk portfolios of ''MBLs outstanding'' and ''Unused commitments for MBLs.'' *See* note 5 *supra*. This threshold corresponds to the general MBL limit of 1.75 times 7 percent of total assets. 12 U.S.C. 1757a(a). Credit unions permitted by exception to have greater levels of member business loans, *id.* § 1757a(b), may need additional net worth to adequately protect the NCUSIF. Experience indicates that the value of typical business loan collateral is more volatile than typical non-business loan collateral. In addition, commercial real estate, as a whole, tends to decline far greater in value during recessions than does single family residential real estate. Therefore, MBLs present a higher level of credit risk than non-business loans, justifying a threshold of 12.25 percent instead of 25 percent.

(c) *Long-term investments.* A threshold of 15 percent of total assets is proposed for long-term investments. Long-term investments expose a credit union to significant interest rate risk. For example, a newly issued 10-year, 6-percent-coupon Treasury note declines in value more than 13 percent for a 200-basis-point increase in rates, and more than 19 percent for a 300-basis-point increase in rates. A credit union with a long-term investments portfolio of 15 percent of total assets in such a security would have an economic value exposure of about 2 percent of total assets with a 200-basis-point increase in rates and about 2.85 percent of total assets with a 300-basis-point increase in rates. Under this scenario, risk could absorb 47.5 percent of the minimum net worth required to be ''adequately capitalized'' (*i.e.,* a 6 percent net worth ratio). The investment portfolio typically is viewed as the guardian of a credit union's liquidity. A credit union needs financial assets that are readily convertible to cash to meet member withdrawal demands and to fund new member loans. Because of interest rate risk, long-term investments do not serve to adequately safeguard a credit union's liquidity.

(d) *Loans sold with recourse.* NCUA proposes a threshold of 5 percent of total assets for loans sold with recourse of any kind. A threshold level below 5 percent of total assets generally is not material. Loans sold with recourse are a contingent liability. When a loan is sold with recourse, net worth ratio generally increases; however, credit exposure typically does not decline.

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[7] A credit union is required to use its calendar month-end account balances, including the balance of total assets, for purposes of sections 702.103 and 702.106. Since Call Report asset accounts are reported as of calendar month-end, the denominator for the eight ''risk portfolios'' also must be calendar month-end total assets. Otherwise, the sum of the balances in asset accounts (reported on a calendar month-end basis) would not necessarily equal assets (on other than a calendar month-end basis). For all other purposes under part 702, a credit union may elect among four methods for calculating its total assets—a daily average over the quarter, the month-end total, and the average of month-end totals for the most recent four quarters—to apply for that quarter. 12 CFR 702.2(j)(2).

4. Section 702.105—RBNW Components to Calculate Risk-Based Net Worth Requirement

The second step of the proposed process, reflected in section 702.105, is to calculate the RBNW requirement that applies to those credit unions which meet section 702.104's definition of ''complex.'' This is accomplished by tallying eight ''RBNW components,'' each of which is derived by multiplying its corresponding ''risk portfolio'' by an RBNW factor corresponding to its level of risk. *See* Table 3 in § 702.105, and Appendix B. One such component, ''Allowance,'' is credited as an offset against the total of the other seven. The sum total percentage for the ''RBNW components'' yields the ''complex'' credit union's actual RBNW requirement, against which its net worth ratio (generally, retained earnings as a percentage of total assets) is compared.

(a) *Long-term real estate loans.* The ''Long-term real estate loans'' risk portfolio, up to its 25 percent threshold, is weighted by a 6 percent RBNW factor, based on the net worth level at which a non-complex credit union is ''adequately capitalized.'' The interest rate risk of this first 25 percent of total assets potentially is large in comparison to a 6 percent net worth ratio based on 100 percent of total assets. Thus, the next 15 percent of total assets in this risk portfolio is weighted by a 14 percent RBNW factor, a higher marginal rate to protect against additional risk. NCUA research indicates that a typical seasoned portfolio of 30-year mortgage loans declines in value by about 14 percent for a 300-basis-point increase in interest rates. As long-term real estate loans exceed 40 percent of a credit union's total assets, examination experience indicates typical increases in credit concentration risk and in the ratio of new loans to seasoned loans, with new loans having greater risk than seasoned loans. Thus, the portion of this risk portfolio in excess of 40 percent of total assets is weighted by 16 percent. By way of comparison, NCUA research indicates a newly-issued 30-year mortgage backed security declines in value by about 17 percent for a 300-basis-point increase in interest rates.

(b) *Member business loans outstanding.* The ''MBLs outstanding'' risk portfolio also is weighted by a 6 percent RBNW factor up to its threshold of 12.25 percent of total assets. Unused commitments for MBLs are weighted separately, below. MBLs outstanding above 12.25 percent of total assets are weighted by a 14 percent RBNW factor. As the level of MBLs increases, the average factor for all MBLs rises. The average factor is 8 percent when this risk portfolio equals 16.33 percent of total assets, comparable to a bank's 8 percent credit-risk-weighted capital requirement.[8] Unlike a bank's credit-risk-weighted capital requirement, this factor also must account for material interest rate risk and other relevant risks. As the amount of MBLs outstanding increases, interest rate risk also typically increases, as may credit concentration risk. The resulting risk-based net worth requirements typically should adequately protect the NCUSIF.

By way of example, assume a credit union has 25.40 percent of total assets in MBLs, no unused commitments or other contingent liabilities, 74.60 percent of total assets in average risk categories (such as the ''Average-risk assets'' risk portfolio), a total of 70 percent of total assets in loans, and an ALL of 1.50 percent of total loans. Such a credit union would have an RBNW requirement of 6.00 percent, equal to the net worth ratio required for a credit union to be ''adequately capitalized.''[9] If this credit union increased MBLs to 37.90 percent of total assets, its RBNW requirement would be 7.00 percent, equal to the net worth ratio for a credit union to be ''well capitalized.''[10] In an extreme example, a credit union with 100 percent of total assets in MBLs, with no unused commitments or contingent liabilities, and an allowance of 1.50 percent of total loans, would have an RBNW requirement of 11.52 percent.[11]

(c) *Long-term investments.* The portion of the ''Long-term investments'' risk portfolio up to and including its threshold of 15 percent of total assets is weighted by an RBNW factor of 6 percent. Long-term investments in excess of 15 percent of total assets are weighted by an RBNW factor of 12 percent. NCUA research indicates a 6-percent-coupon Treasury note with a maturity slightly longer than 5 years declines in value by about 12 percent for a 300-basis-point increase in interest rates. By way of comparison, a new issue 30-year mortgage-backed security declines in value by about 17 percent for a 300-basis-point increase in interest rates, as is the case for a 6-percent-coupon Treasury note with a maturity slightly longer than 8 years.

(d) *Low-risk assets.* All of the ''Low-risk assets'' portfolio is weighted by an RBNW factor of 3 percent. This reflects the credit risk of typical uninsured overnight or short-term accounts in corporate credit unions, other financial institutions, and Fed Funds sold.

(e) *Average-risk assets.* The ''Average-risk assets'' risk portfolio is weighted by an RBNW factor of 6 percent, equivalent to the net worth level required for a credit union to be ''adequately capitalized.'' The average level of risk for all assets in this portfolio typically is expected to be adequately protected by a 6 percent net worth ratio.

(f) *Loans sold with recourse.* This contingent liability is weighted by an RBNW factor of 6 percent. Examination experience indicates 6 percent is an adequate level to protect against credit risk retained and operation risk of servicing such loans.

(g) *Unused member business loan commitments.* This contingent liability is weighted by an RBNW factor of 6 percent. Examination experience indicates that not all commitments ultimately are drawn as loans. Thus, less net worth is necessary to protect against the total of unused commitments than would be necessary to protect against a similar level of outstanding loans.

(h) *Allowance.* This portfolio is weighted by negative 100 percent, thereby reducing the RBNW requirement otherwise resulting from the aggregate of the seven risk portfolios discussed above. § 702.105(a)–(g) .

5. Section 702.106—Alternative Components to Calculate Risk-Based Net Worth Requirement

The third and final step of the proposed process, reflected in section 702.106, gives ''complex'' credit unions the option to reduce the amount of the RBNW requirement calculated under section 702.105. This entails comparing any of three specific ''RBNW components'' in section 702.105 with its corresponding ''alternative component'' in section 702.106. Each ''alternative component,'' derived from additional financial data (to be included in optional, supplemental schedules of the Call Report), may yield a smaller percentage than its counterpart. *See* Appendix G. When this is the case, any of three ''alternative components'' can

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[8] Calculated as ((MBLs to the threshold of 12.25 times 6 percent) plus (MBLs over the threshold of 4.08 times 14 percent)) divided by total MBLs of 16.33.

[9] Calculated as (MBLs to the threshold of 12.25 times 6 percent) plus (MBLs above the threshold of 13.15 times 14 percent) plus (average risk assets of 74.60 times 6 percent) minus (ALL of 1.50 as a percent of total loans times 70 percent total loans/ total assets.)

[10] Calculated as (MBLs to the threshold of 12.25 times 6 percent) plus (MBLs above the threshold of 25.65 times 14 percent) plus (average risk assets of 62.10 times 6 percent) minus (ALL of 1.50 as a percent of total loans times 70 percent total loans/ total assets.)

[11] Calculated as (MBLs to the threshold of 12.25 times 6 percent) plus (MBLs over the threshold of 87.75 times 14 percent) minus (ALL of 1.50 as a percent of total loans times 100 percent total loans/ total assets.)

be substituted for its counterpart ''RBNW component,'' thereby reducing the credit union's RBNW requirement originally calculated under section 702.105.

(a) *Long-term real estate loans.* This ''alternative component'' requires long-term real estate loans to be allocated by remaining maturity into four maturity buckets—greater than 3, but less than or equal to 5 years; greater than 5, but less than or equal to 12 years; greater than 12, but less than or equal to 20 years; and greater than 20 years. These four maturity buckets are weighted by factors of 6, 8, 12, and 16 percent, respectively. The sum of the weighted buckets yields the ''alternative component.'' All long-term real estate loans are included in these four buckets without regard to the 25 percent threshold level in section 702.105(b). *See* Table 4(a) in § 702.106, and Appendix D.

The factors applied to the long-term real estate loan maturity buckets reflect examiner judgment of credit risk and interest rate risk in typical fixed-rate real estate loans. Since such loans are secured by residential real estate, after consideration of an adequate factor for interest rate risk, no additional percentage was judged necessary to adequately cover typical levels of other risks. By way of example, a 4½-year remaining maturity amortizing home equity loan would decline in value by 6-percent for a 300-basis-point increase in interest rates. Similarly, a 6-year remaining maturity amortizing home equity loan would decline in value by about 8 percent for a 300-basis-point increase in interest rates. A pool of 15-year original maturity mortgages, with an average 13-year remaining maturity and assuming a 6 percent constant prepayment rate, would decline in value by about 12 percent for a 300-basis-point increase in interest rates. A pool of 30-year original maturity mortgages, with an average 27-year remaining maturity and assuming a 6 percent constant prepayment rate, would decline in value by about 16 percent for a 300-basis-point increase in interest rates.

(b) *Member business loans outstanding.* This alternative component requires MBLs first to be categorized as fixed-rate or variable-rate. Next, MBLs in each category are allocated by remaining maturity into five maturity buckets—3 years or less; greater than 3, but less than or equal to 5 years; greater than 5, but less than or equal to 7 years; greater than 7, but less than or equal to 12 years; and greater than 12 years.[12] The five maturity buckets of fixed-rate MBLs are weighted by factors of 6, 9, 12, 14, and 16 percent, respectively. The five maturity buckets of variable-rate MBLs are weighted by factors of 6, 8, 10, 12, and 14 percent, respectively. The sum of the weighted buckets yields the ''alternative component.'' All MBLs are included in these ten buckets without regard to the 12.25 percent threshold level in section 702.105(b). *See* Table 4(b) in § 702.106, and Appendix E.

The factors applied to the maturity buckets for fixed- and variable-rate MBLs outstanding reflect examiner judgment of the credit risk and interest rate risk in representative MBLs outstanding. Typical MBLs include operating loans, equipment loans, and commercial real estate loans. Credit union portfolios of shorter (5 years or less) remaining maturity MBLs typically include a mix of types of seasoned MBLs, with reduced levels of credit risk in comparison to longer term loans. For example, a representative fixed-rate MBL is an amortizing loan with a remaining maturity of 1 year and 9 months. Such a loan would decline in value about 2½ percent for a 300-basis-point increase in interest rates. Considering credit risk is not expected to be fully correlated with interest rate risk, 3½ additional percentage points was judged adequate for coverage of credit risk.

For the remaining maturity buckets longer than 5 years, each factor equals the interest rate risk of a representative fixed-rate amortizing MBL for a 300-basis-point increase in interest rates, plus 4 percentage points for adequate coverage of credit risk. Representative fixed rate MBLs are summarized in Table 1 below.

TABLE 1 – REPRESENTATIVE FIXED-RATE MEMBER BUSINESS LOANS

Remaining Maturity Buckets (in years)	*Representative Amortizing Loan*	*Value Decline for 3% Rate Increase (ignoring credit risk change)*	*Adequate Additional Percentage for Credit Risk*	*Proposed Factor (percent)*
3 or less	1 year 9 months	2 ½	3 ½	6
>3 to <5	4 years	5 ½	3 ½	9
> 5 to <7	6 years	8	4	12
> 7 to <12	8 years	10	4	14
>12	13 years	12	4	16

For the variable-rate MBLs, each of the factors for the three categories with a remaining maturity of greater than 5 years was reduced by 2 percent in comparison to the factors for fixed-rate MBLs. The factor for the category with a remaining maturity greater than 3 but less than or equal to 5 years, was reduced by 1 percent in comparison to the factor for the corresponding fixed-rate MBLs. The value of a variable-rate MBL may decline less than the value of

[12] For federally-chartered credit unions, the maturity of MBLs is limited to 12 years, except ''lines of credit are not subject to a statutory or regulatory maturity limit.'' 12 CFR 701.21(c)(4). This limit does not apply to MBLs and lines of credit issued by federally-insured, State-chartered credit unions. Thus, the alternative component for MBLs includes a bucket to accommodate MBLs and lines of credit ''with a remaining maturity greater than 12 years.'' § 702.106(b)(1)(v) and (b)(2)(v).

a similar fixed-rate MBL for a given interest rate change, not considering credit risk. However, credit risk of a variable-rate loan typically increases in a higher rate environment, as the borrower comes under stress from meeting the increased interest expense burden.

(c) *Long-term investments.* This ''alternative component'' requires long-term investments to be allocated in categories by weighted-average life in finer increments than reported in the Call Report investment schedule. The four categories are: greater than 3, but less than or equal to 5 years; greater than 5, but less than or equal to 7 years; greater than 7, but less than or equal to 10 years; and greater than 10 years. These four categories are weighted by factors of 8, 12, 16, and 20 percent, respectively. *See* Table 4(c) in § 702.106, and Appendix F.

The factors applied to the weighted-average life categories approximate the economic value exposure to interest rate risk of representative investment securities. For example, a 300-basis-point increase in interest rates from 6 percent would result in: about an 8 percent decline in value of a 6-percent-coupon Treasury note of just over 3 years remaining maturity; about a 12 percent decline in value of a 6-percent-coupon Treasury note of just over 5 years remaining maturity; about a 16 percent decline in value of a 6-percent-coupon Treasury note of about 7½ years remaining maturity; and about a 20 percent decline in value of a 6-percent coupon Treasury bond of about 10½ years remaining maturity.

C. Impact of Risk-Based Net Worth Requirement

Once calculated, a ''complex'' credit union's RBNW requirement affects its classification among the statutory net worth categories. An ''adequately capitalized'' or a ''well capitalized'' credit union (6 to 6.99% and 7% or greater net worth ratio, respectively) whose net worth ratio meets its RBNW requirement remains classified in its original category. An otherwise ''adequately capitalized'' or ''well capitalized'' credit union whose net worth ratio falls short of its RBNW requirement declines by one or two net worth categories, respectively, to the top tier of the ''undercapitalized'' category, § 1790d(c)(1)(A)(ii) and (B)(ii), and thereby is subject to the four mandatory supervisory actions. 12 CFR 702.202(c).

Using Call Report data as of June 1999, NCUA estimates that 1490 federally-insured credit unions would qualify as ''complex.'' [13] The average estimated RBNW requirement was 6.63 percent for all 1490 of these credit unions. By way of comparison, the individual average net worth ratio for these credit unions is 12.70 percent. The estimated RBNW requirement was less than or equal to 7.01 percent for 75 percent of complex credit unions, and less than or equal to 7.66 percent for 90 percent of complex credit unions. Of the complex credit unions with a net worth ratio of 6 percent or greater, only 35 were estimated to fail their RBNW requirement using RBNW components in section 702.105 and, thus, would decline to the ''undercapitalized'' net worth category. These 35 credit unions still would have the option to substitute one or more ''alternative components'' under section 702.106 in an attempt to reduce their RBNW requirement.

As indicated in Table 2 below, there is a strong relationship between increasing asset size of a federally-insured credit union and the likelihood that it will be deemed ''complex.'' In general, the larger a credit union's asset size, the more likely it is to have the resources to manage the above average risks associated with risk portfolios that would qualify a credit union as ''complex.''

[13] The Call Report as of June 1999 does not provide data in sufficient detail to distinguish money market funds from mutual funds. When revised to conform to part 702, the Call Report will do so.

TABLE 2 – ESTIMATED IMPACT OF "COMPLEX" DEFINITION AND RBNW REQUIREMENT

	A	B	C	D	E
Range of Total Assets (in $millions)	*All CUs*	*Number of Complex CUs*	*Percentage of Complex / All CUs*	*Percentage of All Complex CUs*	*Estimated Number of "Undercap."*
			B/A = C	B/B total = D	
Greater than $500	117	47	40.2%	3.2%	0
Greater than $100 to $500	702	258	36.8%	17.3%	6
Greater than $50 to $100	697	210	30.1%	14.1%	5
Greater than $20 to $50	1,482	282	19.0%	18.9%	7
Greater than $10 to $20	1,481	198	13.4%	13.3%	8
Greater than $5 to $10	1,713	158	9.2%	10.6%	3
Greater than $2 to $5	1,882	132	7.0%	8.9%	3
Less than or equal to $2	2,766	205	7.4%	13.8%	3
Total	10,840	1,490	13.7%		35

The estimates in Table 2 above are based on June 1999 Call Report data as indicated in Tables 3 and 4 below: [14]

[14] Call Report line item references are subject to change when the Call Report is revised to conform with CUMAA and to incorporate the "PCA Worksheet."

TABLE 3 - CALL REPORT LINE ITEMS FOR IDENTIFYING A "COMPLEX" CREDIT UNION

Risk Portfolio	*Assets, Liabilities, and Contingent Liabilities in Risk Portfolio*	*Call Report Reference*
1. Long-term real estate loans	Total real estate loans **Less:** a) The amount of real estate loans that meet the definition of a member business loan. b) Real estate loans that will contractually refinance, reprice or mature within 3 years.	Schedule A, line 3 (Acct. Code 710) **Less:** a) Schedule A, line 9 (Acct. Code 718) b) Schedule A, line 11 (Acct. Code 712)
2. Member business loans	a) Outstanding member business loans. b) Unused Commitments for Commercial Real Estate, Construction, and Land Development.	a) Schedule B, line 3 (Acct. Code 400) b) Schedule G, line 1.D. (Acct. Code 814)
3. Long-term Investments	a) Investments with a weighted average life or repricing interval greater than 3 years. b) Mutual Funds & Common Trust Investments.	a) Schedule C, line 12.(Acct. Code 799C) + (Acct. Code 799D) b) Schedule C, line 4 (Acct. Code 743C)
4. Loans sold with recourse	Outstanding balance of loans sold or swapped with recourse.	Schedule G, line 2.B. (Acct. Code 819)

TABLE 4 - CALL REPORT LINE ITEMS FOR DETERMINING RBNW REQUIREMENT

Risk Portfolio	*Assets, Liabilities, and Contingent Liabilities in Risk Portfolio*	*Call Report Reference*
1. Long-term real estate loans	Total real estate loans **less**: a) The amount of real estate loans that meet the definition of a member business loan. b) Real estate loans that will contractually refinance, reprice or mature within 3 years.	Schedule A, line 3 (Acct. codes 710) **less**: a) Schedule A, line 9 (Acct. code 718) b) Schedule A, line 11 (Acct. code 712)
2. Member business loans	Outstanding member business loans	Schedule B, line 3 (Acct. code 400)
3. Long-term Investments	a) Investments with a weighted-average life or repricing interval greater than 3 years. b) Mutual Funds & Common Trust Investments	a) Schedule C, line 12.(Acct. code 799C) + (Acct. Code 799D) b) Schedule C, line 4 (Acct. code 743C)
4. Low-risk Assets	Cash and Cash Equivalents	Assets, line 1 (Acct. code 730)
5. Average-risk Assets	Total Assets **less:** Risk Portfolios 1- 4.	Assets, line 27 (Acct. code 010) **less**: Risk Portfolio line items 1- 4 above.
6. Loans sold with recourse	Outstanding balance of loans sold or swapped with recourse	Schedule G, line 2.B. (Acct. code 819)
7. Unused MBL Commitments	Commercial Real Estate Construction and Land Development	Schedule G, line 1.D. (Acct. code 814)
8. Allowance for Loan and Lease Losses	Allowance for Loan and Lease Losses	Assets, line 21 (Acct. code 719) (Limited to equivalent of 1.5 percent of total loans.)

D. Potential Impact of New Forms of Regulatory Capital

Many of those who commented on the proposed version of the part 702 final rule advocated a role for new forms of ''regulatory capital'' in PCA. While NCUA may have the statutory authority to permit new sources of capital,[15] CUMAA's express, limited definition of net worth—retained earnings under

[15] FCUA § 107 permits NCUA to authorize regulatory capital in the form of shares and subordinated debt. NCUA may authorize a federal credit union to (1) ''receive from its members, from other credit unions, from an officer, employee or agent of those nonmember units of Federal, Indian Tribal, or local governments and political subdivisions thereof, * * * [shares, share certificates, and share draft accounts]; subject to such terms, rates and conditions as may be established by the board of directors, *within limitations prescribed by the [NCUA] Board''*; and (2) ''borrow *in accordance with such rules as may be prescribed by the [NCUA] Board,* from any source, in an aggregate amount not exceeding * * * 50 per centum of its paid-in and unimpaired capital and surplus.'' 12 U.S.C. 1757(7), 1757(9) (emphasis added).

GAAP—clearly precludes all but low income-designated credit unions from classifying such capital as net worth for PCA purposes. § 1790d(o)(2). Nevertheless, NCUA recognizes that, if established, regulatory capital would be available to absorb losses, thereby insulating the NCUSIF from such losses. For this reason, the part 702 final rule makes regulatory capital, should it be established by NCUA, or authorized by State law and recognized by NCUA, a criterion in evaluating net worth restoration plans. 12 CFR 702.206(e).

Depending on how it is structured, regulatory capital on the balance sheet of a ''complex'' credit union could conceivably reduce the risk for which the RBNW requirement is designed to compensate. Therefore, NCUA may consider proposals to incorporate regulatory capital as a risk portfolio in section 702.103. This portfolio could be applied as an RBNW factor to reduce a credit union's RBNW requirement, as the ''Allowance'' RBNW component does in the proposed rule. § 702.105(h).

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis describing any significant economic impact a proposed regulation may have on a substantial number of small credit unions (primarily those under $1 million in assets). The proposed rule establishes an RBNW requirement to apply to federally-insured credit unions which meet the definition of ''complex.'' The RBNW requirement is expressly mandated by CUMAA as a component of NCUA's system of prompt corrective action. § 1790d(d).

For the purpose of this analysis, credit unions under $1 million in assets will be considered small entities. As of June 30, 1999, there were 1,690 such entities, with a total of $807.3 million in assets, with an average asset size of $0.5 million. These small entities make up 15.6 percent of all credit unions, but only 0.2 percent of all credit union assets.

The proposed rule implements a three-step process involving eight ''risk portfolios.'' The first step is to determine whether a credit union qualifies as ''complex'' based on whether any of four threshold percentages of total assets is exceeded by corresponding ''risk portfolios.'' The second step uses eight ''RBNW components'' (derived from the ''risk portfolios'') to calculate the individual RBNW requirement that applies to a credit union that qualifies as ''complex.'' The third step provides a ''complex'' credit union the opportunity to substitute any of three specific ''RBNW components'' with a corresponding ''alternative component'' that may reduce the RBNW requirement against which the credit union's quarterly net worth ratio is measured.

The NCUA Board does not believe that the proposed regulation would impose reporting or recordkeeping burdens that require specialized professional skills not available to them. Further, NCUA estimates that fewer than 50 of these small entities will meet the definition of ''complex'' and therefore be subject to the additional requirements of the proposed regulation. There are no other relevant federal rules which duplicate, overlap, or conflict with the proposed regulation.

The NCUA Board welcomes comments about ways to ease the burden on small entities.

Paperwork Reduction Act

NCUA has determined that three requirements of the proposed rule constitute collections of information under the Paperwork Reduction Act. The requirements are: (1) To determine whether the credit union qualifies as ''complex'' based on specific threshold percentages of total assets; (2) If a credit union qualifies as ''complex,'' to calculate the individual RBNW requirement; and (3) If a ''complex'' credit union prefers, to calculate any of three ''alternative components'' which may reduce its RBNW requirement. NCUA is submitting a copy of the proposed regulation to the Office of Management and Budget (OMB) for its review.

NCUA estimates that 10,800 federally insured credit unions would have to determine whether the credit union qualifies as ''complex'' under the proposed rule, based on data already collected in the Call Report. NCUA estimates that 1,500 federally-insured credit unions would qualify as ''complex,'' and would therefore be required to calculate the individual RBNW requirement using data already collected in the Call Report. NCUA further estimates that 35 federally-insured credit unions would opt to calculate the ''alternative components.'' For the 23 credit unions which file Call Reports semiannually, the burden of performing the calculation is 8 hours each (4 hours per quarter for the second and fourth quarters) for a total of 184 burden hours. For the 12 credit unions which file Call Reports quarterly, the burden of performing the calculation is 16 hours each (4 hours per quarter) for a total of 192 burden hours. In total, the burden created by the proposed rule is 376 hours. It is NCUA's view that the additional requirements are necessary for affected federally-insured credit unions to comply with the RBNW requirement implemented in the proposed rule as required by statute.

The Paperwork Reduction Act of 1995 and OMB regulations require that the public be provided an opportunity to comment on information collection requirements, including an agency's estimate of the burden of the collection of information. The NCUA Board invites comment on: (1) whether the collection of information is necessary; (2) the accuracy of NCUA's estimate of the burden of collecting the information; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) ways to minimize the burden of collection of information. Comments should be sent to: OMB Reports Management Branch, New Executive Office Building, Room 10202, Washington, D.C. 20503; Attention: Alex T. Hunt, Desk Officer for NCUA. Please send NCUA a copy of any comments you submit to OMB.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily adheres to the fundamental federalism principles addressed by the executive order. This proposed rule will apply to all federally-insured credit unions, including federally-insured, State-chartered credit unions. Accordingly, it may have a 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. This impact is an unavoidable consequence of carrying out the statutory mandate to adopt a system of prompt corrective action to apply to all federally-insured credit unions.

Agency Regulatory Goal

NCUA's goal is clear, understandable regulations that impose a minimal regulatory burden. Although much of the language of this rule is mandated by Congress, we request your comments on whether the proposed rule is understandable and minimally intrusive if implemented as proposed.

List of Subjects in 12 CFR Part 702

Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on February 3, 2000.

Becky Baker,

Secretary of the Board.

Accordingly, it is proposed that 12 CFR part 702 be amended as set forth below:

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. Paragraph (k) is added to § 702.2 to read as follows:

§ 702.2 Definitions.

* * * * *

(k) *Weighted-average life* means, for purposes of §§ 702.103(c)(1) and 702.106(c), 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, and then summing and dividing by the total amount of principal. The time at which the principal is expected to be received must be a reasonable and supportable estimate. The weighted-average life for portfolio investments in registered investment companies or collective investment funds (other than a money market fund) is defined as greater than five (5) years, but less than or equal to seven (7) years.

3. Sections 702.103, 702.104, 702.105 and 702.106 are added to Subpart A of part 702 to read as follows:

§ 702.103 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 month-end total assets corresponding to its Call Report period, rounded to two decimal places (Table 1):

(a) *Long-term real estate loans.* Total real estate loans and real estate lines of credit outstanding, exclusive of those outstanding that will contractually refinance, reprice or mature within 3 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) that are outstanding, exclusive of unused commitments;

(c) *Long-term investments.* Investments (as defined by 12 CFR 703.150 or applicable State law) that are either:

(1) Fixed-rate investments with a weighted-average life (as defined in § 702.2(k)) greater than 3 years;

(2) Variable-rate investments with the next rate adjustment period greater than 3 years; or

(3) Investments in a collective investment fund (*e.g.,* a common trust as defined in 12 CFR 703.100) or a registered investment company (*e.g.,* a mutual fund) other than a money market fund as defined in 17 CFR 270.2a–7;

(d) *Low-risk assets.* Cash and cash equivalents as defined under Generally Accepted Accounting Principles;

(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;

(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 1 -- §702.103 RISK PORTFOLIOS DEFINED

Risk portfolio	*Assets, liabilities or contingent liabilities*
1. 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 3 years
2. MBLs outstanding	Member business loans outstanding
3. Long-term investments	Investments with a weighted-average life (and the next rate adjustment period if variable rate) greater than 3 years; and investments in collective investment funds and registered investment companies other than money market funds
4. Low-risk assets	Cash and cash equivalents
5. Average-risk assets	100% of total assets minus sum of risk portfolios above
6. Loans sold with recourse	Outstanding balance of loans sold or swapped with recourse
7. Unused MBL commitments	Unused commitments for MBLs
8. Allowance	Allowance for Loan and Lease Losses limited to equivalent of 1.50 percent of total loans

§ 702.104 Thresholds to define complex credit unions.

A credit union is deemed complex if it exceeds the threshold percentage of month-end total assets corresponding to its Call Report period, in any of the following risk portfolios (Table 2):

(a) *Long-term real estate loans.* The threshold of long-term real estate loans, as defined in § 702.103(a), is twenty-five percent (25%) of total assets;

(b) *Combined member business loans outstanding and unused commitments.* The threshold of member business loans outstanding, as defined in § 702.103(b), and unused member business loan commitments, as defined in § 702.103(g), in the aggregate, is twelve and one-quarter percent (12.25%) of total assets.

(c) *Long-term investments.* The threshold of long-term investments, as defined in § 702.103(c), is fifteen percent (15%) of total assets; or

(d) *Loans sold with recourse.* The threshold of loans sold with recourse, as defined in § 702.103(f), is five percent (5%) of total assets.

TABLE 2 -- §702.104 THRESHOLDS TO DEFINE COMPLEX CREDIT UNIONS

Risk portfolios to define complex credit unions	*Thresholds to define "complex" (as percent of month-end total assets)*
1. Long-term real estate loans	25.00%
2. Combined portfolios of: a. MBLs outstanding and b. Unused MBL commitments	12.25%
3. Long-term investments	15.00%
4. Loans sold with recourse	5.00%

§ 702.105 RBNW components to calculate risk-based net worth requirement.

For purposes of §§ 702.102 and 702.302, a complex credit union's risk-based net worth requirement is the aggregate of the following RBNW component amounts, each expressed as a percentage of the credit union's month-end total assets corresponding to its Call Report period, rounded to two decimal places (Table 3):

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

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

(2) Fourteen percent (14%) of the amount in excess of twenty-five percent (25%) up to forty percent (40%) of total assets; and

(3) Sixteen percent (16%) of the amount in excess of forty percent (40%) of total assets;

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

(1) Six percent (6%) of the amount of member business loans outstanding up to twelve and one-quarter percent (12.25%) of total assets; and

(2) Fourteen percent (14%) of the amount in excess of twelve and one-quarter percent (12.25%) of total assets;

(c) *Long-term investments.* The sum of:

(1) Six percent (6%) of the amount of long-term investments up to fifteen percent (15%) of total assets; and

(2) Twelve percent (12%) of the amount in excess of fifteen percent (15%) of total assets;

(d) *Low-risk assets.* Three percent (3%) 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 3 -- §702.105 RBNW COMPONENTS TO CALCULATE RBNW REQUIREMENT

Risk portfolio	*Amount of risk portfolio (as percent of month-end total assets) to be multiplied by RBNW factor*	*RBNW factor*
1. Long-term real estate loans	0 to 25.00% over 25.00 to 40.00% over 40.00%	.06 .14 .16
2. MBLs outstanding	0 to 12.25% over 12.25%	.06 .14
3. Long-term investments	0 to 15.00% over 15.00%	.06 .12
4. Low-risk assets	All %	.03
5. Average-risk assets	All %	.06
6. Loans sold with recourse	All %	.06
7. Unused MBL commitments	All %	.06
8. Allowance	Limited to equivalent of 1.50% of total loans (expressed as a percent of total assets)	(1.00)

A complex credit union's RBNW requirement is the sum of eight RBNW components. An RBNW component is calculated for each of the eight risk portfolios, equal to the sum of each amount of a risk portfolio times its RBNW factor. A complex credit union is "undercapitalized" if its net worth ratio is less than its RBNW requirement.

§ 702.106 Alternative components to calculate risk-based net worth requirement.

A complex credit union may substitute an alternative component below, in place of a corresponding RBNW component in § 702.105 above, when any alternative component amount, expressed as a percentage of the credit union's month-end total assets corresponding to its Call Report period, rounded to two decimal places, is smaller (Table 4):

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

(1) Six percent (6%) of the amount of long-term real estate loans with a remaining maturity of greater than 3 years, but less than or equal to 5 years;

(2) 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;

(3) 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

(4) Sixteen percent (16%) of the amount of such loans with a remaining maturity greater than 20 years;

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

(1) 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;

(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 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) *Long-term investments.* The sum of:

(1) Eight percent (8%) of the amount of long-term investments with a weighted-average life (as defined in § 702.2(k) above) greater than 3 years, but less than or equal to 5 years;

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

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

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

TABLE 4 -- §702.106 ALTERNATIVE COMPONENTS FOR RBNW REQUIREMENT

a. LONG-TERM REAL ESTATE LOANS

Amount of Long-term real estate loans by remaining maturity	*Alternative factor*
> 3 years to 5 years	.06
> 5 years to 12 years	.08
> 12 years to 20 years	.12
> 20 years	.16

"Alternative component" is the sum of each amount of the Long-term real estate loans risk portfolio by remaining maturity (as a percent of month-end total assets) times its alternative factor. Substitute for corresponding RBNW component if smaller.

b. MEMBER BUSINESS LOANS

Amount of Member business loans by remaining maturity	*Alternative factor*
Fixed-rate MBLs 0 to 3 years	.06
> 3 years to 5 years	.09
> 5 years to 7 years	.12
> 7 years to 12 years	.14
> 12 years	.16
Variable-rate MBLs 0 to 3 years	.06
> 3 years to 5 years	.08
> 5 years to 7 years	.10
> 7 years to 12 years	.12
> 12 years	.14

"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 month-end total assets) times its alternative factor. Substitute for corresponding RBNW component if smaller.

c. LONG-TERM INVESTMENTS

Amount of Long-term investments by weighted-average life	*Alternative factor*
> 3 years to 5 years	.08
> 5 years to 7 years	.12
> 7 year to 10 years	.16
> 10 years	.20

"Alternative component" is the sum of each amount of the Long-term investments risk portfolio by weighted-average life (as a percent of month-end total assets) times its alternative factor. Substitute for corresponding RBNW component if smaller.

4. Appendices A through H are added to subpart A to read as follows:

Appendices to Subpart A

APPENDIX A – EXAMPLE OF THRESHOLDS TO DEFINE COMPLEX CREDIT UNIONS, §702.104 (EXAMPLE CALCULATION IN GREY)

Risk portfolio(s) for complex determination	*Dollar balance*	*Risk portfolio(s) percent of month-end total assets*	*Threshold to define "complex" percent of month-end total assets*
Month-end total assets	200,000,000.00		
1. Long-term real estate loans risk portfolio	60,000,000.00	30.00%	25.00%
2. Combined MBL portfolios: a) MBLs outstanding risk portfolio b) Unused MBL commitments risk portfolio	 20,000,000.00 16,000,000.00	 10.00% 8.00%	
Combined MBL portfolios (sum of percentages for MBLs outstanding risk portfolio and unused MBL commitments risk portfolio)		18.00%	12.25%
3. Long-term investments risk portfolio	32,000,000.00	16.00%	15.00%
4. Loans sold with recourse risk portfolio	40,000,000.00	20.00%	5.00%

APPENDIX B – EXAMPLE RBNW COMPONENTS FOR RBNW REQUIREMENT, §702.105

(EXAMPLE CALCULATION IN GREY)

Risk portfolio	*Dollar balance*	*Percent of month-end total assets*	*Amount thresholds for RBNW factors*	*Amount of risk portfolio*	*RBNW factor*	*RBNW component*
Month-end total assets	200,000,000.00	100.00%				
1. Long-term real estate loans	60,000,000.00	30.00%				
Base amount			0 to 25.00%	25.00%	.06	1.50%
Second amount			over 25.00 to 40.00%	5.00%	.14	0.70%
Third amount			over 40.00%	0.00%	.16	0.00%
2. MBLs outstanding	20,000,000.00	10.00%				
Base amount			0 to 12.25%	10.00%	.06	0.60%
Second amount			over 12.25%	0.00%	.14	0.00%
3. Long-term investments	32,000,000.00	16.00%				
Base amount			0 to 15.00%	15.00%	.06	0.90%
Second amount			over 15.00%	1.00%	.12	0.12%
4. Low-risk assets	40,000,000.00	20.00%	All %	20.00%	.03	0.60%
Sum of risk portfolio nos. 1 through 4	152,000,000.00	76.00%				
5. Average-risk assets	48,000,000.00.	24.00%[a]	All %	24.00%	.06	1.44%
6. Loans sold with recourse	40,000,000.00	20.00%	All %	20.00%	.06	1.20%
7. Unused MBL commitments	16,000,000.00	8.00%	All %	8.00%	.06	0.48%
8. Allowance	1,800,000.00 [b]	0.90%	All %	0.90%	(1.00)	(0.90)%
Sum of RBNW components: **RBNW requirement** [c]						**6.64%**

[a] The Average-risk assets risk portfolio percent of month-end total assets equals 100.00 percent minus the sum of the percentages in the four risk portfolios above (i.e., Long-term real estate loans, MBLs outstanding, Long-term 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 C below.

[c] A complex credit union is "undercapitalized" if its net worth ratio is less than its RBNW requirement. The dollar equivalent of RBNW requirement may be computed for informational purposes as the RBNW requirement percent of total assets.

APPENDIX C – ALLOWANCE RISK PORTFOLIO DOLLAR BALANCE WORKSHEET

(EXAMPLE CALCULATION IN GREY)

Balance sheet account	*Dollar balance*	*Percent of total loans*	*Range of ALL permitted*	*Permitted ALL percent of total loans*	*Permitted dollar balance of Allowance*
Allowance for Loan and Lease Losses (ALL)	2,400,000.00	2.00%	0 to 1.50%	1.50%	1,800,000.00
Total loans	120,000,000.00				

APPENDIX D – EXAMPLE LONG-TERM REAL ESTATE LOANS ALTERNATIVE COMPONENT, §702.106(a)

(EXAMPLE CALCULATION IN GREY)

Remaining maturity	*Dollar balance of Long-term real estate loans by remaining maturity*	*Percent of total assets by remaining maturity*	*Alternative factors*	*Alternative component calculation*
> 3 years to 5 years	50,000,000.00	25.00%	.06	1.50%
> 5 years to 12 years	0.00	0.00%	.08	0.00%
> 12 years to 20 years	10,000,000.00	5.00%	.12	0.60%
> 20 years	0.00	0.00%	.16	0.00%
Sum of above equals Alternative component*				2.10%

* Substitute for RBNW component if lower.

APPENDIX E – EXAMPLE MEMBER BUSINESS LOANS ALTERNATIVE COMPONENT, §702.106(b)

(EXAMPLE CALCULATION IN GREY)

Remaining maturity	*Dollar balance of Member business loans by remaining maturity*	*Percent of total assets by remaining maturity*	*Alternative factors*	*Alternative component calculation*
Fixed-rate MBLs 0 to 3 years	6,000,000.00	3.00%	.06	0.18%
> 3 years to 5 years	4,000,000.00	2.00%	.09	0.18%
> 5 years to 7 years	2,000,000.00	1.00%	.12	0.12%
> 7 years to 12 years	0.00	0.00%	.14	0.00%
> 12 years	0.00	0.00%	.16	0.00%
Variable-rate MBLs 0 to 3 years	2,000,000.00	1.00%	.06	0.06%
> 3 years to 5 years	4,000,000.00	2.00%	.08	0.16%
> 5 years to 7 years	2,000,000.00	1.00%	.10	0.10%
> 7 years to 12 years	0.00	0.00%	.12	0.00%
>12 years	0.00	0.00%	.14	0.00%
Sum of above equals Alternative component*				0.80%

* Substitute for RBNW component if lower.

APPENDIX F -- EXAMPLE LONG-TERM INVESTMENTS ALTERNATIVE COMPONENT, §702.106(c)

(EXAMPLE CALCULATION IN GREY)

Weighted-average life	*Dollar balance of Long-term investments by weighted average-life*	*Percent of total assets by weighted average-life*	*Alternative factors*	*Alternative component calculation*
> 3 years to 5 years	20,000,000.00	10.00%	.08	0.80%
> 5 years to 7 years	10,000,000.00	5.00%	.12	0.60%
> 7 years to 10 years	2,000,000.00	1.00%	.16	0.16%
> 10 years	0.00	0.00%	.20	0.00%
Sum of above equals Alternative component*				1.56%

* Substitute for RBNW component if lower.

APPENDIX G -- EXAMPLE RBNW REQUIREMENT USING ALTERNATIVE COMPONENTS (EXAMPLE CALCULATION IN GREY)

Risk portfolio	*RBNW component*	*Alternative component*	*Lower of RBNW or Alternative component*
1. Long-term real estate loans	2.20%	2.10%	2.10%
2. MBLs outstanding	0.60%	0.80%	0.60%
3. Long-term investments	1.02%	1.56%	1.02%
			RBNW component
4. Low-risk assets			0.60%
5. Average-risk assets			1.44%
6. Loans sold with recourse			1.20%
7. Unused MBL commitments			0.48%
8. Allowance			(0.90)%
RBNW requirement* Compare to Net Worth Ratio			**6.54%**

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

Appendix H—Structural Overview of §§ 702.103 through 702.106

Sections 702.103 through 702.106 implement a three-step process involving eight "risk portfolios" which are defined in § 702.103. The first step, reflected in § 702.104, is to determine whether a credit union qualifies as "complex" based on whether any of four specific threshold percentages of total assets is exceeded by corresponding "risk portfolios." The second step, reflected in § 702.105, uses eight "RBNW components" (derived from the "risk portfolios" in § 702.103) to calculate the individual RBNW requirement that applies to a credit union which meets § 702.104's definition of "complex." The third and final step, reflected in § 702.106, gives a "complex" credit union the opportunity to substitute any of three specific "RBNW components" with a corresponding "alternative component" that may reduce the RBNW requirement against which the credit union's net worth ratio is measured. While all credit unions determine their net worth ratio quarterly, 12 CFR 702.101(a), the determination whether a credit union is "complex" and, if so, the determination of its RBNW requirement, is made on a quarterly basis by credit unions which file Call Reports quarterly, and on a semiannual basis by credit unions which file Call Reports semiannually.

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