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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 701, 703, 713, 721, 723, and 742

RIN 3133-AD98

Eligible Obligations, Charitable Contributions, Nonmember Deposits, Fixed Assets, Investments, Fidelity Bonds, Incidental Powers, Member Business Loans, and Regulatory Flexibility Program

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule and interim final rule with comment period.

SUMMARY: NCUA is removing certain regulations and eliminating the Regulatory Flexibility Program (RegFlex) to provide regulatory relief to federal credit unions. NCUA is also removing or amending related rules to ease compliance burden while retaining certain safety and soundness standards. Those rules pertain to eligible obligations, charitable contributions, nonmember deposits, fixed assets, investments, incidental powers, and member business loans. In addition, NCUA is issuing an interim final rule

with a request for comment to amend a provision in the fidelity bond rule to remove references to RegFlex.

DATES: *Effective dates:* The final rule, as well as the interim final rule pertaining to the revisions in the fidelity bond rule, §713.6, will go into effect on [Insert date 30 days from date of publication in the FEDERAL REGISTER].

Comment date: We will consider comments on the interim final rule portion (the fidelity bond rule, §713.6), as discussed in section IV of the preamble of this rulemaking. Send your comments to reach us on or before [Insert date 60 days from date of publication in the FEDERAL REGISTER]. We may not consider comments received after the above date in making any decision whether to amend the interim final rule.

ADDRESSES: In commenting on the interim final rule, 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.
- E-mail: Address to regcomments@ncua.gov. Include "[Your name] Comments on Interim Final Rule, Section 713.6, Fidelity Bond" in the e-mail subject line.
- Fax: (703) 518-6319. Use the subject line described above for e-mail.

- 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 website 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 e-mail to OGCMail@ncua.gov.

FOR FURTHER INFORMATION CONTACT: Chrisanthy Loizos, Staff Attorney, Office of General Counsel, at the above address or telephone (703) 518-6540, or Matthew J. Biliouris, Director of Supervision, or J. Owen Cole, Director, Division of Capital Markets, Office of Examination and Insurance, at the above address or telephone (703) 518-6360.

SUPPLEMENTARY INFORMATION:

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II. Summary of Comments on December 2011 Proposed Rule
III. Final Rule

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I. Background

a. Why is NCUA adopting this rule?

On July 11, 2011, President Obama issued Executive Order 13579, ordering independent agencies, including NCUA, to consider whether they can modify, streamline, expand, or repeal existing rules to make their programs more effective and less burdensome. Consistent with the spirit of the Executive Order and as part of NCUA's Regulatory Modernization Initiative, the NCUA Board (Board) is adopting this rule to streamline its regulatory program by eliminating RegFlex. The final rule relieves regulatory burden on federal credit unions (FCUs) because they will no longer need to engage in any process for a RegFlex designation. In addition, the final rule provides regulatory relief to FCUs that are currently not RegFlex eligible because it extends to them most of the flexibilities previously available only to RegFlex FCUs.

The Board issued a Notice of Proposed Rulemaking (NPRM) in December 2011. 76 FR 81421 (Dec. 28, 2011). The comment period on the proposed rule ended on February 27, 2012. NCUA received seventeen comment letters on the NPRM: four from FCUs,

three from trade associations (1 representing banks, 2 representing credit unions), nine from state credit union leagues, and one from a law firm. The majority of the commenters supported the rulemaking generally. Four commenters did not support the rule as proposed, and the remaining commenters offered comments on particular provisions but did not take a position on the initiative as a whole. For the reasons discussed below, the Board is adopting the amendments almost exactly as proposed. As such, the Board does not restate the legal analysis it presented in the NPRM's preamble and incorporates it by reference here in this rulemaking. Id.

b. What was RegFlex?

The Board established RegFlex in 2002. 66 FR 58656 (Nov. 23, 2001). RegFlex relieved FCUs from certain regulatory restrictions and granted them additional powers if they demonstrated sustained superior performance as measured by CAMEL rating and net worth classification. An FCU could qualify for RegFlex treatment automatically or by application to the appropriate regional director. Specifically, an FCU automatically qualified for a RegFlex designation when it received a composite CAMEL rating of "1" or "2" for two consecutive examination cycles and maintained a net worth classification of "well capitalized" under part 702 of NCUA's rules for the last six quarters. An FCU subject to a risk-based net worth (RBNW) requirement under part 702 could also qualify for RegFlex treatment if it remained "well capitalized" for the last six quarters after

applying the applicable RBNW requirement. FCUs that did not automatically qualify for a RegFlex designation could seek one with the appropriate regional director.

The rule gave RegFlex FCUs relief from restrictions in the following six areas or "flexibilities": (1) charitable contributions; (2) nonmember deposits; (3) fixed assets; (4) zero-coupon investments; (5) borrowing repurchase transactions; and (6) commercial mortgage related securities (CMRS). It provided an additional flexibility by specifically authorizing the purchase of obligations from federally insured credit unions beyond those an FCU may purchase under the NCUA's eligible obligations rule, §701.23. RegFlex FCUs were also permitted a higher maximum allowable deductible for fidelity bond coverage under §713.6.

c. What changes did NCUA propose?

The Board proposed to eliminate RegFlex and the charitable contributions rule, and amend the rules that apply to eligible obligations, nonmember deposits, fixed assets, and investments, so that all FCUs could engage in activities previously permitted only for RegFlex FCUs, subject to some conditions. 76 FR 81421 (Dec. 28, 2011).

The NPRM removed the charitable contributions rule in its entirety and placed the remaining six flexibilities of the RegFlex rule into the subject-specific rules that apply to all FCUs. It adjusted the nonmember deposits rule to allow some FCUs to accept more

nonmember deposits. The proposed rule extended to six years the amount of time in which all FCUs must occupy unimproved property under NCUA's fixed assets rule. The proposed amendments to the investment rule permitted extended maturities for zero-coupon investments and borrowing repurchase transactions, as well as the purchase of CMRS under similar conditions allowed for RegFlex FCUs. The NPRM moved the provisions to buy nonmember and other obligations from the RegFlex rule into the eligible obligations rule, §701.23. Lastly, the proposal made a nonsubstantive change to the member business loan rule that cross-references RegFlex.

While providing additional regulatory flexibility, the NPRM made a few modifications to authorities and did not extend the full scope of every RegFlex authority to all FCUs. The Board proposed to remove the automatic exemption from the nonmember deposits limit that had been granted to RegFlex FCUs. In so doing, the Board noted that the change would not negatively impact those FCUs based on the volume of nonmember deposits held by them.

With regard to the investment rule amendments, the NPRM created a "well capitalized standard" based on the automatic designation criteria used in RegFlex. An FCU meets the well capitalized standard if it has received a composite CAMEL rating of "1" or "2" for two consecutive full examinations and (1) has maintained a "well capitalized" net worth classification for the immediately preceding six quarters, or (2) has remained "well

capitalized" for the immediately preceding six quarters after applying the applicable RBNW requirement.

The proposed rule provided that well capitalized FCUs could purchase zero-coupon investments with a maximum maturity of no more than 30 years, while FCUs not meeting the standard would continue to be subject to a maturity cap of 10 years unless they received approval from their regional director. The NPRM permitted FCUs not meeting the well capitalized standard to enter into borrowing repurchase transactions in which the security purchased with the proceeds from the borrowing agreement matured no more than 30 days after the maturity of the borrowing, unless they received additional approval from their regional director. Consistent with the RegFlex program, the NPRM did not impose the 30-day mismatch restriction on FCUs meeting the well capitalized standard. The proposal limited the amount of securities that any FCU, whether well capitalized or not, could purchase with mismatched maturities to 100% of the FCU's net worth. It also permitted FCUs not meeting the well capitalized standard to purchase private label CMRS subject to an aggregate limit of 25% of net worth, unless their regional director granted authority to purchase securities in an amount up to 50% of net worth, which is the cap for FCUs meeting the well capitalized standard.

II. Summary of Comments on December 2011 Proposed Rule

A majority of commenters supported the Board's efforts to extend regulatory flexibility to FCUs. Other commenters felt the proposal did not provide enough relief and failed to extend similar relief to federally insured, state-chartered credit unions. One credit union trade association stated that the proposal removed clear eligibility standards for FCUs to obtain expanded authorities. It opposed the elimination of an appeals process to NCUA's Supervisory Review Committee, similar to the one through which RegFlex FCUs could appeal RegFlex designation revocations, if an FCU were not permitted to engage in the full range of flexibilities. The bank trade association stated that, although it supports efforts to reduce regulatory burdens, NCUA should not extend such regulatory relief to FCUs that are undercapitalized or represent supervisory concerns. Another commenter found that the RegFlex program under part 742 sufficiently accomplished its goals in its current form. The Board has carefully reviewed and analyzed the comment letters and describes specific comments on the NPRM below.

a. Charitable Contributions

In the NPRM, the Board proposed to eliminate the entire charitable contributions rule, §701.25. Section 701.25 restricts an FCU's ability to make donations. It only allows an FCU to make charitable contributions or donations to nonprofit organizations located or conducting activities in a community in which the FCU has a place of business, or to organizations that are tax exempt under §501(c)(3) of the Internal Revenue Code and that operate primarily to promote and develop credit unions. It further requires an

FCU's board of directors to approve charitable contributions based on a determination that the contributions are in the FCU's best interests and are reasonable given the FCU's size and financial condition. Under the rule, directors may establish a budget for charitable donations and authorize FCU officials to select recipients and disburse funds. The RegFlex rule, §742.4(a)(1), exempted RegFlex FCUs from the entire charitable contributions rule. By removing §701.25, the Board is now allowing any FCU to make donations without the prior approval of its board of directors and without regulatory restrictions as to recipients.

In the NPRM, the Board noted that, even in the absence of a charitable contributions rule, an FCU's authority to make donations is authorized by incidental powers given in the Federal Credit Union Act (Act), 12 U.S.C. 1757(17). As such, contributions must be necessary or requisite to enable the FCU to effectively carry on its business. See 12 CFR 721.2. Furthermore, FCU directors have a fiduciary duty to direct management to operate within sound business practices and the best interests of the membership under §701.4. In addition, article XVI, section 4 of the FCU Bylaws prohibits FCU directors, committee members, officers, agents, and employees from conflicts of interest that could arise in the context of making charitable donations.

Two credit union trade associations, four leagues, and three credit unions supported the elimination of the charitable contributions rule. Three of these commenters maintained that the limitations on an FCU's incidental powers, the board's fiduciary duties, and the

FCU Bylaws already set the appropriate standards for charitable contributions. One commenter stated that the change would eliminate a bureaucratic hurdle and enable FCUs to further their mission of helping people of modest means. The bank trade association stated that the charitable contributions rule protects the interests of members and avoids conflicts of interest and, therefore, requested that NCUA retain it. The Board believes the Act, FCU bylaws, part 721, and §701.4 provide sufficient constraints on an FCU's ability to make charitable contributions. Accordingly, the final rule removes §701.25 as proposed.

One credit union commenter expressed concern that FCUs would need to seek approval to make donations because NCUA did not propose to amend §721.3 to expressly identify charitable contributions as a preapproved incidental power. Since 1979, NCUA has recognized that FCUs may make charitable contributions under the provision in the Act that authorizes an FCU ''to exercise such incidental powers as shall be necessary or requisite to enable it to carry on effectively the business for which it is incorporated.'' 44 FR 56691 (Oct. 2, 1979); 64 FR 19441 (Apr. 21, 1999); 12 U.S.C. 1757(17). The Board appreciates the suggestion to clarify an FCU's authority to make charitable contributions and donations in the incidental powers rule. The final rule amends §721.3 accordingly by adding a new paragraph, derived from NCUA legal opinions, identifying this authority.

b. Nonmember Deposits

The Act permits an FCU to receive shares from nonmember public units, political subdivisions, and credit unions, subject to the limits in the nonmember deposits rule, §701.32. 12 U.S.C. 1757(6); 12 CFR 701.32. Under paragraph (b) of §701.32, the maximum amount of all public unit and nonmember shares that an FCU may hold cannot exceed the greater of 20% of the FCU's total shares or $1.5 million. Under paragraph (c) of §701.32, nonmember share deposits that an FCU has accepted to meet a matching requirement for a Community Development Revolving Loan Fund loan count against the nonmember deposit limit once the FCU has repaid the loan. An FCU may request an exemption from its regional director to exceed the limit. If the regional director denies the request for an exemption, the FCU may appeal the decision to the Board. The RegFlex rule exempted RegFlex FCUs from both paragraphs (b) and (c) of §701.32, so RegFlex FCUs have not been subject to the limit on the amount of public unit and nonmember shares.

The NPRM raised the dollar threshold on the nonmember deposit limit in §701.32(b) to $3 million. The Board acknowledged that, by eliminating RegFlex, RegFlex FCUs would lose their blanket exemption from the nonmember deposit cap. Based on the amount of nonmember deposits held by RegFlex FCUs, however, the Board stated that the proposal provided all of the necessary flexibility and regulatory relief to all FCUs without adversely affecting any of the RegFlex FCUs that have accepted nonmember deposits in excess of the cap.

Both credit union trade associations and two leagues objected to the elimination of the RegFlex blanket exemption from the nonmember deposit rule's cap because all FCUs would now need a waiver to exceed the cap. One commenter stated that most FCUs find the waiver process, in general, to be unduly burdensome, time consuming, and, on occasion, arbitrary. One commenter characterized the removal of the exemption as an unfair and inflexible approach, and another stated that the change does not represent an easing of regulatory compliance burden. Three of these commenters generally supported raising the dollar threshold, but one of the trade associations stated it was unclear why NCUA chose the new level to be $3 million. The league commenters agreed with the $3 million threshold, suggested a higher threshold, or advocated preservation of the exemption for RegFlex institutions. One commenter suggested that NCUA eliminate the cap or, at a minimum, increase it to $5 million.

Two league commenters and one credit union supported the change to the nonmember deposit dollar threshold. One commenter stated that, although the rule would eliminate the current exemption, the proposal provided the appropriate amount of flexibility and regulatory relief to FCUs without adversely impacting RegFlex FCUs. Another commenter noted that smaller asset-sized FCUs can enjoy the opportunity to acquire an increased volume of nonmember deposits.

The bank trade association supported the proposed rule's requirement that all FCUs be subject to nonmember share limits. It objected, however, to the proposed increase of the dollar threshold from $1.5 million to $3 million, citing asset liability management and liquidity concerns that could be created for some small FCUs with such an increase. The commenter stated that small FCUs may not have the necessary plans, practices, and experience to manage such an inflow of deposits. It, therefore, recommended the rule require small FCUs taking advantage of the higher threshold of $3 million to adopt policies managing the risk associated with nonmember deposits. The commenter further stated that because NCUA's Prompt Corrective Action rule, §702.202, specifies that the prohibition on accepting nonmember deposits is a discretionary supervisory action for NCUA, undercapitalized credit unions should be prohibited from accepting or rolling over nonmember deposits.

As the Board stated in the NPRM, nonmember shares are characteristically more volatile than core member shares. This additional volatility can pose asset liability management concerns and liquidity concerns. The Board determined it was appropriate to raise the dollar threshold to $3 million because the agency's data reveals that only four RegFlex FCUs currently exceed the limitation in §701.32(b) of the greater of 20% of total shares or $1.5 million in nonmember deposits, and each of those FCUs holds less than $3 million. To raise the maximum dollar threshold to $5 million would create a wider gap for FCUs with lower total shares from the percentage of 20% of total shares threshold without any need for such an increase. For instance, an FCU with

$7.5 million in total shares has been subject to the $1.5 million and 20% percent caps of §701.32. Under this final rule, however, the FCU will be permitted to accept up to $3 million in nonmember deposits, representing 40% of total shares. To permit this FCU to accept up to $5 million in shares would permit the FCU to accept nonmember deposits amounting to two-thirds or over 66% of its total shares. As such, the final rule maintains the proposed adjustment to the dollar threshold in paragraph (b)(1) because it maintains the regulatory relief that RegFlex FCUs have enjoyed. Furthermore, the adjustment extends relief to FCUs, particularly those FCUs that have lower amounts of total shares, and remains attentive to safety and soundness considerations. The Board also finds it unnecessary to include a blanket prohibition for undercapitalized FCUs to accept nonmember deposits in §701.32 as suggested by one commenter. The Prompt Corrective Action rule, §702.202(b)(6), offers NCUA the appropriate flexibility in determining whether limiting or prohibiting an undercapitalized FCU from accepting nonmember deposits is the appropriate supervisory action under particular facts.

c. Fixed Assets

The Act authorizes an FCU to purchase, hold, and dispose of property necessary or incidental to its operations. 12 U.S.C. 1757(4). Generally, the fixed assets rule provides limits on fixed asset investments, establishes occupancy and other requirements for acquired and abandoned premises, and prohibits certain transactions. 12 CFR 701.36. “Fixed assets” is defined in §701.36(e) and includes premises.

"Premises" means any office, branch office, suboffice, service center, parking lot, facility, or real estate where a credit union transacts or will transact business.

When an FCU acquires premises for future expansion and does not fully occupy the space within one year, the rule requires the FCU's board of directors to have a resolution in place by the end of that year with plans for full occupation. 12 CFR 701.36(b)(1). Additionally, the FCU must partially occupy the premises within three years, unless the FCU obtains a waiver within 30 months of acquiring the premises. 12 CFR 701.36(b)(1)-(2). RegFlex FCUs have enjoyed more flexibility by having authority to take up to six years to partially occupy unimproved land they acquired for future expansion. 12 CFR 701.36(d), 742.4(a)(3). In the NPRM, the Board proposed to amend the fixed assets rule to extend the three-year time period to six years for any FCU that acquires unimproved land.

One credit union trade association, five leagues, and two credit unions supported the proposed extension of time from three years to six years. One league noted that, while most FCUs will probably not use the expanded time frame, the flexibility will assist them in implementing building plans efficiently. Another league stated that the change provides relief to FCUs that acquired land during better economic times or rates. It noted that, under the proposed extension, FCUs will not be forced to choose between seeking a waiver or selling land because they could not meet the three-year timeline.

As noted in the NPRM's preamble and discussed in previous rulemakings, the Board recognizes that many real estate transactions are complex and time consuming, and they involve a full array of issues that an FCU must address before it is ready to occupy the premises. This is especially true in the unimproved land context with its construction-related issues. The final rule adopts the change to the fixed assets rule as proposed by permitting any FCU a longer time (up to six years, rather than only three years) to partially occupy the premises if it initially acquired the property as unimproved land.

d. Investment Authorities

Some of the commenters provided general comments applicable to most or all facets of the NPRM's proposed changes to the investment rule. One credit union generally supported the ability of all FCUs to invest in zero-coupon investments and CMRS, as well as to engage in borrowing repurchase transactions. Two leagues stated that, while their members were generally supportive of giving FCUs expanded investment authorities, these relatively sophisticated financial instruments require a baseline of expertise. The commenters stated that the rule should include requirements for staff to have demonstrated expertise to handle these transactions. One league argued that the proposal's well capitalized standard merely eliminates the RegFlex designation while preserving the same restrictions on eligibility. As such, the commenter urged NCUA to consider whether the current restrictions on some types of investments should be

removed for more FCUs to allow flexibility in diversifying investments and to reduce reliance on the "currently limited" investments allowed under NCUA's rules. The Board maintains the standards and conditions for the various investment authorities set forth the proposed rule as discussed in the responses to specific comments below.

1. Zero-coupon Investments

Under §703.16(b), an FCU may not purchase a zero-coupon investment with a maturity date that is more than 10 years from the related settlement date. RegFlex FCUs have been exempt from the maximum maturity length of 10 years in the investment rule. 12 CFR 742.4(a)(4). To balance the risk management concerns inherent in zero-coupon investments with the flexibility previously granted to RegFlex FCUs, the Board proposed to establish the maximum maturity date of zero-coupon investments to 30 years for any FCU that meets the NPRM's well capitalized standard. The Board proposed to grandfather zero-coupon investments purchased in accordance with §742.4(a)(4) before the effective date of the final rule, so FCUs that purchased zero-coupon investments with maturities greater than 10 years under RegFlex authority would not be required to divest those investments. The proposed rule also provided that an FCU not meeting the well capitalized standard may only purchase a zero-coupon investment with a maturity date that is no more than 10 years from the related settlement date, unless it received approval from its regional director to purchase such an investment with a greater maturity.

Three commenters objected to the proposed rule change for zero-coupon investments. One credit union trade association encouraged NCUA to eliminate the 10-year maturity limit for zero-coupon investments. One credit union stated the current rule is sufficient. Both of these commenters stated that this issue is more appropriately addressed within an FCU's investment policy. One league stated that it is more appropriate to adopt a rule specific to interest rate risk rather than remove the current flexibility afforded to certain RegFlex FCUs.

Two leagues supported the proposed changes regarding zero-coupon investments. One commenter stated that it is reasonable to require an FCU that does not meet the well capitalized standard to obtain approval from its regional director to purchase a zero-coupon investment with a maturity greater than ten years. The commenter also supported the creation of a maximum maturity date of 30 years for well capitalized FCUs. Another commenter suggested that the proposal include greater flexibility by permitting well capitalized FCUs to pursue a waiver from the 30-year maturity limit, as other FCUs would have the option to seek waivers from their 10-year maturity cap.

As the Board noted in the NPRM's preamble, the percentage loss on zero-coupon investments increases dramatically with maturity. These losses could make FCUs reluctant to sell zero-coupon investments and recognize losses during periods of liquidity stress. Therefore, consistent with safety and soundness principles, the Board

does not believe it is appropriate to allow FCUs to purchase or hold zero-coupon investments with maturity dates that exceed 30 years. Accordingly, the Board adopts the final rule as proposed.

2. Borrowing Repurchase Transactions

A borrowing repurchase transaction is a transaction in which an FCU agrees to sell a security to a counterparty and to repurchase the same or an identical security from that counterparty at a specified future date and at a specified price. 12 CFR 703.2. Subject to additional restrictions, an FCU may enter into a borrowing repurchase transaction as long as any investments the FCU purchases with borrowed funds mature no later than the maturity of the borrowing repurchase transaction. 12 CFR 703.13(d).

While the investment rule prohibits an FCU from purchasing a security with the proceeds from a borrowing repurchase agreement if the purchased security matures after the maturity of the borrowing repurchase agreement, NCUA adopted a limited exemption for RegFlex FCUs from the maturity restriction. 12 CFR 703.13(d)(3); 68 FR 32958, 32959 (June 3, 2003). A RegFlex FCU has been permitted to purchase securities with maturities exceeding the maturity of the borrowing repurchase transaction, commonly referred to as having mismatched maturities, provided the amount of any such purchased securities does not exceed the FCU's net worth. 12 CFR 742.4(a)(5).

In the NPRM, the Board proposed to continue this flexibility of mismatched maturities for borrowing repurchase transactions for FCUs meeting the well capitalized standard. It also proposed to grandfather borrowing repurchase transactions into which an FCU entered pursuant to its RegFlex authority before the effective date of the final rule. The Board also sought to extend relief from the maturity requirement to FCUs not meeting the well capitalized standard. Under the proposed rule, these FCUs could enter into borrowing repurchase transactions and use the proceeds to purchase investments with maturities no more than 30 days later than the transaction's term, so long as the value of the purchased investments would not exceed the related FCU's net worth. In addition, under the NPRM, FCUs not meeting the well capitalized standard would be allowed to request additional authority from their regional directors to enter transactions whereby the maturity mismatch would be greater than 30 days. Lastly, the Board sought comment on whether the final rule should specify minimum experience requirements for staff involved in the analysis and ongoing risk management of a repurchase agreement book, especially in cases where maturities of sources and uses are mismatched.

Two leagues and one credit union supported the revised standards on maturity matching for borrowing repurchase transactions. One credit union requested that the final rule permit FCUs that are well capitalized under part 702 but that do not have a CAMEL rating of 1 or 2 to enter these transactions without a maturity mismatch limitation, provided the assets pledged are guaranteed by a governmental agency or

government-sponsored enterprise. One credit union trade association did not support any minimum experience requirements for staff involved in the analysis and ongoing risk management of borrowing repurchase transactions, arguing that FCUs should have the flexibility to hire qualified personnel without comparing the applicant to a predetermined set of NCUA criteria.

The final rule makes no substantive change to the proposed rule. It does clarify, however, that when an FCU purchases investments that have mismatched maturities under borrowing repurchase agreements, the aggregate or total value of purchased investments made under these conditions cannot exceed the FCU's net worth. Therefore, under the final rule, an FCU may purchase investments with maturities exceeding the maturity of the borrowing repurchase transaction if the aggregate amount of all such purchased investments does not exceed its net worth. The Board notes that the final rule does not create an exception for purchased investments that are guaranteed by a government agency or government-sponsored entity because the conditions on maturity mismatches are intended to address interest rate risk, rather than default risk. The suggested exception would not further the Board's goal. In addition, the final rule does not include experience requirements. The Board again reminds FCUs, however, that they should position themselves, through in-house or contracted expertise, to properly engage in the analysis and ongoing risk management of borrowing repurchase transactions.

3. Commercial Mortgage Related Security (CMRS)

Pursuant to section 107(15)(B) of the Act, a RegFlex FCU had been permitted to purchase CMRS that are not otherwise permitted by section 107(7)(E) of the Act if: (i) the security is rated in one of the two highest rating categories by at least one nationally-recognized statistical rating organization (NRSRO); (ii) the security meets the definition of mortgage related security as defined in 15 U.S.C. 78c(a)(41) and the definition of CMRS in §703.2; (iii) the pool of loans underlying the CMRS contains more than 50 loans with no one loan representing more than 10 percent of the pool; and (iv) the FCU does not purchase an aggregate amount of CMRS in excess of 50 percent of its net worth. 12 CFR 742.4(a)(6). In the NPRM, the Board proposed to permit FCUs meeting the well capitalized standard to purchase private label CMRS under these same conditions.

The Board also proposed to permit an FCU not meeting the well capitalized standard to purchase private label CMRS under the conditions applicable to well capitalized FCUs, but it limited the aggregate amount of CMRS to 25 percent of the FCU's net worth. The NPRM permitted such an FCU to seek authorization from its regional director to purchase a greater amount of CMRS, up to 50 percent of its net worth, if it could demonstrate three consecutive years of effective CMRS portfolio management and the ability to evaluate key risk factors. The proposed rule also added a grandfather provision for private label CMRS purchased by an FCU under its RegFlex authority

before the effective date of the final rule. In the NPRM, the Board sought comment on whether the conditions for purchasing CMRS should be enhanced to encourage diversity and mitigate risk.

One league and one credit union supported the changes for CMRS as proposed. One credit union trade association advocated additional authority for FCUs in this area and supported removal of limitations on CMRS that are not required by the Act. One credit union stated its particular concern with the proposal because it believes the failure of the corporate credit union system was caused by significant concentrations of private label mortgage related securities. The commenter stated that the proposed rule lacks sufficient guidance related to credit risk management. It suggested that, at a minimum, the rule require: pre-purchase credit analysis, including analysis of underlying collateral, geographic diversification, cash flows, and credit structures, as well as identification and general avoidance of subordinated tranches that represent elevated levels of credit risk in favor of senior tranches; documentation and retention of credit analyses for as long as an FCU holds the CMRS; and ongoing credit monitoring to identify emerging negative trends and potential concerns. While the Board does not incorporate these conditions in the final rule, the Board strongly believes the commenter has identified best practices to which FCUs should adhere if they are to purchase CMRS. The Board adopts the provisions regarding CMRS in the final rule as proposed.

e. Eligible Obligations

The eligible obligations rule permits an FCU to purchase loans from any source, provided that two conditions are satisfied. 12 CFR 701.23. First, the borrower is a member of that FCU. Second, the loan is either of a type the FCU is empowered to grant or the FCU refinances the loan within 60 days of its purchase so that it meets the empowered to grant requirement. 12 CFR 701.23(b)(1)(i). The rule also permits an FCU to purchase student loans and real estate-secured loans, from any source, if the purchasing FCU grants these loans on an ongoing basis and is purchasing either type of loan to facilitate the packaging of a pool of such loans for sale or pledge in the secondary market. 12 CFR 701.23(b)(1)(iii)-(iv). An FCU may also purchase the obligations of a liquidating credit union's individual members from the liquidating credit union. 12 CFR 701.23(b)(ii). The eligible obligations rule restricts the aggregate amount of loans that an FCU may purchase to five percent of the purchasing FCU's unimpaired capital and surplus. 12 CFR 701.23(b)(3). It excludes certain types of loans from this limit, including loans purchased to facilitate a sale or pledge in the secondary market. 12 CFR 701.23(b)(3).

RegFlex FCUs have been permitted to buy loans from other federally insured credit unions without regard to whether the loans are eligible obligations of the purchasing FCU's members or the members of a liquidating credit union. 12 CFR 742.4(b). Loans purchased from a liquidating credit union, however, are subject to the cap of five percent of unimpaired capital and surplus. 12 CFR 742.4(b)(4); 66 FR 15055, 15059

(Mar. 15, 2001). RegFlex FCUs also have been able to purchase student loans and real estate-secured loans without the requirement that loans be purchased to facilitate a secondary market pool package. 12 CFR 742.4(b).

The NPRM retained the flexibility currently provided to RegFlex FCUs for FCUs meeting the well capitalized standard. The proposed rule also grandfathered all eligible obligations purchased by RegFlex FCUs before the effective date of the final rule. The proposed rule similarly amended paragraph (e) in §723.1 to address nonmember business loans purchased under RegFlex authority or obligations purchased under proposed §701.23(b)(2). The Board requested specific comment on whether it should extend the flexibility from the eligible obligations rule to all FCUs or establish an approval process through regional directors for FCUs not meeting the well capitalized standard.

One league supported the expansion in the eligible obligations rule. One credit union trade association recommended, at a minimum, an expansion of this authority to allow FCUs that are somewhat less than well capitalized to take advantage of the flexibility afforded to FCUs meeting the well capitalized standard. Likewise, one league and one credit union commenter urged NCUA to extend the flexibility for eligible obligations to all FCUs or provide a waiver process similar to the process for other expanded authorities. One commenter stated that eligible obligation purchases that are made after an FCU applies proper due diligence do not pose a safety and soundness issue for that FCU or

the National Credit Union Share Insurance Fund. The credit union commenter also urged NCUA to expand the purchasing authority to all FCUs so they can benefit from the stabilizing effects of purchasing well-performing obligations from diverse portfolios of other federally insured credit unions. The commenter further stated that an expansion would enhance safety and soundness in two ways. First, a purchasing FCU can increase earnings by deploying excess liquidity into higher yielding, high quality assets when loan demand from its members may be low. Second, a purchasing FCU can reduce concentration risk because selling institutions have different fields of membership. The commenter also made suggestions to clarify the proposed regulatory text in §701.23.

The final rule substantively adopts the provisions in the proposed rule pertaining to eligible obligations with two changes. It includes a provision that allows FCUs not meeting the well capitalized standard to seek authority from their regional directors to purchase obligations from other federally insured credit unions under the same conditions applicable to FCUs that do meet the well capitalized standard. The final rule also uses plain language rather than paragraph citations within §701.23 for ease of reading.

III. Final Rule

a. RegFlex

The final rule removes part 742 from title 12 to eliminate RegFlex as the Board proposed in the NPRM. The Board noted in the preamble to the proposed rule that it would address the appeals process before NCUA's Supervisory Review Committee for RegFlex designation revocations. In a separate, contemporaneous rulemaking, the Board is amending NCUA Interpretive Ruling and Policy Statement 11-1, 76 FR 23871 (Apr. 29, 2011), to remove RegFlex appeals from the purview of the committee because RegFlex no longer exists as of the effective date of this rule.

b. Charitable Contributions

The final rule removes the entire charitable contributions rule, §701.25, from part 701. With the deletion of this section, an FCU will no longer be restricted by regulation to make donations only to certain recipients and will not be required to obtain prior approval from its board of directors. An FCU's authority to make donations will continue to be governed by its incidental powers authority under the Act, the fiduciary duties of its board, and its bylaws. NCUA has long recognized an FCU's authority to make charitable contributions and donations because an FCU may "exercise such incidental powers as shall be necessary or requisite to enable it to carry on effectively the business for which it is incorporated." 44 FR 56691 (Oct. 2, 1979); 64 FR 19441 (Apr. 21, 1999); 12 U.S.C. 1757(17). Contributions, therefore, must be necessary or requisite to enable the FCU to effectively carry on its business. 12 CFR 721.2. Furthermore,

FCU directors have a fiduciary duty to direct management to operate within sound business practices and the best interests of the membership under §701.4. In addition, article XVI, section 4 of the FCU Bylaws prohibits FCU directors, committee members, officers, agents, and employees from conflicts of interest that could arise in the context of making charitable donations.

As noted, the making of charitable contributions has long been recognized by NCUA as an approved incidental power. The final rule, therefore, amends §721.3 by adding a new paragraph (b) to identify this authority and renumbers the remaining activities in the section.

c. Nonmember Deposits

The final rule raises the dollar threshold on the nonmember deposit limit in §701.32(b) from $1.5 million to $3 million. The maximum amount of all public unit and nonmember shares that any FCU may hold cannot exceed the greater of 20 percent of the FCU's total shares or $3 million. Unlike the former RegFlex rule, the final rule does not provide a standardized exemption from the nonmember deposit cap. Section 701.32, however, continues to permit an FCU to request from its regional director an exemption to exceed the limit on the maximum amount of nonmember deposits. 12 CFR 701.32(b)(3)-(5). If the regional director denies the request for an exemption, the FCU may appeal the decision to the Board. 12 CFR 701.32(b)(5).

d. Fixed Assets

The final rule amends §701.36(b)(2) to permit any FCU a six-year time frame to partially occupy the premises if the FCU acquired unimproved land for its future expansion. As in the current rule, premises are partially occupied when the FCU is using some part of the space on a full-time basis. An FCU may request a waiver from the partial occupation requirement. The amendment applies only to unimproved real property and does not apply to any other kind of premises.

e. Zero-coupon Investments

In order to balance the risk management concerns discussed in the NPRM, the final rule restricts FCUs meeting the well capitalized standard from purchasing any zero-coupon investment with a maturity date greater than 30 years. It also provides that an FCU not meeting the well capitalized standard may not purchase a zero-coupon investment with a maturity date that is more than 10 years from the related settlement date, unless it has received approval from its regional director to purchase such an investment with a greater maturity. In addition, the final rule grandfathers zero-coupon investments purchased under RegFlex authority before the effective date of this rule.

FCUs considering the purchase of zero-coupon investments should be familiar with the dramatic rise in percentage loss on these investments with maturity. Only FCUs with

the appropriate level of expertise positioned to measure the safety and soundness of purchasing zero-coupon investments with extended maturities should consider such investments.

f. Borrowing Repurchase Transactions

Section 703.13(d)(3)(iii) of the final rule permits FCUs meeting the well capitalized standard to purchase investments with maturities exceeding the maturity of the borrowing repurchase transaction. Section 703.13(d)(3)(ii) permits FCUs not meeting the well capitalized standard to enter into borrowing repurchase transactions and use the proceeds to purchase investments with maturities no more than 30 days later than the transaction's term. Under §703.20, these FCUs may request additional authority from their regional directors to enter transactions whereby the maturity mismatch would be greater than 30 days. The final rule also clarifies that the total value of investments that any FCU purchases through transactions with mismatched maturities cannot exceed its net worth. In addition, the final rule contains a grandfather provision for borrowing repurchase transactions into which an FCU entered under its RegFlex authority before the effective date of this rule.

The final rule, therefore, sets out three possible scenarios for borrowing repurchase transactions under §703.13(d)(3). In the first instance, the borrowing and corresponding investment transactions must have matched maturities. In the second instance, the

matched maturity requirement would not apply if an FCU buys investments that mature no more than 30 days after the maturity of the borrowing repurchase transaction and the aggregate or total value of those investments does not exceed 100 percent of the FCU's net worth. In the third instance, an FCU that meets the well capitalized standard may enter borrowing repurchase transactions with mismatched maturities greater than 30 days if the total value of investments purchased through transactions with mismatched maturities does not exceed 100 percent of the FCU's net worth.

g. CMRS

The final rule removes the prohibition in §703.16 on the purchase of private label CMRS. The final rule permits an FCU that meets the well capitalized standard to purchase CMRS that are not otherwise permitted by section 107(7)(E) of the Act if: (i) the security is rated in one of the two highest rating categories by at least one NRSRO;[1] (ii) the security meets the definition of mortgage related security as defined in 15 U.S.C. 78c(a)(41) and the definition of CMRS in §703.2; (iii) the pool of loans underlying the

[1] As required by Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), the Board issued a proposal on March 1, 2011 to change this prong in part 742 with the following language: "The issuer has at least a very strong capacity to meet its financial obligations, even under adverse economic conditions, for the projected life of the security." 76 FR 11164 (Mar. 1, 2011). When NCUA adopts a final rule for the proposed rulemaking issued in March 2011, the standard will change accordingly.

CMRS contains more than 50 loans with no one loan representing more than 10 percent of the pool; and (iv) the FCU does not purchase an aggregate amount of CMRS in excess of 50 percent of its net worth. The final rule provides that an FCU that does not meet the well capitalized standard may purchase private label CMRS under conditions (i) through (iii) above, but limits the aggregate amount of private label CMRS to 25 percent of its net worth. Section 703.20 establishes an approval process so that such an FCU may seek authorization from its regional director to purchase a greater amount of CMRS, up to a maximum of 50% of its net worth. As part of its request for approval, an FCU must demonstrate three consecutive years of effective CMRS portfolio management and the ability to evaluate key risk factors.

Finally, the final rule adds a grandfather provision to §703.18 for private label CMRS purchased by an FCU under its RegFlex authority before the effective date of this rule. As such, an FCU that does not meet the well capitalized standard, but which holds private label CMRS in excess of 25% of its net worth on the effective date of this rule, is not required to divest those holdings on its books. The FCU, however, cannot make additional purchases of CMRS while its aggregate CMRS holdings exceed 25% of its net worth, without the approval from the appropriate regional director under §703.20.

The Board notes again that the authority to purchase private label CMRS, as with all of the flexibilities in the final rule, is not appropriate for every FCU. Selection of CMRS consistent with safety and soundness requires careful analysis of the underlying

commercial mortgages and corresponding collateral, as well as analysis of the cash flow, credit structure, and market performance of the security.

As with all investments, FCUs must understand and be capable of managing the risks associated with CMRS before purchasing them. The investment rule's §703.3 requires an FCU's board of directors to develop investment policies that address credit, liquidity, interest rate, and concentration risks. 12 CFR 703.3. The policy must also identify the characteristics of any investments that are suitable for the FCU. FCUs that purchase CMRS must develop sound risk management policies and construct limits that represent the FCU board's risk tolerance. If necessary, NCUA may require an FCU to divest its investments or assets for substantive safety and soundness reasons, on a case-by-case basis.

h. Eligible Obligations

The final rule renumbers §701.23 and, under paragraph (b)(2), permits FCUs that meet the well capitalized standard to buy loans from other federally insured credit unions without regard to whether the loans are eligible obligations of the purchasing FCU's members or the members of a liquidating credit union. The final rule subjects loans purchased from a liquidating credit union to the eligible obligations cap of five percent of unimpaired capital and surplus. FCUs meeting the well capitalized standard may also purchase student loans and real estate-secured loans without the requirement that the

loans be purchased to facilitate a secondary market pool package. The final rule also grandfathers all obligations purchased under RegFlex authority before the effective date of this rule and makes a similar amendment to paragraph (e) in §723.1 to address nonmember business loans purchased under RegFlex authority or obligations under §701.23(b)(2).

In addition, the final rule permits FCUs that do not meet the well capitalized standard to request authority from their regional directors to engage in this activity through a written request similar to the process created in paragraph (b) of §703.20.

IV. The Interim Final Rule and Request for Comment

In issuing the proposed rule, NCUA inadvertently omitted changes to RegFlex references in its rule setting the permissible deductible for fidelity bond coverage. 12 CFR 713.6. That rule establishes a formula for calculating the maximum allowable deductible based on asset size with a cap of $200,000, but permits RegFlex FCUs a higher maximum deductible of up to $1 million. 12 CFR 713.6(a)(1), (c). With the elimination of RegFlex, the Board is issuing an interim final rule to amend the fidelity bond rule so that it is consistent with the other subject-specific rules discussed in this preamble. The interim final rule changes the applicable benchmark for increased deductible limits in §713.6 from RegFlex FCUs to FCUs meeting the same well capitalized standard used in the other rules impacted by the elimination of RegFlex.

The amendments track those that the Board makes in the final rule, as well as the §713.6 provisions the Board adopted in 2005 for FCUs that automatically qualified for a RegFlex designation. 70 FR 61713 (Oct. 26, 2005)

The interim final rule permits a maximum deductible for fidelity bond coverage of $1 million if the FCU has: (1) received a composite CAMEL rating of "1" or "2" during its last two full examinations and (2) maintained a "well capitalized" net worth classification for the immediately preceding six quarters or has remained "well capitalized" for the immediately preceding six quarters after applying the applicable RBNW requirement.

Once a year, an FCU meeting the interim final rule's well capitalized standard must review its continued eligibility for a higher deductible under the rule, which is the same approach applied by the Board when it adopted the fidelity bond RegFlex provisions in 2005. Id. at 61714. An FCU's continued eligibility will be based on its asset size as reflected in its most recent year-end 5300 call report and its net worth as reflected in that same report. If an FCU that previously qualified for the higher deductible has a decrease in assets based on its most recent year-end 5300 call report or its net worth has decreased so that it would no longer qualify under the well capitalized standard in the rule, then it must obtain the coverage otherwise required by §713.6. Likewise, if an FCU meets the assets threshold and its net worth would otherwise continue to qualify it for the well capitalized standard, but it failed to receive either a CAMEL rating of 1 or 2

during its most recent examination report, it must obtain the required coverage with a deductible of no more than $200,000.

The Board is adopting this rulemaking as an interim final rule because it meets the good cause exception to the procedures under the Administrative Procedure Act (APA), 5 U.S.C. 553(b)(3). Notice and public procedures are impracticable and contrary to the public interest in this matter because the final rule eliminates RegFlex. To maintain cross-references to RegFlex in the fidelity bond coverage rule would cause confusion in implementation by FCUs, as well as undue and untimely execution of NCUA's functions in monitoring compliance with §713.6. The interim final rule complements the final rule, and it is appropriate for the Board to synchronize its adoption of all of the rule changes made in this document. The Board finds these reasons are good cause to dispense with the APA's notice and comment period and the procedures in NCUA's Interpretive Ruling and Policy Statement 87-2. 5 U.S.C. 553(b)(3)(B); 52 FR 35213 (Sept. 18, 1987), as amended by 68 FR 31949 (May 29, 2003). The interim final rule has an effective date 30 days after publication in the Federal Register, which coincides with the final rule's effective date. Although the rule is being issued as an interim final rule, the Board encourages interested parties to submit comments within 60 days so the Board can consider any amendments to the rule.

V. Rule Summary Table

In a further effort to comply with the Plain Writing Act of 2010 (Public Law 111-274), the Board includes the following table to assist readers by distinguishing the authorities for FCUs that meet the well capitalized standard and FCUs that do not. We are providing this table for your reference only. Please refer to regulatory text, as well as the preambles for the NPRM and the final rule, for specific information.

Final Rule Authority	FCUs Meeting Well Capitalized Standard	FCUs Not Meeting Well Capitalized Standard
Charitable Contributions	Well capitalized FCUs may make donations consistent with their incidental powers authority and board's fiduciary duties.	This flexibility applies to all FCUs.
Nonmember Deposits	May accept up to the greater of 20% total shares or $3 million. May request exemption from regional director for greater amount.	This flexibility applies to all FCUs.

Unimproved Property for Future Expansion	May take up to six years to partially occupy unimproved real property purchased for future expansion.	This flexibility applies to all FCUs.
Zero-coupon Investments*	May purchase zero-coupon investments with maturity dates up to 30 years.	May purchase zero-coupon investments with maturity dates up to 10 years. May request authority from regional director for maturities up to 30 years.
Borrowing Repurchase Transaction*	May enter into Borrowing Repurchase Transactions where the underlying investments mature later than the borrowing, provided the total amount of investments purchased do not exceed 100 percent of net worth.	May enter into Borrowing Repurchase Transactions where the underlying investments mature no later than 30 days after the borrowing, provided the total amount of investments purchased do not exceed 100 percent of net worth. May request authority from regional director for longer maturity mismatch.

Private Label Commercial Mortgage Related Security (CMRS)*	Not restricted to purchasing only CMRS issued by Fannie Mae or Freddie Mac. May purchase Private Label CMRS if: (i) the security is rated in one of the two highest rating categories by at least one NRSRO; (ii) it is a "mortgage related security" under the Securities Exchange Act of 1934 and §703.2; (iii) the pool of loans underlying the CMRS contains more than 50 loans with no one loan representing more than 10	Similar flexibilities apply to all FCUs, under the following conditions: Requirements (i)-(iii) would be the same as for Well Capitalized FCUs. The limit in requirement (iv) is 25 percent of net worth. May request approval from the regional director for higher limit, up to 50 percent of net worth, if FCU has 3 consecutive years of effective CMRS portfolio management and the ability to evaluate key risk factors.

	percent of the pool; and (iv) the FCU does not purchase an aggregate amount in excess of 50 percent of net worth.	
Purchase of Eligible Obligations *	In addition to the authority in the current §701.23, may buy loans from other federally insured credit unions without regard to whether the loans are obligations of the purchasing FCU's members. May also purchase nonmember student loans and real estate loans without the need for purchase to facilitate a secondary market pool package. Also may purchase loans from a liquidating credit union regardless of whether the loans	These flexibilities may be extended if approved by regional director, otherwise limited to the other provisions of §701.23 for purchasing eligible obligations (subject to membership or pooling requirements).

	were made to liquidating CU's members, subject to the aggregate cap on eligible obligations of 5 percent of unimpaired capital and surplus.	
Fidelity Bond Coverage - Maximum Deductible for FCUs with Over $1 million in Assets	$2,000 plus 1/1000 of total assets up to a maximum of $1,000,000	$2,000 plus 1/1000 of total assets up to a maximum of $200,000

*All authorized activity entered into before the effective date of the final rule is grandfathered.

VI. Regulatory Procedures

a. Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a rule may have on a substantial number of small entities (primarily those under ten million dollars in assets). This rule reduces compliance burden and extends regulatory relief while maintaining existing safety and soundness standards. NCUA has determined and certifies that this rule will not have a significant economic impact on a substantial number of small credit unions.

b. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) applies to rulemakings in which an agency by rule creates a new paperwork burden on regulated entities or modifies an existing burden. 44 USC 3507(d); 5 CFR part 1320. 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. As required, NCUA has applied to the Office of Management and Budget (OMB) for approval of the information collection requirement described below.

The final rule contains an information collection in the form of a voluntary written request for additional authorities from a regional director under proposed §703.20 and §701.23(h). An FCU that does not meet the well capitalized standard may submit a written request to its regional director to request expanded authority above any or all of

the following provisions in the rule: (1) the borrowing repurchase transaction maximum maturity mismatch of 30 days under proposed §703.13(d)(3)(ii), (2) the zero-coupon investment 10-year maximum maturity under proposed §703.14(i), up to a maturity of no more than 30 years, (3) the aggregate commercial mortgage related security limit of 25% of net worth under proposed §703.14(j), up to no more than 50% of net worth, and (4) the membership and pooling limitations in §701.23(b)(1) when purchasing loans under §701.23(b)(2). An FCU meets the well capitalized standard if the FCU has received a composite CAMEL rating of "1" or "2" during its last two full examinations and (1) has maintained a "well capitalized" net worth classification for the immediately preceding six quarters, or (2) has remained "well capitalized" for the immediately preceding six quarters after applying the applicable RBNW requirement. In the proposed rule, the Board estimated 1,770 FCUs may apply for an additional authority. The cumulative total annual paperwork burden is estimated to be approximately 1,770 hours.

OMB is currently reviewing NCUA's submission and NCUA will publish the OMB number assigned to this rulemaking once issued.

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 final rule will 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 rule does not constitute a policy that has federalism implications for purposes of the executive order.

d. Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104-121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

e. Assessment of Federal Regulations and Policies on Families

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

List of Subjects

12 CFR part 701

Credit unions.

12 CFR part 703

Credit unions, Investments.

12 CFR part 713

Credit unions, Insurance, Reporting and recordkeeping requirements.

12 CFR part 721

Credit unions.

12 CFR part 723

Credit, Credit unions, Reporting and recordkeeping requirements.

12 CFR part 742

Credit unions, reporting and recordkeeping requirements.

By the National Credit Union Administration Board on May 24, 2012.

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Mary Rupp

Secretary of the Board

For the reasons discussed above, NCUA amends 12 CFR parts 701, 703, 713, 721, 723, and 742 as follows:

PART 701 – ORGANIZATION AND OPERATIONS OF FEDERAL CREDIT UNIONS

1. The authority citation for part 701 continues to read as follows:

Authority: 12 U.S.C. 1752(5), 1755, 1756, 1757, 1759, 1761a, 1761b, 1766, 1767, 1782, 1784, 1787, and 1789. Section 701.6 is also authorized by 31 U.S.C. 3717. Section 701.31 is also authorized by 15 U.S.C. 1601 et seq., 42 U.S.C. 1861 and 42 U.S.C. 3601-3610. Section 701.35 is also authorized by 42 U.S.C. 4311-4312.

2. In §701.23:

a. Redesignate paragraphs (b)(2) and (3) as paragraphs (b)(3) and (4);

b. Add new paragraph (b)(2):

c. In newly redesignated paragraph (b)(4) introductory text, remove the phrase "under paragraph (b) of this section" and add in its place "under paragraphs (b)(1) and (b)(2)(ii) of this section";

d. Add paragraph (b)(5);

e. Add paragraph (h).

The additions read as follows:

The additions read as follows:

§701.23 Purchase, sale, and pledge of eligible obligations.

* * * * *

(b) * * *

(2) *Purchase of obligations from a FICU.* A federal credit union that received a composite CAMEL rating of “1” or “2” for the last two (2) full examinations and maintained a net worth classification of “well capitalized” under part 702 of this chapter for the six (6) immediately preceding quarters or, if subject to a risk-based net worth (RBNW) requirement under part 702 of this chapter, has remained “well capitalized” for the six (6) immediately preceding quarters after applying the applicable RBNW requirement may purchase and hold the following obligations, provided that it would be empowered to grant them:

(i) *Eligible obligations.* Eligible obligations without regard to whether they are obligations of its members, provided they are purchased from a federally-insured credit union and the obligations are either:

(A) Loans the purchasing credit union is empowered to grant; or

(B) Loans refinanced with the consent of the borrowers, within 60 days after they are purchased, so that they are loans the purchasing credit union is empowered to grant;

(ii) *Eligible obligations of a liquidating credit union.* Eligible obligations of a liquidating credit union without regard to whether they are obligations of the liquidating credit union's members.

(iii) *Student loans.* Student loans provided they are purchased from a federally-insured credit union only;

(iv) *Real estate-secured loans.* Real estate-secured loans provided they are purchased from a federally-insured credit union only;

* * * * *

(5) *Grandfathered purchases.* Subject to safety and soundness considerations, a federal credit union may hold any of the loans described in paragraph (b)(2) of this section provided it was authorized to purchase the loan and purchased the loan before [Insert date 30 days from date of publication in the FEDERAL REGISTER].

* * * * *

(h) *Additional authority.* (1) A federal credit union may submit a written request to its regional director seeking expanded authority to purchase loans described in paragraph (b)(2) of this section, if it is not otherwise authorized by this section. The written request must include the following:

(i) A copy of the credit union's purchase policy;

(ii) The types of eligible obligations under paragraph (b)(2) of this section that the credit union seeks to purchase;

(iii) An explanation of the need for additional authority; and

(iv) An analysis of the credit union's prior experience with the purchase of eligible obligations.

(2) *Approval process.* A regional director will provide a written determination on a request for expanded authority within 60 calendar days after receipt of the request; however, the 60-day period will not begin until the requesting credit union has submitted all necessary information to the regional director. The regional director will inform the

requesting credit union, in writing, of the date the request was received and of any additional documentation that the regional director requires in support of the request. If the regional director approves the request, the regional director will establish a limit on loan purchases as appropriate and subject to the limitations in this section. If the regional director does not notify the credit union of the action taken on its request within 60 calendar days of the receipt of the request or the receipt of additional requested supporting information, whichever occurs later, the credit union may purchase loans it requested under paragraph (b)(2) of this section.

(3) *Appeal to NCUA Board.* A federal credit union may appeal any part of the determination made under this paragraph to the NCUA Board by submitting its appeal through the regional director within 30 days of the date of the determination.

§ 701.25 [Removed and Reserved]

3. Remove and reserve §701.25.

§ 701.32 [Amended]

4. In §701.32 amend paragraph (b)(1) by removing “$1.5 million” after the words “federal credit union” and adding in its place “$3 million”.

5. Amend §701.36 by revising paragraph (b)(2) and removing paragraph (d) and redesignating paragraph (e) as paragraph (d):

The revision reads as follows:

§701.36 FCU ownership of fixed assets.

*** * * * ***

(b) * * *

(2) When a federal credit union acquires premises for future expansion, it must partially occupy the premises within a reasonable period, not to exceed three years, unless the credit union has acquired unimproved real property for future expansion. If a federal credit union has acquired unimproved real property to develop for future expansion, it must partially occupy the premises within a reasonable period, not to exceed six years. Premises are partially occupied when the credit union is using some part of the space on a full-time basis. The NCUA may waive this partial occupation requirement in writing upon written request. The request must be made within 30 months after the property is acquired.

* * * * *

PART 703 — INVESTMENTS AND DEPOSIT ACTIVITIES

6. The authority citation for part 703 continues to read as follows:

Authority: 12 U.S.C. 1757(7), 1757(8), 1757(15).

7. In §703.13, revise paragraph (d)(3) to read as follows:

§703.13 Permissible investment activities.

* * * * *

(d) * * *

(3) The investments referenced in paragraph (d)(2) of this section must mature under the following conditions:

(i) No later than the maturity of the borrowing repurchase transaction;

(ii) No later than thirty days after the borrowing repurchase transaction, unless authorized under §703.20, provided the value of all investments purchased with maturities later than borrowing repurchase transactions does not exceed 100 percent of the federal credit union's net worth; or

(iii) At any time later than the maturity of the borrowing repurchase transaction, provided the value of all investments purchased with maturities later than borrowing repurchase transactions does not exceed 100 percent of the federal credit union’s net worth and the credit union received a composite CAMEL rating of “1” or “2” for the last two (2) full examinations and maintained a net worth classification of “well capitalized” under part 702 of this chapter for the six (6) immediately preceding quarters or, if subject to a risk-based net worth (RBNW) requirement under part 702 of this chapter, has remained

"well capitalized" for the six (6) immediately preceding quarters after applying the applicable RBNW requirement.

* * * * *

8. Amend §703.14 by adding paragraphs (i) and (j) to read as follows:

§703.14 Permissible investments.

* * * * *

(i) *Zero-coupon investments.* A federal credit union may only purchase a zero-coupon investment with a maturity date that is no greater than 10 years from the related settlement date, unless authorized under §703.20 or otherwise provided in this paragraph. A federal credit union that received a composite CAMEL rating of "1" or "2" for the last two (2) full examinations and maintained a net worth classification of "well capitalized" under part 702 of this chapter for the six (6) immediately preceding quarters or, if subject to a risk-based net worth (RBNW) requirement under part 702 of this chapter, has remained "well capitalized" for the six (6) immediately preceding quarters after applying the applicable RBNW requirement, may purchase a zero-coupon investment with a maturity date that is no greater than 30 years from the related settlement date.

(j) *Commercial mortgage related security (CMRS).* A federal credit union may purchase a CMRS permitted by Section 107(7)(E) of the Act; and, pursuant to Section 107(15)(B)

of the Act, a CMRS of an issuer other than a government-sponsored enterprise enumerated in Section 107(7)(E) of the Act, provided:

(1) The CMRS is rated in one of the two highest rating categories by at least one nationally-recognized statistical rating organization;

(2) The CMRS meets the definition of mortgage related security as defined in 15 U.S.C. 78c(a)(41) and the definition of commercial mortgage related security as defined in §703.2 of this part;

(3) The CMRS's underlying pool of loans contains more than 50 loans with no one loan representing more than 10 percent of the pool; and

(4) The aggregate amount of private label CMRS purchased by the federal credit union does not exceed 25 percent of its net worth, unless authorized under §703.20 or as otherwise provided in this subparagraph. A federal credit union that has received a composite CAMEL rating of "1" or "2" for the last two (2) full examinations and maintained a net worth classification of "well capitalized" under part 702 of this chapter for the six (6) immediately preceding quarters or, if subject to a risk-based net worth (RBNW) requirement under part 702 of this chapter, has remained "well capitalized" for the six (6) immediately preceding quarters after applying the applicable RBNW requirement, may hold private label CMRS in an aggregate amount not to exceed 50% of its net worth.

§703.16 [Amended]

9. In §703.16, remove paragraphs (b) and (d) and redesignate paragraphs (c), (e), and (f) as paragraphs (b), (c), and (d) respectively.

10. In §703.18, redesignate paragraph (b) as paragraph (c) and add new paragraph (b) read as follows:

§703.18 Grandfathered investments.

* * * * *

(b) A federal credit union may hold a zero-coupon investment with a maturity greater than 10 years, a borrowing repurchase transaction in which the investment matures at any time later than the maturity of the borrowing, or CMRS that cause the credit union's aggregate amount of CMRS from issuers other than government-sponsored enterprises to exceed 25% of its net worth, in each case if it purchased the investment or entered the transaction under the Regulatory Flexibility Program before [Insert date 30 days from date of publication in the FEDERAL REGISTER].

11. Add §703.20 to read as follows:

§703.20 Request for additional authority.

(a) *Additional authority.* A federal credit union may submit a written request to its regional director seeking expanded authority above the following limits in this part:

(1) Borrowing repurchase transaction maximum maturity mismatch of 30 days under §703.13(d)(3)(ii).

(2) Zero-coupon investment 10-year maximum maturity under §703.14(i), up to a maturity of no more than 30 years.

(3) CMRS aggregate limit of 25% of net worth under §703.14(j), up to no more than 50% of net worth. To obtain approval for additional authority, the federal credit union must demonstrate three consecutive years of effective CMRS portfolio management and the ability to evaluate key risk factors.

(b) *Written request.* A federal credit union desiring additional authority must submit a written request to the NCUA regional office having jurisdiction over the geographical area in which the credit union's main office is located, that includes the following:

(1) A copy of the credit union’s investment policy;

(2) The higher limit sought;

(3) An explanation of the need for additional authority;

(4) Documentation supporting the credit union’s ability to manage the investment or activity; and

(5) An analysis of the credit union’s prior experience with the investment or activity.

(c) *Approval process.* A regional director will provide a written determination on a request for expanded authority within 60 calendar days after receipt of the request; however, the 60-day period will not begin until the requesting credit union has submitted all necessary information to the regional director. The regional director will inform the

requesting credit union, in writing, of the date the request was received and of any additional documentation that the regional director requires in support of the request. If the regional director approves the request, the regional director will establish a limit on the investment or activity as appropriate and subject to the limitations in this part. If the regional director does not notify the credit union of the action taken on its request within 60 calendar days of the receipt of the request or the receipt of additional requested supporting information, whichever occurs later, the credit union may proceed with its proposed investment or investment activity.

(d) *Appeal to NCUA Board.* A federal credit union may appeal any part of the determination made under paragraph (c) to the NCUA Board by submitting its appeal through the regional director within 30 days of the date of the determination.

PART 713 – FIDELITY BONDS AND INSURANCE COVERAGE FOR FEDERAL CREDIT UNIONS

12. The authority citation for part 713 continues to read as follows:

Authority: 12 U.S.C. 1761a, 1761b, 1766(a), 1766(h), 1789(a)(11).

13. In §713.6, revise paragraphs (a)(1) and (c) to read as follows:

§713.6 What is the permissible deductible?

(a)(1) The maximum amount of allowable deductible is computed based on a federal credit union's asset size and capital level, as follows:

Assets	Maximum Deductible
$0 to $100,000	No deductible allowed
$100,001 to $250,000	$1,000
$250,000 to $1,000,000	$2,000
Over $1,000,000	$2,000 plus 1/1000 of total assets up to a maximum of $200,000; for credit unions that have received a composite CAMEL rating of "1" or "2" for the last two (2) full examinations and maintained a net worth classification of "well capitalized" under part 702 of this chapter for the six (6) immediately preceding quarters or, if subject to a risk-based net worth (RBNW) requirement under part 702 of this chapter, has remained "well capitalized" for the six (6) immediately preceding quarters after applying the applicable RBNW

	requirement, the maximum deductible is $1,000,000.

* * *

(c) A federal credit union that has received a composite CAMEL rating of "1" or "2" for the last two (2) full examinations and maintained a net worth classification of "well capitalized" under part 702 of this chapter for the six (6) immediately preceding quarters or, if subject to a risk-based net worth (RBNW) requirement under part 702 of this chapter, has remained "well capitalized" for the six (6) immediately preceding quarters after applying the applicable RBNW requirement is eligible to qualify for a deductible in excess of $200,000. The credit union's eligibility is determined based on it having assets in excess of $1 million as reflected in its most recent year-end 5300 call report. A federal credit union that previously qualified for a deductible in excess of $200,000, but that subsequently fails to qualify based on its most recent year-end 5300 call report because either its assets have decreased or it no longer meets the net worth requirements of this paragraph or fails to meet the CAMEL rating requirements of this paragraph as determined by its most recent examination report, must obtain the coverage otherwise required by paragraph (b) of this section within 30 days of filing its year-end call report and must notify the appropriate NCUA regional office in writing of its changed status and confirm that it has obtained the required coverage.

PART 721 – INCIDENTAL POWERS

14. The authority citation for part 721 continues to read as follows:

Authority: 12 U.S.C. 1757(17), 1766, 1789.

15. In §721.3, redesignate paragraphs (b) through (l) as paragraphs (c) through (m) and add new paragraph (b) to read as follows:

§721.3 What categories of activities are preapproved incidental powers necessary or requisite to carry on a credit union's business?

* * * * *

(b) *Charitable contributions and donations.* Charitable contributions and donations are gifts you provide to assist others through contributions of staff, equipment, money, or other resources. Examples of charitable contributions include donations to community groups, nonprofit organizations, other credit unions or credit union affiliated causes, political donations, as well as donations to create charitable foundations.

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PART 723 — MEMBER BUSINESS LOANS

16. The authority citation for part 723 continues to read as follows:

Authority: 12 U.S.C. 1756, 1757, 1757A, 1766, 1785, 1789.

17. In §723.1 revise paragraph (e) to read as follows:

§723.1 What is a member business loan?

* * * * *

(e) *Purchases of nonmember loans and nonmember loan participations.* Any interest a credit union obtains in a nonmember loan, pursuant to §§701.22 and 701.23(b)(2), under a Regulatory Flexibility Program designation before [Insert date 30 days from date of publication in the FEDERAL REGISTER] or other authority, is treated the same as a member business loan for purposes of this rule and the risk weighting standards under part 702 of this chapter, except that the effect of such interest on a credit union's aggregate member business loan limit will be as set forth in §723.16(b) of this part.

PART 742 – [REMOVED]

18. Under the authority of 12 U.S.C. 1756 and 1766, the National Credit Union Administration removes part 742.

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