7535-01-U

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 702 and 703

[NCUA-2021-0072]

RIN 3133-AF12

Capital Adequacy: The Complex Credit Union Leverage Ratio; Risk-Based Capital

AGENCY: National Credit Union Administration (NCUA).

ACTION: Proposed rule.

SUMMARY: The NCUA is seeking comment on a proposed rule that would provide a simplified measure of capital adequacy for federally insured, natural-person credit unions (credit unions) classified as complex (those with total assets greater than $500 million). Under the proposed rule, a complex credit union that maintains a minimum net worth ratio, and that meets other qualifying criteria, will be eligible to opt into the complex credit union leverage ratio (CCULR) framework. The minimum net worth ratio would initially be established at 9 percent on January 1, 2022, and be gradually increased to 10 percent by January 1, 2024. A complex credit union that opts into the CCULR framework would not be required to calculate a risk-based capital ratio under the Board's October 29, 2015, risk-based capital final rule, as amended on October 18, 2018. A qualifying complex credit union that opts into the CCULR framework and that maintains the minimum net worth ratio would be considered well capitalized. The proposed rule would also make several amendments to update the NCUA's October 29, 2015, risk-based capital final rule, including addressing asset securitizations issued by credit unions, clarifying the treatment of off-balance sheet exposures, deducting certain mortgage servicing assets from a complex credit union's risk-based capital numerator, updating several derivative-related definitions, and clarifying the definition of a consumer loan.

DATES: Comments must be received on or before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: You may submit comments using one of the following methods (please do not send the same comments via two or more methods):

- Federal eRulemaking Portal: http://www.regulations.gov. The docket number for this proposed rule is NCUA-2021-0072. Follow the instructions for submitting comments.
- Fax: (703) 518–6319. Include “[Your name] Comments on “Capital Adequacy: The Complex Credit Union Leverage Ratio, Amendments to Risk-Based Capital, and other Technical Amendments” in the transmittal.
- Mail: Address to Melane Conyers-Ausbrooks, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.
- Hand Delivery/Courier: Same as mail address.

Public Inspection: All public comments are available on the Federal eRulemaking Portal at: http://www.regulations.gov as submitted, except where technical limitations make posting the comments on the portal impossible. Public comments will not be edited to remove any identifying or contact information. Due to social distancing measures in effect, the usual opportunity to inspect paper copies of comments in the NCUA’s law library is not currently available. After social distancing measures are relaxed, visitors may make an appointment to review paper copies by calling (703) 518–6540 or emailing OGCMail@ncua.gov.

FOR FURTHER INFORMATION CONTACT: *Policy and Accounting*: Thomas Fay, Director, Division of Capital Markets, Office of Examination and Insurance, at (703) 518-1179; *Legal:* Rachel Ackmann, at (703) 623-9363 or Ariel Pereira, at (703) 548-2778; or by mail at National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314.

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I. BACKGROUND

A. THE NCUA'S RISK-BASED CAPITAL REQUIREMENTS.

The NCUA's mission is to ensure the safety and soundness of federally insured credit unions (FICUs), in addition to carrying out other statutory responsibilities. The NCUA performs this function by examining and supervising federally chartered credit unions (FCUs), participating in the examination and supervision of federally insured, state-chartered credit unions (FISCUs) in coordination with state regulators, and insuring members' accounts at all FICUs up to the limits prescribed by statute.

Capital adequacy standards are an important prudential tool to ensure the safety and soundness of individual credit unions and the credit union system as a whole. Capital serves as a buffer for credit unions to prevent institutional failure and dramatic deleveraging during times of stress. During a financial crisis, a buffer can mean the difference between the survival or failure of a financial institution. Higher levels of capital insulate credit unions from the effects of unexpected adverse developments in their financial condition, reduce the probability of a systemic crisis, allow credit unions to continue to serve as credit providers during times of stress without government intervention, and produce benefits that outweigh the associated costs.

Following the 2007–2009 recession, the NCUA substantially reevaluated its capital adequacy standards, which are codified in 12 CFR part 702 (part 702). On October 29, 2015, as amended on October 18, 2018, the Board published a final rule restructuring its capital adequacy regulations (2015 Final Rule).[1] The effective date of the 2015 Final Rule was originally January 1, 2019. The overarching intent of the 2015 Final Rule was to reduce the likelihood that a relatively small number of high-risk credit unions would exhaust their capital and cause large losses to the National Credit Union Share Insurance Fund (NCUSIF). Under the Federal Credit Union Act (FCUA), FICUs are collectively responsible for replenishing losses to and capitalizing the NCUSIF.[2]

The 2015 Final Rule restructured the NCUA's current capital adequacy regulations and made various revisions, including amending the agency's risk-based net worth requirement by replacing a credit union's risk-based net worth ratio with a risk-based capital ratio. The risk-based capital requirements in the 2015 Final Rule are more consistent with the NCUA's risk-based capital ratio measure for corporate credit unions, are more comparable to the risk-based capital measures implemented by the Federal Deposit Insurance Corporation (FDIC), Board of Governors of the Federal Reserve System (Federal Reserve Board), and Office of the Comptroller of Currency (OCC) (collectively, the other banking agencies) in 2013, and consistent with the FCUA.[3]

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[1] 80 FR 66626 (Oct. 29, 2015). *See also*, 83 FR 55467 (Oct. 18, 2018).

[2] *See* 12 U.S.C. 1782(c). At the times the Board prescribes, subject to statutory parameters, the FCUA requires each insured credit union to pay an insurance premium equal to a percentage of the credit union's insured shares. The FCUA also requires each insured credit union to pay and maintain a deposit with the NCUSIF equaling one percent of the credit union's insured shares. The NCUSIF's reserves are available to pay potential share insurance claims, to provide assistance in connection with the liquidation or threatened liquidation of credit unions, and for administrative and other expenses the Board incurs in carrying out the purposes of the share insurance subchapter of the FCUA. *See* 12 U.S.C. 1783(a).

[3] The Federal Reserve Board and OCC issued a joint final rule on October 11, 2013 (78 FR 62018), and the FDIC issued a substantially identical interim final rule on September 10, 2013 (78 FR 55340). On April 14, 2014 (79 FR 20754), the FDIC adopted the interim final rule as a final rule with no substantive changes.

The risk-based capital provisions of the 2015 Final Rule apply only to credit unions that are complex, which the rule defined as those with total assets over $100 million.[4] On November 6, 2018, the Board published a supplemental final rule that raised the threshold level for a complex credit union to $500 million (2018 Supplemental Rule).[5] Therefore, only credit unions with over $500 million in assets are now subject to the risk-based capital requirements of the 2015 Final Rule. The 2018 Supplemental Rule also delayed the effective date of the 2015 Final Rule for one year (from January 1, 2019, to January 1, 2020).

The effective date was delayed a second time through a final rule published on December 17, 2019 (2019 Supplemental Rule).[6] The 2015 Final Rule is now scheduled to become effective on January 1, 2022. The delay has provided credit unions and the NCUA with additional time to implement the 2015 Final Rule. Further, as explained in the 2019 Supplemental Rule, the delay provided the Board additional time to holistically and comprehensively evaluate the NCUA's capital standards for credit unions.[7] Among a few items that the Board made reference to, the rule highlighted a community bank leverage ratio (CBLR) analogue and the treatment of asset securitizations issued by credit unions as items for possible consideration by the Board during the delay.[8]

B. THE OTHER BANKING AGENCIES' RISK-BASED CAPITAL AND CBLR FRAMEWORK.

As discussed previously, the other banking agencies adopted a revised risk-based capital rule in 2013, which was designed to strengthen their capital requirements and improve risk

[4] *See*, *supra* note 1.

[5] 83 FR 55467 (Nov. 6, 2018).

[6] 84 FR 68781 (Dec. 17, 2019).

[7] *Id.* at 68782.

[8] *Id*.

sensitivity. These rules, along with subsequent amendments, were intended to address weaknesses that became apparent during the financial crisis of 2007–08 (the other banking agencies' 2013 capital rule).[9] The other banking agencies' 2013 capital rule provides two methodologies for determining risk-weighted assets: (i) a standardized approach; and (ii) a more complex, models-based approach, which includes both the internal ratings-based approach for measuring credit risk exposure and the advanced measurement approach for measuring operational risk exposure.[10] The standardized approach applied to all banking organizations, whereas the internal ratings-based approach applied only to certain large or internationally active banking organizations.

In 2018, section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), directed the other banking agencies to propose a simplified, alternative measure of capital adequacy for certain federally insured banks.[11] On November 13, 2019, the other banking agencies issued a final rule implementing this statutory directive (CBLR Final Rule).[12]

Under the CBLR Final Rule, the CBLR framework is optional for depository institutions and depository institution holding companies that meet the following criteria:

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[9] *See*, 84 FR 35234, 35235 (July 22, 2019). The other banking agencies' 2013 capital rule also reflected agreements reached by the Basel Committee on Banking Supervision (BCBS) in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" (Basel III), including subsequent changes to the BCBS's capital standards and recent BCBS consultative papers. Their rule also included changes consistent with the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act).

[10] 12 CFR part 3, subparts D & E (OCC); 12 CFR part 217, subparts D & E (Federal Reserve Board); 12 CFR part 324, subparts D & E (FDIC).

[11] Pub. L. 115-174 (May 24, 2018). Section 201 is codified at 12 U.S.C. 5371 note.

[12] 84 FR 61776 (Nov. 13, 2019).

(1) A leverage ratio (equal to tier 1 capital divided by average total consolidated assets) of greater than nine percent;[13]

(2) Total consolidated assets of less than $10 billion;[14]

(3) Total off-balance sheet exposures of 25 percent or less of its total consolidated assets;

(4) Trading assets plus trading liabilities of five percent or less of its total consolidated assets; and

(5) Not an advanced approaches banking organization (advanced approaches banking organizations are generally those with at least $250 billion in total consolidated assets or at least $10 billion in total on-balance sheet foreign exposure, and depository institution subsidiaries of those firms).

The CBLR Final Rule refers to the depository institutions and depository institution holding companies that meet these criteria as "qualifying community banking organizations." Qualifying community banking organizations that opt into the CBLR framework are considered to be in compliance with the other banking agencies' generally applicable risk-based and leverage capital requirements. Further, these qualifying banking organizations will be considered to have met the well-capitalized ratio requirements for purposes of section 38 of the Federal Deposit Insurance Act (FDI Act), which applies prompt corrective action to federally

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[13] Under section 4012 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Pub. L. 116–136, 134 Stat. 281 (Mar. 27, 2020), the CBLR was temporarily set to eight percent. *See*, 85 FR 22924 (Apr. 23, 2020). Under the statute, the temporary CBLR of eight percent ended on December 31, 2020. The CBLR transitions back to nine percent during calendar year 2021. *See*, 85 FR 22930 (Apr. 23, 2020).

[14] *See*, 85 FR 77345 (Dec. 2, 2020), providing temporary relief from December 2, 2020, through December 31, 2021, for purposes of determining the asset size of an institution.

insured depository institutions.[15] Qualifying community banking organizations may opt into or out of the CBLR framework at any time.

The CBLR Final Rule includes a two-quarter grace period during which a qualifying community banking organization that temporarily fails to meet any of the qualifying criteria, including the greater than nine percent leverage ratio requirement, generally will still be deemed well-capitalized so long as the qualifying community banking organization maintains a leverage ratio greater than eight percent. At the end of the grace period, the banking organization must meet all qualifying criteria to remain in the CBLR framework or otherwise must comply with and report under the generally applicable risk-based and leverage capital requirements. Similarly, a banking organization that fails to maintain a leverage ratio greater than eight percent will not be permitted to use the grace period and must comply with the generally applicable capital requirements and file the appropriate regulatory reports.

In March 2020, the CBLR was temporarily set to eight percent by statute.[16] Accordingly, effective the second quarter of 2020, the CBLR requirement was eight percent or greater.[17] At the start of 2021, the CBLR requirement was increased to 8.5 percent or greater and the minimum requirement during the grace period is 7.5 percent.[18] Beginning on January 1, 2022, the CBLR requirement will return to nine percent and the minimum requirement during the grace period will return to eight percent.

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[15] 12 U.S.C. 1831o.

[16] Pub. L. 116-136.

[17] *See*, 85 FR 22924 (Apr. 23, 2020).

[18] *See*, 85 FR 22930 (Apr. 23, 2020).

C. THE NCUA'S ADVANCE NOTICE OF PROPOSED RULEMAKING

At its January 14, 2021, meeting the Board issued an advance notice of proposed rulemaking (ANPR) to solicit comments on two approaches to simplify the 2015 Final Rule.[19] The risk-based leverage ratio (RBLR) is the first alternative to the 2015 Final Rule included in the ANPR, which would replace the 2015 Final Rule with a new capital framework. The RBLR would use relevant risk-attribute thresholds to determine which complex credit unions would be required to hold additional capital buffers above the statutory leverage ratio. The second alternative contemplated in the ANPR is to retain the 2015 Final Rule but enable eligible complex credit unions to opt-in to the CCULR framework.

The ANPR provided for a 60-day comment period that closed on May 10, 2021. The Board received 19 comments. Almost all commenters supported the stated goal of simplifying the 2015 Final Rule. In general, commenters favored the NCUA developing a CCULR complement to risk-based capital rather than adopting a RBLR system of capital adequacy.

Several commenters were opposed to the RBLR framework because it would likely call for higher capital requirements for credit unions holding certain assets compared to the current RBC requirements. Several commenters also stated that introducing a RBLR regime at this point would increase regulatory burden and negate the substantial work complex credit unions have undertaken to achieve compliance with the 2015 Final Rule. Commenters also generally stated that the RBLR would increase transaction costs for complex credit unions as they would be required to invest additional resources to redevelop the processes that have been put in place in anticipation of the RBC requirements. A few commenters also stated that a RBLR framework could result in a capital cliff. These commenters were concerned that a small change in assets

[19] 86 FR 13498 (Mar. 9, 2021).

could move a credit union to a new buffer, thereby causing a large increase in minimum capital requirements.

Almost all commenters that favored the CCULR framework noted that it is a more flexible framework than the RBLR because complex credit unions have the option of calculating the more complex risk-based capital measure for a more precise and generally lower overall capital requirement. A few commenters noted that a benefit of the CCULR framework, as compared to a RBLR framework, is its similarity to the capital framework of the other banking agencies.

After reviewing the comments received in response to the ANPR, the Board decided to issue this proposed rule to provide a simple measure of capital adequacy for complex credit unions that would serve as a complement to the 2015 Final Rule.

II. LEGAL AUTHORITY

This proposed rule would primarily provide a simple measure of capital adequacy for credit unions classified as complex based on the principles of the CBLR framework. The CCULR would relieve complex credit unions that satisfy specified qualifying criteria from having to calculate the risk-based capital ratio. In exchange, the credit union would be required to maintain a higher net worth ratio than is otherwise required for the well-capitalized classification for risk-based capital purposes. This is a similar trade-off to the decision qualifying community banks make under the CBLR. After the initial phase in period, a qualifying complex credit union that has a net worth ratio of 10 percent or greater will be eligible to opt into the CCULR framework.

A qualifying complex credit union that opts into the CCULR framework and maintains the minimum net worth ratio (both during and after the threshold transition) will be considered well capitalized under the 2015 Final Rule.[20] The proposed rule would also make several amendments to update the NCUA's 2015 Final Rule, including addressing asset securitizations issued by credit unions, clarifying the treatment of off-balance sheet exposures, deducting certain mortgage servicing assets from a complex credit union's risk-based capital numerator, updating certain derivative-related definitions and clarifying the definition of a consumer loan.

The Board is issuing this proposed rule pursuant to its authority under the FCUA. Under the FCUA, the NCUA is the chartering and supervisory authority for FCUs and the federal supervisory authority for FICUs.[21] The FCUA grants the NCUA a broad mandate to issue regulations governing both FCUs and all FICUs. Section 120 of the FCUA is a general grant of regulatory authority and authorizes the Board to prescribe rules and regulations for the administration of the FCUA.[22] Section 207 of the FCUA is a specific grant of authority over share insurance coverage, conservatorships, and liquidations.[23] Section 209 of the FCUA is a plenary grant of regulatory authority to the Board to issue rules and regulations necessary or appropriate to carry out its role as share insurer for all FICUs.[24] Accordingly, the FCUA grants the Board broad rulemaking authority to ensure that the credit union industry and the NCUSIF remain safe and sound.

The FCUA also includes an express grant of authority for the Board to develop capital adequacy standards for credit unions. In 1998, Congress enacted the Credit Union Membership

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[20] 12 CFR 702.102(a)(1) (effective Jan. 1, 2022).

[21] 12 U.S.C. 1752-1775.

[22] 12 U.S.C. 1766(a).

[23] 12 U.S.C. 1787(b)(1).

[24] 12 U.S.C. 1789(a)(11).

Access Act (CUMAA).[25] Section 301 of CUMAA added section 216 to the FCUA,[26] which required the Board to adopt by regulation a system of prompt corrective action (PCA) to restore the net worth of credit unions that become inadequately capitalized.[27] Section 216(b)(1)(A) requires the Board to adopt by regulation a system of PCA for credit unions consistent with section 216 of the FCUA and comparable to section 38 of the FDI Act.[28] Section 216(b)(1)(B) requires that the Board, in designing the PCA system, also take into account the "cooperative character of credit unions" (that is, credit unions are not-for-profit cooperatives that do not issue capital stock, must rely on retained earnings to build net worth, and have boards of directors that consist primarily of volunteers).[29] The Board initially implemented the required system of PCA in 2000,[30] primarily in part 702, and, as discussed previously, most recently made substantial updates to the regulation in the 2015 Final Rule.

Among other things, section 216(c) of the FCUA requires the NCUA to use a credit union's net worth ratio to determine its classification among five net worth categories set forth in

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[25] Pub. L. 105–219, 112 Stat. 913 (1998).

[26] 12 U.S.C. 1790d.

[27] The risk-based net worth requirement for credit unions meeting the definition of complex was first applied on the basis of data in the Call Report reflecting activity in the first quarter of 2001. 65 FR 44950 (July 20, 2000). The NCUA's risk-based net worth requirement has been largely unchanged since its implementation, with the following limited exceptions: revisions were made to the rule in 2003 to amend the risk-based net worth requirement for member business loans, 68 FR 56537 (Oct. 1, 2003); revisions were made to the rule in 2008 to incorporate a change in the statutory definition of "net worth," 73 FR 72688 (Dec. 1, 2008); revisions were made to the rule in 2011 to expand the definition of "low-risk assets" to include debt instruments on which the payment of principal and interest is unconditionally guaranteed by NCUA, 76 FR 16234 (Mar. 23, 2011); revisions were made in 2013 to exclude credit unions with total assets of $50 million or less from the definition of complex credit union, 78 FR 4033 (Jan. 18, 2013); and revisions were made in 2020 to reflect loans issued under the Paycheck Protection Program, 85 FR 23212 (Apr. 27, 2020).

[28] 12 U.S.C. 1790d(b)(1)(A); see also 12 U.S.C. 1831o (section 38 of the FDI Act setting forth the PCA requirements for insured banks). In discussing the statutory requirement for comparability, the 2019 Supplemental Rule stated that "the FCU Act requires the Board to adopt a PCA framework comparable to the PCA framework in the FDI Act. The FCU Act, however, does not require the Board to adopt a system of risk-based capital identical to the risk-based capital framework for federally insured banking organizations."

[29] 12 U.S.C. 1790d(b)(1)(B).

[30] 12 CFR part 702; see also 65 FR 8584 (Feb. 18, 2000) and 65 FR 44950 (July 20, 2000).

the FCUA.[31] Section 216(o) generally defines a credit union's net worth as its retained earnings balance as determined under generally accepted accounting principles (GAAP),[32] and a credit union's net worth ratio, as the ratio of its net worth to its total assets.[33] As a credit union's net worth ratio declines, so does its classification among the five net worth categories, thus subjecting it to an expanding range of mandatory and discretionary supervisory actions.[34]

Section 216(d)(1) of the FCUA requires that the NCUA's system of PCA include, in addition to the statutorily defined net worth ratio requirement, "a risk-based net worth[35] requirement for credit unions that are complex, as defined by the Board."[36] The FCUA directs the NCUA to base its definition of complex credit unions "on the portfolios of assets and liabilities of credit unions."[37] If a credit union is not classified as complex, as defined by the NCUA, it is not subject to a risk-based net worth requirement. In addition to granting the NCUA broad authority to determine which credit unions are complex, and therefore subject to a risk-based net worth requirement, the FCUA also grants the NCUA broad authority to design a risk-based net worth requirement to apply to such complex credit unions.[38] Specifically, unlike the terms net worth and net worth ratio, the term risk-based net worth is not defined in the FCUA.

[31] 12 U.S.C. 1790d(c).

[32] 12 U.S.C. 1790d(o)(2).

[33] 12 U.S.C. 1790d(o)(3).

[34] 12 U.S.C. 1790d(c) – (g); 12 CFR 702.204(a) – (b).

[35] 12 U.S.C. 1790d(d)(2). For purposes of this rulemaking, the term risk-based net worth requirement is used in reference to the statutory requirement for the Board to design a risk-based net worth requirement to take account of any material risks against which the net worth ratio required for an insured credit union to be adequately capitalized may not provide adequate protection. The term risk-based capital ratio is used to refer to the specific standards established in the 2015 Final Rule to function as criteria for the statutory risk-based net worth requirement. The term risk-based capital ratio is also used by the other banking agencies and the international banking community when referring to the types of risk-based requirements that are addressed in the 2015 Final Rule. This change in terminology throughout the proposed rule would have no substantive effect on the requirements of the FCUA, and is intended only to reduce confusion for the reader.

[36] 12 U.S.C. 1790d(d)(1).

[37] 12 U.S.C. 1790d(d).

[38] *Id.*

Accordingly, section 216 grants the Board the authority to design risk-based net worth requirements, so long as the regulations are comparable to those applicable to other federally insured depository institutions and consistent with the requirements of the FCUA.

The proposed CCULR framework is comparable to section 38 of the FDI Act, as implemented by CBLR Final Rule.[39] As discussed previously, section 201 of the EGRRCPA amended part of the other banking agencies' capital adequacy framework to direct the other banking agencies to propose a simplified, alternative measure of capital adequacy for certain federally insured banks.[40] The other banking agencies implemented this requirement, including amendments to their PCA regulations under section 38 of the FDI Act, in the CBLR Final Rule. The Board also notes that the proposed amendments to the NCUA's 2015 Final Rule would make the rule more comparable to the other banking agencies' 2013 capital rules.

In addition to satisfying the comparability requirement in section 216, the proposed CCULR framework also meets the requirements in section 216 for the NCUA's risk-based net worth framework. Section 216 has two express provisions that authorize an NCUA analogue to the CBLR—the definition of complex credit unions and the mandate for the Board to design a risk-based net worth requirement. In designing its CCULR framework, the Board considered both its legal authority to exclude credit unions from risk-based net worth requirements under the definition of complex, and its authority to design a system of risk-based net worth that includes a higher net worth ratio in place of calculating a ratio based on risk-adjusted assets.[41]

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[39] 12 CFR part 3 (OCC), 12 CFR part 217 (Federal Reserve Board), and 12 CFR part 324 (FDIC).

[40] 12 U.S.C. 5371.

[41] The Board also briefly considered an additional independent legal basis for the proposed CCULR framework. As discussed in the section III.D. Calibration of the CCULR, the proposed CCULR framework would result in complex credit unions generally holding more capital than under the 2015 Final Rule. Because of the higher capital requirements under the proposed CCULR framework, the Board also considered whether the proposal could be considered an alternative method to demonstrate compliance with the 2015 Final Rule, instead of an alternative measure of risk-based net worth. This approach would be within the Board's general discretion to determine the

The Board considered its express authority under section 216 to define which credit unions are complex, and thus exclude noncomplex credit unions from the risk-based net worth requirement.[42] The express delegation grants the Board significant discretion to determine which credit unions are considered complex. Under this legal basis, the Board would continue to limit the definition of complex to only those credit unions with quarter-end total assets that exceed $500 million dollars. In using asset size as a proxy for complexity, the Board complied with the statutory directive that the definition of complex be based on the portfolios of assets and liabilities of credit unions. Specifically, the Board relied on a complexity index that counted the number of complex products and services provided by credit unions.[43] The complexity index demonstrated that credit unions with greater than $500 million in total assets held complex assets and liabilities as larger share of their total assets than smaller credit unions.[44]

The Board, however, could also propose a definition of complex that, rather than looking at the assets and liabilities of credit unions in the aggregate, looks at the individual portfolios of credit unions with total assets greater than $500 million. This approach is also consistent with the statutory provision that the complex definition should be based on the portfolios of assets and liabilities of credit unions. The Board would use the same qualifying criteria as in the proposed rule, as measures of complexity. If a credit union would otherwise meet the proposed definition

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means and manner by which it measures compliance with its regulations, including the risk-based net worth requirement. However, in light of the express statutory authority to define complex and design a risk-based net worth framework, the Board believes this alternative basis, while valid, is not necessary to support the proposed rule.

[42] When Congress expressly authorizes or directs an agency to define a statutory term, it grants the agency broad discretion. Under these circumstances, an agency is permitted to interpret a term so long as its interpretation is not manifestly contrary to the statute. The interpretation need not conform to the ordinary meaning of the term. *See Am. Bankers Ass'n v. Nat'l Credit Union Admin.*, 934 F.3d 649, 663 (D.C. Cir. 2019) ("An express delegation of definitional power "necessarily suggests that Congress did *not* intend the [terms] to be applied in [their] plain meaning sense," *Women Involved in Farm Econ. v. U.S. Dep't of Agric.*, 876 F.2d 994, 1000 (D.C. Cir. 1989), that they are not "self-defining," *id.*, and that the agency "enjoy[s] broad discretion" in how to define them, *Lindeen v. SEC*, 825 F.3d 646, 653 (D.C. Cir. 2016)).

[43] *Supra* note 5 at 55470.

[44] *Id*.

of a qualifying credit union, it would be considered not complex, and therefore not subject to risk-based capital, as implemented by the 2015 Final Rule. This alternative approach would create a functionally equivalent requirement to the one set forth in this proposed rule, with the only difference being the technical details of the implementing regulatory text in part 702.

The Board also considered its express authority and mandate to design the CCULR on the basis that the CCULR constitutes a risk-based net worth requirement, as required for complex credit unions in section 216(d). As discussed previously, the FCUA does not define the term risk-based net worth requirement and only sets forth general guidelines for the design of the risk-based net worth requirement mandated under section 216(d)(1). Specifically, section 216(d)(2) requires that the Board "design the risk-based net worth requirement to take account of any material risks against which the net worth ratio required for an insured credit union to be adequately capitalized may not provide adequate protection." Under section 216(c)(1)(B) of the FCUA, the net worth ratio required for a credit union to be adequately capitalized is six percent.

The plain language of section 216(d)(2) supports the NCUA's interpretation that Congress intended for the NCUA to design the risk-based net worth requirement to take into account any material risks beyond those already addressed through the statutory six percent net worth ratio required for a credit union to be adequately capitalized. In other words, the language in paragraph 216(d)(2) simply identifies the types of risks that the NCUA's risk-based net worth requirement must address, that is, those risks not already addressed by the statutory six percent net worth requirement. Notably, the FCUA does not require that the risk-based net worth requirement include risk-adjusted assets as part of its calculation.[45] Instead, the Board interprets "risk-based" to require an accounting for risks in some manner—that is, the measure must be

[45] Case law research revealed no decisions discussing the meaning of "risk-based" under the FCUA or other statutes that impose risk-based capital requirements on financial institutions.

based on a consideration of risks—but not any particular manner of doing so.[46] Therefore, provided the Board determines that the proposed CCULR considers all material risks against which the six percent net worth ratio does not provide protection, then the Board has satisfied the statutory requirements for a risk-based net worth ratio.[47]

The Board believes that both approaches to designing the CCULR framework are supported by the FCUA. The Board, however, has chosen to draft the proposed rule under its authority to design a risk-based net worth requirement. The Board believes that considering the CCULR as an alternative way to calculate a risk-based net worth requirement is more straightforward, consistent with the structure of section 216, and simpler for complex credit unions to implement.

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[46] By contrast, in 2010, Congress specifically elaborated on the risk-based measures applicable to banks by providing that the generally applicable risk-based capital requirements for those institutions must include risk-weighted assets in the denominator of the ratio. Pub. L. 111-203, codified at 12 U.S.C. 5371. Congress did not elect to amend the FCUA to add a similar elaboration on the risk-based net worth requirement applicable to complex credit unions, which is consistent with the Board's interpretation that the term risk-based by itself does not necessarily entail risk-weighted assets. This reading is consistent with judicial interpretations of the closely related phrase "based on," which the Supreme Court has held to indicate a causal or but-for causation relationship between the phrase "based on" and the term it modifies. *Babb v. Wilkie*, 140 S.Ct. 1168, 2020 WL 1668281, at *4 (Apr. 6. 2020). Similarly, a "risk-based" requirement can be understood as a requirement that bears a causal relationship to the relevant risks but does not require a specific form for the calculation of this requirement.

[47] In a similar manner, the Board initially explored a non-risk-adjusted approach in the advance notice of proposed rulemaking that the Board issued following CUMAA's enactment in 1998, in which it requested comments on addressing this provision through increased net worth requirements as well as through risk-adjusted measures. 63 FR 57938 (Oct. 29, 1998). This approach is also consistent with the Senate report accompanying CUMAA, which stated: "The NCUA must design the risk-based net worth requirement to take into account any material risks against which the *6 percent net worth ratio* required for an insured credit union to be adequately capitalized may not provide adequate protection. Thus the NCUA should, for example, consider whether the six 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 risk-based net worth requirement should reflect a reasoned judgment about the actual risks involved." S. Rep. No. 105-193 at 14 (May 21, 1998) (emphasis added). The report indicates that Congress did not intend to prescribe the manner in which the Board accounts for any relevant risks that the six percent net worth ratio does not adequately address.

III. PROPOSED RULE

A. OVERVIEW OF THE CCULR FRAMEWORK

This proposed rule would provide a simplified measure of capital adequacy for credit unions classified as complex (credit unions with total assets greater than $500 million). Under the proposed rule, a qualifying complex credit union that meets the minimum CCULR, which is equal to its net worth ratio, would be eligible to opt into the CCULR framework and would be considered well capitalized. The proposed CCULR framework is based on the principles of the CBLR framework. It would relieve complex credit unions that meet specified qualifying criteria and have opted into the CCULR framework from having to calculate a risk-based capital ratio, as implemented by the 2015 Final Rule. In exchange, the qualifying complex credit union would be required to maintain a higher net worth ratio than is otherwise required for the well-capitalized classification. This is a similar trade-off to the one qualifying community banking organizations are able to make under the CBLR. The CCULR would further the goal of the FCUA's PCA requirements by ensuring that complex credit unions continue to hold sufficient capital, while minimizing the burden associated with complying with the NCUA's risk-based capital requirement.

As noted previously, the 2015 Final Rule is scheduled to take effect on January 1, 2022. Accordingly, the regulatory amendments contained in this proposed rule, if finalized, would not take effect until January 1, 2022, and qualifying complex credit unions would not be able to opt into the proposed CCULR framework prior to this effective date.

B. QUALIFYING COMPLEX CREDIT UNIONS

Under the proposal, a qualifying complex credit union would be defined as a complex credit union under § 702.103 that meets the following criteria (qualifying criteria), each as described further below:

(1) Has a CCULR (net worth) of 10 percent or greater, subject to an initial transition period;[48]

(2) Has total off-balance sheet exposures of 25 percent or less of its total assets;

(3) Has the sum of total trading assets and total trading liabilities of five percent or less of its total assets; and

(4) Has the sum of total goodwill, including goodwill that meets the definition of excluded goodwill, and total other intangible assets, including intangible assets that meet the definition of excluded other intangible assets, of two percent or less of its total assets.

The Board believes that complex credit unions that do not meet any one of the qualifying criteria should remain subject to risk-based capital to ensure that such credit unions hold capital commensurate with the risk profile of their activities. The Board would continue to evaluate the qualifying criteria over time to ensure that they continue to be appropriate.

Question 1: The Board invites comment on the qualifying criteria. What are the advantages and disadvantages of each qualifying criterion? What is the burden associated with

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[48] For an additional discussion on why the Board set the ratio to 10 percent, see *Section D. Calibration of the CCULR*. For additional information on the transition period, see *Section I. Transition Provision*.

determining whether a complex credit union meets the proposed qualifying criteria? What other criteria, if any, should the Board consider in the proposed definition? What are commenters' views on the tradeoffs between simplicity and having additional qualifying criteria? In specifying any alternative qualifying criteria regarding a credit union's risk profile, please provide information on how alternative qualifying criteria should be considered in conjunction with the calibration of the CCULR level and why the Board should consider such alternative criteria. For example, if the Board were to consider a CCULR of less than 10 percent to be well capitalized, should additional qualifying criteria be incorporated? The Board may consider qualifying criteria related to mortgage servicing assets, investments in credit union service organizations (CUSOs), or investments in corporate credit unions if a permanent CCULR of less than 10 percent is considered.

1. CCULR of 10 percent or Greater

After the transition period, the proposed rule would require a complex credit union to have a CCULR of at least 10 percent to be classified as a qualifying complex credit union. An otherwise qualifying complex credit union could not opt into the CCULR framework unless its CCULR was at least 10 percent.

Transition Provision

Under the proposed rule, there is a transition provision to phase in the 10 percent CCULR over two years to give complex credit unions time to adjust and adapt to the new requirements. The transition provision provides for full effectiveness of the 10 percent CCULR on January 1, 2024. From January 1, 2022, to December 31, 2022, a complex credit union may opt into the CCULR framework if it has a CCULR of nine percent or greater. Therefore, a qualifying complex credit union that opts into the CCULR framework and that maintains a CCULR of nine percent would be considered well capitalized. Beginning January 1, 2023, a complex credit union that has opted into the CCULR framework must have a CCULR of 9.5 percent or greater to meet the eligibility criteria and be considered well-capitalized. After January 1, 2024, a complex credit union would need to maintain a CCULR of 10 percent to be considered well-capitalized. Accordingly, the proposed rule provides a complex credit union two years to meet a CCULR of 10 percent or greater. See, Section *I. Transition Provision* for additional information.

2. Off-Balance Sheet Exposures

Under the proposal, a qualifying complex credit union would be required to have total off-balance sheet exposures of 25 percent or less of its total assets, as of the end of the most recent calendar quarter. The Board is including these qualifying criteria in the CCULR framework because the CCULR includes only on-balance sheet assets in its denominator and thus would not require a qualifying complex credit union to hold capital against its off-balance sheet exposures. This qualifying criterion is intended to reduce the likelihood that a qualifying complex credit union with significant off-balance sheet exposures would be required to hold less capital under the CCULR framework than under the risk-based capital ratio.[49]

The other banking agencies' CBLR framework also excludes banking organizations with significant off-balance sheet exposures. The CBLR Final Rule excludes banking organizations that have more than 25 percent of total consolidated assets in off-balance sheet exposures. The other banking agencies' definition of off-balance sheet exposures, however, has several differences from the current definition of off-balance sheet exposures in the 2015 Final Rule. Therefore, to make the CCULR framework more comparable to the CBLR and to improve on the effectiveness of the 2015 Final Rule, the proposed rule would amend the NCUA's definition of

[49] The proposed amendments to § 702.104, Risk-based capital ratio, include credit conversion factors and risk-weights for off-balance sheet exposures.

off-balance sheet exposures. The proposed amendments to the definition of off-balance sheet exposure would apply to both the proposed CCULR framework and the risk-based capital framework.[50]

Under the proposed CCULR framework, off-balance sheet exposures would mean:

(1) For unfunded commitments, excluding unconditionally cancellable commitments, the remaining unfunded portion of the contractual agreement.

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

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

(4) For financial standby letters of credit, the total potential exposure of the credit union under the contractual agreement.

(5) For forward agreements that are not derivative contracts, the future contractual obligation amount.

(6) For sold credit protection through guarantees and credit derivatives, the total potential exposure of the credit union under the contractual agreement.

(7) For off-balance sheet securitization exposures, the notional amount of the off-balance sheet credit exposure (including any credit enhancements, representations, or warranties that obligate a credit union to protect another party

[50] The proposed rule would also include risk weights for each new exposure in the definition of off-balance sheet exposure. See, *Section M. Amendments to the 2015 Final Rule*.

from losses arising from the credit risk of the underlying exposures) that arises from a securitization.

(8) For securities borrowing or lending transactions, the amount of all securities borrowed or lent against collateral or on an uncollateralized basis.[51]

Each element of the off-balance sheet definition is discussed in more detail below.

Unfunded Commitments

The current definition of off-balance sheet exposures in the 2015 Final Rule includes all unfunded commitments. The proposed definition, however, would not include commitments that are unconditionally cancellable. Under the proposed rule, an unconditionally cancellable commitment would mean a commitment that a credit union may, at any time, with or without cause, refuse to extend credit under (to the extent permitted under applicable law). The Board notes that for an exposure to be treated as unconditionally cancellable, the contractual agreement must explicitly state that the credit union can unconditionally refuse to extend credit under the commitment. A provision stating the credit union can cancel the commitment for good cause would be insufficient.

Loans Transferred with Limited Recourse

The current definition of off-balance sheet exposures in the 2015 Final Rule includes all other loans transferred with limited recourse or other seller-provided credit enhancements and that qualify for true sales accounting. The proposed rule would make no substantive changes to this prong of the off-balance sheet exposure definition. The exposure amount for loans

[51] New exposure categories may require changes to the Call Report. For example, unconditionally cancellable commitments, off-balance sheet securitization exposures, forward agreements, sold credit protection through guarantees and credit derivatives, and securities borrowing and lending transactions may require additional Call Report fields.

transferred with limited recourse is the maximum contractual amount the credit union is exposed to according to the agreement, net of any related valuation allowance.

Loans transferred under the Federal Home Loan Bank (FHLB) Mortgage Partnership Finance Program Loans

The current definition of off-balance sheet exposures in the 2015 Final Rule includes loans transferred under the FHLB mortgage partnership finance program. The proposed rule would clarify the language of this item in the off-balance sheet exposure definition but would make no other substantive change. The exposure amount for loans that meet the definition of mortgage partnership finance program and are transferred under the FHLB mortgage partnership finance program is the outstanding loan balance as of the reporting date, net of any related valuation allowance.

Financial Standby Letters of Credit

The proposed rule would include financial standby letters of credit in the definition of off-balance sheet exposures. These exposures are not explicitly included in the current definition of off-balance sheet exposure in the 2015 Final Rule; however, they are included as off-balance sheet items. Under the proposed rule, the exposure amount for financial standby letters of credit would be the total potential exposure of the credit union under the contractual agreement.

Forward Agreements

The proposed definition of off-balance exposures would also include forward agreements that are not derivative contracts. Forward agreements are not explicitly included in the current definition of off-balance sheet exposure in the 2015 Final Rule; however, forward agreements are included as off-balance sheet items. A forward agreement would mean a legally binding contractual obligation to purchase assets with certain drawdown at a specified future date, not including commitments to make residential mortgage loans or forward foreign exchange contracts. The exposure amount of a forward agreement that is not a derivative contract would be the future contractual obligation amount.

Similar to the other banking agencies, the Board is also clarifying that typical mortgage lending activities such as forward loan delivery commitments between credit unions and investors are typically derivative contracts, and therefore, would be excluded from the off-balance sheet exposure definition.[52] The Board also notes that put and call options on mortgage-backed securities are also typically derivatives and would be excluded from the definition of off-balance sheet exposure. A contractual obligation for the future purchase of a "to be announced" (that is, when-issued) mortgage securities contract that does not meet the definition of a derivative contract, however, would be captured by the off-balance sheet exposure definition as it would be considered a forward agreement. In contrast, a contractual obligation for the future sale (rather than purchase) of a "to be announced" mortgage securities contract that does not meet the definition of a derivative contract would not be captured in the off-balance sheet qualifying criterion, as it would not be considered a forward agreement.

Sold credit protection through guarantees and credit derivatives

The proposed definition of off-balance sheet exposure would also include sold credit protection through guarantees[53] and credit derivatives. These exposures are not explicitly

[52] Derivative contract means a financial contract whose value is derived from the values of one or more underlying assets, reference rates, or indices of asset values or reference rates. Derivative contracts include interest rate derivative contracts, exchange rate derivative contracts, equity derivative contracts, commodity derivative contracts, and credit derivative contracts. Derivative contracts also include unsettled securities, commodities, and foreign exchange transactions with a contractual settlement or delivery lag that is longer than the lesser of the market standard for the particular instrument or five business days. 12 CFR 702.2 (effective Jan. 1, 2022).

[53] A guarantee means a financial guarantee, letter of credit, insurance, or similar financial instrument that allows one party to transfer the credit risk of one or more specific exposures to another party. 12 CFR 702.2 (effective Jan. 1, 2022).

included in the definition of off-balance sheet exposure in the 2015 Final Rule; however, guarantees are included as off-balance sheet items. Credit derivatives are included in the other banking agencies' CBLR framework as part of the off-balance sheet threshold. Under the proposed definition, the exposure amount for sold credit protection through guarantees and credit derivatives would be the total potential exposure of the credit union under the contractual agreement. A credit derivative would mean a financial contract executed under standard industry credit derivative documentation that allows one party (the protection purchaser) to transfer the credit risk of one or more exposures (reference exposure[s]) to another party (the protection provider) for a certain period of time. At this time, FCUs are not permitted to have credit derivatives and the Board is unaware of any state-chartered credit unions engaging in credit derivatives. The Board is including this provision for consistency with the other banking agencies and to ensure that the proposed rule is flexible should credit unions hold credit derivatives in the future.

Off-balance Sheet Securitizations

Additionally, compared to the current definition of off-balance sheet exposure, the proposed definition would include off-balance sheet securitizations, including any credit enhancements, representations, or warranties that obligate a credit union to protect another party from losses arising from the credit risk of the underlying exposures.[54] Off-balance sheet securitizations are not included in the current definition of off-balance sheet exposure or off-balance sheet items, but are included in the other banking agencies' CBLR framework as part of the off-balance sheet threshold. An off-balance sheet securitization exposure could arise in a number of circumstances. For example, if an originating credit union provides liquidity or credit

[54] The other banking agencies define the term "credit enhancements, representations, or warranties." The Board believes the definition used by the other banking agencies introduces additional complexity and therefore is not adopting it at this time and, instead, will rely on the plain meaning of these terms.

support for an issued securitization, the credit union may report an off-balance sheet securitization exposure. The exposure amount of an off-balance sheet securitization exposure would be the notional amount of the exposure.

Securities Borrowing or Lending Transactions

Finally, the proposed rule would explicitly include securities borrowing or lending transactions. Securities borrowing or lending transactions are not included in the current definition of off-balance sheet exposure or off-balance sheet items, but are included in the other banking agencies' CBLR framework as part of the off-balance sheet qualifying criterion. These types of transactions are permissible for FCUs under part 703 of NCUA regulations and may be permissible for FISCUs as well.[55] For these transactions, the exposure amount would be the amount of all securities borrowed or lent against collateral or on an uncollateralized basis.

Collectively, the above eight elements comprise the proposed definition of off-balance sheet exposures that would apply to both the proposed CCULR framework and the risk-based capital framework under the 2015 Final Rule. *Section M. Amendments to the 2015 Final Rule*, which addresses two additional off-balance sheet exposures, that are not part of the off-balance exposure definition because they are not included as an off-balance sheet exposure in either the CCULR or the other banking agencies' CBLR off-balance sheet thresholds. However, they are considered in the other banking agencies' 2013 capital rule and are proposed amendments to the NCUA's 2015 risk-based capital rule. By applying the proposed changes to both frameworks, the Board would establish consistency between the 2015 Final Rule and the proposed CCULR framework. Without these conforming amendments to the definition of off-balance sheet

[55] 12 CFR 703.13. 12 CFR 703.2 defines securities lending as lending a security to a counterparty, either directly or through an agent, and accepting collateral in return.

exposures, a credit union might be required to hold less capital under the CCULR framework than under the risk-based capital framework of the 2015 Final Rule.

The Board proposes a 25 percent threshold for off-balance sheet exposures, as this threshold is similar to the CBLR framework and it would provide enough flexibility for complex credit unions to engage in normal lending practices. The Board does not believe that traditional banking activities, such as extending loan commitments to members, should necessarily preclude a complex credit union from qualifying to use the CCULR framework. The 25 percent threshold will also ensure that complex credit unions engaging in substantial off-balance sheet activity will also have the commensurate regulatory capital requirement. Therefore, the Board proposes a 25 percent threshold for off-balance sheet exposures, consistent with the CBLR Final Rule.

Question 2: The Board invites comment on the proposed off-balance sheet exposures qualifying criterion. What aspects of the off-balance sheet exposures qualifying criterion, including the related definition, requires further clarity? What other alternatives should the Board consider for purposes of defining the proposed qualifying criterion? What impact would the proposed qualifying criterion have on a complex credit union's business strategies and lending decisions? Is a 25 percent threshold appropriate? If commenters believe an alternative threshold is more appropriate, please provide data.

3. Trading Assets and Liabilities

Under the proposal, a qualifying complex credit union would be required to have the sum of its total trading assets and total trading liabilities be five percent or less of its total assets, each measured as of the end of the most recent calendar quarter.[56] The proposed rule would include

[56] Currently, the Call Report does not include a reporting requirement for trading assets and trading liabilities. As discussed in *Section III. L. Illustrative Reporting Forms to Support the CCULR*, if the proposed rule is finalized, the

new definitions for the terms trading assets and trading liabilities. Trading assets would be defined as securities or other assets acquired, not including loans originated by the credit union, for the purpose of selling in the near term or otherwise with the intent to resell to profit from short-term price movements. Trading assets would not include shares of a registered investment company or a collective investment fund used for liquidity purposes. Trading assets, however, would include derivatives recorded as assets on a credit union's balance sheet that are used for trading purposes. The Board notes that FCUs do not currently have the authority under part 703 to enter into derivative transactions for trading.

The Board is proposing to define trading assets similarly to the other banking agencies' definition with the exception of including securities or investments acquired through underwriting or dealing, or securities acquired as an accommodation to a customer. The Board does not believe these are activities that credit unions currently engage in and, additionally, they would still likely be captured in the definition of trading assets. The Board notes that any loan originated by a credit union would not be considered a trading asset. However, under the proposed definition, loans purchased with the intent to sell in the short-term would be considered trading assets.

Trading liabilities would be defined as the total liability for short positions of securities or other liabilities held for trading purposes. A short position is established when an investor sells an investment that the investor does not own. The following is an example of a short position that would not be included within the definition of trading liability because it is used to manage interest rate risk. In managing interest rate risk, an investor might sell a 10-year Treasury Note to decrease the price volatility of the investor's bond/loan portfolio. The value of the 10-year Treasury Note, which is a liability for the investor, would change in the same direction as the

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NCUA would update the Call Report before January 1, 2022. The revised Call Report would include reporting requirements for trading assets and trading liabilities.

bond/loan portfolio, reducing interest rate risk if the price change of assets minus liabilities is less than it would have been without shorting the 10-year Treasury Note. If a credit union engaged in such a transaction, it would not be included in the trading liabilities definition. The Board also notes that FCUs do not currently have the authority to short securities.[57] Additionally, trading liabilities would include derivatives recorded as liabilities on a credit union's balance sheet that are used for trading purposes. The Board notes that FCUs do not currently have the authority to enter into derivative transactions for trading.

These qualifying criteria would be calculated in accordance with the reporting instructions in the Call Report and the complex qualifying credit union would divide the sum of its total trading assets and total trading liabilities by its total assets.

The other banking agencies limited a qualifying community banking organization to having total trading assets and trading liabilities of five percent or less of its total consolidated assets. In the CBLR Final Rule, the other banking agencies discussed the potential elevated levels of risk and complexity that can be associated with certain trading activities and, therefore, required banking organizations with significant trading assets and liabilities to be subject to risk-based capital requirements. The other banking agencies noted that elevated levels of trading activity can produce a heightened level of earnings volatility, which has implications for capital adequacy. The other banking agencies also expressed concerns about making the CBLR framework available to banking organizations with material market risk exposure. For similar reasons, the Board believes it is important to have a qualifying criterion based on the sum of total trading assets and trading liabilities.

[57] 12 CFR 703.15.

Based on the Board's analysis of currently available Call Report data and permissible activities for FCUs, the Board believes the vast majority of complex credit unions do not have material amounts of trading assets and trading liabilities.[58] The Board has included a trading activity criterion, despite the general lack of credit union trading activity, because the Board recognizes the potential elevated levels of risk and complexity that can be associated with certain trading activities even if is not applicable to most complex credit unions. In addition, the Board recognizes that the level of credit union trading activity could increase in the future.

Question 3: The Board invites comment on the proposed trading activity criterion. What other alternative measures of trading activity should the Board consider for purposes of defining a qualifying complex credit union and why?

4. Goodwill and Other Intangible Assets

Under the proposal, a qualifying complex credit union would be required to have the sum of total goodwill and other intangible assets of two percent or less of its total assets. Qualifying complex credit unions would be required to include excluded goodwill and excluded other intangible assets in this calculation.[59] Goodwill is defined as an intangible asset, maintained in accordance with GAAP, representing the future economic benefits arising from other assets acquired in a business combination (for example, a merger) that are not individually identified

[58] Even though it is permissible for FCUs to trade securities, Call Report data shows FCUs do not hold substantial trading assets. *See*, 12 CFR 703.13(f). Depending on state law, FISCUs also may be permitted to hold trading assets, however, again, the Board's analysis shows that FISCUs do not hold material amounts of trading assets. As of December 2020, the largest concentration in trading debt securities at a complex credit union was 2.3 percent of assets. Furthermore, only four complex credit unions had over one percent of assets in trading debt securities.

[59] Excluded goodwill means the outstanding balance, maintained in accordance with GAAP, of any goodwill originating from a supervisory merger or combination that was completed on or before December 28, 2015. This term and definition expire on January 1, 2029. Excluded other intangible assets means the outstanding balance, maintained in accordance with GAAP, of any other intangible assets such as core deposit intangible, member relationship intangible, or trade name intangible originating from a supervisory merger or combination that was completed on or before December 28, 2015. This term and definition expire on January 1, 2029. 12 CFR 702.2 (effective Jan. 1, 2022).

and separately recognized. Other intangible assets mean intangible assets, other than servicing assets and goodwill, maintained in accordance with GAAP. Other intangible assets do not include excluded other intangible assets. These are the same definitions as in the 2015 Final Rule. However, as discussed previously, for purposes of the CCULR, complex credit unions would be required to include in the proposed threshold excluded goodwill and excluded other intangible assets, even though excluded goodwill and excluded other intangible assets are not included in the goodwill deduction under the 2015 Final Rule. The 2015 Final Rule established an implementation period for deducting goodwill and other intangible assets acquired by certain supervisory mergers prior to the publication of the 2015 Final Rule. This approach ensured credit unions were not treated punitively for goodwill and other intangible assets acquired before the publication of the 2015 Final Rule. However, the CCULR framework is voluntary and the same fairness concerns are not present. Therefore, the Board has chosen to include the full amount of goodwill and other intangible assets for this criterion.

The Board is proposing a qualifying criterion related to goodwill and other intangible assets because goodwill and other intangible assets contain a high level of uncertainty regarding a credit union's ability to realize value from these assets, especially under adverse financial conditions. Due to the uncertainty of recognizing value from goodwill and other intangible assets, the other banking agencies require insured banks to deduct goodwill and intangible assets from tier 1 capital.[60] The Board believes it is prudent to assess the credit union's balance of goodwill and other intangible assets to ensure comparability with the banking industry. Without this proposed criterion, a qualifying credit union could use the CCULR despite substantial goodwill and intangible assets, which would be inconsistent with the principles of the CBLR

[60] *See e.g.*, 12 CFR 324.22.

framework. The Board also notes that under the 2015 Final Rule, goodwill and other intangible assets are deducted from both the risk-based capital ratio numerator and denominator.

As stated previously, the proposed rule includes a two percent threshold on goodwill and other intangibles assets. The Board believes that complex credit unions with two percent or less of their assets in goodwill and other intangibles assets would not hold less capital under the CCULR framework than under the risk-based capital ratio. In addition, a two percent threshold only would exclude a small portion of otherwise qualifying complex credit unions, an estimated four credit unions as of December 31, 2020, from the CCULR framework. Therefore, the Board believes a two percent threshold balances regulatory relief for most qualifying complex credit unions, while still recognizing the uncertainty and volatility of goodwill and other intangible assets. The Board believes that complex credit unions with substantial goodwill and other intangible assets should calculate their capital adequacy using the risk-based capital ratio, as their portfolios may require higher capital levels.

Question 4: The Board invites comment on the proposed qualifying criterion for the sum of total goodwill and other intangible assets. What are commenters' views on the inclusion of such a qualifying criterion? Should qualifying complex credit unions be required to include excluded goodwill and excluded other intangible assets that would have been excluded under the 2015 Final Rule?

Question *5:* As discussed previously, under the 2015 Final Rule, goodwill and other intangible assets are deducted from both the risk-based capital ratio numerator and denominator in order to achieve a risk-based capital ratio numerator reflecting equity available to cover losses in the event of liquidation. The Board, however, recognized that requiring the exclusion of goodwill and other intangibles associated with supervisory mergers and combinations of credit unions that occurred prior to the 2015 Final Rule could directly reduce a credit union's risk-based capital ratio. Accordingly, under the 2015 Final Rule, the Board also permitted credit unions to exclude certain goodwill and other intangible assets from the deduction in the risk-based capital ratio numerator. In particular, the 2015 Final Rule excluded from the definition of goodwill, which must be deducted from the risk-based capital ratio numerator, certain goodwill or other intangible assets acquired by a credit union in a supervisory merger or consolidation.

Under the 2015 Final Rule, excluded goodwill is defined as the outstanding balance, maintained in accordance with GAAP, of any goodwill originating from a supervisory merger or combination that was completed on or before December 28, 2015. This term and definition expire on January 1, 2029. Excluded other intangible assets is defined as the outstanding balance, maintained in accordance with GAAP, of any other intangible assets such as core deposit intangible, member relationship intangible, or trade name intangible originating from a supervisory merger or combination that was completed on or before December 28, 2015. This term and definition expire on January 1, 2029. The Board added these two definitions to take into account the impact goodwill or other intangible assets recorded from transactions defined as supervisory mergers or combinations have on the calculation of the risk-based capital ratio upon implementation. Both definitions apply to supervisory mergers or combinations that occurred before December 28, 2015. The date, December 28, 2015, was 60 days after the 2015 Final Rule was published in the Federal Register, which provided sufficient notice to complex credit unions contemplating supervisory mergers at the time the 2015 Final Rule was issued. The Board understands, however, that there is some confusion as to whether the dates were amended after the subsequent delays to the 2015 Final Rule in the 2018 Supplemental Rule and the 2019 Supplemental Rule. The Board notes that as currently written, the delays to the effective date of the 2015 Final Rule do not amend the December 28, 2015, date for excluded goodwill and other intangible assets. Any supervisory mergers that included goodwill and other intangible assets after December 28, 2015, are required deductions once the 2015 Final Rule becomes effective on

January 1, 2022. The Board, however, is open to considering an amendment to the 2015 Final Rule. Should the Board amend the December 28, 2015, date to alleviate any potential confusion in the date caused by the delayed effective date of the 2015 Final Rule? The Board also notes that the CCULR framework, as proposed, would not require a deduction, so any potential amendment would only be relevant for complex credit unions that are not qualifying complex credit unions or that have not opted to calculate their risk-based capital measure under the CCULR framework. What are the advantages and disadvantages of deducting goodwill from regulatory capital under the 2015 Final Rule? As goodwill is not a tangible asset, how would not deducting goodwill from regulatory capital adequately protect the NCUSIF in the event of a failure and liquidation?

Question 6: Please comment on whether the Board should consider qualifying criteria for other categories of exposures that are subject to heightened risk weights under the 2015 Final Rule. Should the Board combine several categories of higher risk-weighted exposures to ensure a complex credit union's aggregate exposure is under a certain threshold?

5. Other CBLR Eligibility Criteria

Total assets of less than $10 billion

Under the other banking agencies' CBLR framework, only depository institutions or depository institution holding companies with total consolidated assets of less than $10 billion are eligible to use the CBLR. The $10 billion limitation was included in the EGRRCPA.[61] The other banking agencies also stated that a risk-based capital ratio is more appropriate for larger banking organizations because such banking organizations may present risks that are not

[61] *Supra* note 11.

appropriately captured by the CBLR framework.[62] Commenters to the ANPR that addressed the scope of eligible institutions generally favored not using the CBLR threshold of $10 billion. One commenter stated that because credit unions are generally subject to more stringent portfolio shaping regulations than banks, a $10 billion cap was not appropriate. One commenter stated that the NCUA could set a higher threshold of $15 billion or $20 billion to harmonize the CCULR with the more granular stress testing tiers. Other non-credit union commenters favored a $10 billion limit on eligibility to opt into the CCULR framework.

The Board is not proposing to include this qualifying criterion in the proposed rule. The Board believes that the CCULR framework would appropriately capture the risk for all complex credit unions regardless of asset size. The FCUA limits the types of assets a Federal credit union can hold compared to banking organizations. Consequently, larger banking organizations may be more likely to include assets that cannot be adequately risk weighted with a leverage ratio than a complex credit union. Therefore, the Board believes permitting all complex credit unions regardless of asset size to opt into the CCULR framework is prudent and does not present a risk to the NCUSIF. Permitting credit unions with total assets over $10 billion would only include 18 additional credit unions, with total assets of over $438 billion, or 27 percent of all complex credit union assets as of March 31, 2021. In addition, these credit unions are highly capitalized and have an average net worth ratio of just under 10 percent. Twelve of the eighteen credit unions have net worth ratios over nine percent. The remaining six credit unions with total assets over $10 billion as of March 2021 have an average net worth ratio of 8.32 percent.

The Board notes that $10 billion is the threshold for credit unions to begin capital planning under part 702. In addition, complex credit unions with $20 billion or more in total

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[62] *Supra* note 12.

assets are subject to stress testing requirements.[63] These requirements are independent of the complex credit union's CCULR selection. Therefore, a complex credit union that meets the applicable thresholds for capital planning and stress testing requirements will be subject to such requirements regardless of its CCULR opt in election.

Question 7*:* Should the Board consider limiting eligibility to the CCULR framework to only complex credit unions with less than $10 billion in total assets? The Board seeks comments on a potential $10 billion asset limitation and whether it is appropriate for the CCULR framework.

Question 8: In contrast to the other banking agencies' CBLR statute and regulation, the Board is not proposing to include a qualifying criterion for mortgage servicing assets (MSAs). As discussed subsequently in this preamble, the Board is proposing changes to the risk-weighting of MSAs under the 2015 Final Rule consistent with the other banking agencies' risk-based capital regulations. Currently, MSA balances are insignificant enough relative to total assets that the Board believes a qualifying criterion would be unnecessary and would not have much, or any, effect. However, as discussed in the section on risk-based capital, revisions to the other banking agencies' capital rules on this subject and potential increases in future activity warrant at least some adjustment to the risk-based capital treatment of MSAs. But the Board does not currently find that even that potential increase, which is not certain and would depend on a separate, pending rulemaking, would warrant including MSAs as a qualifying criterion for the CCULR framework. The Board invites comment on this issue. What are commenters' views on the exclusion of such a qualifying criterion?

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[63] 12 CFR 702.502.

C. THE CCULR RATIO

Under the proposal, the CCULR would be the net worth ratio, which is defined under the 2015 Final Rule as the ratio of the credit union's net worth to its total assets rounded to two decimal places.[64] Therefore, any amendments to the definition of the net worth ratio would also be applicable to the calculation of CCULR. For example, the Board finalized changes to the net worth ratio to provide that, for purposes of the prompt corrective action regulations, credit unions may phase-in the day-one impact of transitioning to the Current Expected Credit Loss (CECL) methodology over a three-year period.[65] This change would be part of a credit union's net worth ratio, and therefore, its CCULR. The 2015 Final Rule, as amended, defines net worth as:

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

(2) With respect to a low-income designated credit union, the outstanding principal amount of Subordinated Debt treated as Regulatory Capital in accordance with § 702.407, and the outstanding principal amount of Grandfathered Secondary Capital treated as Regulatory Capital in accordance with § 702.414, in each case that is:

(i) Uninsured; and

(ii) Subordinate to all other claims against the credit union, including claims of creditors, shareholders, and the NCUSIF.

[64] 12 CFR 702.2 (effective Jan. 1, 2022).

[65] 86 FR 34924 (July. 1, 2021).

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

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

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

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

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

(iv) Are not insured by the NCUSIF;

(v) Have non-cumulative dividends;

(vi) Are transferable; and

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

The proposed denominator of the CCULR would be a complex credit union's total assets, consistent with the net worth ratio. Total assets, as defined under the 2015 Final Rule, means:

(1) Average quarterly balance. The credit union's total assets measured by the average of quarter-end balances of the current and three preceding calendar quarters;

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

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

(4) Quarter-end balance. The credit union's total assets measured by the quarter-end balance of the applicable calendar quarter as reported on the credit union's Call Report.[66]

The Board is proposing to use the net worth ratio for the CCULR for its simplicity. Complex credit unions are required to calculate their net worth ratio regardless of whether they opt into the CCULR framework. Therefore, complex credit unions would not be required to calculate a unique ratio for purposes of opting into the CCULR framework. Additionally, complex credit unions are already familiar with the net worth ratio, which would reduce compliance costs compared to a unique ratio designed for the CCULR. The Board intends for the CCULR to be a simple alternative to the risk-based capital ratio and is concerned that the

[66] 12 CFR 702.2 (effective Jan. 1, 2022).

burden imposed by a unique CCULR would exceed its possible utility as a capital reporting measure.

The Board notes that the other banking agencies originally proposed a new ratio for purposes of the CBLR, but declined to adopt the definition due to the complexities that would be created by adopting a new measure of capital.[67] Instead, the other banking agencies based the CBLR on the existing tier 1 capital definition, which is also the basis of the other banking agencies' leverage ratio.[68] Similarly, the Board is proposing to use the established and well understood net worth ratio rather than proposing a new definition of capital for purposes of the CCULR.

The Board considered using the risk-based capital ratio numerator from the 2015 Final Rule.[69] The Board believes that the numerator to the 2015 Final Rule is a more conservative measure of capital compared to the net worth ratio because it includes several deductions, including deductions for the NCUSIF capitalization deposit, goodwill, other intangible assets, and identified losses not reflected in the risk-based capital ratio numerator. The 2015 Final Rule, however, is not yet effective, and complex credit unions are not familiar with calculating and implementing the definition of capital.[70] Therefore, the Board believes it is preferable to base the CCULR on the net worth ratio.

Several commenters to the ANPR requested that all complex credit unions be permitted to use Subordinated Debt under any proposed CCULR framework. Under the proposed rule, however, the CCULR is defined as net worth; therefore, Subordinated Debt would not eligible

[67] *Supra* note 12, at 61783.

[68] See, 12 CFR 324.10(b)(4).

[69] 12 CFR 702.104(b) (effective Jan. 1, 2022).

[70] As proposed, both the 2015 Final Rule and this CCULR framework would be effective January 1, 2022.

for inclusion as capital under the CCULR framework unless the complex credit union is also a low-income designated credit union. As raised in Question 9, the Board could consider alternative definitions of capital, for example, the risk-based capital numerator, such that Subordinated Debt is included as capital for purposes of the CCULR framework. However, the Board notes that the risk-based capital numerator also includes deductions that are not included in the definition of net worth.

Question 9: What are the advantages and disadvantages of using the net worth ratio as the measure of capital adequacy under the CCULR? Should the Board consider alternative measures for the CCULR? Instead of the existing net worth definition, the proposed rule could use the risk-based capital ratio numerator from the 2015 Final Rule. The Board could also consider drafting a new numerator for purposes of the CCULR. For example, the Board could use net worth as the basic framework for the CCULR numerator, but then make additional deductions.

D. CALIBRATION OF THE CCULR

Under the proposal, a qualifying complex credit union may opt into the CCULR framework if it meets the minimum CCULR at the time of opting into the CCULR framework. A qualifying complex credit union opting into the CCULR framework that maintains the minimum ratio or higher would be considered well capitalized.

Commenters to the ANPR, recommended a wide range for the minimum amount of capital necessary for the CCULR framework. Some commenters stated the CCULR should be no greater than eight percent. One commenter supported eight percent by referring to a 2020 Federal Deposit Insurance Corporation (FDIC) survey. The commenter stated that the FDIC's 2020 study of the CBLR found that under the nine percent leverage ratio, only three percent of banks would see their capital buffers shrink by taking the CBLR option. The commenter stated that for credit unions, a comparable measure of capital relief would be accomplished with a leverage ratio set between eight and 8.5 percent. Other commenters, including a banking trade organization, said nine percent should be the minimum (the CBLR is set at nine percent). One commenter recommended 11 percent, which is 400 basis points above the well capitalized leverage ratio (the CBLR is set 400 basis points above the other banking agencies' well-capitalized leverage ratio). A commenter also recommended a reduced calibration due to accelerated asset growth in the last year.

In proposing 10 percent as the fully phased-in well-capitalized ratio requirement for qualifying complex credit unions, the Board considered several factors. The proposed calibration of the CCULR, in conjunction with the qualifying criteria, seeks to strike a balance among several objectives, including maintaining strong capital levels in the credit union system, ensuring safety and soundness, and providing appropriate regulatory burden relief to as many credit unions as possible. The CCULR framework is designed to generally require credit unions to hold more capital than would be required for a credit union under the 2015 Final Rule. The Board also considered aggregate levels of capital among complex credit unions. The CCULR framework would not result in a reduction of the minimum amount of capital held by complex credit unions and would likely result in an overall increase in minimum amount of required capital held by complex credit unions. Additional data on capital levels under the proposed rule are discussed below.

The Board also considered comparability to the other banking agencies' CBLR framework, which established a CBLR of nine percent (that is, if an insured bank has a CBLR of nine percent it is considered well capitalized). As discussed previously, the EGRRCPA mandates a higher capital requirement to qualify for the CBLR framework than the five percent leverage ratio required for well-capitalized status under the other banking agencies' capital regulations.[71] Specifically, the EGRRCPA requires that the CBLR be not less than eight percent and not more than 10 percent for qualifying community banks.[72] This statutory requirement calibrates the CBLR to maintain the overall amount of capital currently held by qualifying community banking organizations.[73] The NCUA is not subject to the statutory requirement of not less than eight percent and not more than 10 percent; however, the Board considers the congressional directive as an important reference point in considering a comparable CCULR framework.

The 8 to 10 percent range established by Congress for the CBLR is 300 to 500 basis points higher than the five percent leverage ratio required for well-capitalized status under the other banking agencies' PCA framework. Insured banks and credit unions, however, have different minimum requirements under their PCA frameworks. Insured banks must maintain a leverage ratio of five percent to be considered well capitalized, whereas insured credit unions are statutorily required to have a seven percent net worth ratio to be considered well capitalized. Therefore, a similar 300 to 500 basis points range would equate to a CCULR of 10 to 12 percent for credit unions.

The Board notes that one of the underlying reasons for the higher statutory net worth requirement may no longer be as relevant given changes in the credit union industry since CUMAA was enacted over 20 years ago. When CUMAA was enacted in 1998, Congress determined that a higher net worth ratio was appropriate because credit unions cannot quickly issue capital stock to raise their net worth as soon as a financial need arises.[74] Instead, credit unions must rely on retained earnings to build net worth, which necessarily takes time. In

[71] 12 CFR 6.4 (OCC), 12 CFR 208.43 (Federal Reserve Board), and 12 CFR 324.403 (FDIC).

[72] *Supra* note 11.

[73] *Supra* note 12, at 61778.

[74] The Department of the Treasury, Comparing Credit Unions With Other Depository Institutions, p. 11 (Jan. 2001)(2001 Treasury Report).

addition, according to the 2001 Treasury Report, issued pursuant to CUMAA on the NCUA's compliance with the statute, Congress established a capital level two percentage points higher because one percent of a credit union's capital is dedicated to the NCUSIF and another one percent of a typical credit union's capital is dedicated to its corporate credit union.[75] In 1998, most credit unions had at least .5 percent of their assets in corporate credit unions.[76] That is no longer true. Today, a significant amount of complex credit unions have less than 0.25 percent of their capital invested in corporate credit unions.[77] Furthermore, the aggregate total capital complex credit unions have dedicated to corporate credit unions, through nonperpetual capital and perpetual contributed capital, is just under 0.04 percent of complex credit union assets. Due to the reduction of concentration in corporate credit union capital, the Board initially considered a potential ratio for the CCULR of 9 to 11 percent.

When considering the appropriate calibration for the proposed CCULR, the Board intended to strike a balance between strong capital levels and providing appropriate regulatory burden relief. To that end, the Board analyzed the potential impact in terms of safety and soundness and burden reduction for potential CCULRs of 9 and 10 percent.

- The Board estimates that as, of December 31, 2020, the majority of complex credit unions would constitute qualifying complex credit unions and would meet a proposed CCULR well capitalized standard of nine percent. Based on reported data, approximately 73 percent of complex credit unions would qualify to use the

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[75] *Id.*

[76] Note, 6,874 of 10,972 credit unions had more than 0.5 percent of assets in Membership Capital Share Deposit and Paid-In Capital of Corporate Credit Unions as of December 1998. The Board also notes that an FCU is permitted to invest up to two percent of its assets in the perpetual and nonperpetual capital in one corporate credit union. An FCU's aggregate amount of contributed capital in all corporate credit unions is limited to four percent of assets. Therefore, it is possible that in the future credit union investments in corporate credit unions exceeds the current investment amounts. *See* 12 CFR 703.14(b).

[77] 616 of 649 complex credit unions have less than 0.25 percent of assets in nonperpetual capital and perpetual contributed capital as of December 2020.

CCULR framework and be well capitalized under a nine percent calibration. Of the 649 complex credit unions, 472 have net worth greater than nine percent as of December 31, 2020, and would be well capitalized under a nine percent CCULR standard. Of those 472 credit unions, it is estimated that two credit unions would not meet the proposed qualifying criteria, and thus would not be eligible to opt into the CCULR. The total minimum capital required for these 470 credit unions under the 2015 Final Rule to be well capitalized is estimated at $82 billion. Under the proposed CCULR, if all estimated 470 credit unions opted into the CCULR and held the minimum nine percent to be well capitalized, the total minimum net worth required would be estimated at $104.6 billion, an increased capital requirement of $22 billion.

- Based on reported data as of December 31, 2020, approximately 48 percent of complex credit unions would qualify to use the CCULR framework and be well capitalized under a 10 percent calibration. Of the 649 complex credit unions, 313 have net worth greater than 10 percent as of December 31, 2020, and would be well capitalized under a 10 percent CCULR standard. Of those 313 credit unions, it is estimated that one credit union would not meet the proposed qualifying criteria, and thus would not be eligible to opt into the CCULR framework. The total minimum capital required for those 312 credit unions under the 2015 Final Rule to be well capitalized is estimated at $57.5 billion. Under the proposed CCULR, if all estimated 312 credit unions opted into the CCULR and held the minimum 10 percent net worth required to be well capitalized, the total minimum net worth required would be estimated at $81.7 billion, and increased capital requirement of $24 billion.

A nine percent CCULR would allow more credit unions to opt into the CCULR framework but could incentivize some qualifying complex credit unions to hold less regulatory capital than they do today. In contrast, a 10 percent well-capitalized standard would ensure strong capital levels and more certainty that qualifying complex credit unions are holding greater levels of capital than under the 2015 Final Rule. The Board has proposed a 10 percent well-capitalized threshold for the CCULR framework. A 10 percent well-capitalized standard for the CCULR would be 300 basis points above the well-capitalized threshold for the net worth ratio, and 400 basis points above a six percent well-capitalized standard for the net worth ratio when considering credit unions decreased holdings in corporate credit unions. In addition, a 10 percent well-capitalized threshold for the CCULR would be 100 basis points higher than the nine percent threshold established by the other banking agencies for the CBLR. As discussed previously, the total minimum capital required to be well capitalized under the 2015 Final Rule is $57.5 billion for credit unions that also meet the CCULR qualifying criteria and would be well capitalized under a 10 percent calibration for the CCULR. If all those credit unions meeting the qualifying criteria opted into the CCULR and held the minimum 10 percent net worth required to be well capitalized, the total minimum net worth required would be estimated at $81.6 billion. This figure is approximately $24.2 billion in excess of the risk-based capital requirement under the 2015 Final Rule. The Board believes that the proposed 10 percent CCULR requirement strikes the right balance between maintaining strong capital levels and providing a simpler option to comply with risk-based capital requirements.

Question 10: The Board invites comment on the proposed CCULR calibration. What are the advantages and disadvantages to the Board considering a CCULR of 8, 9 or 10 percent? Should the Board consider further modifications to its methodology in calibrating the CCULR? What other factors should the Board consider in calibrating the CCULR and why? The Board requests that commenters include a discussion of how the proposed CCULR level should be affected by potential changes to other aspects of the proposed framework, such as the definition of CCULR and the definition of a qualifying complex credit union.

Question 11: One factor in the Board's calibration of the CCULR is the recent trend in credit unions investing in fewer corporate credit union capital instruments. The Board is soliciting comment on whether the trend is likely to continue or whether it is likely that the trend is temporary and in response to the 2007–2009 recession.

E. OPTING INTO THE CCULR FRAMEWORK

Under the proposal, a qualifying complex credit union with a CCULR of 10 percent or greater, subject to the transition provisions, may opt into the CCULR framework at the end of each calendar quarter. Similar to the other banking agencies' CBLR framework, a qualifying complex credit union may only opt into the CCULR framework if it would be well capitalized. Requiring credit unions to be at least be well capitalized when they opt into the framework would ensure that complex credit unions that do not meet the minimum CCULR are reporting capital under the 2015 Final Rule, which is a more risk-sensitive measure of capital adequacy. A qualifying complex credit union choosing to opt into the CCULR would indicate its decision by completing a CCULR reporting schedule in its Call Report.

Question 12: The Board invites comment on the proposed procedure a qualifying complex credit union would use to opt into the CCULR framework. What are commenters' views on the frequency with which a qualifying complex credit union may opt into the CCULR framework? What other alternatives should the Board consider for purposes of qualifying complex credit unions' opt in elections to use and report the CCULR and why?

F. VOLUNTARILY OPTING OUT OF THE CCULR FRAMEWORK

Under the proposal, after a qualifying complex credit union has adopted the CCULR framework, it may voluntarily opt out of the framework by providing written notice to the appropriate Regional Director or the Director of the Office of National Examinations and Supervision (ONES). The notice must be provided at least 30 days before the end of the calendar quarter that the credit union will begin reporting its risk-based capital ratio.

The notice must include several items:

- A statement of intent explaining why the qualifying complex credit union is opting out of the CCULR framework.

- A copy of board meeting minutes showing that the credit union's board of directors was notified of the opt out election.

- The calendar quarter that the qualifying complex credit union will begin calculating its risk-based capital ratio. The earliest a complex credit union may begin calculating its risk-based capital ratio is the calendar quarter that the credit union submits its notification.

- A completed Call Report schedule as if the complex credit union had calculated its risk-based capital ratio the prior quarter. For example, if a credit union seeks to begin using a risk-based capital ratio in the second quarter, it would have to provide notice to the appropriate Regional Director or the Director of the ONES by June 1st and would have to include a Call Report with data as of March 31st.

Under the other banking agencies' CBLR framework, qualifying complex credit unions that have opted into the CBLR may opt out of the framework at any time. In addition, commenters to the ANPR generally favored allowing credit unions to liberally opt into and out of the CCULR framework. The Board believes, however, that qualifying complex credit unions should not opt out of the CCULR framework at any time because, in contrast to qualifying community banking organizations, qualifying complex credit unions are not currently calculating risk-based capital under the 2015 Final Rule.

The Board notes that qualifying community banking organizations had been complying with their revised risk-based capital requirements for several years when the CBLR was implemented.[78] Banking organizations had systems and processes in place to implement risk-based capital, staff had acquired experience calculating their capital ratios under risk-based capital, and qualifying complex banking organizations had been examined for compliance with risk-based capital standards. In contrast, complex credit unions will be subject to the risk-based capital ratio requirement established in the 2015 Final Rule for the first time when they are eligible to opt into the CCULR framework. It is likely that a qualifying complex credit union opting out of the CCULR framework would not have any experience calculating a risk-based capital ratio under the 2015 Final Rule.

The Board does not believe it is prudent to allow qualifying complex credit unions opting out of the CCULR framework the same flexibility as provided to qualifying community banking organizations under the CBLR. Instead, the Board believes a qualifying complex credit union opting out of the CCULR framework should notify the NCUA of its intentions to begin calculating a risk-based capital ratio. Following notification to the NCUA, the NCUA may, through the supervisory process, monitor whether the credit union has acquired the necessary

[78] *Supra* note 3.

systems and processes to be capable of calculating and reporting its risk-based capital ratio accurately.

Question 13: The Board invites comment on the proposed procedure a complex credit union would use to opt out of the CCULR framework. What are commenters' views on the frequency with which qualifying complex credit unions may opt out of the CCULR framework? Do qualifying complex credit unions anticipate frequent switching between the CCULR framework and the risk-based capital requirements, and if so, why? What are the operational or other challenges associated with switching between frameworks?

G. COMPLIANCE WITH THE PROPOSED CRITERIA TO BE A QUALIFYING COMPLEX CREDIT UNION

Under the proposal, after a qualifying complex credit union has adopted the CCULR framework and then no longer meets the proposed qualifying criteria, it would be required, within a limited grace period of two calendar quarters, either to once again meet the qualifying criteria or comply with the risk-based capital ratio requirements. The grace period would begin at the end of the calendar quarter in which the credit union ceases to satisfy the criteria to be a qualifying complex credit union and would end after two consecutive calendar quarters. For example, if the complex credit union exceeded one of the qualifying criteria after December 31st (and still does not meet the criteria as of the end of that quarter), the grace period for such a credit union would begin at the quarter ending March 31st and would end at the quarter ending September 30th. The complex credit union could continue to use the CCULR framework as of June 30th, but would need to fully comply with the risk-based capital ratio (including the associated reporting requirements) as of September 30th, unless at that time the qualifying complex credit once again met the qualifying criteria of the CCULR framework. The Board believes that this limited grace period is appropriate to mitigate potential volatility in capital and associated regulatory reporting requirements based on temporary changes in a credit union's risk profile from quarter to quarter, while capturing more permanent changes in risk profile.

During the grace period, the credit union continues to be treated as a qualifying complex credit union and must continue calculating and reporting its CCULR, unless it has opted out of using the CCULR framework. Additionally, during the grace period, the qualifying complex credit union continues to be considered to have met the capital ratio requirements for the well-capitalized capital category. However, if the qualifying complex credit union has a CCULR of less than seven percent, it would not be considered well capitalized. Instead, its capital classification would be determined by its net worth ratio. For additional discussion on the treatment of a qualifying complex credit union when its CCULR falls below 10 percent, see Section H - *Treatment of a Qualifying Complex Credit Union That Falls Below the CCULR Requirement*.

The two-quarter grace period is similar to the other banking agencies' CBLR framework. However, unlike the CBLR framework, under the proposed rule, a qualifying complex credit union that is likely to not meet the requirements to be a qualifying complex credit union by the end of the grace period must submit written notification to the appropriate Regional Director or the Director of the ONES. The notification must be submitted at least 30 days before the end of the grace period and state that the credit union may cease to meet the requirements to be a qualifying complex credit union. The Board believes it is necessary to receive notice in case the complex credit union begins calculating a risk-based capital ratio. As discussed previously, qualifying complex credit unions initially opting into the CCULR would not likely have calculated a risk-based capital ratio under the 2015 Final Rule. Therefore, the notice would provide the NCUA the option, through the supervisory process, to monitor whether the appropriate systems and processes are being developed to calculate a risk-based capital ratio.

The Board acknowledges that a credit union may believe it is reasonably likely to meet the qualifying criteria, and not submit a notice, and then be subject to risk-based capital requirements at the end of the quarter for failure to comply with qualifying criteria. The Board is providing credit unions flexibility with notice requirements as a form of burden reduction. It would be unnecessary for every credit union to file notice during the grace period, as some credit unions will be certain of their compliance with the qualifying criteria. For such credit unions, completing the required notification would be an unnecessary burden. The Board believes that it would be rare for a credit union to not provide the notice when required. The notice would be submitted only 30 days before the end of the grace period and a credit union that is being prudently managed should be able to accurately predict whether it would be likely to meet the qualifying criteria. The Board believes that if a credit union does not provide the required notice, it raises supervisory concerns and the credit union may be subject to a lower management rating as a result.

The notification would be similar to the notification required for credit unions voluntarily opting out of the CCULR framework. First, the notification must provide the reason for the potential disqualification. The notification would also be required to include a copy of the board meeting minutes showing that the credit union's board of directors was notified that the credit union might cease to meet the qualifying complex credit union requirements. Finally, the notification also would be required to include a Call Report schedule completed as if the credit union calculated its risk-based capital ratio the previous calendar quarter.

Under the CBLR Final Rule, a qualifying community banking organization that ceases to meet the qualifying criteria as a result of a business combination is not provided a grace period. The proposed rule would include a similar limitation. Therefore, under the proposed rule a qualifying complex credit union that has opted into the CCULR framework and that ceases to meet the qualifying criteria as a result of a business combination would receive no grace period and would be required to revert to a risk-based capital framework immediately. The Board believes this approach is appropriate, as complex credit unions should consider the regulatory capital implications of a planned business combination and be prepared to comply with the applicable requirements. Therefore, a qualifying complex credit union that would not meet the qualifying criteria as a result of a business combination must fully comply with the 2015 Final Rule for the regulatory reporting period during which the transaction is completed.

Question 14: The Board invites comment on the proposed treatment for a complex credit union that no longer meets the definition of a qualifying complex credit union after opting into the CCULR framework. Specifically, what are the advantages and disadvantages of the proposed grace period? What other alternatives should the Board consider with respect to a complex credit union that no longer meets the definition of a qualifying complex credit union and why? Should the Board consider requiring complex credit unions that no longer meet the qualifying criteria to begin to immediately calculate their assets according to the risk-based capital ratio? Is notification that a credit union will not meet the qualifying criteria necessary? Should the Board consider a grace period for previously qualified credit unions that have opted into the CCULR framework if after a business combination the credit union no longer qualified as of the next reporting period? Should the Board consider alternative notification requirements or consider not requiring any notification at all?

H. TREATMENT OF A QUALIFYING COMPLEX CREDIT UNION THAT FALLS BELOW THE CCULR REQUIREMENT

As discussed previously, under the proposal, a qualifying complex credit union that has opted into the CCULR framework and has a CCULR of 10 percent or greater, subject to the transition provisions, would be considered well capitalized. A qualifying complex credit union's CCULR may deteriorate due to a decline in its level of retained earnings, growth in its total assets, or a combination of both. In such a case, a credit union may choose to stop using the CCULR framework and instead become subject to the risk-based capital ratio. However, the Board recognizes that some qualifying complex credit unions may find it unduly burdensome to begin complying with the more complex risk-based capital ratio reporting requirements at the same time that the credit union is experiencing a decline in its CCULR.

Under the proposed rule, a minimum CCULR (10 percent after the transition period) is one of the qualifying criteria. Therefore, if a qualifying complex credit union has a CCULR that falls below the minimum requirement, it would receive the same grace period of two calendar quarters, as applicable when a credit union ceases to meet the other qualifying criteria. After the two-quarter grace period, the qualifying complex credit union would either have to once again meet the minimum CCULR ratio or comply with the risk-based capital ratio requirements. During the grace period, the credit union would be deemed to have met the well-capitalized capital ratio requirements for PCA purposes, provided that its net worth ratio remains seven percent or greater.

If a credit union's net worth ratio falls below seven percent, it will not be considered to have met the capital ratio requirements for the well-capitalized capital category and its capital classification is determined by its net worth ratio. A credit union that becomes less than well capitalized during the two-quarter grace period would not be required to begin calculating its capital under the 2015 Final Rule immediately. Instead, the credit union would still be eligible for the full two-quarter grace period; however, it would be subject to any applicable PCA requirements for its capital category.

Under the other banking agencies' CBLR framework, an electing banking organization with a leverage ratio of eight percent or less is not eligible for the grace period and must comply with the generally applicable rule, that is, for the quarter in which the banking organization reports a leverage ratio of eight percent or less. An electing banking organization experiencing or anticipating such an event would be expected to notify its primary federal supervisory agency, which would respond as appropriate to the circumstances of the banking organization.[79] The Board believes that it would be unduly burdensome to require complex credit unions to immediately begin calculating their capital under the 2015 Final Rule.

As discussed previously, credit unions have not previously been subject to the 2015 Final Rule. The Board believes it is reasonable to provide complex credit unions the full two-quarter grace period regardless of their CCULR as the 2015 Final Rule would be a new system of capital adequacy and would require an adjustment for the complex credit union. The Board does not believe permitting two quarters to comply with the qualifying criteria or to begin calculating capital under the 2015 Final Rule presents unreasonable risk to the NCUSIF.

Question 15: What are the advantages and disadvantages of permitting a two-quarter grace period? Should the Board consider including the CCULR in the PCA framework similar to the other banking agencies' CBLR proposed rule? To what extent does the calibration of the CCULR relate to the Board's choice between including the CCULR into the PCA framework versus relying on a grace period when a credit union's CCULR falls below 10 percent?

I. TRANSITION PROVISION

In light of strains in economic conditions related to the COVID–19 pandemic and stress in U.S. financial markets, the NCUA has taken a number of actions intended to: (i) restore market functioning and support the flow of credit to households, businesses, and Communities; and (ii) increase flexibility and tailor regulations.

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[79] *Supra* note 12.

Among those actions, the NCUA has communicated a number of rules and supervisory guidance designed to mitigate the economic consequences of the COVID–19 pandemic, facilitate the safe and effective operations of credit unions, and protect credit union members.[80] Credit unions have played an instrumental role in the nation's financial response to the COVID–19 pandemic, and many have experienced significant balance sheet growth because of the COVID–19 pandemic and the policy response to the event.

The unprecedented and significant balance sheet growth is largely a result of individual member response to actions taken by monetary and fiscal authorities. At the start of the COVID–19 pandemic, consumer spending decreased as individual states or major metropolitan areas ordered millions of Americans to stay home. Additionally, market volatility pushed savers with money in financial markets to safer assets, including insured shares. Fiscal stimulus applied additional upward pressure on credit union total assets.

The Board is aware that the unprecedented balance sheet growth has resulted in declining net worth ratios for most complex credit unions. To help mitigate the impact of this unprecedented balance sheet growth, the Board is proposing a two-year transition provision to delay the introduction of a 10 percent CCULR. This two-year phase would permit complex credit unions time to increase their net worth ratios.

Under the proposed rule, from January 1, 2022, to December 31, 2022, a complex credit union may opt into the CCULR framework if it has a net worth ratio of nine percent or greater. Therefore, a qualifying complex credit union that opts into the CCULR framework and that maintains a nine percent CCULR would be considered well capitalized. Beginning January 1, 2023, a complex credit union that has opted into the CCULR framework must have a CCULR of

[80] *See. e.g.*, 86 FR 15397 (Mar. 23, 2021).

9.5 percent or greater to meet the eligibility criteria. Finally, beginning January 1, 2024, a complex credit union must have a CCULR of 10 percent or greater to be eligible to determine their capital adequacy under the CCULR framework. Once an eligible credit union opts into the CCULR framework it would be eligible to use the two-quarter grace period, as discussed in section G. *Compliance with the Proposed Criteria to be a Qualifying Complex Credit Union.* Therefore, if a credit union has a CCULR of nine percent when it opts into the CCULR framework on March 31, 2022, but does not have a CCULR of 9.5 percent on March 31, 2023, the credit union would have until September 30th to either have a CCULR of 9.5 percent or determine their capital adequacy under the risk-based capital framework.

As discussed previously, the temporary changes to the CBLR framework implemented through the CARES Act expired December 31, 2021.[81] Therefore, the temporary reduction in the CBLR to eight percent (and 8.5 percent in calendar year 2021) will not be in effect when the 2015 Final Rule becomes effective. The Board, however, believes that due to credit unions' unique structure and dependence on retained earnings to accumulate capital, additional time to accumulate capital will be beneficial to complex credit unions. The Board believes that the CCULR framework is beneficial to complex credit unions due to the reduced compliance costs for managing and documenting risk-based capital standards, and to the NCUSIF as complex credit unions that opt into the CCULR framework will be required to hold higher capital levels under the CCULR framework than the risk-based capital framework. The Board does not want complex credit unions that would have otherwise been eligible to opt into a CCULR framework calibrated at 10 percent to be temporarily ineligible due to unexpected asset growth following the COVID–19 pandemic. The Board believes two years is sufficient time for complex credit unions that want to opt into the CCULR framework to build the necessary capital.

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[81] Coronavirus Aid, Relief, and Economic Security Act, Pub. L. 116–136, 134 Stat. 281.

Question 16: What are the advantages and disadvantages of the transition provision starting at nine percent and permitting a transition period to a CCULR of 10 percent? Should the Board consider a transition period longer or shorter than two years? If suggesting a longer transition period, such as four years, discuss the merits of a longer phase-in and why the additional time over two years would be needed. Please provide specific data.

J. RESERVATION OF AUTHORITY

In general, a complex credit union that meets the eligibility criteria may opt into the CCULR framework. However, there may be limited instances in which the CCULR framework would be inappropriate and not require sufficient capital to adequately protect the NCUSIF. To address such situations, the proposed rule includes a reservation of authority. Under the reservation of authority, the Board can require a complex credit union that has opted into the CCULR framework to use the risk-based capital framework to calculate its capital adequacy if the Board determines that the complex credit union's capital requirements are not commensurate with its credit or other risks. When making any such determination, the Board would consider all relevant factors affecting the complex credit union's safety and soundness.

The Board expects to apply the reservation of authority only in limited circumstances. Under the reservation of authority, credit unions would be entitled to a two-quarter grace period before being required to comply with the risk-based capital framework. The other banking agencies also have reserved the authority to disallow the use of the CBLR framework by a depository institution or depository institution holding company, based on the risk profile of the banking organization.

Question 17: The Board invites general comment on the reservation of authority in the proposed rule. Should the Board consider a reservation of authority that applies to the risk-based capital rule? Should the Board consider a general waiver provision or consider including a statement that assets can be provided a more conservative risk weight than provided in the proposed rule? Should the Board consider adopting notice and response procedures to be used in determining whether the reservation of authority should be used?

K. EFFECT OF THE CCULR ON OTHER REGULATIONS

1. Member Business Loan Cap

Section 107A of the FCUA generally limits the aggregate amount of member business loans (MBLs) that an insured credit union may make, subject to exceptions for some categories of loans, such as loans granted by a corporate credit union to another credit union.[82] In addition, the FCUA exempts certain credit unions from compliance with the aggregate MBL limit. Specifically, an insured credit union chartered for the purpose of making MBLs, or that has a history of making MBLs to its members, as determined by the Board, is not subject to the aggregate MBL limit.[83] Also, an insured credit union that serves predominantly low-income members, as defined by the Board, or is a community development financial institution, as defined in 12 U.S.C. 4702, is also not subject to the aggregate MBL limit.[84]

An insured credit union that is subject to the aggregate MBL limit may not make an MBL that would result in the total amount of outstanding MBLs at the credit union being more than the lesser of 1.75 times the actual net worth of the credit union or 1.75 times the minimum net worth required for a credit union to be well capitalized under section 216(c)(1)(A) of the FCUA.[85] Section 107A defines net worth for purposes of that section, providing that it includes

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[82] 12 U.S.C. 1757a(c)(1)(B).

[83] 12 U.S.C. 1757a(b)(1).

[84] 12 U.S.C. 1575a(b)(2).

[85] 12 U.S.C. 1757a(a).

the retained earnings balance, as determined under GAAP. Net worth under this section also includes, for credit unions that serve predominantly low-income members (which the Board defines as low-income designated credit unions), secondary capital accounts that are uninsured and subordinate to all other claims against the credit union, including the claims of creditors, shareholders, and the NCUSIF.[86]

For credit unions that are not complex and therefore are not subject to a risk-based net worth requirement under section 216(d) of the FCUA, MBLs are limited to 1.75 times the net worth required for the credit union to meet the seven percent net worth ratio under section 216(c)(1)(A)(i) (assuming the credit union's actual net worth is greater than the minimum required to be well capitalized). To determine its maximum allowable outstanding balance of MBLs, a credit union multiplies 1.75 by seven percent of its total assets.

Until 2016, the Board calculated the MBL limitation in the same manner for complex credit unions that are subject to a risk-based net worth requirement under section 216(d) without considering any greater amount of net worth that a complex credit union might need to hold to be well capitalized under a risk-based net worth requirement.[87] However, in the 2015 proposed rule on MBLs, the Board proposed to amend the MBL regulation to incorporate section 107A more faithfully and noted that complex credit unions could have a different limitation caused by the need to hold more net worth under a risk-based requirement.[88] The preamble to the 2016 final

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[86] This definition does not expressly cover two elements that were added to the definition of net worth in section 216(o)(2) for PCA purposes in a 2011 enactment: (1) amounts that were previously retained earnings of any other credit union with which the insured credit union has combined; and (2) assistance that the Board has provided under Section 208. Pub. L. 111–382, 124 Stat. 4135 (Jan. 4, 2011). In the 2016 MBL final rule, the Board included these elements in net worth for purposes of the MBL limitation by defining net worth in the MBL regulation through a cross-reference to the current part 702 definition of net worth, which includes all the elements in section 216(o)(2). The 2015 Final Rule amended the definition of net worth in part 702 effective January 1, 2022, but did not add or remove any of the components of net worth in the current regulation.

[87] Prior to amendments that the Board adopted in the 2016, the MBL regulation limited MBLs to 12.25 percent of an insured credit union's total assets—1.75 times the seven percent net worth ratio.

[88] 80 FR 37898, 37909 (July 1, 2015).

rule on MBLs and commercial loans analyzed this issue in response to comments on the rule and explained that under the 2015 Final Rule on risk-based capital, the MBL limitation would be calculated in the following manner. The preamble to the 2016 final rule stated that where actual net worth is greater than the minimum to be well capitalized, the limit on MBLs is 1.75 times the greater of the following calculations: (i) the minimum amount of capital (in dollars) required by the net worth ratio, which is seven percent times total assets; and (ii) the minimum amount of capital (in dollars) required by the risk based capital ratio, which is 10 percent times total risk-weighted assets. Then, the credit union must solve for the minimum amount of net worth needed after accounting for other forms of qualifying capital allowed under the 2015 Final Rule.[89]

Therefore, a complex credit union subject to a risk-based capital requirement under the 2015 Final Rule would have to calculate the minimum amount of net worth required by both its net worth ratio and risk-based capital requirement. First, the net worth ratio requires a complex credit union to hold net worth (in dollars) equal to seven percent of its total assets. Second, for purposes of computing the MBL cap,[90] the risk-based capital ratio requires a complex credit union to hold net worth (in dollars) equal to 10 percent of the credit union's risk-weighted assets, as calculated under § 702.104. The complex credit union would then compare the two net worth amounts as calculated in the preceding discussion. The credit union would take the larger of the two net worth amounts, which is the minimum amount of net worth necessary to be well capitalized under either the net worth ratio or the risk-based capital ratio, and compare that to actual net worth. The lesser of these two net worth amounts is used to compute the complex credit union's MBL cap, which would be 1.75 times the lesser of these two net worth amounts.

[89] 81 FR 13530, 13548 (Mar. 14, 2016).

[90] The Board notes that the amount of capital a complex credit union needs to be well capitalized under the 2015 Final Rule for PCA purposes is a different calculation than the amount of net worth required to be well capitalized for purposes of the MBL cap. The reason is the 2015 Final Rule permits complex credit unions to include several forms of capital for purposes of determining its PCA status that do not meet the statutory definition of net worth. The MBL cap, however, is limited by statute to net worth.

While the 2015 Final Rule is not yet effective, the agency currently implements this approach for the small number of complex credit unions that are required to hold more net worth under the current risk-based net worth requirement than the net worth ratio.

The Board continues to find that this approach reflects the correct reading of sections 107A and 216 and re-affirms this interpretation over any prior interpretation that disregarded the risk-based net worth requirement for this purpose.[91] For complex credit unions, the amount to be well capitalized under section 216(c)(1)(A) is seven percent of total assets (the net worth ratio) or the amount required by the risk-based net worth requirement (which could be either the risk-based capital ratio under the 2015 Final Rule or the proposed CCULR framework). A complex credit union must satisfy both of these requirements to be well capitalized under section 216(c)(1)(A), which means that, in section 107A's terms, the minimum net worth required to be well capitalized is the higher of the amount required by the net worth ratio or the risk-based net worth requirement. The Board finds this is a clear, plain language reading of both provisions. Section 107A(a) points to section 216(c)(1)(A) to determine the minimum net worth required, and in turn, section 216(c)(1)(A) includes both the seven percent net worth ratio and the net worth required by any applicable risk-based net worth requirement, for complex credit unions. Reading section 107A(a) to exclude the net worth required for complex credit unions under section 216(c)(1)(A)(ii) would ignore a key component of the plain language of section 216(c)(1)(A) and inappropriately treat it as surplusage.

The Board also finds that even if sections 107A and 216(c)(1)(A) were considered ambiguous or unclear, it would interpret them in the same way. For instance, the Board observes two key textual indicators that Congress did not intend to limit this calculation to the seven percent net worth ratio. First, section 107A was enacted in the same legislation as

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[91] Therefore, the current language in part 723 remains valid, and the Board is not proposing any changes to part 723 at this time.

section 216. Thus, Congress was aware that section 216(c)(1)(A) set a seven percent net worth ratio to be well capitalized. Yet in section 107A(a), rather than specifying that the MBL limitation is determined by the amount of net worth required to achieve a seven percent net worth ratio, Congress provided more broadly that the limitation is determined by reference to the minimum net worth required under section 216(c)(1)(A). Second, Congress could have limited this calculation to the seven percent net worth ratio by providing that the MBL limitation is determined by reference only to the minimum net worth required under section 216(c)(1)(A)(i), which would have excluded the risk-based net worth requirement. Instead, section 107A points to section 216(c)(1)(A), which encompasses both applicable net worth requirements for complex credit unions.

The Board acknowledges that the Senate Report associated with the legislation that enacted sections 107A and 216 refers to the MBL limitation as being based on the seven percent net worth ratio in a parenthetical statement. A statement by an individual Senator also refers to the limitation as being determined by the seven percent net worth ratio.[92] But this discussion in the Senate Report is brief and does not touch upon the risk-based net worth requirement or explain how the Senate believed the MBL limitation should work for complex credit unions, which are subject to additional net worth requirements. In any event, this general discussion does not expressly contradict the language and structure of sections 107A and 216, which the Board finds to be better indicators of the meaning and purpose of these provisions.

Applying this approach to the proposed CCULR framework, the Board proposes that for qualifying complex credit unions opting into the CCULR framework, such credit unions may calculate a different limitation on MBLs from what they do currently under the seven percent net worth ratio. This is because, as discussed previously in the Legal Authority section, the CCULR

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[92] S. Rep. No. 105-193 (May 21, 1998), at 5, 10, 29.

is considered a risk-based net worth requirement, and thus falls under section 216(c)(1)(A)(ii) as a measure of the minimum net worth required to be well capitalized. Accordingly, under the proposed rule, a qualifying complex credit union that opts into the CCULR would determine its MBL limitation by reference to the amount of net worth required to be well capitalized under the CCULR. Complex credit unions that do not qualify or do not opt into the CCULR would determine their MBL limitation by reference to the 10 percent risk-based capital ratio, as described in the 2016 MBL final rule, quoted previously. In either scenario, if a complex credit union has actual net worth below those measures, its actual net worth would determine its MBL limitation.

2. Capital Adequacy

Under the 2015 Final Rule, a complex credit union must have a process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive written strategy for maintaining an appropriate level of capital.[93] While a qualifying complex credit union opting into the CCULR framework, is required to have a comprehensive written strategy for maintaining an appropriate level of capital, such strategy may be straightforward and minimally state how the credit union intends to comply with the CCULR framework, including minimum capital requirements and qualifying criteria. In contrast, complex credit unions that do not opt into the CCULR framework will be required to have a more detailed written strategy. The NCUA intends to review the written strategies during the supervisory process.

L. ILLUSTRATIVE REPORTING FORMS TO SUPPORT THE CCULR

The NCUA intends to separately seek comment on the proposed changes to the Call Report for complex, qualifying credit unions that elect to use the CCULR framework. Chart 1,

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[93] 12 CFR 702.101(b)(2) (effective Jan. 1, 2022).

provided below, is an example of what the CCULR election form may look like in the Call report. Details supporting lines 2 through 6 can be found in section B of this proposed rule.

Chart 1 – Complex Credit Union Leverage Ratio form

SCHEDULE FC-R **Complex Credit Union Leverage Ratio (CCULR)**					
Input is required if your credit union is electing to opt into the Complex Credit Union Leverage Ratio (CCULR)					
Election	**Election**				**Account**
1. Is your credit union opting into the Complex Credit Union Leverage Ratio for the current quarter? (See Instructions for qualifications)	(1= Yes, 0 = No)		Required Input		CCLR1
Qualifications	**Amount**	**Account**	**Percentage**		**Account**
2. CCULR Ratio (Account 998).....................			Auto-populated		CCLR2
3. Total Assets (Account 010).....................	Auto-populated	CCLR3			
Other Qualifying Criteria *(see Instructions)*					
4. Off-Balance sheet exposures are 25% or less of Total Assets	Required Input	CCLR4	Auto-Calculation		CCLR7
5. Trading Assets and Trading liabilities are 5% or less of Total assets	Required Input	CCLR5	Auto-Calculation		CCLR8
6. Goodwill and Other Intangible Assets are 2% or less of Total Assets	Auto-populated	CCLR6	Auto-Calculation		CCLR9

This form provides an indication of the potential reporting format and potential reporting burden relative to the regulatory requirements associated with electing to use the CCULR framework.

Similarly, in support of the off-balance sheet exposures qualifying criteria, Chart 2 provides an example of what an off-balance sheet exposures Call Report form may look like. Details supporting this schedule are in section B and M of this proposed rule.

Chart 2 – Off-Balance Sheet Exposures Form

			Off-Balance Sheet Exposures	Column A Face or Notional Amount
All off-balance sheet exposures for risk based capital rule	Off-balance sheet exposure definition	1	**Total Unfunded Commitments for all loan types**	
			Total Unconditionally Cancelable Unfunded Commitments for all loan types	
			Conditionally Cancelable Unfunded Commitments:	
			A. Unfunded Commitment - Commercial loans	
			B. Unfunded Commitment - Consumer Loans - Secured & Real Estate	
			C Unfunded Commitment - Consumer Loans - Unsecured	
		2	**Loans transferred with limited recourse, or other seller-provided credit enhancements**	
			A. Loans Transferred Limited Recourse - Commercial loans	
			B. Loans Transferred Limited Recourse - Consumer Loans	
		3	**Federal Home Loan Bank under the MPF program**	
		4	**Financial Standby Letter of Credits (813A2)**	
		5	**Forward Agreements that are not derivative contracts**	
		6	**Sold Credit Protection through**	
			A. Guarantees	
			B. Credit Derivatives	
		7	**Off-balance-Sheet Securitization Exposures**	
		8	**Securities Borrowing or Lending transactions**	
		9	**Off-balance sheet exposure of repurchase transactions**	
		10	**All other off-balance sheet exposures not specifically listed, but meet the definition of Commitments**	

This form provides an indication of the potential reporting format and reporting burden relative to the regulatory requirements associated with the proposed off-balance sheet exposures for the CCULR framework and the risk-based capital framework under the 2015 Final Rule.

M. AMENDMENTS TO THE 2015 FINAL RULE

The Board stated its intent to holistically and comprehensively reevaluate the NCUA's capital standards for credit unions in the 2019 Final Rule. A principal component of this review is the proposed CCULR framework. The Board also stated it would consider whether to make more substantive revisions to the 2015 Final Rule.[94] The Board has completed this analysis and is proposing several changes to the 2015 Final Rule. Each change is discussed below.

[94] 84 FR 68781, 68783 (Dec. 17, 2019).

1. Off-Balance Sheet Exposure Risk Weights

The 2015 Final Rule states that the risk-weighted amounts for all off-balance sheet items[95] are determined by multiplying the off-balance sheet exposure amount[96] by the appropriate credit conversion factor and the assigned risk weight. However, the definition of off-balance sheet items is not aligned with the definition of off-balance sheet exposure. Under the 2015 Final Rule, only commitments, loans transferred with limited recourse, and loans transferred under the FHLB mortgage partnership finance program are provided explicit exposure amounts. The rule is silent on the appropriate treatment for the remaining items included in the definition of off-balance sheet items (contingent items, guarantees, certain repo-style transactions, financial standby letters of credit, and forward agreements). In addition, the 2015 Final Rule does not include a credit conversion factor or risk weight for the off-balance sheet items that are not provided a specific exposure amount in the definition of off-balance sheet exposure.

The proposed rule would make several changes to clarify the treatment of off-balance sheet items. First, as discussed previously, the proposed rule would amend the definition of off-balance sheet exposures. This definition is used as one of the CCULR eligibility criteria and is proposed to be amended to more closely align with the other banking agencies' CBLR framework. As a consequence of amending the definition of off-balance sheet exposure for the CCULR framework, the proposed off-balance sheet exposure definition would also more closely

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[95] Off-balance sheet items are defined as items such as commitments, contingent items, guarantees, certain repo-style transactions, financial standby letters of credit, and forward agreements that are not included on the statement of financial condition, but are normally reported in the financial statement footnotes. 12 CFR 702.2 (effective Jan. 1, 2022).

[96] Off-balance sheet exposure means: (1) For loans transferred under the Federal Home Loan Bank mortgage partnership finance program, the outstanding loan balance as of the reporting date, net of any related valuation allowance. (2) For all other loans transferred with limited recourse or other seller-provided credit enhancements and that qualify for true sales accounting, the maximum contractual amount the credit union is exposed to according to the agreement, net of any related valuation allowance. (3) For unfunded commitments, the remaining unfunded portion of the contractual agreement. 12 CFR 702.2 (effective Jan. 1, 2022).

align with the existing definition of off-balance sheet items.[97] Therefore, under the proposed rule, several items currently defined as an off-balance sheet item, but not included in the current definition of off-balance sheet exposure, would be provided an exposure amount. This change reduces ambiguity in the 2015 Final Rule. In addition, in the proposed rule, each item included in the definition of off-balance sheet exposure would be provided an explicit credit conversion factor and risk weight for purposes of the risk-based capital rule. Each proposed change to the risk-based capital rule is discussed in detail below.

The proposed rule would state that unconditionally cancellable commitments have a zero percent credit conversion factor. Therefore, any unconditionally cancellable commitment would be excluded from a credit union's risk-based capital calculation. Under the 2015 Final Rule, these exposures would receive a minimum of a 10 percent credit conversion factor and could receive up to a 50 percent credit conversion factor. The Board believes that many of credit unions' commitments would qualify as unconditionally cancellable and that credit unions are currently subject to a more conservative treatment for unfunded commitments than banking organizations. Therefore, the Board believes providing a zero percent conversion factor will not only make the 2015 Final Rule more comparable to the other banking agencies' 2013 capital rule but will also provide a significant burden reduction for credit unions calculating their capital adequacy under the 2015 Final Rule.

The proposed rule would provide that financial standby letters of credit are given a 100 percent credit conversion factor. The 2015 Final Rule does not provide a credit conversion factor for financial standby letters of credit. Including an explicit 100 percent conversion factor

[97] The only item included in the current definition of off-balance sheet item that would not be provided an explicit exposure amount would be contingent items. However, as discussed below, the Board is proposing to amend the definition of off-balance sheet item and would no longer include contingent items.

would provide parity between the other banking agencies and the NCUA. The risk weight would be 100 percent.

For forward agreements that are not derivative contracts, the proposed rule would provide for a 100 percent credit conversion factor. The 2015 Final Rule does not provide a credit conversion factor for forward agreements that are not derivative contracts. Including an explicit 100 percent conversion factor would provide parity between the other banking agencies and the NCUA. The risk weight would be 100 percent.

For sold credit protection through guarantees and credit derivatives, the proposed rule would provide for a 100 percent credit conversion factor. The 2015 Final Rule does not provide a credit conversion factor for sold credit protection through guarantees or credit derivatives. The proposed rule would provide different risk weights for guarantees and credit derivatives. Guarantees would receive a 100 percent risk weight. For credit derivatives, the risk weight would be determined through the applicable provisions of FDIC's capital rules. A credit union offering credit protection through a credit derivative would risk weight the exposure according to 12 CFR 324.34 (for derivatives that are not cleared) or 324.35 (for derivatives that are cleared exposures).

The Board understands the proposed treatment of credit derivatives is complex and compliance with these requirements increases the regulatory burden for credit unions that offer credit protection through credit derivatives. However, credit derivatives are complex instruments. Furthermore, credit derivatives are not a permissible activity for FCUs and the Board believes that state-chartered credit unions should only offer credit derivatives if the credit union has the appropriate resources and capabilities to manage the complexity associated with them. The Board believes any credit union that has offered credit protection through credit derivatives should also be capable of complying with the complexity in the FDIC's capital rules.

Therefore, the Board believes it is appropriate to reference the other banking agencies' 2013 capital rules when determining the appropriate risk weights for credit derivatives.

For off-balance sheet securitization exposures, the credit conversion factor would be 100 percent. The 2015 Final Rule does not currently provide a credit conversion factor for the off-balance sheet portion of securitization exposures. The risk weight would be determined as if the exposure is an on-balance sheet securitization exposure. Under the 2015 Final Rule, the risk weight for securitization exposures is dependent upon whether the exposure is a subordinated or non-subordinated tranche. Non-subordinated tranches can receive a 100 percent risk weight (credit unions also have the option to use the gross up approach).[98] In contrast, a subordinated tranche would receive a 1,250 percent risk weight (credit unions also have the option to use the gross-up approach).[99]

For securities borrowing or lending transactions, the proposed credit conversion factor would be 100 percent. The 2015 Final Rule does not provide a credit conversion factor for securities borrowing or lending transactions. Including an explicit 100 percent credit conversion factor would provide parity between the other banking agencies and the NCUA. Unlike the other banking agencies' rules, the proposed rule would include a risk weight of 100 percent for these transactions. The Board is aware this may be a more conservative risk weight than for securities borrowing and lending transactions under the other banking agencies' 2013 capital rule.

The Board is proposing a 100 percent risk weight for simplicity. However, a credit union may recognize the credit risk mitigation benefits of financial collateral by risk weighting the collateralized portion of the exposure under the applicable provisions of 12 CFR 324.35 or 324.37. Any collateral recognized would have to meet the definition of financial collateral under

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[98] 12 CFR 702.104(c)(2)(v)(B)(8) (effective Jan. 1, 2022).

[99] 12 CFR 702.104(c)(2)(x) (effective Jan. 1, 2022).

the other banking agencies 2013 capital rules.[100] The Board solicits comments on whether referencing the other banking agencies' risk mitigation provisions introduces undue complexity. The Board understands that some credit unions engaged in securities lending and borrowing transactions would benefit from a lower risk weight, as provided by the other banking agencies' rules; however, the Board believes most credit unions do not engage in a substantial amount of securities lending and borrowing activities and therefore would benefit from a simple, although conservative, 100 percent risk weight.

The proposed rule would also include a specific credit conversion factor and risk weight for the off-balance sheet exposure amount of repurchase transactions.[101] Under the proposed rule, the off-balance sheet exposure amount for a repurchase transaction would equal all of the positions the credit union has sold or bought subject to repurchase or resale, which equals the sum of the current fair values of all such positions. The off-balance sheet exposure amounts of repurchase transactions are not provided a credit conversion factor under the 2015 Final Rule. The proposed rule would provide a 100 percent risk weight for the off-balance sheet exposure amounts of repurchase transactions. A credit union may recognize the credit risk mitigation benefits of financial collateral, as defined by 12 CFR 324.2, by risk weighting the collateralized portion of the exposure under the applicable provisions of 12 CFR 324.35 or 324.37.

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[100] *See* 12 CFR 324.2. Financial collateral means collateral: (1) In the form of: (i) Cash on deposit with the FDIC–supervised institution (including cash held for the FDIC–supervised institution by a third-party custodian or trustee); (ii) Gold bullion; (iii) Long-term debt securities that are not resecuritization exposures and that are investment grade; (iv) Short-term debt instruments that are not resecuritization exposures and that are investment grade; (v) Equity securities that are publicly traded; (vi) Convertible bonds that are publicly traded; or (vii) Money market fund shares and other mutual fund shares if a price for the shares is publicly quoted daily; and (2) In which the FDIC–supervised institution has a perfected, first-priority security interest or, outside of the United States, the legal equivalent thereof (with the exception of cash on deposit; and notwithstanding the prior security interest of any custodial agent or any priority security interest granted to a CCP in connection with collateral posted to that CCP).

[101] Repurchase transactions would mean either a transaction in which a credit union 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 or a transaction in which an investor agrees to purchase a security from a counterparty and to resell the same or an identical security to that counterparty at a specified future date and at a specified price.

The Board notes that repurchase transactions are not included in the definition of off-balance sheet exposure. This exclusion of repurchase transactions from the definition of off-balance sheet exposure is because the other banking agencies did not include repurchase transactions in their related measure of CBLR and the definition of off-balance sheet exposure is used for purposes of the CCULR eligibility criteria.[102]

Even though, for purposes of the CCULR framework, repurchase transactions are excluded from the off-balance sheet criterion, the Board believes that the off-balance sheet portion of repurchase transactions should be risk-weighted under the risk-based capital ratio. First, repurchase transactions are included in the current definition of off-balance sheet items. Second, the other banking agencies risk-weight the off-balance sheet portion of repurchase transactions in their risk-based capital framework.[103]

The Board, however, does not believe that repurchase transactions are a material exposure for credit unions. As of December 31, 2020, there are only 31 complex credit unions with repurchase transactions on their balance sheets. Therefore, the proposed rule would include the off-balance sheet portion of repurchase transactions for purposes of risk-based capital, even though such transactions are not included as part of the off-balance sheet eligibility criteria under the CCULR framework.[104]

Finally, the proposed rule would include a "catchall" category. Under the proposed rule, all other off-balance sheet exposures not explicitly provided a credit conversion factor or risk weight that meet the definition of a commitment would be given a credit conversion factor of

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[102] 12 CFR 324.12(a)(2)(iii).

[103] 12 CFR 324.33(b)(4)(ii).

[104] The proposed rule would also revise the definition of off-balance sheet items. The proposed definition of off-balance sheet items would include off-balance sheet exposures and the off-balance sheet exposure amount of repurchase transactions. This change is necessary to ensure repurchase transactions are not included as part of the off-balance sheet criteria for eligibility in the CCULR framework.

100 percent and a risk weight of 100 percent. The Board believes a catchall category is necessary given that the definition of commitment is broad. Commitments include any legally binding arrangement that obligates the credit union to extend credit, purchase or sell assets, enter into a borrowing agreement, or enter into a financial transaction.[105] To ensure all off-balance sheet exposures that met the definition of commitment are provided a credit conversion factor and risk weight, the proposed rule would include a new catchall category for such exposures.

2. Asset Securitizations Issued by Complex Credit Unions

The 2019 Supplemental Rule included asset securitizations as one of the reasons the Board sought a holistic reevaluation of the 2015 Final Rule. The Board has further considered asset securitizations issued by credit unions and has decided to propose to amend the 2015 Final Rule to explicitly address credit union issued securitizations.

The proposed rule would require credit unions that issue securitizations to use the other banking agencies' 2013 capital rules when determining whether assets transferred in connection with a securitization are excluded from risk-based capital. The Board has reviewed these standards and finds they would be appropriate as applied to credit union securitizations, with the minor differences noted below. Specifically, under the proposed rule, a credit union must follow the requirements of the applicable provisions of 12 CFR 324.41 when it transfers exposures in connection with a securitization. A credit union may only exclude the transferred exposures from the calculation of its risk-weighted assets if each condition in 12 CFR 324.41 is satisfied. The conditions for traditional securitizations in 12 CFR 324.41 are as follows (adapted for credit unions):

[105] 12 CFR 702.2 (effective Jan. 1, 2022).

(1) The exposures are not reported on the credit union's consolidated balance sheet under GAAP;

(2) The credit union has transferred to one or more third parties credit risk associated with the underlying exposures;

(3) Any clean-up calls relating to the securitization are eligible clean-up calls (a defined term under the other banking agencies' 2013 capital rules);[106] and

(4) The securitization does not:

(i) Include one or more underlying exposures in which the borrower is permitted to vary the drawn amount within an agreed limit under a line of credit; and

(ii) Contain an early amortization provision.

A credit union that meets the conditions, but retains any credit risk for the transferred exposures, must hold risk-based capital against the credit risk it retains in connection with the securitization.

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[106] Under the other banking agencies' 2013 capital rules, eligible clean-up call means a clean-up call that: (1) is exercisable solely at the discretion of the originating institution or servicer; (2) is not structured to avoid allocating losses to securitization exposures held by investors or otherwise structured to provide credit enhancement to the securitization; and (3)(i) for a traditional securitization, is only exercisable when 10 percent or less of the principal amount of the underlying exposures or securitization exposures (determined as of the inception of the securitization) is outstanding; or (ii) for a synthetic securitization, is only exercisable when 10 percent or less of the principal amount of the reference portfolio of underlying exposures (determined as of the inception of the securitization) is outstanding.

The other banking agencies' 2013 rule includes conditions for both traditional securitizations and synthetic securitizations.[107] The Board believes almost all securitizations issued by credit unions would be traditional securitizations and subject to the conditions in 12 CFR 324.41(a). The Board does not believe that credit unions are likely to engage in synthetic securitizations, however, if a credit union issues a synthetic securitization, it would be subject to the conditions in 12 CFR 324.41(b).

The Board also notes that 12 CFR 324.41(c) includes explicit due diligence requirements for banking organizations' investments in securitizations. The Board is not proposing to adopt these requirements at this time. The proposed rule only references 12 CFR 324.41 to incorporate the factors a credit union must consider when excluding assets transferred in connection with a securitization from risk-weighted assets. The Board intends to use its supervisory authority to monitor securitizations for safety and soundness purposes and is not currently proposing to adopt any new regulatory requirements for such transactions.

The other banking agencies' 2013 capital rule has an explicit treatment for any gain-on-sale in connection with a securitization exposure and any credit-enhancing interest only strips (CEIOs) retained by a banking organization that do not qualify as a gain-on-sale. Any gain-on-sale in connection with a securitization exposure is deducted from a banking organization's common equity tier 1 capital.[108] CEIOs that do not qualify as a gain-on-sale are given a

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[107] Under the other banking agencies' 2013 capital rule, a synthetic securitization means a transaction in which: (1) All or a portion of the credit risk of one or more underlying exposures is retained or transferred to one or more third parties through the use of one or more credit derivatives or guarantees (other than a guarantee that transfers only the credit risk of an individual retail exposure); (2) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority; (3) Performance of the securitization exposures depends upon the performance of the underlying exposures; and (4) All or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities). *See*, 12 CFR 324.2.

[108] *See*, 12 CFR 324.22(a)(4) and 12 CFR 324.42(a)(1).

1,250 percent risk weight.[109] The other banking agencies provided punitive treatments for these exposures because of historical supervisory concerns with the subjectivity involved in valuations of gains-on-sale and CEIOs. Furthermore, although the treatments for gains-on-sale and CEIOs can increase an originating banking organization's risk-based capital requirement following a securitization, the other banking agencies believe that such anomalies are rare where a securitization transfers significant credit risk to third parties.

The 2015 Final Rule does not include specific treatments for gain-on-sales or CEIOs because, as discussed previously, in 2015 credit unions had not issued any securitizations. Under the 2015 Final Rule, however, most CEIOs would still receive a 1,250 percent risk weight because they constitute a subordinated tranche. However, the 2015 Final Rule permits a credit union to use the gross-up approach as an alternative. The Board believes that credit union-issued securitizations should be given a similar capital treatment under the 2015 Final Rule as under the other banking agencies' risk-based capital rule.

Therefore, the proposed rule would include a specific risk weight for certain exposures associated with securitization activities. While the Board believes the capital treatment for credit union-issued securitizations should be similar to bank-issued securitizations, for simplicity, the proposed rule is slightly different than the other banking agencies' 2013 risk-based capital rule. Under the proposed rule, the gain-on-sale amount from a securitization transaction, generally the CEIO, will be included the numerator in calculating a credit union's net worth. This is a different approach than the other banking agencies' rule, which excludes gains-on-sale in calculating a bank's common equity tier 1 capital. Instead, the Board has chosen to address the risks associated with a gain-on-sale amount by requiring that a 1,250 percent risk weighting be applied to retained non-security beneficial interests. The Board believes the proposed approach

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[109] *See*, 12 CFR 324.42(a)(1).

is simpler and that it provides a more conservative risk weight overall than the other banking agencies' approach. The Board believes this approach is warranted given the limited securitizations issued by credit unions at this time.

Under the proposed rule, a non-security beneficial interest is defined as the residual equity interest in the special purpose entity that represents a right to receive possible future payments after specified payment amounts are made to third-party investors in the securitized receivables. Therefore, under the proposed rule, if a credit union has a non-security beneficial interest, such as a CEIO or cash collateral account, it cannot be risk-weighted with the gross-up approach and, instead, would be given a 1,250 risk weight. The Board believes this treatment is similar to the treatment provided by the other banking agencies in their 2013 risk-based capital rule.

The Board notes that subordinate tranches, either retained by the securitization sponsor or offered to investors as securities, that are also senior in payment priority to the non-security beneficial interest, are allowed to be risk weighted using the gross-up approach.

Question 18: What are the advantages and disadvantages of relying on the other banking agencies' risk-based capital rule for determining whether a credit union has transferred the credit risk associated with a securitization? Should credit union-issued securitizations be subject to the same capital treatment as bank-issued securitizations? Should there be an option for complex credit unions to use the gross-up approach for risk weighting non-security beneficial interest of a securitization? If so, please provide examples where the gross-up approach would sufficiently capture the risks of a non-security beneficial interest of a securitization.

3. Mortgage Servicing Assets

The Board is proposing to amend § 702.104(b), risk-based capital numerator, to deduct mortgage servicing assets that exceed 25 percent of the sum of the capital elements in § 702.104(b)(1), less deductions required under § 702.104(b)(2)(i) through (iv) of this section. Under the 2015 Final Rule, MSAs are assets, maintained in accordance with GAAP, resulting from contracts to service loans secured by real estate (that have been securitized or owned by others) for which the benefits of servicing are expected to more than adequately compensate the servicer for performing the servicing.[110]

To determine if a complex credit union would be subject to the MSA deduction from the risk-based capital numerator in this proposal, the complex credit union would first need to calculate the risk-based capital numerator before the MSA deduction. This calculation is in the current rule and requires that the complex credit union add all the capital elements of the risk-based capital numerator and subtract all risk-based capital numerator deductions, not including the MSA deduction. The complex credit union would then determine if its MSA exposure exceeds 25 percent of the previous calculation. If its MSAs do not exceed 25 percent, then the previous calculation is the risk-based capital numerator. If its MSAs exceed 25 percent, the complex credit union will need to deduct the amount of MSAs that exceed 25 percent of the previous calculation. All MSA exposures that are not deducted from the risk-based capital numerator are risk weighted at 250 percent.

The current rule does not include a deduction to the risk-based capital numerator for MSAs. The Board chose not to include a deduction for MSA exposures because, when the 2015 Final Rule was issued, the other banking agencies' risk-based capital rule included a complex

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[110] 12 CFR 702.2 (effective Jan. 1, 2022).

deduction for MSAs that included other items that were not comparable to the credit union structure. In 2015, the other banking agencies made numerator adjustment based on the collective exposure to MSAs, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks, and significant investments in capital of nonconsolidated financial institutions in the form of common stock. As the other banking agencies' 2015 approach was not comparable to the credit union capital structure and added significant complexity to their rule, the Board did not include a similar deduction to the 2015 Final Rule.

The Board is now proposing a deduction to the risk-based capital numerator for MSAs that exceed 25 percent of the risk-based capital numerator for two primary reasons. First, this change will make the NCUA's risk-based capital calculation more consistent with the other banking agencies' revised risk-based capital rules as the other banking agencies simplified their MSA calculation post-issuance of the 2015 Final Rule.[111] Under the other banking agencies' revised risk-based capital rule, banking organizations deduct MSAs that exceed 25 percent of the banking organization's common equity tier 1 capital.[112] The Board believes the simplification of the other banking agencies' approach easily allows the NCUA to be consistent with the other banking agencies' risk-based capital rule. Also, the Board believes it would be important to implement prudential conditions around MSAs if the Board adopts the recent proposed rule to amend parts 703 and 721 to allow FCUs to purchase mortgage servicing rights[113] from other FICUs.[114] If adopted, this rule could increase MSA holdings for complex credit unions. But

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[111] 84 FR 35234 (July 22, 2019).

[112] 12 CFR 324.22(d).

[113] The terms mortgage servicing rights and MSAs are used interchangeably.

[114] 85 FR 86867 (Dec. 31, 2020).

even if the Board does not adopt the proposed rule on mortgage servicing rights, the other considerations in this section support the proposed amendment to the 2015 Final Rule.

The Board believes that by including a deduction to the risk-based capital numerator for MSAs in risk-based capital, complex credit unions will be encouraged to avoid excessive exposures in MSAs relative the other risks on their balance sheets. As mentioned in the preamble of the 2015 Final Rule, the Board believes the risks of MSAs contribute to a high level of uncertainty regarding the ability of credit unions to realize value from these assets. Therefore, the Board believes it is appropriate to add the proposed risk-based numerator deduction to address the potential of complex credit unions purchasing MSAs from other FICUs.

The Board does not believe the proposed treatment would have an immediate effect on complex credit unions. As of December 31, 2020, the largest concentration in MSAs held by complex credit unions was just under 15 percent of the credit union's net worth. While net worth and the risk-based capital numerator are different calculations, the Board believes the two calculations are similar enough to state, with a high degree of certainty, there are no complex credit unions that would be required to deduct MSAs from the risk-based capital numerator were risk-based capital currently in effect.

Finally, the Board is aware that complex credit unions may believe that deducting exposures of MSAs over 25 percent of their risk-based capital numerator is punitive. However, the Board notes that both the Board and other banking agencies have stated that MSAs have a relatively high level of uncertainty regarding the ability to both value and realize value from these assets.[115] The Board also believes including the proposed MSA deduction from the risk-

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[115] Report to Congress on the Effect of Capital Rules on Mortgage Servicing Assets, Report to the Congress on the Effect of Capital Rules on Mortgage Servicing Assets, June 2016, *available at* https://www.federalreserve.gov/publications/other-reports/files/effect-capital-rules-mortgage-servicing-assets-201606.pdf.

based capital numerator is prudential for potential balance sheets complex credit union may have in the future.

Question 19: What are the advantages and disadvantages of deducting MSAs from the risk-based capital numerator? Should the Board consider a higher or lower deduction threshold? Why or why not?

4. Supranational Organizations and Multilateral Development Banks

The Board is proposing to amend the risk-based capital rule to assign a risk weighting of zero percent to an obligation of the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, the European Stability Mechanism, the European Financial Stability Facility, and multilateral development banks (MDBs). The 2015 Final Rule did not specifically discuss MDBs, which would have a risk weight of 100 percent under the catchall category for all other assets not specifically assigned a risk weight.[116] Assigning a risk-weight of zero percent is consistent with the other banking agencies' risk-based capital rule and the Board believes the zero percent risk weight is appropriate due to the generally high-credit quality of the issuers. This proposed change to the risk-based capital risk weighting was also requested in a comment letter in the ANPR. As part of this change, the Board would add a definition listing MDBs and criteria for non-listed multilateral lending institutions or regional development banks to be included in the MDB category. The MDBs listed in the definition are:

- International Bank for Reconstruction and Development;
- Multilateral Investment Guarantee Agency;

[116] 12 CFR 702.104(c)(2)(v)(C) (effective Jan. 1, 2022).

- International Finance Corporation;
- Inter-American Development Bank;
- Asian Development Bank;
- African Development Bank;
- European Bank for Reconstruction and Development;
- European Investment Bank;
- European Investment Fund;
- Nordic Investment Bank;
- Caribbean Development Bank;
- Islamic Development Bank; and
- Council of Europe Development Bank.
- Multilateral lending institution or regional development bank in which the U.S. government is a shareholder or contributing member are also included in the definition of MDBs.

Furthermore, the Board notes that MDBs are not permissible investments for FCUs under the general investment authorities. However, FCUs may invest in MDBs under § 701.19 and under § 721.3(b), subject to some conditions.

Question 20: Are there any supranational entities that should be included in the zero percent risk weight category? Specifically, the Board is requesting whether this proposed change sufficiently aligns NCUA's risk-weightings with the other banking agencies' risk weights for supranational organizations and MDBs.

5. Paycheck Protection Program Loans

As discussed previously in connection with the other banking agencies' CBLR regulation, the CARES Act was enacted in 2020 to provide aid to the U.S. economy during the COVID–19 pandemic.[117] The CARES Act authorized the Small Business Administration (SBA) to create a loan guarantee program, the Paycheck Protection Program (PPP), to help certain affected businesses meet payroll needs and utilities (including employee salaries, sick leave, other paid leave, and health insurance expenses) as a result of the COVID–19 pandemic. Provided credit union lenders comply with the applicable lender obligations set forth in the SBA's interim final rule, the SBA fully guaranteed loans issued under the PPP. Most FICUs were eligible to make PPP loans to members. Under the CARES Act, PPP loans must receive a zero percent risk weighting under the NCUA's risk-based capital requirements.[118] The NCUA issued a 2020 interim final rule to explicitly state that PPP loans under the risk-based net worth requirement receive a zero percent risk-weight.[119] The 2020 interim final rule stated that the NCUA's risk-based capital regulations would be amended in the future. The Board is now proposing to update the 2015 Final Rule to reflect that PPP loans receive a zero percent risk weight.

[117] Pub. L. 116–136 (Mar. 27, 2020).

[118] Pub. L. 116–136, 134 Stat. 281 (Mar. 27, 2020)

[119] 85 FR 23212 (Apr. 27, 2020).

6. Updates to derivative-related definitions

The Board recently amended its rule on derivatives to modernize the rule and make it more principles-based, while retaining key safety and soundness components.[120] The rulemaking amended several defined terms. A few of those defined terms are also included in the 2015 Final Rule. For consistency, the proposed rule would update those definitions that are also included in the 2015 Final Rule. First, under the proposed rule, the term derivative would be defined as "a financial contract that derives its value from the value and performance of some other underlying financial instrument or variable, such as an index or interest rate."[121] Second the proposed rule would make minor changes to the definitions of a derivative clearing organization and swap dealer by including a more general reference to the Commodity Futures Trading Commission (CFTC)'s regulations (for both definitions, the 2015 Final Rule references the definitions used by the CFTC).[122]

7. Definitions of Consumer Loan and Current

The Board is proposing to amend the definitions for Consumer Loan and Current in § 702.2. The Board is proposing these changes as a clarification to the 2015 Final Rule. The 2015 Final Rule does not include leases in the definition in Consumer Loan, despite the fact that the

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[120] 85 FR 23212 (Apr. 27, 2020).

[121] The 2015 Final Rule defines a derivative contract as "a financial contract whose value is derived from the values of one or more underlying assets, reference rates, or indices of asset values or reference rates. Derivative contracts include interest rate derivative contracts, exchange rate derivative contracts, equity derivative contracts, commodity derivative contracts, and credit derivative contracts. Derivative contracts also include unsettled securities, commodities, and foreign exchange transactions with a contractual settlement or delivery lag that is longer than the lesser of the market standard for the particular instrument or five business days." 12 CFR 702.2 (effective Jan. 1, 2022).

[122] The 2015 Final Rule states a derivative clearing organization is "as defined by the Commodity Futures Trading Commission in 17 CFR 1.3(d)." The proposed rule would state that a derivative clearing organization "as defined by the Commodity Futures Trading Commission (CFTC) in 17 CFR 1.3." Essentially the proposed rule would remove the "(d)". Similarly, the more specific reference in the 2015 Final Rule would be updated with the more general reference included in the recent derivative rule.

2014 Risk-Based Capital NPR stated "[c]onsumer loans (unsecured credit card loans, lines of credit, automobile loans, and leases) are generally highly desired credit union assets and a key element of providing basic financial services."[123] The Board is providing this proposed change for clarity. Without this proposed change the treatment of consumer leases is unclear and, therefore, may be risk weighted in the catchall category of 100 percent. The change makes clear that consumer leases receive a 75 percent risk weight. Due to the proposed change in the definition of a consumer loan, the definition of current will also be amended for consistency and would include the term leases.

N. TECHNICAL AMENDMENTS

The proposed rule would also include two technical amendments to 12 CFR part 703. Both amendments would make minor corrections related to the 2015 Final Rule.

O. ILLUSTRATIVE REPORTING FORMS FOR RISK-BASED CAPITAL

In January 2018, the Board issued a Request for Comment (RFI) seeking comments on all proposed changes to the Call Report form 5300, the Profile form 4501A, and the accompanying instructions. The proposed forms and instructions are available on the NCUA's Call Report Modernization web page.[124] The proposed Call Report form included six risk-based capital schedules (FC-T-1 through FC-T-6) designed to collect information consistent with the 2015 Final Risk-based Capital Rule. The Board also provided other risk-based capital tools detailed on the Risk-based Capital Rule Resources Page on the NCUA's website.[125]

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[123] 79 FR 11184, 11198 (Feb. 27, 2014).

[124] https://www.ncua.gov/regulation-supervision/examination-modernization-initiatives/call-report-modernization.

[125] https://www.ncua.gov/regulation-supervision/regulatory-compliance-resources/risk-based-capital-rule-resources.

The Board is illustrating as part of this proposal the draft forms that may be used as the risk-based capital Call Report schedules. Any new Call Report forms to support risk-based capital will be accompanied with detailed instructions. The NCUA intends to separately seek comment on the proposed changes to the Call Report for complex credit unions that use the risk-based capital framework. The examples below illustrate what the risk-based capital form for the numerator and denominator may look like. The illustration consists of three sections: Part I - Numerator, Part II - Denominator for on-balance sheet assets, and Part III - Denominator for off-balance sheet exposures and derivatives.

The illustration of the capital elements for the risk-based capital numerator are consistent with the 2015 Final rule in § 702.104(b)(1) with the addition of the proposed MSA deduction as proposed in the Amendments to the 2015 Final Rule, section M.

Chart 3 Part I – Capital elements of the risk-based capital numerator

Risk-Based Capital Form Part I - Numerator	
EQUITY	**TOTALS**
Undivided earnings......	
Regular reserves......	
Appropriations for non-conforming investments......	
Other reserves......	
Equity acquired in merger......	
Net income......	
Total Equity......	
ADDITIONS	
Allowance for Credit Losses......	
Subordinated Debt in accordance with §702.407......	
Section 208 Assistance included in net worth as defined in §702.2...	
Total Additions......	
DEDUCTIONS	
NCUSIF capitalization deposit......	
Goodwill......	
Less: Excluded Goodwill......	
Other intangible assets......	
Less: Excluded intangible assets......	
Identified losses not reflected in the risk-based capital numerator.	
Total Deductions......	
TOTAL RISK-BASED CAPITAL BEFORE MSA DEDUCTION	
Less: MSA balance exceeding 25% of RBC Numerator......	
TOTAL RISK-BASED CAPITAL NUMERATOR......	

The illustration for Part II - Denominator form for on-balance sheet assets may auto-populate the totals from other schedules in the Call Report (see table below for "Totals from Schedules" column with greyed out boxes). The Board will also provide a detailed instruction guide consistent with the 2015 Final Rule § 702.104(c)(2) for risk weighting the on-balance sheet assets into their respective risk weight categories. An empty box underneath each risk-weight category indicates a possible asset amount for each line item in accordance with the 2015 Final Rule.

Chart 4 Part II – Risk weight asset form for on-balance sheet assets

Risk-Weight Asset Form - Part II Denominator			*Risk Weight Category and Asset Allocations*										
			1	2	3	4	5	6	7	8	9	10	Alt RW
On-Balance Sheet Items	**Totals from Schedules**	**Adj's to Totals**	**0%**	**20%**	**50%**	**75%**	**100%**	**150%**	**250%**	**300%**	**400%**	**1250%**	**Other**
Cash, Cash Equivalents, Deposits in Finc'l Insts or Reserve Banks													
INVESTMENTS													
Securities													
Other Investments													
Allowance for Credit Losses & AFS Gain/(Loss)(Securities)													
Total Investments													
LOANS													
First Lien Residential Real Estate Loans													
Junior-Lien Residential Real Estate Loans													
Consumer Loans													
Commercial Loans													
Loans held for sale													
Allowance for Credit Losses (Loans)													
Total Loans													
OTHER ASSETS													
TOTAL ON-BALANCE ASSETS by RISK WEIGHT													
TOTAL RISK-WEIGHTED ASSETS - ON BALANCE SHEET	Calc												

The Board is proposing to improve the clarity and completeness of off-balance sheet and derivative exposures with the Part III - Denominator form example below. Similar to Part II, a detailed instruction guide consistent with the 2015 Final Rule § 702.104(4) and § 702.105 will supplement the schedule for risk weighting the off-balance sheet and derivative exposures into their respective risk weight categories. Both the Credit Conversion Factor (CCF) and the Credit Equivalent Amount (CEA) assist in calculating the amount to be risk weighted.

Chart 5 Part III – Risk weight form for off-balance sheet exposures and derivatives

Risk-Weight Asset Form - Part III Denominator Off-Balance Sheet and Derivative Exposures	Face or Notional Amount	Adj's to Totals	CCF	CEA	*Credit Equivalent Risk Weight Allocations* 0%	2%	4%	20%	50%	75%	100%	Other
Total Conditionally Cancelable Unfunded Commitments:												
A. Unfunded Commitment - Commercial loans..............................			50%	-								
B. Unfunded Commitment - Consumer Loans - Secured & RE........			10%	-								
C. Unfunded Commitment - Consumer Loans - Unsecured............			10%	-								
Federal Home Loan Bank under the MPF program...............................			20%	-								
All other off-balance sheet exposures (see instructions)..................			100%	-								
Over-the-counter derivatives..			(Instructions)									
Centrally cleared derivatives..			(Instructions)									
TOTAL OFF-BALANCE SHEET AND DERIVATIVE EXPOSURES........................												
TOTAL RISK-WEIGHTED ASSETS - OFF BAL AND DERIVATIVE EXPOSURES	Calc											

IV. REGULATORY PROCEDURES

A. REGULATORY FLEXIBILITY ACT

The Regulatory Flexibility Act[126] requires the NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small entities (primarily those under $100 million in assets).[127] This proposed rule would affect only credit unions with over $500 million in assets, which are subject to the 2015 Final Rule and the 2018 Supplemental Rule when they go into effect in January 2022. As a result, credit unions with $100 million or less in total assets would not be affected by this proposed rule. Accordingly, the NCUA certifies that this proposed rule would not have a significant economic impact on substantial number of small credit unions.

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[126] 5 U.S.C. 601 *et seq*.

[127] 5 U.S.C. 603(a).

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 amends an existing burden. For purposes of the PRA, a paperwork burden may take the form of a reporting, disclosure or recordkeeping requirement, each referred to as an information collection. The proposed changes to part 702 may revise existing information collection requirements to the Call Report. Should changes be made to the Call Report, they will be addressed in a separate *Federal Register* notice. The revisions to the Call Report will be submitted for approval by the Office of Information and Regulatory Affairs at the Office of Management and Budget prior to their effective date.

C. EXECUTIVE ORDER 13132 ON FEDERALISM

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests.[128] The 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. The proposed rule will apply to all federally insured natural-person credit unions, including federally insured, state-chartered natural-person credit unions. Accordingly, it may have, to some degree, 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. The Board believes this impact is minor, and it is an unavoidable consequence of carrying out the statutory mandate to adopt a system of PCA to apply to all federally insured, natural-person credit unions. Throughout the

[128] 64 FR 43255 (Aug. 4, 1999).

rulemaking process, however, NCUA has consulted with representatives of state regulators regarding the impact of the proposed rule.

D. ASSESSMENT OF FEDERAL REGULATIONS AND POLICIES ON FAMILIES

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

List of Subjects

12 CFR Part 702

Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 703

Credit unions, Investments, Reporting and recordkeeping requirements

By the National Credit Union Administration Board on July 22, 2021.

Melane Conyers-Ausbrooks,

Secretary of the Board.

For the reasons stated in the preamble, the NCUA proposes to amend 12 CFR parts 702 and 703, as follows:

PART 702 – CAPITAL ADEQUACY

1. The authority for part 702 continues to read as follows:

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

2. In § 702.2, revise the definitions of "*Consumer Loan*", "*Current*", "*Derivative contract*", "*Derivatives Clearing Organization*", "*Off-balance sheet exposure*", "*Off-balance sheet items*", and "*Swap dealer*" and add definitions of "*CCULR*", "*Credit derivative*", "*Forward agreement*", "*Multilateral development bank*", "*Non-security beneficial interest*" "*Repurchase transaction*," "*Trading assets*", "*Trading liabilities*", and "*Unconditionally cancelable*", in alphabetical order, to read as follows:

§ 702.2 Definitions.

* * * * *

CCULR means the complex credit union leverage ratio. It is calculated in the same manner as the net worth ratio under § 702.2.

* * * * *

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

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Credit derivative means a financial contract executed under standard industry credit derivative documentation that allows one party (the protection purchaser) to transfer the credit risk of one or more exposures (reference exposure(s)) to another party (the protection provider) for a certain period of time.

*   *   *   *   *

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

*   *   *   *   *

Derivative contract means a financial contract that derives its value from the value and performance of some other underlying financial instrument or variable, such as an index or interest rate.

Derivatives Clearing Organization has the meaning as defined by the Commodity Futures Trading Commission (CFTC) in 17 CFR 1.3.

*   *   *   *   *

Forward agreement means a legally binding contractual obligation to purchase assets with certain drawdown at a specified future date, not including commitments to make residential mortgage loans or forward foreign exchange contracts.

*   *   *   *   *

Multilateral development bank (MDB) means the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance

Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, and any other multilateral lending institution or regional development bank in which the U.S. government is a shareholder or contributing member.

*   *   *   *   *

Non-security beneficial interest is defined as the residual equity interest in the Special Purpose Entity (SPE) that represents a right to receive possible future payments after specified payment amounts are made to third-party investors in the securitized receivables. For purposes of this definition, a SPE means a trust, bankruptcy remote entity or other special purpose entity which is wholly owned, directly or indirectly, by the credit union and which is formed for the purpose of, and engages in no material business other than, acting as an issuer or a depositor in a securitization.

*   *   *   *   *

Off-balance sheet exposure mean:

(1) For unfunded commitments, excluding unconditionally cancellable commitments, the remaining unfunded portion of the contractual agreement.

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

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

(4) For financial standby letters of credit, the total potential exposure of the credit union under the contractual agreement.

(5) For forward agreements that are not derivative contracts, the future contractual obligation amount.

(6) For sold credit protection through guarantees and credit derivatives, the total potential exposure of the credit union under the contractual agreement.

(7) For off-balance sheet securitization exposures, the notional amount of the off-balance sheet credit exposure (including any credit enhancements, representations, or warranties that obligate a credit union to protect another party from losses arising from the credit risk of the underlying exposures) that arises from a securitization.

(8) For securities borrowing or lending transactions, the amount of all securities borrowed or lent against collateral or on an uncollateralized basis.

Off-balance sheet items mean off-balance sheet exposures and the off-balance sheet exposure amount of repurchase transactions.

* * * * *

Repurchase transactions mean either a transaction in which a credit union 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 or a transaction in which an investor agrees to purchase a security from a counterparty and to resell the same or an identical security to that counterparty at a specified future date and at a specified price. The off-balance sheet exposure amount for a repurchase transaction equals all of the positions the credit union has sold or bought subject to repurchase or resale, which equals the sum of the current fair values of all such positions.

* * * * *

Swap Dealer has the meaning as defined by the CFTC in 17 CFR 1.3.

* * * * *

Trading assets means securities or other assets acquired, not including loans originated by the credit union, for the purpose of selling in the near term or otherwise with the intent to resell in order to profit from short-term price movements. Trading assets would not include shares of a registered investment company or a collective investment fund used for liquidity purposes.

Trading liabilities means the total liability for short positions of securities or other liabilities held for trading purposes.

* * * * *

Unconditionally cancelable means with respect to a commitment, that a credit union may, at any time, with or without cause, refuse to extend credit under the commitment (to the extent permitted under applicable law).

* * * * *

3. In § 702.101, revise paragraph (a)(2) to read as follows:

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

(a) * * *

(2) If determined to be applicable under § 702.103, either the risk-based capital ratio under §702.104(a) through (c) or the CCULR framework under § 702.104(d).

* * * * *

4. In § 702.102, revise paragraph (a)(1)(i) and (ii), and Table 1to read as follows:

§ 702.102 Capital classification.

(a) * * *

(1) * * *

(i)(A) *Net worth ratio*. The credit union has a net worth ratio of 7.0 percent or greater; and

(B) *Risk-based capital ratio.* The credit union, if complex, has a risk-based capital ratio of 10 percent or greater; or

(ii) *Complex credit union leverage ratio.* (A) The complex credit union is a qualifying complex credit union that has opted into the CCULR framework under § 702.104(d) and it has a CCULR of 10 percent or greater, subject to any applicable transition provisions in § 702.104(d)(8); or

(B) The complex credit union is a qualifying complex credit union that has opted into the CCULR framework under § 702.104(d), is in the grace period, as defined in § 702.104(d)(7), and has a CCULR of 7 percent or greater.

* * * * *

TABLE 1 to § 702.102—CAPITAL CATERGORIES

Capital classification	**Net worth ratio**		**Risk-based capital ratio, if applicable**		**CCULR, if applicable**	**And subject to following condition(s) . . .**
Well Capitalized	7% or greater	And	10% or greater	Or	10% or greater*	
Adequately Capitalized	6% or greater	And	8% or greater	Or	N/A	And does not meet the criteria to be classified as well capitalized.
Undercapitalized	4% to 5.99%	Or	Less than 8%	Or	N/A	
Significantly Undercapitalized	2% to 3.99%		N/A		N/A	Or if "undercapitalized at <5% net worth and (a) fails to timely submit, (b) fails to materially implement, or (c) receives notice of the

Capital classification	**Net worth ratio**		**Risk-based capital ratio, if applicable**		**CCULR, if applicable**	**And subject to following condition(s) . . .**
						rejection of a net worth restoration plan.
Critically Undercapitalized	Less than 2%		N/A		N/A	
* A qualifying complex credit union opting into the CCULR framework should refer to 12 CFR 702.104(d)(7) if its CCULR falls below 10 percent and 12 CFR 702.104(d)(8) if the transition provisions are applicable.						

*　*　*　*　*

5. Revise § 702.103 to read as follows:

§ 702.103 Applicability of risk-based capital measures.

For purposes of § 702.102, a credit union is defined as “complex” and a risk-based capital measure is applicable only if the credit union’s quarter-end total assets exceed five hundred million dollars ($500,000,000), as reflected in its most recent Call Report. A complex credit union may calculate its risk-based capital measure either by using the risk-based capital ratio under §702.104(a) through (c), or, for a qualifying complex credit union opting into the CCULR framework, by using the CCULR framework under § 702.104(d).

6. In § 702.104:

a. Revise the introductory text;

b. Remove "; and" in paragraph (b)(2)(iii) and add in its place a semicolon, remove the period at the end of paragraph (b)(2)(iv) and add in its place "; and", and add paragraph (b)(2)(v);

c. Add paragraphs (c)(2)(i)(B)(*3*) and (c)(2)(i)(D);

d. Revise paragraphs (c)(2)(vii) and (x);

e. Revise paragraph (c)(4) introductory text;

f. Redesignate paragraphs (c)(4)(iii)(A) through (E) as (c)(4)(iii)(B) through (F) and add new paragraph (c)(4)(iii)(A);

g. Add paragraphs (c)(4)(iv) through (x); and

h. Add paragraphs (c)(6), (d), and (e).

The revisions and additions read as follows:

§ 702.104 Risk-based capital ratio.

A complex credit union must calculate its risk-based capital measure in accordance with this section. A complex credit union may calculate its risk-based capital measure either by using the risk-based capital ratio under paragraphs (a) through (c) of this section, or, for a qualifying complex credit union opting into the CCULR framework, by using the CCULR framework under paragraph (d) of this section.

*   *   *   *   *

(b)   *   *   *

(2)   *   *   *

(v) Mortgage servicing assets that exceed 25 percent of the sum of the capital elements in paragraph (b)(1) of this section, less deductions required under paragraphs (b)(2)(i) thorough (iv) of this section.

(c)   *   *   *

(2)   *   *   *

(i)   *   *   *

(B)   *   *   *

(*3*) An obligation of the Bank for International Settlements, the European Central Bank, the European Commission, the International Monetary Fund, the European Stability Mechanism, the European Financial Stability Facility, or an MDB.

*   *   *   *   *

(D) Covered loans issued under the Small Business Administration's Paycheck Protection Program, 15 U.S.C. 636(a)(36).

*   *   *   *   *

(vii) Category 7—250 percent risk weight. A credit union must assign a 250 percent risk weight to the carrying value of mortgage servicing assets not deducted from the risk-based capital numerator pursuant to § 702.104(b).

*   *   *   *   *

(x) *Category 10—1,250 percent risk weight*. A credit union must assign a 1,250 percent risk weight to the exposure amount of any subordinated tranche of any investment, with the option to use the gross-up approach in paragraph (c)(3)(iii)(A) of this section. However, a credit union may not use the gross-up approach for non-security beneficial interests.

*   *   *   *   *

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

*   *   *   *   *

(iii) *   *   *

(A) For a commitment that is unconditionally cancelable, a 0 percent CCF.

*   *   *   *   *

(iv) For financial standby letter of credits, a 100 percent CCF and a 100 percent risk weight.

(v) For forward agreements that are not derivative contracts, a 100 percent CCF and a 100 percent risk weight.

(vi) For sold credit protection through guarantees and credit derivatives, a 100 percent CCF and a 100 percent risk weight for guarantees; for credit derivatives the risk weight is determined by the applicable provisions of 12 CFR 324.34 or 324.35.

(vii) For off-balance sheet securitization exposures, a 100 percent CCF, and the risk weight is determined as if the exposure is an on-balance sheet securitization exposure.

(viii) For securities borrowing or lending transactions, a 100 percent CCF and a 100 percent risk weight. A credit union may recognize the credit risk mitigation benefits of financial collateral, as defined under 12 CFR 324.2, by risk weighting the collateralized portion of the exposure under the applicable provisions of 12 CFR 324.35 or 324.37.

(ix) For the off-balance sheet portion of repurchase transactions, a 100 percent CCF and a 100 percent risk weight. A credit union may recognize the credit risk mitigation benefits of financial collateral, as defined by 12 CFR 324.2, by risk weighting the collateralized portion of the exposure under the applicable provisions of 12 CFR 324.35 or 324.37.

(x) For all other off-balance sheet exposures not explicitly provided a CCF or risk weight in this paragraph (c) that meet the definition of a commitment, a 100 percent CCF and a 100 percent risk weight.

* * * * *

(6) Asset Securitizations Issued by Complex Credit Unions. A credit union must follow the requirements of the applicable provisions of 12 CFR 324.41 when it transfers exposures in connection with a securitization. A credit union may only exclude the transferred

exposures from the calculation of its risk-weighted assets if each condition in 12 CFR 324.41 is satisfied. A credit union that meets these conditions, but retains any credit risk for the transferred exposures, must hold risk-based capital against the credit risk it retains in connection with the securitization.

(d) *Complex Credit Union Leverage Ratio (CCULR) Framework.* (1) *General.* A qualifying complex credit union that has opted into the CCULR framework under paragraph (d)(5) of this section is considered to have met the capital ratio requirements for the well capitalized capital category under § 702.102(a)(1) if it has a CCULR of 10 percent or greater, subject to the transition provisions in paragraph (d)(8) of this section.

(2) *Qualifying Complex Credit Union*. For purposes of this part, a qualifying complex credit union means a complex credit union under § 702.103 that satisfies all of the following criteria:

(i) Has a CCULR of 10 percent or greater, subject to the transition provisions in paragraph (d)(8) of this section;

(ii) Has total off-balance sheet exposures of 25 percent or less of its total assets;

(iii) Has the sum of total trading assets and total trading liabilities of 5 percent or less of its total assets; and

(iv) Has the sum of total goodwill, including goodwill that meets the definition of excluded goodwill, and total other intangible assets, including intangible assets that meet the definition of excluded other intangible assets, of 2 percent or less of its total assets.

(3) *Calculation of Qualifying Criteria*. Each of the qualifying criteria in paragraph (d)(2) of this section is calculated based on data reported in the Call Report as of the end of the most recent calendar quarter.

(4) *Calculation of the CCULR*. A qualifying complex credit union opting into the CCULR framework under this paragraph (d) calculates its CCULR in the same manner as its net worth ratio under § 702.2.

(5) *Opting into the CCULR Framework*. (i) A qualifying complex credit union may opt into the CCULR framework by completing the applicable reporting requirements of its Call Report.

(ii) A qualifying complex credit union can opt into the CCULR framework at the end of each calendar quarter.

(6) *Opting Out of the CCULR Framework*. (i) A qualifying complex credit union may voluntarily opt out of the framework with prior written notification to the appropriate Regional Director or the Director of the Office of National Examinations and Supervision.

(ii) The notification must be submitted at least 30 days before the end of the calendar quarter that the credit union will report its risk-based capital ratio under paragraphs (a) through (c) of this section.

(iii) The notification must include:

(A) A statement of intent explaining why the qualifying complex credit union is opting out of the CCULR framework.

(B) A copy of board meeting minutes showing that the credit union's board of directors was notified of the CCULR framework opt out election.

(C) The calendar quarter that the qualifying complex credit union will begin calculating its risk-based capital ratio under paragraphs (a) through (c) of this section. The earliest a complex credit union may begin calculating a risk-based capital ratio is the calendar quarter it submits its notification.

(D) A risk-based capital ratio calculation Call Report schedule that includes the required information for a complex credit union calculating its risk-based capital ratio under paragraphs (a) through (c) of this section. The data must be as of the end of the most recent calendar quarter.

(7) *Treatment when ceasing to meet the qualifying complex credit union requirements*. (i) If a qualifying complex credit union that has opted into the CCULR framework ceases to meet the qualifying criteria in paragraph (d)(2) of this section, the credit union has two calendar quarters (grace period) either to satisfy the requirements to be a qualifying complex credit union or to calculate its risk-based capital ratio under paragraphs (a) through (c) of this section.

(ii) The grace period begins at the end of the calendar quarter in which the credit union no longer satisfies the criteria to be a qualifying complex credit union. The grace period ends on the last day of the second consecutive calendar quarter following the beginning of the grace period.

(iii) During the grace period, the credit union continues to be treated as a qualifying complex credit union for the purpose of this part and must continue calculating and reporting its CCULR, unless the qualifying complex credit union has opted out of using the CCULR framework under paragraph (d)(6) of this section. The qualifying complex credit union also continues to be considered to have met the capital ratio requirements for the well capitalized capital category under § 702.102(a)(1). However, if the qualifying complex credit union has a CCULR of less than seven percent it will not be considered to have met the capital ratio requirements for the well capitalized capital category under § 702.102(a)(1) and its capital classification is determined by its net worth ratio.

(iv)(A) A qualifying complex credit union that is likely to not meet the requirements to be a qualifying complex credit union by the end of the grace period must submit written notification to the appropriate Regional Director or the Director of the Office of National Examinations and Supervision. The notification must be submitted at least 30 days before the end of the grace period and state that the credit union may cease to meet the requirements to be a qualifying complex credit union.

(B) The notification must provide the reason for the potential disqualification.

(C) The notification must include a copy of the board meeting minutes showing that the credit union's board of directors was notified that the credit union might cease to meet the qualifying complex credit union requirements.

(D) The notification must include a risk-based capital ratio calculation Call Report schedule that includes the required information for a credit union calculating its risk-based capital ratio under paragraphs (a) through (c) of this section. The data must be as of the end of the most recent calendar quarter.

(v) A qualifying complex credit union that ceases to meet the qualifying criteria in paragraph (d)(2) of this section as a result of a merger or acquisition has no grace period and must comply with the risk-based capital ratio under paragraphs (a) through (c) of this section in the quarter it ceases to be a qualifying complex credit union.

(8) *Transition Provisions.* (i) From January 1, 2022, to December 31, 2022, a complex credit union that has opted into the CCULR framework under paragraph (d)(5) of this section, must have a CCULR of 9 percent or greater.

(ii) From January 1, 2023, to December 31, 2023, a complex credit union that has opted into the CCULR framework under paragraph (d)(5) of this section, must have a CCULR of 9.5 percent or greater.

(iii) After January 1, 2024, a complex credit union that has opted into the CCULR framework under paragraph (d)(5) of this section, must have a CCULR of 10 percent or greater.

(e) *Reservation of Authority*. The NCUA may require a complex credit union that otherwise would meet the definition of a qualifying complex credit union to comply with the risk-based capital ratio under paragraphs (a) through (c) of this section if the NCUA determines that the complex credit union's capital requirements under paragraph (d) of this section are not commensurate with its risks. Any credit union required to comply with the risk-based capital ratio under this paragraph (e), would be permitted a minimum of a two-quarter grace period before being subject to risk-based capital requirements.

§ 702.111 [Amended]

7. In § 702.111, amend paragraph (c)(1)(i) by removing "risk-based capital ratio" and adding in its place "risk-based capital measure".

PART 703—INVESTMENT AND DEPOSIT ACTIVITIES

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

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

§ 703.2 [Amended]

9. In § 703.2, amend the definition of "Net worth" by removing "§702.2(f) " and adding in its place "§702.2".

§ 703.13 [Amended]

11. In § 703.13, revise paragraph (d)(3)(iii) by removing "net worth classification" and adding in its place "capital classifications" and removing "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".

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