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## **Title 12 - Banks and Banking**

### **Chapter VII - National Credit Union Administration**

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## **PART 741 - REQUIREMENTS FOR INSURANCE**

**Authority:** 12 U.S.C. 1757, 1766(a), 1781-1790, and 1790d; 31 U.S.C. 3717.

**Source:** 60 FR 58504, Nov. 28, 1995, unless otherwise noted.

**Editorial Note:** Nomenclature changes to part 741 appear at 84 FR 1608, Feb. 5, 2019.

### **§ 741.0 Scope.**

The provisions of this part apply to federal credit unions, federally insured state-chartered credit unions, and credit unions making application for insurance of accounts pursuant to title II of the Act, unless the context of a provision indicates its application is otherwise limited. This part prescribes various requirements for obtaining and maintaining federal insurance and the payment of insurance premiums and capitalization deposit. Subpart A of this part contains substantive requirements that are not codified elsewhere in this chapter. Subpart B of this part lists

additional regulations, set forth elsewhere in this chapter as applying to federal credit unions, that also apply to federally insured state-chartered credit unions. As used in this part, "insured credit union" means a credit union whose accounts are insured by the National Credit Union Share Insurance Fund (NCUSIF).

## **Subpart A - Regulations That Apply to Both Federal Credit Unions and Federally Insured State-Chartered Credit Unions and That Are Not Codified Elsewhere in NCUA's Regulations**

### **§ 741.1 Examination.**

As provided in Sections 201 and 204 of the Act (12 U.S.C. 1781 and 1784), the NCUA Board is authorized to examine any insured credit union or any credit union making application for insurance of its accounts. Such examination may require access to all records, reports, contracts to which the credit union is a party, and information concerning the affairs of the credit union. Upon request, such documentation must be provided to the NCUA Board or its representative. Any credit union which makes application for insurance will be required to pay the cost of such examination and processing. To the maximum extent feasible, the NCUA Board will utilize examinations conducted by state regulatory agencies.

### **§ 741.2 Maximum borrowing authority.**

- (a) Any credit union which makes application for insurance of its accounts pursuant to title II of the Act, or any insured credit union, must not borrow, from any source, an aggregate amount in excess of 50 per centum of its paid-in and unimpaired capital and surplus (shares and undivided earnings, plus net income or minus net loss).
- (b) A federally insured state-chartered credit union may apply to the regional director for a waiver of paragraph (a) of this section up to the amount permitted under the applicable state law or by the state regulator. The waiver request must include:
  - (1) Written approval from the state regulator;
  - (2) A detailed analysis of the safety and soundness implications of the proposed waiver;
  - (3) A proposed aggregate dollar amount or percentage of paid-in and unimpaired capital and surplus limitation; and
  - (4) An explanation demonstrating the need to raise the limit.
- (c) The regional director will approve the waiver request if the proposed borrowing limit will not adversely affect the safety and soundness of the federally insured state-chartered credit union.

*[60 FR 58504, Nov. 28, 1995, as amended at 69 FR 8547, Feb. 25, 2004]*

### **§ 741.3 Criteria.**

In determining the insurability of a credit union which makes application for insurance and in continuing the insurability of its accounts pursuant to title II of the Act, the following criteria shall be applied:

- (a) **Reserves -**
  - (1) **General rule.** State-chartered credit unions are subject to section 216 of the Act, 12 U.S.C. 1790d, and to part 702 and subpart L of part 747 of this chapter.

(2) ***Special reserve for nonconforming investments.*** State-chartered credit unions (except state-chartered corporate credit unions) are required to establish an additional special reserve for investments if those credit unions are permitted by their respective state laws to make investments beyond those authorized in the Act or the NCUA Rules and Regulations. For purposes of this paragraph, if a state-chartered credit union conducts and documents an analysis that reasonably concludes an investment is at least investment grade, as defined in § 703.2 of this chapter, and the investment is otherwise permissible for Federal credit unions, that investment is not considered to be beyond those authorized by the Act or the NCUA Rules and Regulations. For any investment other than loans to members and obligations or securities expressly authorized in title I of the Act and part 703 of this chapter, as amended, state-chartered credit unions (except state-chartered corporate credit unions) are required to establish and maintain at the end of each accounting period and prior to payment of any dividend, an Appropriation for Non-conforming Investments in an amount at least equal to the net excess of book value over current market value of the investments. If the market value cannot be determined, an amount equal to the full book value will be established. When at the end of any dividend period, the amount in the Appropriation for Non-conforming Investments exceeds the difference between book value and market value, the board of directors may authorize the transfer of the excess to Undivided Earnings.

(b) ***Financial condition and policies.*** The following factors are to be considered in determining whether the credit union's financial condition and policies are both safe and sound:

- (1) The existence of unfavorable trends which may include excessive losses on loans (i.e., losses which exceed the regular reserve or its equivalent [in the case of state-chartered credit unions] plus other irrevocable reserves established as a contingency against losses on loans), the presence of special reserve accounts used specifically for charging off loan balances of deceased borrowers, and an expense ratio so high that the required transfers to reserves create a net operating loss for the period or that the net gain after these transfers is not sufficient to permit the payment of a nominal dividend;
- (2) The existence of written lending policies, including adequate documentation of secured loans and the protection of security interests by recording, bond, insurance or other adequate means, adequate determination of the financial capacity of borrowers and co-makers for repayment of the loan, adequate determination of value of security on loans to ascertain that said security is adequate to repay the loan in the event of default, loan workout arrangements, and nonaccrual standards that include the discontinuance of interest accrual on loans past due by 90 days or more and requirements for returning such loans, including member business loans, to accrual status.
- (3) Investment policies which are within the provisions of applicable law and regulations, i.e., the Act and part 703 of this chapter for federal credit unions and the laws of the state in which the credit union operates for state-chartered credit unions, except state-chartered corporate credit unions. State-chartered corporate credit unions are permitted to make only those investments that are in conformance with part 704 of this chapter and applicable state laws and regulations;
- (4) The presence of any account or security, the form of which has not been approved by the Board, except for accounts authorized by state law for state-chartered credit unions.
- (5) The existence of a written interest rate risk policy ("IRR policy") and an effective interest rate risk management program ("effective IRR program") as part of asset liability management. Federally insured credit unions ("FICUs") with assets of more than \$50 million, as measured by the most recent Call Report filing, must adopt a written IRR policy and implement an effective IRR program.

Appendix A to this part 741 provides guidance on how to develop an IRR policy and an effective IRR program. The guidance describes widely accepted best practices in the management of interest rate risk for the benefit of all FICUs.

- (c) ***Fitness of management.*** The officers, directors, and committee members of the credit union must have conducted its operations in accordance with provisions of applicable law, regulations, its charter and bylaws. No person shall serve as a director, officer, committee member, or employee of an insured credit union who has been convicted of any criminal offense involving dishonesty or breach of trust, except with the written consent of the Board.
- (d) ***Insurance of member accounts would not otherwise involve undue risk to the NCUSIF.*** The credit union must maintain adequate fidelity bond coverage as specified in § 741.201. Any circumstances which may be unique to the particular credit union concerned shall also be considered in arriving at the determination of whether or not an undue risk to the NCUSIF is or may be present. For purposes of this section, the term “undue risk to the NCUSIF” is defined as a condition which creates a probability of loss in excess of that normally found in a credit union and which indicates a reasonably foreseeable probability of the credit union becoming insolvent because of such condition, with a resultant claim against the NCUSIF.
- (e) ***Powers and purposes.*** The credit union must not perform services other than those which are consistent with the promotion of thrift and the creation of a source of credit for its members, except as otherwise permitted by law or regulation.
- (f) ***Letter of disapproval.*** A credit union whose application for share insurance is disapproved shall receive a letter indicating the reasons for such disapproval, a citation of the authority for such disapproval, and suggested methods by which the applying credit union may correct its deficiencies and thereby qualify for share insurance.
- (g) Nothing in this section shall preclude the NCUA Board from imposing additional terms or conditions pursuant to the insurance agreement.

[60 FR 58504, Nov. 28, 1995, as amended at 64 FR 41040, July 29, 1999; 65 FR 8593, Feb. 18, 2000; 67 FR 71094, Nov. 29, 2002; 77 FR 32001, May 31, 2012; 77 FR 5162, Feb. 2, 2012; 77 FR 74112, Dec. 13, 2012; 78 FR 4037, Jan. 18, 2013; 84 FR 1608, Feb. 5, 2019]

#### § 741.4 Insurance premium and one percent deposit.

- (a) ***Scope.*** This section implements the requirements of Section 202 of the Act (12 U.S.C. 1782) providing for capitalization of the NCUSIF through the maintenance of a deposit by each insured credit union in an amount equaling one percent of its insured shares and payment of an insurance premium.
- (b) ***Definitions.*** For purposes of this section:

***Aggregate amount of insured shares*** means the sum of all insured shares reported by federally insured credit unions in calendar year-end Call Reports from the calendar year for which the Board declares an NCUSIF equity distribution pursuant to paragraph (e) of this section.

***Aggregate average amount of insured shares*** means the sum of the average amount of insured shares as then reported by all financial institutions eligible to receive an NCUSIF equity distribution under subparagraph (e)(1) of this section in quarterly Call Reports over the calendar year for which the Board declares an NCUSIF equity distribution divided by the number of reporting periods in that calendar year.

*Available assets ratio* means the ratio of:

- (i) The amount determined by subtracting -
  - (A) Direct liabilities of the NCUSIF and contingent liabilities for which no provision for losses has been made from
  - (B) The sum of cash and the market value of unencumbered investments authorized under § 203 of the Federal Credit Union Act (12 U.S.C. 1783), to
- (ii) The aggregate amount of insured shares in all federally insured credit unions.

*Average amount of insured shares* means the sum of insured shares as then reported by a financial institution eligible to receive an NCUSIF equity distribution under subparagraph (e)(1) of this section over the calendar year for which the Board declares an NCUSIF equity distribution divided by the number of reporting periods in that calendar year.

*Board* means the NCUA Board or any individual or group of individuals with the delegated authority to act on behalf of the Board to implement the requirements of this section.

*Equity ratio* means the ratio of:

- (i) The amount determined by subtracting -
  - (A) Direct liabilities of the NCUSIF and contingent liabilities for which no provision for losses has been made from
  - (B) The sum of all one percent deposits made by federally insured credit unions pursuant to paragraph (c) of this section and the retained earnings balance of the NCUSIF, to
- (ii) The aggregate amount of insured shares in all federally insured credit unions.

*Federally insured credit union* means a federal or state-chartered credit union that maintains federal share insurance coverage from the NCUSIF.

*Financial institution* means a federally insured credit union, non-federally insured credit union, or an insured depository institution, including a liquidation or receivership estate of any such credit union or depository institution.

*Insured depository institution* means any bank or savings association the deposits of which are insured by the Federal Deposit Insurance Corporation pursuant to the Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.).

*Insured shares* means the total amount of a federally insured credit union's share, share draft and share certificate accounts, or their equivalent under state law (which may include deposit accounts), authorized to be issued to members, other credit unions, public units, or nonmembers (where permitted under the Act or equivalent state law), but does not include amounts in excess of insurance coverage as provided in part 745 of this chapter.

*Modified premium/distribution ratio* means one minus the premium/distribution ratio.

*National Credit Union Share Insurance Fund or NCUSIF* refers to a revolving fund established by Congress within the U.S. Treasury to provide federal share insurance coverage to federally insured credit union members and to offset the NCUA's administrative expenses associated with the conservatorship and liquidation of federally insured credit unions.

**NCUSIF equity distribution** means a distribution of excess equity from the NCUSIF to financial institutions eligible to receive a pro rata share of that distribution pursuant to the requirements of § 202 of the Federal Credit Union Act (12 U.S.C. 1782) and the special rules set out in subparagraph (e)(5) of this section.

**Normal operating level** means an equity ratio not less than 1.2 percent and not more than 1.5 percent, as established by action of the NCUA Board.

**Premium/distribution ratio** means the number of full remaining months in the calendar year following the date of the institution's conversion or merger divided by 12.

**Reporting period** means span of time covered by a set of financial statements. For purposes of paragraph (c) of this section, *reporting period* refers to a calendar year for federally insured credit unions with total assets of less than \$50,000,000 and refers to a semiannual period for federally insured credit unions with total assets of \$50,000,000 or more. For all other provisions of this section, *reporting period* refers to the span of time covered by a quarterly Call Report.

- (c) **One percent deposit.** Each insured credit union must maintain with the NCUSIF during each reporting period a deposit in an amount equaling one percent of the total of the credit union's insured shares at the close of the preceding reporting period. For credit unions with total assets of less than \$50,000,000, insured shares will be measured and adjusted annually based on the insured shares reported in the credit union's 5300 report for December 31 of each year. For credit unions with total assets of \$50,000,000 or more, insured shares will be measured and adjusted semiannually based on the insured shares reported in the credit union's 5300 reports for December 31 and June 30 of each year.

(d) **Insurance premium charges -**

- (1) **In general.** Each insured credit union will pay to the NCUSIF, on dates the NCUA Board determines, but not more than twice in any calendar year, an insurance premium in an amount stated as a percentage of insured shares, which will be the same percentage for all insured credit unions.

(2) **Relation of premium charge to equity ratio of NCUSIF.**

- (i) The NCUA Board may assess a premium charge only if the NCUSIF's equity ratio is less than 1.3 percent and the premium charge does not exceed the amount necessary to restore the equity ratio to 1.3 percent.
- (ii) If the equity ratio of the NCUSIF falls to between 1.0 and 1.2 percent, the NCUA Board is required to assess a premium in an amount it determines is necessary to restore the equity ratio to at least 1.2 percent, as provided for in the restoration plan adopted under Section 202(c)(2)(D) of the Act (12 U.S.C. 1782(c)(20)(D)). If the equity ratio of the NCUSIF falls below 1.0 percent, the NCUA Board is required to assess a deposit replenishment charge in an amount it determines is necessary to restore the equity ratio to 1.0 percent and to assess a premium charge in an amount it determines is necessary to restore the equity ratio to, at least 1.2 percent, as provided for in the restoration plan adopted under Section 202(c)(2)(D) of the Act (12 U.S.C. 1782(c)(20)(D)).

- (e) **NCUSIF equity distribution.** Except as otherwise provided for by federal law or regulation, the following procedures shall apply to any NCUSIF equity distribution declared by the Board:

- (1) **Eligibility for an NCUSIF equity distribution.** The Board shall make an NCUSIF equity distribution to any financial institution that files at least one quarterly Call Report as a federally insured credit union for a reporting period in the calendar year for which the Board declares the NCUSIF equity distribution.
- (2) **Requirement to make an NCUSIF equity distribution.** The Board shall make an NCUSIF equity distribution on a pro rata basis to financial institutions after each calendar year if, as of the end of the calendar year:
  - (i) Any loans to the NCUSIF from the Federal Government, and any interest on those loans, have been repaid;
  - (ii) The NCUSIF's equity ratio exceeds the normal operating level; and
  - (iii) The NCUSIF's available assets ratio exceeds one percent.
- (3) **Amount of NCUSIF equity distribution.** The Board shall make the maximum possible NCUSIF equity distribution that does not:
  - (i) Reduce the NCUSIF's equity ratio below the normal operating level; and
  - (ii) Reduce the NCUSIF's available assets ratio below one percent.
- (4) **Form of NCUSIF equity distribution.** The Board shall have the discretion to determine the form of an NCUSIF equity distribution including a waiver of federal share insurance premiums, a rebate of federal share insurance premiums, a dividend, or any combination thereof.
- (5) **Calculation of pro rata share of NCUSIF equity distribution.** The Board shall determine a financial institution's pro rata share of an NCUSIF equity distribution by dividing the dollar amount of the declared NCUSIF equity distribution by the aggregate average amount of insured shares for that calendar year and then multiplying by a financial institution's average amount of insured shares.
  - (i) **Special rules.** The following special rules shall apply to newly chartered federally insured credit unions, financial institutions that convert to federal share insurance coverage from the NCUSIF, financial institutions that terminate federal share insurance coverage from the NCUSIF, mergers between federally insured credit unions, and purchase and assumption transactions:
    - (A) **New charters.** A newly chartered federally insured credit union that obtains federal share insurance coverage from the NCUSIF during the calendar year shall not receive an NCUSIF equity distribution for that calendar year unless the federally insured credit union has filed at least one quarterly Call Report as a federally insured credit union for a reporting period in the calendar year for which the Board has declared a distribution. For purposes of calculating the newly chartered federally insured credit union's average amount of insured shares, the federally insured credit union shall be treated as having no insured shares for reporting periods preceding the first reporting period in which the federally insured credit union files its first quarterly Call Report.
    - (B) **Conversion to federal share insurance.** A financial institution that converts to federal share insurance coverage from the NCUSIF during the calendar year for which the Board declares an NCUSIF equity distribution (including through merger into a federally insured credit union) shall receive a prorated NCUSIF equity distribution for that calendar year provided that the financial institution has filed at least one quarterly Call Report as a federally insured credit union for a reporting period in the applicable calendar year. For



purposes of calculating the financial institution's average amount of insured shares, the financial institution shall be treated as having no insured shares for reporting periods preceding the date of conversion to federal share insurance coverage. In cases of conversion through merger, only the insured shares attributable to the continuing federally insured credit union shall be used to determine the average amount of insured shares for reporting periods preceding the date of conversion.

- (C) ***Conversion from, or termination of, federal share insurance.*** A financial institution that terminates federal share insurance coverage from the NCUSIF during the calendar year for which the Board declares an NCUSIF equity distribution (including through a conversion to, or merger into, a non-federally insured credit union or an insured depository institution) shall receive a prorated NCUSIF equity distribution for that calendar year provided that the financial institution has filed at least one quarterly Call Report as a federally insured credit union for a reporting period in the applicable calendar year. For purposes of calculating the financial institution's average amount of insured shares, the financial institution shall be treated as having no insured shares for reporting periods following the date of termination of federal share insurance coverage. For purposes of this subparagraph, a financial institution that terminates federal share insurance coverage from the NCUSIF through liquidation will be treated as terminating federal share insurance coverage during the calendar year when it enters liquidation.
- (D) ***Mergers between federally insured credit unions.*** A federally insured credit union that merges with a federally insured credit union shall receive an equity distribution equivalent to what the continuing federally insured credit union and the merging federally insured credit union would have received separately but for the consummation of the merger provided that the merging federally insured credit union has filed at least one quarterly Call Report as a federally insured credit union for a reporting period in the calendar year for which the Board declares the distribution. For purposes of calculating the continuing federally insured credit union's average amount of insured shares, any insured shares previously reported by the merging federally insured credit union on its quarterly Call Reports filed prior to the consummation of the merger during that calendar year for which the Board declares the distribution shall be combined with the insured shares reported on the continuing federally insured credit union's quarterly Call Reports.
- (E) ***Purchase and assumption transactions.*** A federally insured credit union that acquires all of the insured shares of another federally insured credit union in the calendar year for which the Board declares an NCUSIF equity distribution shall receive an amount equivalent to what the acquiring federally insured credit union and the selling federally insured credit union would have received but for the consummation of the purchase and assumption transaction provided that the selling federally insured credit union has filed at least one quarterly Call Report as a federally insured credit union for a reporting period in the calendar year for which the Board declares an NCUSIF equity distribution. For purposes of calculating the acquiring federally insured credit union's average amount of insured shares, any insured shares previously reported during that calendar year for which the Board declares an NCUSIF equity distribution by the selling federally insured credit union on its quarterly Call Reports filed prior to the consummation of the purchase and assumption transaction shall be combined with the insured shares reported on the acquiring federally insured credit union's quarterly Call Reports.

- (f) **Invoices.** The NCUA provides invoices to all federally insured credit unions stating any change in the amount of a credit union's one percent deposit and the computation and funding of any NCUSIF premium or deposit replenishment assessments due. Invoices for federal credit unions also include any annual operating fees that are due. Invoices are calculated based on a credit union's insured shares as of the most recently ended reporting period. The invoices may also provide for any distribution the NCUA Board declares in accordance with paragraph (e) of this section, resulting in a single net transfer of funds between a credit union and the NCUA.
- (g) **New charters.** A newly-chartered credit union that obtains share insurance coverage from the NCUSIF during the calendar year in which it has obtained its charter will not be required to pay for insurance for that calendar year. The credit union will fund its one percent deposit on a date to be determined by the NCUA Board in the following calendar year.
- (h) **Depletion of one percent deposit.** All or part of the one percent deposit may be used by the NCUSIF if necessary to meet its expenses. The NCUSIF may invoice credit unions in an amount necessary to replenish the one percent deposit at any time following the effective date of the depletion.
- (i) **Conversion to Federal insurance.**
  - (1) A credit union or other institution that converts to insurance coverage with the NCUSIF will:
    - (i) Immediately fund its one percent deposit based on the total of its insured shares as of the last day of the most recently ended reporting period prior to the date of conversion;
    - (ii) If the NCUSIF assesses a premium in the calendar year of conversion, pay a premium based on the institution's insured shares as of the last day of the most recently ended reporting period preceding the invoice date times the institution's premium/distribution ratio;
    - (iii) If the NCUSIF declares, in the calendar year of conversion on or before the date of conversion, an assessment to replenish the one-percent deposit, pay nothing related to that assessment;
    - (iv) If the NCUSIF declares, at any time after the date of conversion through the end of that calendar year, an assessment to replenish the one-percent deposit, pay a replenishment amount based on the institution's insured shares as of the last day of the most recently ended reporting period preceding the invoice date; and
  - (2) A federally insured credit union that merges with a non-federally insured credit union or other non-federally insured institution (the "merging institution"), where the federally insured credit union is the continuing institution, will:
    - (i) Immediately on the date of merger increase the amount of its NCUSIF deposit by an amount equal to one percent of the merging institution's insured shares as of the last day of the merging institution's most recently ended reporting period preceding the date of merger;
    - (ii) With regard to any NCUSIF premiums assessed in the calendar year of merger, pay a two-part premium, with one part calculated on the merging institution's insured shares as described in paragraph (i)(1)(ii) of this section, and the other part calculated on the continuing institution's insured shares as of the last day of its most recently ended reporting period preceding the date of merger; and
- (j) **Conversion from, or termination of, Federal share insurance.**

- (1) A federally insured credit union whose insurance coverage with the NCUSIF terminates, including through a conversion to, or merger into, a non-federally insured credit union or a noncredit union entity, will:
  - (i) Receive the full amount of its NCUSIF deposit paid, less any amounts applied to cover NCUSIF losses that exceed NCUSIF retained earnings, immediately after the final date on which any shares of the credit union are NCUSIF-insured;
  - (ii) If the NCUSIF assesses a premium in the calendar year of conversion or merger on or before the day in which the conversion or merger is completed, pay a prorated premium based on the financial institution's insured shares as of the last day of the most recently ended reporting period preceding the conversion or merger multiplied by the ratio of the amount of full calendar months for which the financial institution maintained federal share insurance coverage from the NCUSIF to the number of full calendar months for the entire calendar year. If the financial institution has previously paid a premium based on this same assessment that exceeds this amount, the financial institution will receive a refund of the difference following the completion of the conversion or merger.
- (2) Notwithstanding the requirements of paragraph (j)(1) of this section:
  - (i) Any insolvent credit union that is closed for involuntary liquidation will not be entitled to a return of its deposit;
  - (ii) Any solvent credit union that is closed due to voluntary or involuntary liquidation will be entitled to a return of its deposit paid, less any amounts applied to cover NCUSIF losses that exceed NCUSIF retained earnings, prior to final distribution of member shares; and
  - (iii) The Board reserves the right to delay return of the deposit to any credit union converting from or terminating its federal insurance, or voluntarily liquidating, for up to one year if the Board determines that immediate repayment would jeopardize the NCUSIF.
- (k) **Assessment of administrative fee and interest for delinquent payment.** Each federally insured credit union must pay to the NCUA an administrative fee, the costs of collection, and interest on any delinquent payment of its capitalization deposit or insurance premium. A payment will be considered delinquent if it is postmarked or electronically posted later than the date stated in the invoice provided to the credit union. The NCUA may waive or abate charges or collection of interest, if circumstances warrant.
  - (1) The administrative fee for a delinquent payment shall be an amount as fixed from time to time by the NCUA Board based upon the administrative costs of such delinquent payments to the NCUA in the preceding year.
  - (2) The costs of collection shall be calculated as the actual hours expended by NCUA personnel multiplied by the average hourly cost of the salaries and benefits of such personnel.
  - (3) The interest rate charged on any delinquent payment shall be the U.S. Department of the Treasury Tax and loan Rate in effect on the date when the loan payment is due as provided in 31 U.S.C. 3717.
  - (4) The Act contains specific penalties and other consequences for delinquent payments, including, but not limited to:

- (i) Section 202(d)(2)(B) of the Act (12 U.S.C. 1782(d)(2)(B)) provides that the Board may assess and collect a penalty from an insured credit union, up to the amount specified in § 747.1001 of this chapter, for each day the credit union fails or refuses to pay any deposit or premium due to the fund; and
- (ii) Section 202(d)(3) of the Act (12 U.S.C. 1782(d)(3)) provides, generally, that no insured credit union shall pay any dividends on its insured shares or distribute any of its assets while it remains in default in the payment of its deposit or any premium charge due to the fund. Section 202(d)(3) further provides that any director or officer of any insured credit union who knowingly participates in the declaration or payment of any such dividend or in any such distribution shall, upon conviction, be fined not more than \$1,000 or imprisoned more than one year, or both.

[74 FR 63279, Jan. 4, 2010, as amended at 76 FR 60367, Sept. 29, 2011; 80 FR 57288, Sept. 23, 2015; 83 FR 7960, Feb. 23, 2018; 83 FR 14741, Apr. 6, 2018; 85 FR 62213, Oct. 2, 2020]

### § 741.5 Notice of termination of excess insurance coverage.

In the event of a credit union's termination of share insurance coverage other than that provided by the NCUSIF, the credit union must notify all members in writing of such termination at least thirty days prior to the effective date of termination.

### § 741.6 Financial and statistical and other reports.

- (a) Upon written notice from the NCUA Board, Regional Director, Director of the Office of Examination and Insurance, or Director of the Office of National Examinations and Supervision, insured credit unions must file financial and other reports in accordance with the instructions in the notice. Insured credit unions must use NCUA's information management system, or other electronic means specified by NCUA, to submit their data online.
  - (1) **Credit Union Profile.** Insured credit unions must submit to NCUA a Credit Union Profile, NCUA Form 4501 or its equivalent, within 10 days after an election or appointment of senior management or volunteer officials or within 30 days of any change of the information in the profile.
  - (2) **Financial and statistical report.** Natural person credit unions must file a Call Report with NCUA quarterly in accordance with the instructions in the NCUA Form 5300. Corporate credit unions must file a Corporate Credit Union Call Report with NCUA monthly in accordance with the instructions in the NCUA Form 5310. Credit unions must submit a corrected Call Report upon notification or the discovery of a need for correction.
- (b) **Consistency with GAAP.** The accounts of financial statements and reports required to be filed quarterly under paragraph (a) of this section must reflect GAAP if the credit union has total assets of \$10 million or greater, but may reflect regulatory accounting principles other than GAAP if the credit union has total assets of less than \$10 million (except that a Federally insured State-chartered credit union may be required by its state credit union supervisor to follow GAAP regardless of asset size).
- (c) **GAAP sources.** GAAP means generally accepted accounting principles, as defined in § 715.2(e) of this chapter. GAAP is distinct from GAAS, which means generally accepted auditing standards, as defined in § 715.2(f) of this chapter. Authoritative sources of GAAP include, but are not limited to, pronouncements of

the Financial Accounting Standards Board (FASB) and its predecessor organizations, the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA), the FASB's Emerging Issues Task Force (EITF), and the applicable AICPA Audit and Accounting Guide.

[60 FR 58504, Nov. 28, 1995, as amended at 64 FR 41040, July 29, 1999; 67 FR 12464, Mar. 19, 2002; 71 FR 4034, Jan. 25, 2006; 74 FR 35769, July 21, 2009; 78 FR 32545, May 31, 2013; 78 FR 64885, Oct. 30, 2013]

### **§ 741.7 Conversion to a state-chartered credit union.**

Any federal credit union that petitions to convert to a state-chartered federally insured credit union is required to apply to the Regional Director for continued insurance of its accounts and meet the requirements as stated in the Act and this part. If the application for continued insurance is not approved, such insurance will terminate subject to the conditions set forth in section 206(d) of the Act.

### **§ 741.8 Purchase of assets and assumption of liabilities.**

- (a) Any credit union insured by the National Credit Union Share Insurance Fund (NCUSIF) must receive approval from the NCUA before purchasing loans or assuming an assignment of deposits, shares, or liabilities from:
  - (1) Any credit union that is not insured by the NCUSIF;
  - (2) Any other financial-type institution (including depository institutions, mortgage banks, consumer finance companies, insurance companies, loan brokers, and other loan sellers or liability traders); or
  - (3) Any successor in interest to any institution identified in paragraph (a)(1) or (a)(2) of this section.
- (b) Approval is not required for:
  - (1) Purchases of student loans or real estate secured loans to facilitate the packaging of a pool of loans to be sold or pledged on the secondary market under § 701.23(b)(1)(iii) or (iv) of this chapter or comparable state law for state-chartered credit unions, or purchases of member loans under § 701.23(b)(1)(i) of this chapter or comparable state law for state-chartered credit unions;
  - (2) Assumption of deposits, shares or liabilities as rollovers or transfers of member retirement accounts or in which a federally insured credit union perfects a security interest in connection with an extension of credit to any member.
  - (3) Purchases of assets, including loans, or assumptions of deposits, shares, or liabilities by any credit union insured by the NCUSIF from another credit union insured by the NCUSIF, except a purchase or assumption as a part of a merger under part 708b; or
  - (4) Purchases of loan participations as defined in and meeting the requirements of § 701.22 of this chapter.
- (c) A credit union seeking approval under paragraph (a) of this section must submit a request for approval to the appropriate regional director. The request must state the nature of the transaction and include copies of all relevant transaction documents. The regional director will approve or disapprove the request as soon as possible depending on the complexity of the proposed transaction. Credit unions should submit a request for approval in sufficient time to close the transaction.

[70 FR 75725, Dec. 21, 2005, as amended at 75 FR 34622, June 18, 2010; 78 FR 32545, May 31, 2013; 78 FR 37958, June 25, 2013; 84 FR 1608, Feb. 5, 2019]

### § 741.9 Uninsured membership shares.

Any credit union that is insured pursuant to title II of the Act may not offer membership shares that, due to the terms and conditions of the account, are not eligible for insurance coverage. This prohibition does not apply to shares that are uninsured solely because the amount is in excess of the maximum insurance coverage provided pursuant to part 745 of this chapter.

### § 741.10 Disclosure of share insurance.

Any credit union which is insured pursuant to title II of the Act and is permitted by state law to accept nonmember shares or deposits from sources other than other credit unions and public units (or, for low-income designated credit unions, any nonmembers), shall identify such nonmember accounts as nonmember shares or deposits on any statement or report required by the NCUA Board for insurance purposes. Immediately after a state-chartered credit union receives notice from NCUA that its member accounts are federally insured, the credit union shall advise any present nonmember share and deposit holders by letter that their accounts are not insured by the NCUSIF. Also, future nonmember share and deposit fund holders will be so advised by letter as they open accounts.

### § 741.11 Foreign branching.

- (a) **Application and prior NCUA approval required.** Any credit union insured under title II of the Act must apply for and receive approval from the regional director before establishing a credit union branch outside the United States unless the foreign branch is located on a United States military installation or embassy outside the United States. The regional director will have 60 days to approve or deny the request.
- (b) **Contents of application.** The application must include a business plan, written approval by the state supervisory agency if the applicant is a state-chartered credit union, and documentation evidencing written permission from the host country to establish the branch that explicitly recognizes NCUA's authority to examine and take any enforcement action, including conservatorship and liquidation actions.
- (c) **Contents of business plan.** The written business plan must address the following:
  - (1) Analysis of market conditions in the area where the branch is to be established;
  - (2) The credit union's plan for addressing foreign currency risk;
  - (3) Operating facilities, including office space/equipment and supplies;
  - (4) Safeguarding of assets, bond coverage, insurance coverage, and records preservation;
  - (5) Written policies regarding the branch (shares, lending, capital, charge-offs, collections);
  - (6) The field of membership or portion of the field of membership to be served through the foreign branch and the financial needs of the members to be served and services and products to be provided;
  - (7) Detailed *pro forma* financial statements for branch operations (balance sheet and income and expense projections) for the first and second year including assumptions;
  - (8) Internal controls including cash disbursement procedures for shares and loans at the branch;
  - (9) Accounting procedures used to identify branch activity and performance; and

(10) Foreign income taxation and employment law.

- (d) **Revocation of approval.** A State regulator that revokes approval of the branch office must notify NCUA of the action once it issues the notice of revocation. The regional director may revoke approval of the branch office for failure to follow the business plan in a material respect or for substantive and documented safety and soundness reasons. If the regional director revokes the approval, the credit union will have six months from the date of the revocation letter to terminate the operations of the branch. The credit union can request reconsideration of the revocation and/or appeal this revocation to the NCUA Board in accordance with the procedures set forth in subpart B to part 746 of this chapter.
- (e) **Insurance coverage.** Accounts at foreign branches are insured by the NCUSIF only if denominated in U.S. dollars and only if payable, by the terms of the account agreement, at a U.S. office of the credit union. If the host country requires insurance from its own system, accounts will not be insured by the National Credit Union Share Insurance Fund.

[68 FR 23030, Apr. 30, 2003, as amended at 82 FR 50294, Oct. 30, 2017]

## § 741.12 Liquidity and contingency funding plans.

- (a) Any credit union insured pursuant to Title II of the Act that has assets of less than \$50 million must maintain a basic written policy that provides a credit union board-approved framework for managing liquidity and a list of contingent liquidity sources that can be employed under adverse circumstances.
- (b) Any credit union insured pursuant to Title II of the Act that has assets of \$50 million or more must establish and document a contingency funding plan (CFP) that meets the requirements of paragraph (d) of this section.
- (c) In addition to the requirement specified in paragraph (b) of this section to establish and maintain a CFP, any credit union insured pursuant to Title II of the Act that has assets of \$250 million or more must establish and document access to at least one contingent federal liquidity source for use in times of financial emergency and distressed economic circumstances. These credit unions must conduct advance planning and periodic testing to ensure that contingent funding sources are readily available when needed. A credit union subject to this paragraph may demonstrate access to a contingent federal liquidity source by:
- (1) Maintaining regular membership in the Central Liquidity Facility (Facility), as described in part 725 of this chapter;
  - (2) Maintaining membership in the Facility through an Agent, as described in part 725 of this chapter; or
  - (3) Establishing borrowing access at the Federal Reserve Discount Window by filing the necessary lending agreements and corporate resolutions to obtain credit from a Federal Reserve Bank pursuant to 12 CFR part 201.
- (d) **Contingency Funding Plan:** A credit union must have a written CFP commensurate with its complexity, risk profile, and scope of operations that sets out strategies for addressing liquidity shortfalls in emergency situations. The CFP may be a separate policy or may be incorporated into an existing policy such as an asset/liability policy, a funds management policy, or a business continuity policy. The CFP must address, at a minimum, the following:
- (1) The sufficiency of the institution's liquidity sources to meet normal operating requirements as well as contingent events;

- (2) The identification of contingent liquidity sources;
  - (3) Policies to manage a range of stress environments, identification of some possible stress events, and identification of likely liquidity responses to such events;
  - (4) Lines of responsibility within the institution to respond to liquidity events;
  - (5) Management processes that include clear implementation and escalation procedures for liquidity events; and
  - (6) The frequency that the institution will test and update the plan.
- (e) A credit union is subject to the requirements of paragraphs (b) or (c) of this section when two consecutive Call Reports show its assets to be at least \$50 million or \$250 million, respectively. A FICU then has 120 days from the effective date of that second Call Report to meet the greater requirements.

[78 FR 64883, Oct. 30, 2013]

### § 741.13 NCUSIF equity distribution related to the Corporate System Resolution Program.

- (a) **Definitions.** For purposes of this section, the following definitions apply:
- (1) **Aggregate amount of insured shares** means the sum of all insured shares reported by federally insured credit unions in calendar year-end Call Reports from the calendar year for which the Board declares an NCUSIF equity distribution pursuant to paragraph (b) of this section.
  - (2) **Aggregate average amount of insured shares** means the sum of the average amount of insured shares as then reported by all financial institutions eligible to receive an NCUSIF equity distribution under subparagraph (b)(1) of this section in quarterly Call Reports over a given time horizon divided by the number of reporting periods in that time horizon.
  - (3) **Available assets ratio** means the ratio of:
    - (i) The amount determined by subtracting -
      - (A) Direct liabilities of the NCUSIF and contingent liabilities for which no provision for losses has been made from
      - (B) The sum of cash and the market value of unencumbered investments authorized under section 203 of the Federal Credit Union Act (12 U.S.C. 1783), to
    - (ii) The aggregate amount of insured shares in all federally insured credit unions.
  - (4) **Average amount of insured shares** means the sum of insured shares as then reported by a financial institution eligible to receive an NCUSIF equity distribution under subparagraph (b)(1) of this section over a given time horizon divided by the number of reporting periods in that time horizon.
  - (5) **Board** means the NCUA Board or any individual or group of individuals with the delegated authority to act on behalf of the Board to implement the requirements of this section.
  - (6) **Corporate System Resolution Program** refers to a special program established by the Board to stabilize the corporate credit union system.
  - (7) **Federally insured credit union** means a federal or state-chartered credit union that maintains federal share insurance coverage from the NCUSIF.



- (8) **Financial institution** means a federally insured credit union, non-federally insured credit union, or an insured depository institution, including a liquidation or receivership estate of any such credit union or depository institution.
- (9) **Insured depository institution** means any bank or savings association the deposits of which are insured by the Federal Deposit Insurance Corporation pursuant to the Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.).
- (10) **Insured shares** means the total amount of a federally insured credit union's share, share draft and share certificate accounts, or their equivalent under state law (which may include deposit accounts), authorized to be issued to members, other credit unions, public units, or nonmembers (where permitted under the Act or equivalent state law), but does not include amounts in excess of insurance coverage as provided in part 745 of this chapter.
- (11) **National Credit Union Share Insurance Fund or NCUSIF** refers to a revolving fund established by Congress within the U.S. Treasury to provide federal share insurance coverage to federally insured credit union members and to offset the NCUA's administrative expenses associated with the conservatorship and liquidation of federally insured credit unions.
- (12) **NCUSIF equity distribution** means a distribution of excess equity from the NCUSIF to financial institutions eligible to receive a pro rata share of that distribution pursuant to the requirements of section 202 of the Federal Credit Union Act (12 U.S.C. 1782) and the special rules set out in paragraph (b)(5) of this section.
- (13) **NCUSIF equity ratio** means the ratio of:
  - (i) The amount determined by subtracting -
    - (A) Direct liabilities of the NCUSIF and contingent liabilities for which no provision for losses has been made from
    - (B) The sum of all one percent deposits made by federally insured credit unions pursuant to § 741.4 of this chapter and the retained earnings balance of the NCUSIF, to
  - (ii) The aggregate amount of insured shares in all federally insured credit unions.
- (14) **Normal operating level** means an NCUSIF equity ratio not less than 1.2 percent and not more than 1.5 percent, as established by action of the Board.
- (b) **NCUSIF equity distributions related to the Corporate System Resolution Program.** Notwithstanding § 741.4 of this chapter, the following procedures shall apply to any NCUSIF equity distribution declared for calendar years 2017 through 2021:
  - (1) **Eligibility for an NCUSIF equity distribution.** The Board shall make an NCUSIF equity distribution to any financial institution that files at least one quarterly Call Report as a federally insured credit union for a reporting period in the calendar year for which the Board declares the NCUSIF equity distribution.
  - (2) **Requirement to make an NCUSIF equity distribution.** The Board shall make an NCUSIF equity distribution on a pro rata basis to financial institutions after each calendar year if, as of the end of the calendar year:
    - (i) Any loans to the NCUSIF from the federal government, and any interest on those loans, have been repaid;

- (ii) The NCUSIF's equity ratio exceeds the normal operating level; and
  - (iii) The NCUSIF's available assets ratio exceeds one percent.
- (3) **Amount of NCUSIF equity distribution.** The Board shall make the maximum possible NCUSIF equity distribution that does not:
  - (i) Reduce the NCUSIF's equity ratio below the normal operating level; and
  - (ii) Reduce the NCUSIF's available assets ratio below one percent.
- (4) **Form of NCUSIF equity distribution.** The Board shall have the discretion to determine the form of an NCUSIF equity distribution including a waiver of federal share insurance premiums, a rebate of federal share insurance premiums, a dividend, or any combination thereof.
- (5) **Calculation of pro rata share of NCUSIF equity distribution.** The Board shall determine a financial institution's pro rata share of an NCUSIF equity distribution by dividing the dollar amount of the declared NCUSIF equity distribution by the aggregate average amount of insured shares for that given time horizon and then multiplying by a financial institution's average amount of insured shares.
  - (i) **Time horizons.** When calculating the average amount of insured shares and the aggregate average amount of insured shares for an NCUSIF equity distribution, the following time horizons shall apply:
    - (A) **NCUSIF equity distribution for 2017.** The average amount of insured shares and aggregate average amount of insured shares for an NCUSIF equity distribution declared for calendar year 2017 shall be based on information from quarterly Call Reports from the preceding 36 quarters, including the calendar year-end Call Report for 2017.
    - (B) **NCUSIF equity distribution for 2018.** The average amount of insured shares and aggregate average amount of insured shares for an NCUSIF equity distribution declared for calendar year 2018 shall be based on information from quarterly Call Reports from the preceding 40 quarters, including the calendar year-end Call Report for 2018.
    - (C) **NCUSIF equity distribution for 2019.** The average amount of insured shares and aggregate average amount of insured shares for an NCUSIF equity distribution declared for calendar year 2019 shall be based on information from quarterly Call Reports from the preceding 44 quarters, including the calendar year-end Call Report for 2019.
    - (D) **NCUSIF equity distribution for 2020.** The average amount of insured shares and aggregate average amount of insured shares for an NCUSIF equity distribution declared for calendar year 2020 shall be based on information from quarterly Call Reports from the preceding 48 quarters, including the calendar year-end Call Report for 2020.
    - (E) **NCUSIF equity distribution for 2021.** The average amount of insured shares and aggregate average amount of insured shares for an NCUSIF equity distribution declared for calendar year 2021 shall be based on information from quarterly Call Reports from the preceding 52 quarters, including the calendar year-end Call Report for 2021.
  - (ii) **Special rules.** The following special rules shall apply to newly-chartered federally insured credit unions, financial institutions that convert to federal share insurance coverage from the NCUSIF, financial institutions that terminate federal share insurance coverage from the NCUSIF, mergers between federally insured credit unions, and purchase and assumption transactions:

- (A) ***New charters.*** A newly chartered federally insured credit union that obtains federal share insurance coverage from the NCUSIF during the calendar year shall not receive an NCUSIF equity distribution for that calendar year unless the federally insured credit union has filed at least one quarterly Call Report as a federally insured credit union for a reporting period in the calendar year. For purposes of calculating the newly chartered federally insured credit union's average amount of insured shares, the federally insured credit union shall be treated as having no insured shares for reporting periods preceding the first reporting period in which the federally insured credit union files its first quarterly Call Report.
- (B) ***Conversion to federal share insurance.*** A financial institution that converts to federal share insurance coverage from the NCUSIF during the calendar year for which the Board declares an NCUSIF equity distribution (including through merger into a federally insured credit union) shall receive a prorated NCUSIF equity distribution for that calendar year provided that the financial institution has filed at least one quarterly Call Report as a federally insured credit union for a reporting period in the calendar year. For purposes of calculating the financial institution's average amount of insured shares, the financial institution shall be treated as having no insured shares for reporting periods preceding the date of conversion to federal share insurance coverage. In cases of conversion through merger, only the insured shares attributable to the continuing federally insured credit union shall be used to determine the average amount of insured shares for reporting periods preceding the date of conversion.
- (C) ***Conversion from, or termination of, federal share insurance.*** A financial institution that terminates federal share insurance coverage from the NCUSIF during the calendar year for which the Board declares an NCUSIF equity distribution (including through a conversion to, or merger into, a non-federally insured credit union or an insured depository institution) shall receive a prorated NCUSIF equity distribution for that calendar year provided that the financial institution has filed at least one quarterly Call Report as a federally insured credit union for a reporting period in the calendar year. For purposes of calculating the financial institution's average amount of insured shares, the financial institution shall be treated as having no insured shares for reporting periods following the date of termination of federal share insurance coverage. For purposes of this subparagraph, a financial institution that terminates federal share insurance coverage from the NCUSIF through liquidation will be treated as terminating federal share insurance coverage during the calendar year when it enters liquidation.
- (D) ***Mergers between federally insured credit unions.*** A continuing federally insured credit union that merges with a federally insured credit union shall receive an equity distribution equivalent to what the continuing federally insured credit union and the merging federally insured credit union would have received separately but for the consummation of the merger provided that the merging federally insured credit union has filed at least one quarterly Call Report as a federally insured credit union for a reporting period in the calendar year for which the Board declares the distribution. For purposes of calculating the continuing federally insured credit union's average amount of insured shares, any insured shares previously reported by the merging federally insured credit union on its quarterly Call Reports filed prior to the consummation of the merger during that calendar year for which the Board declares the distribution shall be combined with the insured shares reported on the continuing federally insured credit union's quarterly Call Reports.

(E) **Purchase and assumption transactions.** A federally insured credit union that acquires all of the insured shares of another federally insured credit union in the calendar year for which the Board declares an NCUSIF equity distribution shall receive an amount equivalent to what the acquiring federally insured credit union and the selling federally insured credit union would have received but for the consummation of the purchase and assumption transaction provided that the selling federally insured credit union has filed at least one quarterly Call Report as a federally insured credit union for a reporting period in the calendar year for which the Board declares an NCUSIF equity distribution. For purposes of calculating the acquiring federally insured credit union's average amount of insured shares, any insured shares previously reported during that calendar year for which the Board declares an NCUSIF equity distribution by the selling federally insured credit union on its quarterly Call Reports filed prior to the consummation of the purchase and assumption transaction shall be combined with the insured shares reported on the acquiring federally insured credit union's quarterly Call Reports.

(c) **Expiration.** This section shall expire and no longer be applicable after December 31, 2022.

[83 FR 7962, Feb. 23, 2018]

**Effective Date Note:** At 83 FR 7962, Feb. 23, 2018, § 741.13 was added, effective Mar. 26, 2018, until Dec. 31, 2022.

## **Subpart B - Regulations Codified Elsewhere in NCUA's Regulations as Applying to Federal Credit Unions That Also Apply to Federally Insured State-Chartered Credit Unions**

### **§ 741.201 Minimum fidelity bond requirements.**

- (a) Any credit union which makes application for insurance of its accounts pursuant to title II of the Act must possess the minimum fidelity bond coverage stated in §§ 713.3, 713.5, and 713.6 in order for its application for such insurance to be approved and for such insurance coverage to continue. A federally insured credit union whose fidelity bond coverage is terminated shall mail notice of such termination to the Regional Director not less than 35 days prior to the effective date of such termination.
- (b) Corporate credit unions must comply with § 704.18 of this chapter in lieu of part 713 of this chapter.

[60 FR 58504, Nov. 28, 1995, as amended at 64 FR 28721, May 27, 1999; 70 FR 61716, Oct. 26, 2005; 84 FR 1608, Feb. 5, 2019]

### **§ 741.202 Audit and verification requirements.**

- (a) The supervisory committee of each credit union insured pursuant to title II of the Act shall make or cause to be made an audit of the credit union at least once every calendar year covering the period elapsed since the last audit. The audit must fully meet the applicable requirements set forth in part 715 of this chapter or applicable state law, whichever requirement is more stringent.
- (b) Each credit union which is insured pursuant to title II of the Act shall verify or cause to be verified, under controlled conditions, all passbooks and accounts with the records of the financial officer not less frequently than once every 2 years. The verification must fully meet the requirements set forth in § 715.8 of this chapter.

[60 FR 58504, Nov. 28, 1995, as amended at 64 FR 41040, July 29, 1999]

### **§ 741.203 Minimum loan policy requirements.**

Any credit union which is insured pursuant to title II of the Act must:

- (a) Adhere to the requirements stated in part 723 of this chapter concerning commercial lending and member business loans, § 701.21(c)(8) of this chapter concerning prohibited fees, and § 701.21(d)(5) of this chapter concerning non-preferential loans. Federally insured state chartered credit unions in a given state are exempt from these requirements if the state supervisory authority for that state adopts substantially equivalent regulations as determined by the NCUA Board or, in the case of the commercial lending and member business loan requirements, if the state supervisory authority administers a state commercial and member business loan rule for use by federally insured credit unions chartered in that state that at least covers all the provisions in part 723 of this chapter and is no less restrictive, upon determination by NCUA. In nonexempt states, all required NCUA reviews and approvals will be handled in coordination with the state credit union supervisory authority; and
- (b) Adhere to the requirements stated in part 722 of this chapter concerning appraisals.
- (c) Adhere to the requirements stated in § 701.21(h) of this chapter concerning third-party servicing of indirect vehicle loans. Before a state-chartered credit union applies to a regional director for a waiver under § 701.21(h)(2), it must first notify its state supervisory authority. The regional director will not grant a waiver unless the appropriate state official concurs in the waiver. The 45-day period for the regional director to act on a waiver request, as described § 701.21(h)(3), will not begin until the regional director has received the state official's concurrence and any other necessary information.

[60 FR 58504, Nov. 28, 1995, as amended at 63 FR 51802, Sept. 29, 1998; 64 FR 28733, May 27, 1999; 71 FR 36667, June 28, 2006; 81 FR 13559, Mar. 14, 2016]

### **§ 741.204 Maximum public unit and nonmember accounts, and low-income designation.**

Any credit union that is insured, or that makes application for insurance, pursuant to title II of the Act must:

- (a) Adhere to the requirements of § 701.32 of this chapter regarding public unit and nonmember accounts, provided it has the authority to accept such accounts.
- (b) Obtain a low-income designation in order to accept nonmember accounts, other than from public units or other credit unions, provided it has the authority to accept such accounts under state law. The state regulator shall make the low-income designation with the concurrence of NCUA. The designation will be made and reviewed by the state regulator on the same basis as that provided in § 701.34(a) of this chapter for federal credit unions. Removal of the designation by the state regulator for such credit unions shall be with the concurrence of NCUA.
- (c) Follow the requirements of § 702.414 of this chapter for any Grandfathered Secondary Capital (as defined in part 702 of this chapter).

[60 FR 58504, Nov. 28, 1995, as amended at 61 FR 3792, Feb. 2, 1996; 71 FR 4240, Jan. 26, 2006; 78 FR 4032, Jan. 18, 2013; 84 FR 58309, Oct. 31, 2019; 85 FR 62213, Oct. 2, 2020; 86 FR 11085, Feb. 23, 2021; 86 FR 72809, Dec. 23, 2021]

### **§ 741.205 Reporting requirements for credit unions that are newly chartered or in troubled**

## **condition.**

Any federally insured credit union chartered for less than 2 years or any credit union defined to be in troubled condition as set forth in § 701.14(b)(3) of this chapter must adhere to the requirements stated in § 701.14(c) of this chapter concerning the prior notice and NCUA review. Federally insured state-chartered credit unions must submit required information to both the appropriate NCUA Regional Director and their state supervisor. NCUA will consult with the state supervisor before making its determination. NCUA will notify the state supervisor of its approval/disapproval no later than the time that it notifies the affected individual.

[60 FR 58504, Nov. 28, 1995, as amended at 78 FR 4029, Jan. 18, 2013]

## **§ 741.206 Corporate credit unions.**

Any corporate credit union insured pursuant to title II of the Act shall adhere to the requirements of part 704 of this chapter.

## **§ 741.207 Community development revolving loan program for credit unions.**

Any credit union which is insured pursuant to title II of the Act and is a “participating credit union,” as defined in § 705.2 of this chapter, shall adhere to the requirements stated in part 705 of this chapter.

[60 FR 58504, Nov. 28, 1995, as amended at 76 FR 67591, Nov. 2, 2011]

## **§ 741.208 Mergers of federally insured credit unions: voluntary termination or conversion of insured status.**

Any credit union which is insured pursuant to title II of the Act and which merges with another credit union or non-credit union institution, and any state-chartered credit union which voluntarily terminates its status as a federally insured credit union, or converts from federal insurance to other insurance from a government or private source authorized to insure member accounts, shall adhere to the applicable requirements stated in section 206 of the Act and parts 708a and 708b of this chapter concerning mergers and voluntary termination or conversion of insured status.

## **§ 741.209 Management official interlocks.**

Any credit union which is insured pursuant to title II of the Act shall adhere to the requirements stated in part 711 of this chapter concerning management official interlocks, issued under the provisions of the Depository Institution Management Interlocks Act (12 U.S.C. 3201 et seq.).

## **§ 741.210 Central liquidity facility.**

Any credit union which is insured pursuant to title II of the Act and is a member of the Central Liquidity Facility, shall adhere to the requirements stated in part 725 of this chapter.

## **§ 741.211 Advertising.**

Any credit union which is insured pursuant to title II of the Act shall adhere to the requirements prescribed by part 740 of this chapter.

### **§ 741.212 Share insurance.**

- (a) Member share accounts received by any credit union which is insured pursuant to title II of the Act in its usual course of business, including regular shares, share certificates, and share draft accounts, are insured subject to the limitations and rules in subpart A of part 745 of this chapter.
- (b) The payment of share insurance and the appeal process applicable to any credit union which is insured pursuant to title II of the Act are addressed in subpart B of part 745 of this chapter.

### **§ 741.213 Administrative actions, adjudicative hearings, rules of practice and procedure.**

Any credit union which is insured pursuant to title II of the Act shall adhere to the applicable rules of practice and procedures for administrative actions and adjudicative hearings prescribed by part 747 of this chapter. Subpart E of part 747 of this chapter applies only to federal credit unions.

### **§ 741.214 Report of crime or catastrophic act and Bank Secrecy Act compliance.**

Any credit union which is insured pursuant to title II of the Act shall adhere to the requirements stated in part 748 of this chapter.

### **§ 741.215 Records preservation program.**

Any credit union which is insured pursuant to title II of the Act shall maintain a records preservation program as prescribed by part 749 of this chapter.

### **§ 741.216 Flood insurance.**

Any credit union which is insured pursuant to title II of the Act shall adhere to the requirements stated in part 760 of this chapter.

### **§ 741.217 Truth in savings.**

Any credit union which is insured pursuant to title II of the Act shall adhere to the requirements stated in part 707 of this chapter.

### **§ 741.218 Involuntary liquidation and creditor claims.**

Any credit union which is insured pursuant to title II of the Act shall adhere to the applicable provisions in part 709 of this chapter. Section 709.3 of this chapter applies only to federal credit unions.

### **§ 741.219 Investment requirements.**

- (a) Any credit union which is insured pursuant to title II of the Act must adhere to the requirements stated in part 703 of this chapter concerning transacting business with corporate credit unions.
- (b) Any credit union that is insured pursuant to title II of the Act must notify the applicable NCUA Regional Director in writing within five business days after entering into its first Derivatives transaction. Such transactions do not include those included in § 703.14 of this chapter.

[79 FR 5247, Jan. 31, 2014, as amended at 86 FR 28250, May 26, 2021]

### **§ 741.220 Privacy of consumer financial information.**

Any credit union which is insured pursuant to title II of the Act must adhere to the requirements stated in part 1016 of this title (Regulation P).

[65 FR 31750, May 18, 2000, as amended at 78 FR 32545, May 31, 2013]

### **§ 741.221 Suretyship and guaranty requirements.**

Any credit union, which is insured pursuant to title II of the Act, must adhere to the requirements in § 701.20 of this chapter. State-chartered, NCUSIF-insured credit unions may only enter into suretyship and guaranty agreements to the extent authorized under state law.

[69 FR 8548, Feb. 25, 2004]

### **§ 741.222 Credit union service organizations.**

- (a) Any credit union that is insured pursuant to Title II of the Act must adhere to the requirements in §§ 712.2(d)(2)(ii), 712.3(d), 712.4 and 712.11(b) and (c) of this chapter concerning permissible investment limits for less than adequately capitalized credit unions, agreements between credit unions and their credit union service organizations (CUSOs), the requirement to maintain separate corporate identities, and investments and loans to CUSOs investing in other CUSOs. For purposes of this section, a CUSO is any entity in which a credit union has an ownership interest or to which a credit union has extended a loan, and that entity is engaged primarily in providing products or services to credit unions or credit union members, or, in the case of checking and currency services, including cashing checks and money orders for a fee, and selling negotiable checks, including travelers checks, money orders, and other similar money transfer instruments (including international and domestic electronic fund transfers and remittance transfers, as defined in section 919 of the Electronic Fund Transfer Act, 15 U.S.C. 1693o-1), to persons eligible for membership in any credit union having a loan, investment or contract with the entity. A CUSO also includes any entity in which a CUSO has an ownership interest of any amount, if that entity is engaged primarily in providing products or services to credit unions or credit union members.
- (b) This section shall have no preemptive effect with respect to the laws or rules of any state providing for access to CUSO books and records or CUSO examination by credit union regulatory authorities.

[78 FR 72550, Dec. 3, 2013]

### **§ 741.223 Registration of residential mortgage loan originators.**

Any credit union which is insured pursuant to title II of the Act must adhere to the requirements stated in part 1007 of this title (Regulation G).

[75 FR 44704, July 28, 2010, as amended at 78 FR 32545, May 31, 2013]

### **§ 741.224 Golden parachute and indemnification payments.**

Any credit union insured pursuant to title II of the Act must adhere to the requirements stated in part 750 of this chapter.

[76 FR 30517, May 26, 2011]



### **§ 741.225 Loan participations.**

Any credit union that is insured pursuant to Title II of the Act must adhere to the requirements stated in § 701.22 of this chapter, except that federally insured state-chartered credit unions are exempt from the requirement in § 701.22(b)(4).

[78 FR 37958, June 25, 2013]

### **§ 741.226 Subordinated Debt.**

Any credit union that is insured, or that makes application for insurance, pursuant to title II of the Act must follow the requirements of subpart D of part 702 of this chapter before it may issue Subordinated Debt, as that term is defined in § 702.402 of this chapter, and to the extent not inconsistent with applicable state law and regulation.

[86 FR 11085, Feb. 23, 2021]

### **§ 741.227 Loans to credit unions.**

Any credit union that is insured pursuant to Title II of the Act must adhere to the requirements in § 701.25 of this chapter.

[86 FR 11085, Feb. 23, 2021]

## **Appendix A to Part 741 - Guidance for an Interest Rate Risk Policy and an Effective Program**

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## I. Introduction

This appendix provides guidance to FICUs in developing an interest rate risk (IRR) policy and program that addresses aspects of asset liability management in a single framework. An effective IRR management program identifies, measures, monitors, and controls IRR and is central to safe and sound credit union operations. Given the differences among credit unions, each credit union should use the guidance in this appendix to formulate a policy that embodies its own practices, metrics and benchmarks appropriate to its operations.

These practices should be established in light of the nature of the credit union's operations and business, as well as its complexity, risk exposure, and size. As these elements increase, NCUA believes the IRR practices should be implemented with increasing degrees of rigor and diligence to maintain safe and sound operations in the area of IRR management. In particular, rigor and diligence are required to manage complexity and risk exposure. Complexity relates to the intricacy of financial instrument structure, and to the composition of assets and liabilities on the balance sheet. In the case of financial instruments, the structure can have numerous characteristics that act simultaneously to affect the behavior of the instrument. In the case of the balance sheet, which contains multiple instruments, assets and liabilities can act in ways that are compounding or can be offsetting because their impact on the IRR level may act in the same or opposite directions. High degrees of risk exposure require a credit union to be diligently aware of the potential earnings and net worth exposures under various interest rate and business environments because the margin for error is low.

### A. Complexity

In influencing the behavior of instruments and balance sheet composition, complexity is a function of the predictability of the cash flows. As cash flows become less predictable, the uncertainty of both instrument and balance sheet behavior increases. For example, a residential mortgage is subject to prepayments that will change at the option of the borrower. Mortgage borrowers may pay off their mortgage loans due to geographical relocation, or may increase the amount of their monthly payment above the minimum contractual schedule due to other changes in the borrower's circumstances. This cash flow unpredictability is also found in investments, such as collateralized mortgage obligations, because these contain mortgage loans. Additionally, cash flow unpredictability affects liabilities. For example, nonmaturity share balances vary at the discretion of the depositor making deposits and withdrawals, and this may be influenced by a credit union's pricing of its share accounts.

### B. IRR Exposure

Exposure to IRR is the vulnerability of a credit union's financial condition to adverse movements in market interest rates. Although some IRR exposure is a normal part of financial intermediation, a high degree of this exposure may negatively affect a credit union's earnings and net economic value. Changes in interest rates influence a credit union's earnings by altering interest-sensitive income and expenses (e.g. loan income and share dividends). Changes in interest rates also affect the economic value of a credit union's assets and liabilities, because the present value of future cash flows and, in some cases, the cash flows themselves may change when interest rates change. Consequently, the management of a credit union's pricing strategy is critical to the control of IRR exposure.

All FICUs required to have an IRR policy and program should incorporate the following five elements into their IRR program:

1. Board-approved IRR policy.
2. Oversight by the board of directors and implementation by management.
3. Risk measurement systems assessing the IRR sensitivity of earnings and/or asset and liability values.
4. Internal controls to monitor adherence to IRR limits.
5. Decision making that is informed and guided by IRR measures.

## II. IRR Policy

The board of directors is responsible for ensuring the adequacy of an IRR policy and its limits. The policy should be consistent with the credit union's business strategies and should reflect the board's risk tolerance, taking into account the credit union's financial condition and risk measurement systems and methods commensurate with the balance sheet structure. The policy should state actions and authorities required for exceptions to policy, limits, and authorizations.

Credit unions have the option of either creating a separate IRR policy or incorporating it into investment, ALM, funds management, liquidity or other policies. Regardless of form, credit unions must clearly document their IRR policy in writing.

The scope of the policy will vary depending on the complexity of the credit union's balance sheet. For example, a credit union that offers short-term loans, invests in non-complex or short-term bullet investments (*i.e.* a debt security that returns 100 percent of principal on the maturity date), and offers basic share products may not need to create an elaborate policy. The policy for these credit unions may limit the loan portfolio maturity, require a minimum amount of short-term funds, and restrict the types of permissible investments (*e.g.* Treasuries, bullet investments). More complex balance sheets, especially those containing mortgage loans and complex investments, may warrant a comprehensive IRR policy due to the uncertainty of cash flows.

The policy should establish responsibilities and procedures for identifying, measuring, monitoring, controlling, and reporting IRR, and establish risk limits. A written policy should:

- Identify committees, persons or other parties responsible for review of the credit union's IRR exposure;
- Direct appropriate actions to ensure management takes steps to manage IRR so that IRR exposures are identified, measured, monitored, and controlled;
- State the frequency with which management will report on measurement results to the board to ensure routine review of information that is timely (*e.g.* current and at least quarterly) and in sufficient detail to assess the credit union's IRR profile;
- Set risk limits for IRR exposures based on selected measures (*e.g.* limits for changes in repricing or duration gaps, income simulation, asset valuation, or net economic value);
- Choose tests, such as interest rate shocks, that the credit union will perform using the selected measures;

- Provide for periodic review of material changes in IRR exposures and compliance with board approved policy and risk limits;
- Provide for assessment of the IRR impact of any new business activities prior to implementation (e.g. evaluate the IRR profile of introducing a new product or service); and
- Provide for at least an annual evaluation of policy to determine whether it is still commensurate with the size, complexity, and risk profile of the credit union.

IRR policy limits should maintain risk exposures within prudent levels. Examples of limits are as follows:

**GAP:** less than  $\pm 10$  percent change in any given period, or cumulatively over 12 months.

**Income Simulation:** net interest income after shock change less than 20 percent over any 12-month period.

**Asset Valuation:** after shock change in book value of net worth less than 50 percent, or after shock net worth of 4 percent or greater.

**Net Economic Value:** after shock change in net economic value less than 25 percent, or after shock net economic value of 6 percent or greater.

NCUA emphasizes these are only for illustrative purposes, and management should establish its own limits that are reasonably supported. Where appropriate, management may also set IRR limits for individual portfolios, activities, and lines of business.

### III. IRR Oversight and Management

#### A. Board of Directors Oversight

The board of directors is responsible for oversight of their credit union and for approving policy, major strategies, and prudent limits regarding IRR. To meet this responsibility, understanding the level and nature of IRR taken by the credit union is essential. Accordingly, the board should ensure management executes an effective IRR program.

Additionally, the board should annually assess if the IRR program sufficiently identifies, measures, monitors, and controls the IRR exposure of the credit union. Where necessary, the board may consider obtaining professional advice and training to enhance its understanding of IRR oversight.

#### B. Management Responsibilities

Management is responsible for the daily management of activities and operations. In order to implement the board's IRR policy, management should:

- Develop and maintain adequate IRR measurement systems;
- Evaluate and understand IRR risk exposures;
- Establish an appropriate system of internal controls (e.g. separation between the risk taker and IRR measurement staff);

- Allocate sufficient resources for an effective IRR program. For example, a complex credit union with an elevated IRR risk profile will likely necessitate a greater allocation of resources to identify and focus on IRR exposures;
- Develop and support competent staff with technical expertise commensurate with the IRR program;
- Identify the procedures and assumptions involved in implementing the IRR measurement systems; and
- Establish clear lines of authority and responsibility for managing IRR; and
- Provide a sufficient set of reports to ensure compliance with board approved policies.

Where delegation of management authority by the board occurs, this may be to designated committees such as an asset liability committee or other equivalent. In credit unions with limited staff, these responsibilities may reside with the board or management. Significant changes in assumptions, measurement methods, tests performed, or other aspects involved in the IRR process should be documented and brought to the attention of those responsible.

## IV. IRR Measurement and Monitoring

### A. Risk Measurement Systems

Generally, credit unions should have IRR measurement systems that capture and measure all material and identified sources of IRR. An IRR measurement system quantifies the risk contained in the credit union's balance sheet and integrates the important sources of IRR faced by a credit union in order to facilitate management of its risk exposures. The selection and assessment of appropriate IRR measurement systems is the responsibility of credit union boards and management.

Management should:

- Rely on assumptions that are reasonable and supportable;
- Document any changes to assumptions based on observed information;
- Monitor positions with uncertain maturities, rates and cash flows, such as nonmaturity shares, fixed rate mortgages where prepayments may vary, adjustable rate mortgages, and instruments with embedded options, such as calls; and
- Require any interest rate risk calculation techniques, measures and tests to be sufficiently rigorous to capture risk.

### B. Risk Measurement Methods

The following discussion is intended only as a general guide and should not be used by credit unions as an endorsement of a particular method. An IRR measurement system may rely on a variety of different methods. Common examples of methods available to credit unions are GAP analysis, income simulation, asset valuation, and net economic value. Any measurement method(s) used by a credit union to analyze IRR exposure should correspond with the complexity of the credit union's balance sheet so as to identify any material sources of IRR.

## GAP Analysis

GAP analysis is a simple IRR measurement method that reports the mismatch between rate sensitive assets and rate sensitive liabilities over a given time period. GAP can only suffice for simple balance sheets that primarily consist of short-term bullet type investments and non mortgage-related assets. GAP analysis can be static, behavioral, or based on duration.

## Income Simulation

Income simulation is an IRR measurement method used to estimate earnings exposure to changes in interest rates. An income simulation analysis projects interest cash flows of all assets, liabilities, and off-balance sheet instruments in a credit union's portfolio to estimate future net interest income over a chosen timeframe. Generally, income simulations focus on short-term time horizons (e.g. one to three years). Forecasting income is assumption sensitive and more uncertain the longer the forecast period. Simulations typically include evaluations under a base-case scenario, and instantaneous parallel rate shocks, and may include alternate interest-rate scenarios. The alternate rate scenarios may involve ramped changes in rates, twisting of the yield curve, and/or stressed rate environments devised by the user or provided by the vendor.

## NCUA Asset Valuation Tables

For credit unions lacking advanced IRR methods that seek simple valuation measures, the NCUA Asset Valuation Tables are available and prepared quarterly by the NCUA. These are available on the NCUA Web site through [www.ncua.gov](http://www.ncua.gov).

These measures provide an indication of a credit union's potential interest rate risk, based on the risk associated with the asset categories of greatest concern - (e.g., mortgage loans and investment securities).

The tables provide a simple measure of the potential devaluation of a credit union's mortgage loans and investment securities that occur during  $\pm 300$  basis point parallel rate shocks, and report the resulting impact on net worth.

## Net Economic Value (NEV)

NEV measures the effect of interest rates on the market value of net worth by calculating the present value of assets minus the present value of liabilities. This calculation measures the long-term IRR in a credit union's balance sheet at a fixed point in time. By capturing the impact of interest rate changes on the value of all future cash flows, NEV provides a comprehensive measurement of IRR. Generally, NEV computations demonstrate the economic value of net worth under current interest rates and shocked interest rate scenarios.

One NEV method is to discount cash flows by a single interest rate path. Credit unions with a significant exposure to assets or liabilities with embedded options should consider alternative measurement methods such as discounting along a yield curve (e.g. the U.S. Treasury curve, LIBOR

curve) or using multiple interest rate paths. Credit unions should apply and document appropriate methods, based on available data (e.g. utilizing observed market values), when valuing individual or groups of assets and liabilities.

## C. Components of IRR Measurement Methods

In the initial setup of IRR measurement, critical decisions are made regarding numerous variables in the method. These variables include but are not limited to the following.

### Chart of Accounts

Credit unions using an IRR measurement method should define a sufficient number of accounts to capture key IRR characteristics inherent within their product lines. For example, credit unions with significant holdings of adjustable-rate mortgages should differentiate balances by periodic and lifetime caps and floors, the reset frequency, and the rate index used for rate resets. Similarly, credit unions with significant holdings of fixed-rate mortgages should differentiate at least by original term, e.g., 30 or 15-year, and coupon level to reflect differences in prepayment behaviors.

### Aggregation of Data Input

As the credit union's complexity, risk exposure, and size increases, the degree of detail should be based on data that is increasingly disaggregated. Because imprecision in the measurement process can materially misstate risk levels, management should evaluate the potential loss of precision from any aggregation and simplification used in its measurement of IRR.

### Account Attributes

Account attributes define a product, including: Principal type, rate type, rate index, repricing interval, new volume maturity distribution, accounting accrual basis, prepayment driver, and discount rate.

### Assumptions

IRR measurement methods rely on assumptions made by management in order to identify IRR. The simplest example is of future interest rate scenarios. The management of IRR will require other assumptions such as: Projected balance sheet volumes; prepayment rates for loans and investment securities; repricing sensitivity, and decay rates of nonmaturity shares. Examples of these assumptions follow.

*Example 1.* Credit unions should consider evaluating the balance sheet under flat (*i.e.* static) and/or planned growth scenarios to capture IRR exposures. Under a flat scenario, runoff amounts are reinvested in their respective asset or liability account. Conducting planned growth scenarios allows management to assess the IRR impact of the projected change in volume and/or composition of the balance sheet.

*Example 2.* Loans and mortgage related securities contain prepayment options that enable the borrower to prepay the obligation prior to maturity. This prepayment option makes it difficult to project the value and earnings stream from these assets because the future outstanding principal balance at any given time is unknown. A number of factors affect prepayments, including the refinancing incentive, seasonality (the particular time of year), seasoning (the age of the loan), member mobility, curtailments (additional principal payments), and burnout (borrowers who don't respond to changes in the level of rates, and pay as scheduled). Prepayment speeds may be estimated or derived from numerous national or vendor data sources.

*Example 3.* In the process of IRR measurement, the credit union must estimate how each account will reprice in response to market rate fluctuations. For example, when rates rise 300 basis points, the credit union may raise its asset or liability rates in a like amount or not, and may choose to lag the timing of its pricing change.

*Example 4.* Nonmaturity shares include those accounts with no defined maturity such as share drafts, regular shares, and money market accounts. Measuring the IRR associated with these accounts is difficult because the risk measurement calculations require the user to define the principal cash flows and maturity. Credit unions may assume that there is no value when measuring the associated IRR and carry these values at book value or par. Many credit unions adopt this approach because it keeps the measurement method simple.

Alternatively, a credit union may attribute value to these shares (*i.e.* premium) on the basis that these shares tend to be lower cost funds that are core balances by virtue of being relatively insensitive to interest rates. This method generally results in nonmaturity shares priced/valued in a way that will produce an increased net economic value. Therefore, the underlying assumptions of the shares require scrutiny.

Credit unions that forecast share behavior and incorporate those assumptions into their risk identification and measurement process should perform sensitivity analysis.

## V. Internal Controls

Internal controls are an essential part of a safe and sound IRR program. If possible, separation of those responsible for the risk taking and risk measuring functions should occur at the credit union.

Staff responsible for maintaining controls should periodically assess the overall IRR program as well as compliance with policy. Internal audit staff would normally assume this role; however, if there is no internal auditor, management, or a supervisory committee that is independent of the IRR process, may perform this role. Where appropriate, management may also supplement the internal audit with outside expertise to assess the IRR program. This review should include policy compliance, timeliness, and accuracy of reports given to management and the board.



Audit findings should be reported to the board or supervisory committee with recommended corrective actions and timeframes. The individuals responsible for maintaining internal controls should periodically examine adherence to the policy related to the IRR program.

## **VI. Decision-Making Informed by IRR Measurement Systems**

Management should utilize the results of the credit union's IRR measurement systems in making operational decisions such as changing balance sheet structure, funding, pricing strategies, and business planning. This is particularly the case when measures show a high level of IRR or when measurement results approach board-approved limits.

NCUA recognizes each credit union has its own individual risk profile and tolerance levels. However, when measures of fair value indicate net worth is low, declining, or even negative, or income simulations indicate reduced earnings, management should be prepared to identify steps, if necessary, to bring risk within acceptable levels. In any case, management should understand and use their IRR measurement results, whether generated internally or externally, in the normal course of business. Management should also use the results proactively as a tool to adjust asset liability management for changes in interest rate environments.

## **VII. Guidelines for Adequacy of IRR Policy and Effectiveness of Program**

The following guidelines will assist credit unions in determining the adequacy of their IRR policy and the effectiveness of their program to manage IRR.

<b>Policy</b>	
Board oversight	Policy is consistent with credit union strategy and balance sheet complexity, clearly defines board risk tolerances through reasonable interest rate risk limits, and states actions required to address policy exceptions.
Responsible parties identified	A committee or individual(s) is designated as being responsible for IRR management activities, including review and monitoring of IRR.
Direct appropriate action to measure, monitor, control IRR	Policy states all actions that are sufficient to manage IRR, including measurement and monitoring methods, and interest rate risk reduction alternatives.
Reporting frequency specified	Reporting of results is required with sufficient frequency and detail to alert management to emerging IRR.
Risk limits stated with appropriate measures	Clearly defined risk limits are established and are appropriate for the size and complexity of the credit union.
Tests for limits	Tests substantially display the level and range of credit union IRR.
Review of material IRR changes	Any changes beyond a stated level are reported to management and, where appropriate, the Board.
Impact of new business	IRR impact of all business initiatives (new products, lines of business, pricing changes) is required where these will affect future IRR.
Periodic policy review	Review by Board required at least annually to ensure continued relevance and applicability of policy to management of IRR.
<b>IRR Oversight &amp; Management</b>	
Oversight	Board approves policy and strategies and understands IRR faced by its own credit union.
Oversight assessment of program effectiveness	Board periodically evaluates program effectiveness by monitoring management's IRR knowledge. Use of third-party professional advice is acceptable, but does not absolve the Board of its responsibility for informed and knowledgeable oversight and governance.
Choice of IRR measurement systems	Management selects and maintains systems that are able to capture the complexity of IRR risks. The systems used by the credit union must be able to capture IRR (e.g., balance sheet contains material options in investments, mortgage loans or core deposits - calls, prepayments, or administered rates).
Evaluation of IRR risk exposures	Credit union understands all material IRR exposures and evaluates these accordingly relative to credit union strategy. If management relies on outside parties to evaluate credit union's IRR, it must be able to explain the IRR measurement method or the results.
System of internal controls	Internal controls encompass and effectively evaluate programs that manage elements of IRR at the credit union. Internal audit has addressed the correction of IRR deficiencies (e.g. processes for tracking changes in measurement assumptions, such as repricing of core deposits).
IRR resource management	Credit union has allocated initial or additional qualified staff resources sufficient to properly measure and manage IRR by means that address sources of risk.
Expertise of IRR program staff	Staff responsible for IRR measurement and monitoring correctly identifies sources of IRR and can quantify these risks, and is knowledgeable about the operation and limitations of the IRR model, even if modeling is performed by a third party vendor.
Procedures and assumptions of IRR measurement systems	Credit union identifies reasonable procedures and is responsible for supportable assumptions, even if modeling is performed by a third party vendor.
Accountability of IRR management	Responsibility for managing IRR is specific and clearly delineated.
Transparency of changes in assumptions, methods and IRR tests.	Management requires clear disclosure of relevant changes in all material assumptions and methods.
<b>IRR Measurement and Monitoring</b>	
Reasonable and supportable assumptions	Credit union carefully evaluates all assumptions and assesses the sensitivity of results relative to each key assumption. Key assumptions should be demonstrated to be supportable (e.g. mortgage prepayments capture contraction and extension risk and core deposit premiums indicate reasonable maturities).

	(e.g. proper use of statistical correlations).
Positions with uncertain maturities, rates and cash flows	Activity is monitored on a regular basis and compared to projected behavior in order to validate reasonableness of modeling assumptions.
Rigor of interest rate measures and tests	Measures and tests employed capture the material risks embedded in the credit union's balance sheet (e.g., rate shocks trigger the embedded options in some products).
<b>Components of IRR Measurement Methods</b>	
Chart of accounts	A sufficient number of accounts have been defined to capture key IRR characteristics inherent within each product (e.g. 15- and 30-year fixed-rate mortgages are modeled separately in order to capture various coupons and prepayment behaviors).
Data aggregation	The level of data disaggregation is sufficient given the credit union's complexity and risk exposure (e.g. instrument level processing).
Account attributes	Account set-up is appropriate to allow for the capture of key IRR characteristics (e.g. adjustable-rate mortgages are modeled with periodic and lifetime caps and floors).
Discounting methodology	Methodology used properly calculates the value of the asset or liability being modeled (e.g., discount rates or maturities or cash flows are accurate and appropriate in discounting calculations).
Assumptions	Credit union carefully evaluates all assumptions and assesses the sensitivity of results relative to each key assumption (e.g. mortgage prepayments reflect contraction and extension risk and core deposit premiums indicate reasonable maturities).
<b>Internal Controls</b>	
Internal assessment of IRR program	Staff is identified and have annually assessed policy and program to correct any weaknesses.
Compliance with policy	IRR program is evaluated semi-annually for any policy exceptions, including compliance with approved limits.
Timeliness and accuracy of reports	Reports that are routinely provided to management and the Board successfully communicate material IRR exposure of the credit union.
Audit findings reported to board or supervisory committee	IRR program deficiencies and policy exceptions are reported to the Board in accordance with the policy.
<b>Decision-making and IRR</b>	
Use of IRR measurement results in operational decisions	Measured IRR results form part of the credit union's ongoing business decisions and are substantive considerations routinely included in the business decision process.
Escalated use of results when IRR exposure is raised or approaching limits	Procedure specifies review escalation at specific levels with increasing contingency triggers close to limits.
Application to reduce elevated levels of IRR	Credit union utilizes IRR results to clearly define and formulate response (balance sheet structure, funding or pricing strategies) to increased IRR levels.

NCUA acknowledges both the range of IRR exposures at credit unions, and the diverse means that they may use to accomplish an effective program to manage this risk. NCUA therefore does not stipulate specific quantitative standards or limits for the management of IRR applicable to all credit unions, and does not rely solely on the results of quantitative approaches to evaluate the effectiveness of IRR programs. Assumptions, measures and methods used by a credit union in light of its size, complexity and risk exposure determine the specific appropriate standard. However, NCUA strongly affirms the need for adequate practices for a program to effectively manage IRR. For example, policy limits on IRR exposure are not adequate if they allow a credit union to operate with an exposure that is unsafe or unsound, which

means that the credit union may suffer material losses under plausible adverse circumstances as a result of this exposure. Credit unions that do not have a written IRR policy or that do not have an effective IRR program are out of compliance with § 741.3 of NCUA's regulations.

## VIII. Additional Guidance for Large Credit Unions With Complex or High Risk Balance Sheets

FICUs with assets of \$500 million or greater must obtain an annual audit of their financial statements performed in accordance with generally accepted accounting standards. 12 CFR 715.5, 715.6, 741.202. For purposes of data collection, NCUA also uses \$500 million and above as its largest credit union asset range. In order to gather information and to monitor IRR exposure at larger credit unions as it relates to the share insurance fund, NCUA will use this as the criterion for definition of large credit unions for purposes of this section of the guidance. Given the increased exposure to the share insurance fund, NCUA encourages the responsible officials at large credit unions that are complex or high risk to fully understand all aspects of interest rate risk, including but not limited to the credit union's IRR assessment and potential directional changes in IRR exposures. For example, the credit union should consider the following:

- A policy which provides for the use of outside parties to validate the tests and limits commensurate with the risk exposure and complexity of the credit union;
- IRR measurement systems that report compliance with policy limits as shown both by risks to earnings and net economic value of equity under a variety of defined and reasonable interest rate scenarios;
- The effect of changes in assumptions on IRR exposure results (e.g. the impact of slower or faster prepayments on earnings and economic value); and,
- Enhanced levels of separation between risk taking and risk assessment (e.g. assignment of resources to separate the investments function from IRR measurement, and IRR monitoring and oversight).

## IX. Definitions

**Basis risk:** The risk to earnings and/or value due to a financial institution's holdings of multiple instruments, based on different indices that are imperfectly correlated.

**Interest rate risk:** The risk that changes in market rates will adversely affect a credit union's net economic value and/or earnings. Interest rate risk generally arises from a mismatch between the timing of cash flows from fixed rate instruments, and interest rate resets of variable rate instruments, on either side of the balance sheet. Thus, as interest rates change, earnings or net economic value may decline.

**Option risk:** The risk to earnings and/or value due to the effect on financial instruments of options associated with these instruments. Options are embedded when they are contractual within, or directly associated with, the instrument. An example of a contractual embedded option is a call option on an agency bond. An example of a behavioral embedded option is the right of a residential mortgage holder to vary prepayments on the mortgage through time, either by making additional premium payments, or by paying off the mortgage prior to maturity.

**Repricing risk:** The repricing of assets or liabilities following market changes can occur in different amounts and/or at different times. This risk can cause returns to vary.

**Spread risk:** The risk to earnings and/or value resulting from variations through time of the spread between assets or liabilities to an underlying index such as the Treasury curve.

**Yield curve risk:** The risk to earnings and/or value due to changes in the level or slope of underlying yield curves. Financial instruments can be sensitive to different points on the curve. This can cause returns to vary as yield curves change.

[77 FR 5162, Feb. 2, 2012, as amended at 77 FR 57990, Sept. 19, 2012. Redesignated at 83 FR 7964, Feb. 23, 2018]

## Appendix B to Part 741 - Loan Workouts, Nonaccrual Policy, and Regulatory Reporting of Troubled Debt Restructured Loans

This Appendix establishes requirements for the management of loan *workout*<sup>[1]</sup> arrangements, loan nonaccrual, and regulatory reporting of *troubled debt restructured loans* (herein after referred to as TDR or TDRs). This Appendix applies to all federally insured credit unions.

Under this Appendix, TDRs are as defined in *generally accepted accounting principles (GAAP)*, and the Board does not intend to change the Financial Accounting Standards Board's (FASB) definition of TDR in any way through this policy. In addition to existing agency policy, this Appendix sets the NCUA's supervisory expectations governing loan workout policies and practices and loan accruals.

### Written Loan Workout Policy and Monitoring Requirements<sup>[2]</sup>

For purposes of this Appendix, types of workout loans to borrowers in financial difficulties include *re-agings, extensions, deferrals, renewals, or rewrites*. See the Glossary entry on workouts for further descriptions of each term. Borrower retention programs or *new loans* are not encompassed within this policy nor considered by the Board to be workout loans.

A credit union can use loan workouts to help borrowers overcome temporary financial difficulties such as loss of job, medical emergency, or change in family circumstances such as the loss of a family member. Loan workout arrangements must consider and balance the best interests of both the borrower and the credit union.

The lack of a sound written policy on workouts can mask the true performance and *past due* status of the loan portfolio. Accordingly, the credit union board and management must adopt and adhere to an explicit written policy and standards that control the use of loan workouts, and establish controls to ensure the policy is consistently applied. The loan workout policy and practices should be commensurate with a credit union's size and complexity, and must conform with a credit union's broader risk mitigation strategies. The policy must define eligibility requirements (that is, under what conditions the credit union will consider a loan workout), including establishing limits on the number of times an individual loan may be modified.<sup>[3]</sup> The policy must also ensure credit unions make loan workout decisions based on a borrower's renewed willingness and ability to repay the loan. If a credit union restructures a loan more frequently than once a year or twice in five years, examiners will have higher expectations

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<sup>[1]</sup> Terms defined in the Glossary will be italicized on their first use in the body of this Appendix.

<sup>[2]</sup> For additional guidance on commercial and member business lending extension, deferral, renewal, and rewrite policies, see *Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts* (October 30, 2009) transmitted by Letter to Credit Unions No. 10-CU-07, and available at <http://www.ncua.gov>.

for the documentation of the borrower's renewed willingness and ability to repay the loan. The NCUA is concerned about restructuring activity that pushes existing losses into future reporting periods without improving a loan's collectability. One way a credit union can provide convincing evidence that multiple restructurings improve collectability is to validate completed multiple restructurings that substantiate the claim. Examiners will ask for such validation documentation if a credit union engages in multiple restructurings of a loan.

In addition, the policy must establish sound controls to ensure loan workout actions are appropriately structured.<sup>[4]</sup> The policy must explicitly prohibit the authorization of additional advances to finance credit union fees and commissions. The credit union may, however, make advances to cover third-party fees, such as force-placed insurance or property taxes. For loan workouts granted, a credit union must document the determination that the borrower is willing and able to repay the loan.

Modifications of loans that result in capitalization of unpaid interest are appropriate only when a borrower has the ability to repay the debt. At a minimum, if a FICU's loan modification policy permits capitalization of unpaid interest, the policy must require:

1. Compliance with all applicable federal and state consumer protection laws and regulations, including, but not limited to, the Equal Credit Opportunity Act, the Fair Housing Act, the Truth In Lending Act, the Real Estate Settlement Procedures Act, the Fair Credit Reporting Act, and the prohibitions against the use of unfair, deceptive or abusive acts or practices in the Consumer Financial Protection Act of 2010.
2. Documentation that reflects a borrower's ability to repay, a borrower's source(s) of repayment, and when appropriate, compliance with the FICU's valuation policies at the time the modification is approved.
3. Providing borrowers with written disclosures that are accurate, clear and conspicuous and that are consistent with Federal and state consumer protection laws.
4. Appropriate reporting of loan status for modified loans in accordance with applicable law and accounting practices. The FICU shall not report a modified loan as past due if the loan was current prior to modification and the borrower is complying with the terms of the modification.

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<sup>[3]</sup> Broad based credit union programs commonly used as a member benefit and implemented in a safe and sound manner limited to only accounts in good standing, such as Skip-a-Pay programs, are not intended to count toward these limits.

<sup>[4]</sup> In developing a written policy, the credit union board and management may wish to consider similar parameters as those established in the FFIEC's "Uniform Retail Credit Classification and Account Management Policy" (FFIEC Policy). 65 FR 36903 (June 12, 2000) (<https://www.govinfo.gov/content/pkg/FR-2000-06-12/pdf/00-14704.pdf>). The FFIEC Policy sets forth specific limitations on the number of times a loan can be re-aged (for open-end accounts) or extended, deferred, renewed or rewritten (for closed-end accounts). NCUA Letter to Credit Unions (LCU) 09-CU-19, "Evaluating Residential Real Estate Mortgage Loan Modification Programs," also outlines policy best practices for real estate modifications (<https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/evaluating-residential-real-estate-mortgage-loan-modification-programs>). Those best practices remain applicable to real estate loan modifications (with the exception to the capitalization of credit union fees) but could be adapted in part by the credit union in their written loan workout policy for other loans.

5. Prudent policies and procedures to help borrowers resume affordable and sustainable repayments that are appropriately structured, while at the same time minimizing losses to the credit union. The prudent policies and procedures must consider
  - i. Whether the loan modifications are well-designed, consistently applied, and provide a favorable outcome for borrowers.
  - ii. The available options for borrowers to repay any missed payments at the end of their modifications to avoid delinquencies or other adverse consequences.
6. Appropriate safety and soundness safeguards to prevent the following:
  - i. Masking deteriorations in loan portfolio quality and understating charge-off levels;<sup>[5]</sup>
  - ii. Delaying loss recognition resulting in an understated allowance for loan and lease losses account or inaccurate loan valuations;
  - iii. Overstating net income and net worth (regulatory capital) levels; and
  - iv. Circumventing internal controls.

The credit union's risk management framework must include thresholds, based on aggregate volume of loan workout activity, which trigger enhanced reporting to the board of directors. This reporting will enable the credit union's board of directors to evaluate the effectiveness of the credit union's loan workout program, understand any implications to the organization's financial condition, and make any compensating adjustments to the overall business strategy. This information will also be available to examiners upon request.

To be effective, management information systems need to track the principal reductions and *charge-off* history of loans in workout programs by type of program. Any decision to re-age, extend, defer, renew, or rewrite a loan, like any other revision to contractual terms, must be supported by the credit union's management information systems. Sound management information systems identify and document any loan that is re-aged, extended, deferred, renewed, or rewritten, including the frequency and extent of such action. Documentation normally shows that credit union personnel communicated with the borrower, the borrower agreed to pay the loan in full under any new terms, and the borrower has the ability to repay the loan under any new terms.

## Regulatory Reporting of Workout Loans Including TDR Past Due Status

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<sup>[5]</sup> Refer to NCUA guidance on charge-offs set forth in LCU 03-CU-01, "Loan Charge-off Guidance," dated January 2003 (<https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/loan-charge-guidance>). Examiners will require that a reasonable written charge-off policy is in place and that it is consistently applied. Additionally, credit unions need to adjust historical loss factors when calculating ALLL needs for pooled loans to account for any loans with protracted charge-off timeframes (for example, 12 months or more). See discussions on the latter point in the 2006 Interagency ALLL Policy Statement transmitted by Accounting Bulletin 06-1 (December 2006) (<https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/interagency-advisory-addressing-all-key-concepts-and-requirements>). Upon implementation of ASC 326 - Financial Instruments - Credit Losses, credit unions will use the guidance in Interagency Policy Statement on Allowances for Credit Losses (May 2020) (<https://www.ncua.gov/files/press-releases-news/policy-statement-allowances-credit-losses.pdf>).

Credit unions will calculate the past due status of all loans consistent with loan contract terms, including amendments made to loan terms through a formal restructure. Credit unions will report delinquency on the Call Report consistent with this policy.<sup>[6]</sup>

## Loan Nonaccrual Policy

Credit unions must recognize interest income appropriately. Credit unions must place loans in nonaccrual status when doubt exists as to full collection of principal and interest or the loan has been in default for a period of 90 days or more. Upon placing a loan in nonaccrual, a credit union must reverse or charge-off previously accrued but uncollected interest. A nonaccrual loan may be returned to accrual status when a credit union expects repayment of the remaining contractual principal and interest or it is well secured and in process of collection.<sup>[7]</sup> This policy on loan accrual is consistent with longstanding credit union industry practice as implemented by the NCUA over the last several decades. The balance of the policy relates to *commercial* and *member business loan* workouts and is similar to the policies adopted by the federal banking agencies<sup>[8]</sup> as set forth in the FFIEC Call Report for banking institutions and its instructions.<sup>[9]</sup>

## Nonaccrual Status

Credit unions may not accrue interest<sup>[10]</sup> on any loan where principal or interest has been in default for a period of 90 days or more unless the loan is both “*well secured*” and “*in the process of collection*.”<sup>[11]</sup> For purposes of applying the “well secured” and “in process of collection” test for nonaccrual status listed above, the date on which a loan reaches nonaccrual status is determined by its contractual terms.

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<sup>[6]</sup> Subsequent Call Reports and accompanying instructions will reflect this policy, including focusing data collection on loans meeting the definition of TDR under GAAP. In reporting TDRs on regulatory reports, the data collections will include all TDRs that meet the GAAP criteria for TDR reporting, without the application of materiality threshold exclusions based on scoping or reporting policy elections of credit union preparers or their auditors. Credit unions should also refer to ASC Subtopic 310-40 when determining if a restructuring of a debt constitutes a TDR.

<sup>[9]</sup> FFIEC Report of Condition and Income Forms, Instructions and Supplemental Instructions, <https://www.ffiec.gov/forms041.htm>.

<sup>[8]</sup> The federal banking agencies are the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency.

<sup>[7]</sup> Placing a loan in nonaccrual status does not change the loan agreement or the obligations between the borrower and the credit union. Only the parties can effect a restructuring of the original loan terms or otherwise settle the debt.



While a loan is in nonaccrual status, a credit union may treat some or all of the cash payments received as interest income on a cash basis provided no doubt exists about the collectability of the remaining *recorded investment in the loan*. A credit union must handle the reversal of previously accrued, but uncollected, interest applicable to any loan placed in nonaccrual status in accordance with GAAP.<sup>[12]</sup>

## Restoration to Accrual Status for All Loans Except Commercial and Member Business Loan Workouts

A nonaccrual loan may be restored to accrual status when:

- Its past due status is less than 90 days and the credit union expects repayment of the remaining contractual principal and interest within a reasonable period;
- It otherwise becomes both *well secured* and *in the process of collection*; or
- The asset is a purchased impaired loan and it meets the criteria under GAAP for accrual of interest income under the accretable yield method. See ASC 310-30.

In restoring all loans to accrual status, if the credit union applied any interest payments received while the loan was in nonaccrual status to reduce the recorded investment in the loan, the credit union must not reverse the application of these payments to the loan's recorded investment (and must not credit interest income). Likewise, a credit union cannot restore the accrued but uncollected interest reversed or charged-off at the point the loan was placed on nonaccrual status to accrual; it can only be recognized as income if collected in cash or cash equivalents from the member.

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<sup>[11]</sup> A purchased credit impaired loan asset need not be placed in nonaccrual status as long as the criteria for accrual of income under the interest method in GAAP is met. Also, the accrual of interest on workout loans is covered in a later section of this Appendix.

<sup>[10]</sup> Nonaccrual of interest also includes the amortization of deferred net loan fees or costs, or the accretion of discount. Nonaccrual of interest on loans past due 90 days or more is a longstanding agency policy and credit union practice.

<sup>[12]</sup> Acceptable accounting treatment includes a reversal of all previously accrued, but uncollected, interest applicable to loans placed in a nonaccrual status against appropriate income and balance sheet accounts. For example, one acceptable method of accounting for such uncollected interest on a loan placed in nonaccrual status is to reverse all of the unpaid interest by crediting the "accrued interest receivable" account on the balance sheet; to reverse the uncollected interest that has been accrued during the calendar year-to-date by debiting the appropriate "interest and fee income on loans" account on the income statement, and to reverse any uncollected interest that had been accrued during previous calendar years by debiting the "allowance for loan and lease losses" account on the balance sheet. The use of this method presumes that credit union management's additions to the allowance through charges to the "provision for loan and lease losses" on the income statement have been based on an evaluation of the collectability of the loan and lease portfolios and the "accrued interest receivable" account.

## Restoration to Accrual Status on Commercial and Member Business Loan Workouts<sup>[13]</sup>

A formally restructured commercial or member business loan workout need not be maintained in nonaccrual status, provided the restructuring and any charge-off taken on the loan are supported by a current, well-documented credit evaluation of the borrower's financial condition and prospects for repayment under the revised terms. Otherwise, the restructured loan must remain in nonaccrual status.

The credit union's evaluation must include consideration of the borrower's sustained historical repayment performance for a reasonable period prior to the date on which the loan is returned to accrual status. A sustained period of repayment performance is a minimum of six consecutive payments, and includes timely payments under the restructured loan's terms of principal and interest in cash or cash equivalents. In returning the commercial or member business workout loan to accrual status, a credit union may consider sustained historical repayment performance for a reasonable time prior to the restructuring. Such a restructuring must improve the collectability of the loan in accordance with a reasonable repayment schedule and does not relieve the credit union from the responsibility to promptly charge off all identified losses.

The following graph provides an example of a schedule of repayment performance to demonstrate a determination of six consecutive payments. If the original loan terms required a monthly payment of \$1,500, and the credit union lowered the borrower's payment to \$1,000 through formal commercial or member business loan restructure, then based on the first row of the graph, the "*sustained historical repayment performance for a reasonable time prior to the restructuring*" would encompass five of the pre-workout consecutive payments that were at least \$1,000 (months 1 through 5). In total, the six consecutive repayment burden would be met by the first month post workout (month 6).

In the second row, only one of the pre-workout payments would count toward the six consecutive repayment requirement (month 5), because it is the first month in which the borrower made a payment of at least \$1,000 after failing to pay at least that amount. Therefore, the loan would remain on nonaccrual for at least five post-workout consecutive payments (months 6 through 10) provided the borrower continues to make payments consistent with the restructured terms.

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<sup>[13]</sup> This policy is derived from the "Interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts" the NCUA and the other financial regulators issued on October 30, 2009.

Pre-workout					Post-workout				
Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10
\$1,500	\$1,200	\$1,200	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000
1,500	1,200	900	875	1,000	1,000	1,000	1,000	1,000	1,000

After a formal restructure of a commercial or member business loan, if the restructured loan has been returned to accrual status, the loan otherwise remains subject to the nonaccrual standards of this policy. If any interest payments received while the commercial or member business loan was in nonaccrual status were applied to reduce the recorded investment in the loan the application of these payments to the loan's recorded investment must not be reversed (and interest income must not be credited). Likewise, accrued but uncollected interest reversed or charged-off at the point the commercial or member business workout loan was placed on nonaccrual status cannot be restored to accrual; it can only be recognized as income if collected in cash or cash equivalents from the member.

The following tables summarize nonaccrual and restoration to accrual requirements previously discussed:

Table 1 - Nonaccrual Criteria

Action	Condition identified	Additional consideration
Nonaccrual on All Loans	90 days or more past due unless loan is both well-secured and in the process of collection; or The loan is maintained on the Cash basis because there is a deterioration in the financial condition of the borrower, or for which payment in full of principal or interest is not expected.	See Glossary definitions for "well secured" and "in the process of collection."
Nonaccrual on Commercial or Member Business Loan Workouts	Continue on nonaccrual at workout point and until restore to accrual criteria are met.	See Table 2 - Restore to Accrual.

Table 2 - Restore to Accrual

Action	Condition identified	Additional consideration
Restore to Accrual on All Loans except Commercial or Member Business Loan Workouts	When a loan is less than 90 days past due and the credit union expects repayment of the remaining contractual principal and interest within a reasonable period, or When it otherwise becomes both "well secured" and "in the process of collection"; or The asset is a	See Glossary definitions for "well secured" and "in the process of collection." Interest payments received while the loan was in nonaccrual status and applied to reduce the recorded investment in the loan must not be reversed and income credited. Likewise, accrued but uncollected interest reversed or charged-off at the point the loan was placed on nonaccrual status cannot be restored to accrual.

Action	Condition identified	Additional consideration
	purchased impaired loan and it meets the criteria under GAAP (see ASC 310-30) for accrual of interest income under the accretable yield method.	
Restore to Accrual on Commercial or Member Business Loan Workouts	Formal restructure with a current, well documented credit evaluation of the borrower's financial condition and prospects for repayment under the revised terms.	The evaluation must include consideration of the borrower's sustained historical repayment performance for a minimum of six timely consecutive payments comprised of principal and interest. In returning a loan to accrual status, a credit union may take into account sustained historical repayment performance for a reasonable time prior to the restructured terms. Interest payments received while the commercial or member business loan was in nonaccrual status and applied to reduce the recorded investment in the loan must not be reversed and income credited. Accrued but uncollected interest reversed or charged-off at the point the commercial or member business loan was placed on nonaccrual status cannot be restored to accrual.

## Glossary<sup>14</sup>

**“Capitalization of Interest”** constitutes the addition of accrued but unpaid interest to the principal balance of a loan.

**“Cash Basis”** method of income recognition is set forth in GAAP and means while a loan is in nonaccrual status, some or all of the cash interest payments received may be treated as interest income on a cash basis provided no doubt exists about the collectability of the remaining recorded investment in the loan.<sup>[15]</sup>

**“Charge-off”** means a direct reduction (credit) to the carrying amount of a loan carried at amortized cost resulting from uncollectability with a corresponding reduction (debit) of the ALLL. Recoveries of loans previously charged off must be recorded when received.

**“Commercial Loan”** is defined consistent with Section 723.2 of the NCUA's MEMBER BUSINESS LOANS; COMMERCIAL LENDING Rule, 12 CFR 723.2.

<sup>[15]</sup> Acceptable accounting practices include allocating contractual interest payments among interest income, reduction of the recorded investment in the asset, and recovery of prior charge-offs. If this method is used, the amount of income that is recognized would be equal to that which would have been accrued on the loan's remaining recorded investment at the contractual rate; and, accounting for the contractual interest in its entirety either as income, reduction of the recorded investment in the asset, or recovery of prior charge-offs, depending on the condition of the asset, consistent with its accounting policies for other financial reporting purposes.

*"Generally accepted accounting principles (GAAP)"* means official pronouncements of the FASB as memorialized in the FASB Accounting Standards Codification® as the source of authoritative principles and standards recognized to be applied in the preparation of financial statements by federally insured credit unions in the United States with assets of \$10 million or more.

*"In the process of collection"* means collection of the loan is proceeding in due course either:

- (1) Through legal action, including judgment enforcement procedures, or
- (2) In appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to a current status in the near future, *i.e.*, generally within the next 90 days.

*"Member Business Loan"* is defined consistent with § 723.8 of the NCUA's MEMBER BUSINESS LOANS; COMMERCIAL LENDING Rule, 12 CFR 723.8.

*"New Loan"* means the terms of the revised loan are at least as favorable to the credit union (*i.e.*, terms are market-based, and profit driven) as the terms for comparable loans to other customers with similar collection risks who are not refinancing or restructuring a loan with the credit union, and the revisions to the original debt are more than minor.

*"Past Due"* means a loan is determined to be delinquent in relation to its contractual repayment terms including formal restructures, and must consider the time value of money. Credit unions may use the following method to recognize partial payments on "consumer credit," *i.e.*, credit extended to individuals for household, family, and other personal expenditures, including credit cards, and loans to individuals secured by their personal residence, including home equity and home improvement loans. A payment equivalent to 90 percent or more of the contractual payment may be considered a full payment in computing past due status.

*"Recorded Investment in a Loan"* means the loan balance adjusted for any unamortized premium or discount and unamortized loan fees or costs, less any amount previously charged off, plus recorded accrued interest.

*"Troubled Debt Restructuring"* is as defined in GAAP and means a restructuring in which a credit union, for economic or legal reasons related to a member borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider.<sup>[16]</sup> The restructuring of a loan may include, but is not necessarily limited to:

- (1) The transfer from the borrower to the credit union of real estate, receivables from third parties, other assets, or an equity interest in the borrower in full or partial satisfaction of the loan,
- (2) A modification of the loan terms, such as a reduction of the stated interest rate, principal, or accrued interest or an extension of the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk, or
- (3) A combination of the above.

A loan extended or renewed at a stated interest rate equal to the current market interest rate for new debt with similar risk is not to be reported as a restructured troubled loan.

*"Well secured"* means the loan is collateralized by:

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<sup>[16]</sup> FASB ASC 310-40, "Troubled Debt Restructuring by Creditors."

- (1) A perfected security interest in, or pledges of, real or personal property, including securities with an estimable value, less cost to sell, sufficient to recover the recorded investment in the loan, as well as a reasonable return on that amount, or
- (2) by the guarantee of a financially responsible party.

**“Workout Loan”** means a loan to a borrower in financial difficulty that has been formally restructured so as to be reasonably assured of repayment (of principal and interest) and of performance according to its restructured terms. A workout loan typically involves a *re-aging, extension, deferral, renewal, or rewrite* of a loan.<sup>[17]</sup> For purposes of this policy statement, workouts do not include loans made to market rates and terms such as refinances, borrower retention actions, or new loans.<sup>[18]</sup>

**“Extension”** means extending monthly payments on a closed-end loan and rolling back the maturity by the number of months extended. The account is shown current upon granting the extension. If extension fees are assessed, they must be collected at the time of the extension and not added to the balance of the loan.

**“Deferral”** means deferring a contractually due payment on a closed-end loan without affecting the other terms, including maturity, of the loan. The account is shown current upon granting the deferral.

**“Renewal”** means underwriting a matured, closed-end loan generally at its outstanding principal amount and on similar terms.

**“Rewrite”** means significantly changing the terms of an existing loan, including payment amounts, interest rates, amortization schedules, or its final maturity.

[86 FR 34617, June 30, 2021]

<sup>[14]</sup> Terms defined in the Glossary will be italicized on their first use in the body of this guidance.

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<sup>[18]</sup> There may be instances where a workout loan is not a TDR even though the borrower is experiencing financial hardship. For example, a workout loan would not be a TDR if the fair value of cash or other assets accepted by a credit union from a borrower in full satisfaction of its receivable is at least equal to the credit union's recorded investment in the loan, e.g., due to charge-offs.

<sup>[17]</sup> **“Re-Age”** means returning a past due account to current status without collecting the total amount of principal, interest, and fees that are contractually due.