

# Office of Examination & Insurance Report

## REGULATORY FLEXIBILITY PROGRAM CHANGES EXPLAINED

Late last year, NCUA revised provisions of its Regulatory Flexibility (RegFlex) program rules (Part 742). RegFlex exempts credit unions with strong CAMEL and net worth levels from certain regulatory restrictions. NCUA reevaluated the 10 areas of regulatory relief established under RegFlex in 2002 and amended four of the areas for safety and soundness reasons.

Two of the changes have generated much interest—those related to the fixed-asset limit and the member business loan (MBL) personal guarantee. The rule changes also affected discretionary control of assets and the stress testing of assets.

### Fixed-Asset Waivers

Previously, NCUA's RegFlex rule exempted RegFlex-eligible credit unions from limits on the amount a federal credit union with more than \$1 million in assets may invest in fixed assets. Now, credit unions must seek a waiver for asset acquisitions exceeding 5 percent of shares and retained earnings.

#### **What if a credit union acquired assets exceeding the cap before the change to RegFlex?**

A credit union that had already exceeded the 5 percent limit by Nov. 29, 2010, is grandfathered at that limit. However, as the credit union's level of fixed assets subsequently declines, so will the level at which it is grandfathered. New acquisitions of fixed assets will require a waiver. The credit union does not need to seek a waiver for the existing assets, but must seek a waiver for any new acquisitions.

#### **How can a credit union with a fixed-asset level above 5 percent avoid having to request multiple waivers to replace and repair plant and equipment?**

A credit union can seek a waiver that includes a reasonable annual operating range for necessary plant and equipment. Subsequent fixed-asset acquisitions require a waiver request only if the new fixed-asset level exceeds any predetermined operating level approved by the Regional Director.

### Personal Guarantees for MBLs

There is no longer an exemption for RegFlex credit unions from the requirement that MBLs be secured by the personal liability and guarantee of the principals. Credit unions, however, can seek a waiver of the guarantee requirement.

#### **What if a RegFlex credit union already had MBLs without the personal liability and guarantee of the principals?**

MBLs granted by RegFlex credit unions without the personal liability and guarantee of principals before the effective date of this rule change are grandfathered. However, MBLs granted subsequent to the effective date of this rule change must comply. Credit unions must also require a personal

guarantee if a grandfathered loan is modified or refinanced, unless the Regional Director grants a waiver.

**What is NCUA doing to improve the MBL waiver process?** Regional Directors have discretionary authority to approve blanket waivers that allow a credit union to underwrite MBLs without the personal guarantee of the principals.

#### **Who should provide the personal guarantee for MBLs granted to cooperatives?**

The structure of each cooperative and existing state law will dictate who is considered the principal. The blanket waiver process will allow well-run credit unions to continue serving cooperatives.

### Discretionary Control of Investments

As a result of the rule change, RegFlex credit unions no longer have an exemption from the limit on the amount of investments for which discretionary control can be delegated: 100 percent of net worth. Investments purchased by RegFlex credit unions prior to the effective date of this rule change are grandfathered.

### Stress Testing of Investments

The RegFlex rule change also removed an exemption for eligible credit unions from the requirement to stress test securities meeting certain characteristics to assess the impact of an extreme shift in interest rates. Call Report data show that credit unions are investing in longer-term instruments to improve yield. Though this practice improves yield today, an increase in market rates may result in a significant decrease in value and could have severe liquidity implications. Stress testing of investments is an important part of safe-and-sound asset liability management practices.

**What if a credit union already had securities in excess of net worth that meet the characteristics of NCUA's investment rule (Section 703.12(b)) on the effective date of this rule change?** Credit unions with securities in excess of net worth that meet required characteristics must begin monitoring monthly and stress testing such securities quarterly regardless of the date of purchase.

For more information about the RegFlex rule changes, credit unions may refer to the final rule available at [http://www.ncua.gov/Resources/RegulationsOpinionsLaws/final/75fr66295\[2010-27149\].pdf](http://www.ncua.gov/Resources/RegulationsOpinionsLaws/final/75fr66295[2010-27149].pdf). Credit unions can also contact NCUA examiners or regional offices for additional guidance. 