

# Chapter 17

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## PROMPT CORRECTIVE ACTION

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## Chapter 17 – Part 1

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### PROMPT CORRECTIVE ACTION

#### Examination Objectives

- Assess the calculation for the net worth ratio as mandated by Congress
- Determine whether the credit union meets the definition of complex and must adhere to the applicable risk-based net worth (RBNW) requirement
- Determine whether mandatory supervisory actions (MSAs) apply to the credit union
- Determine whether discretionary supervisory actions (DSAs) apply to the credit union
- Assess whether the Net Worth Restoration Plan (NWRP) or, for new credit unions, the Revised Business Plan, meets the requirements of the statute and provides sufficient measures for the credit union to achieve and maintain a minimum six percent net worth ratio
- Determine the criteria for mandatory and discretionary conservatorships and liquidations

#### Associated Risks

- Reputation risk may occur when PCA efforts are not successful and the credit union fails.

#### Overview

(Please note that at the time of this writing, the NCUA Board was considering revisions and adjustments to Part 702, Prompt Corrective Action. This chapter does not reflect any proposed changes. Therefore, users should also consult the latest version of Part 702 when relying on this chapter as a guide to implementation of PCA.)

The *Credit Union Membership Access Act* (CUMAA) amended the *Federal Credit Union Act* to mandate a system of net-worth based capital standards for federally insured credit unions (FICUs.) This amendment to the *FCU Act* required the NCUA Board to (1) adopt, by regulation, a system of PCA to restore the net worth of inadequately capitalized FICUs; and (2) develop an alternative system of PCA for new credit unions that carries out the purpose of PCA while allowing reasonable time to build net worth to an adequate level. PCA does not limit NCUA's authority to take additional supervisory action. The

NCUA Board often delegates specific authority to the regional directors (*FCU Act §216, NCUA Rules and Regulations §702.201, §702.202-§702.204, §702.303-§703.305, and §741.3.*)

Part 702 of the *NCUA Rules and Regulations* establishes the components and requirements of PCA. As a credit union's net worth ratio continues to decline, the actions required of the credit union to restore its net worth ratio to an acceptable level become progressively more stringent. Subpart B addresses requirements for credit unions that do not meet the definition of new; while Subpart C addresses requirements for credit unions defined as new. The three main components of PCA include:

- A framework combining:
  - MSAs prescribed by Congress and indexed to five statutory net worth categories, and
  - DSAs developed by NCUA to enhance PCA when imposed;
- Alternative PCA requirements for credit unions defined by CUMAA as new; and
- RBNW requirement for credit unions that NCUA defines as complex.

## **Definitions**

PCA definitions for some terms may differ from their definitions for other purposes. The following definitions also apply to new credit unions unless otherwise specified:

- **Complex and applicable RBNW requirement.** For purposes of §702.102, a credit union is defined as complex and a RBNW requirement applies only if the credit union meets both of the following criteria as reflected in its most recent call report:
  - Minimum asset size - its quarter-end total assets exceed \$10 million; and
  - Minimum RBNW calculation - its risk-based net worth requirement as calculated under §702.106 exceeds 6 percent.

(Examiners should use the term “applicable RBNW requirement” rather than “complex.”)

- **Contribution.** Per generally accepted accounting principles (GAAP), a contribution consists of cash or other assets the credit union receives unconditionally. Under GAAP, credit unions report donations in the form of cash

or other assets (e.g., fixed assets) as contributions and recognize them as revenues of the period. The credit unions would close them from net income into undivided earnings. Thus, the credit union will include these amounts in net worth. However, any condition placed on the donation prohibits the credit union from accounting for it as a contribution, and conditional donations will not count as part of net worth.

- **Discretionary supervisory actions (DSAs.)** Those actions developed by NCUA to supplement MSAs, and described in more detail in this chapter (§702 Subparts B and C.) DSAs do not include Discretionary Conservatorship or Liquidation under §702.203(c) and §702.304(c.)
- **Mandatory supervisory actions (MSAs) for credit unions that do not meet the definition of new.** The following four Congressionally prescribed MSAs apply to undercapitalized credit unions with less than 6 percent net worth. The earnings transfer to regular reserves also applies to adequately capitalized credit unions with net worth ratios of 6 percent to less than 7 percent. MSAs consist of the following (§702 Subpart B):
  - Earnings transfer to regular reserves;
  - NWRP;
  - Restriction of asset growth; and
  - Restriction of member business loans.
- **Mandatory supervisory actions (MSAs) for credit unions that meet the definition of new.** The following MSAs, developed through NCUA regulation, apply to new credit unions (§702 Subpart C):
  - Earnings transfer to regular reserves;
  - Submission of a revised business plan; and
  - Restriction of member business loans.
- **NCUA examiner.** Any NCUA district examiner, economic development specialist, problem case officer, or AMAC staff member.
- **Net worth.** The retained earnings balance of the credit union at quarter end as determined under generally accepted accounting principles (GAAP) (§702.2(f)). Retained earnings consist of undivided earnings, regular reserves, and any other appropriations designated by management or regulatory authorities. This means that only undivided earnings and appropriations of undivided earnings are included in net worth. For low-income designated credit unions, net worth also includes secondary capital accounts that are uninsured and subordinate to all other claims, including claims of creditors, shareholders and the NCUSIF. Net worth does not include (1) the Allowance for Loan and Lease Losses account; (2) the Unrealized Gain/Loss on Available for Sale Securities; (3) contributions of tangible fixed assets recorded as Donated Equity, per regulatory accounting practice (RAP) that have not been closed into income, or any donations encumbered by conditions; or (4) alternative sources of capital (e.g., secondary capital and paid-in-capital accounts) except as noted above. See also the definition of Retained Earnings.
- **Net worth ratio.** The ratio of the net worth of the credit union (numerator) to the total assets of the credit union (denominator) described in more detail in this chapter (§702.2(g)).

- **Net Worth Restoration Plan (NWRP.)** Management's written plan detailing the steps the credit union will take to become adequately capitalized by the end of the plan's term, and remain so for four consecutive quarters. The credit union will submit the plan within the mandated time frames to the appropriate regional director and, if state-chartered, the appropriate state supervisory authority (SSA) (§702.206.) For PCA purposes, the regulation refers to a new credit union's equivalent of a NWRP as a revised business plan (§702.304(a)(2)).
- **New credit union.** A credit union that has been in operation for less than 10 years and has \$10 million or less in total assets (§702.2(h)). NCUA may classify a credit union that exceeds \$10 million in total assets as new if its total assets subsequently decline to \$10 million or below while it is within its operational limit of less than 10 years (§702.301(b)). NCUA may deem a credit union formed as a result of a spin off of a group from the field-of-membership (FOM) of an existing credit union to be in operation since the effective date of the spin off. A credit union whose total assets decline to \$10 million or below as a result of a spin-off group within its FOM is deemed to be new if it has been in operation less than 10 years (§702.301(c)).
- **Retained earnings.** Retained earnings consist of undivided earnings, regular reserves, and any other appropriations designated by management or regulatory authorities. An appropriation of undivided earnings consists of a set aside of such an account, e.g., the regular reserve. Items of retained earnings must flow naturally through the income statement.
- **Risk-based net worth requirement.** Additional net worth necessary to compensate for material risks against which the 6 percent net worth ratio does not provide adequate protection. The computation of a credit union's RBNW requirement uses the standard calculation of §702.106. A credit union may substitute one or more alternative components in place of the corresponding standard components (§702.107.)
- **Spin-off credit union.** A newly-chartered credit union formed from a group from the field of membership of an existing credit union (§702.301(c)).
- **Total assets.** For each quarter, a credit union must elect a measure of total assets from the choices below to apply for PCA purposes. The credit union will use this measure of total assets for all of the quarterly PCA calculations, except the risk-based net worth requirements. (§702.103 - §702.106, §702.201(a)).
  - Average quarterly balance - the average of quarter-end balances of the four most recent calendar quarters;
  - Average monthly balance - the average of month-end balances over the three calendar months of the calendar quarter;
  - Average daily balance - the average daily balance over the calendar quarter;
  - Quarter-end balance - the quarter-end balance of the calendar quarter as reported on the credit union's call report.

If the credit union elects one of the alternative methods to compute its NWR, it must also use this total assets election for purposes of computing the reserve transfer amount for the current quarter. For example, if the credit union chooses average daily assets, it must use 0.1 percent of average daily assets for its reserve transfer. Or, if the credit union makes no optional total

assets election, by default its transfer amount will be 0.1 percent of quarter-end total assets.

## **Net Worth Calculation**

The net worth calculation for credit unions is as follows:

$$\text{Net Worth Ratio} = \text{Net Worth} / \text{Total Assets}$$

A credit union with assets over \$10 million must also perform a RBNW calculation to determine if the credit union has an applicable RBNW requirement as described in the Risk-Based Net Worth Requirement section of this chapter.

The following items further describe the net worth calculation and its importance in the examination process:

- Net worth numerator. For purposes of the net worth ratio, the numerator is the credit union's net worth at quarter end. CUMAA defines net worth generally as GAAP retained earnings. The Definitions section of this chapter contains a definition of both net worth and of retained earnings. Net worth includes amounts the credit union had previously closed from net income into undivided earnings. If the credit union does not close its net income into undivided earnings during interim periods, examiners will treat the net income as if it had been closed into undivided earnings.
- Net worth denominator. The definition of "total assets" in the Definitions section of this chapter contains the methods available for determining total assets for the purposes of the net worth ratio. Each quarter, credit unions elect which method of determining total assets they will use to calculate the net worth ratio and, if applicable, the earnings transfer and asset growth restriction. The total asset measurement selected also applies to the determination of whether or not a credit union falls within the definition of "new." A credit union need not maintain consistency from one period to the next in its choice of method for determining total assets; it has the option of choosing the most favorable method each quarter. Absent an election by the credit union, NCUA will use quarter-end total assets as the default.

- Net worth documentation. Responsibility for calculating the net worth ratio at the end of each calendar quarter falls on the individual credit union. The call report contains the PCA Net Worth Calculation worksheet. It automatically computes the credit union's net worth ratio and provides the net worth classification (§702.106.) All credit unions must determine their net worth calculations at the end of each quarter and retain the calculation documentation.
  
- Effective date. The effective date of the net worth classification is the most recent of the following:
  - The last day of the calendar month following the end of the calendar quarter (quarter-end effective date); or
  - The date the credit union's net worth ratio is recalculated by, or as a result of, its most recent final examination report (corrected net worth category); or
  - The date the credit union received written notice from NCUA or the SSA of reclassification to a lower net worth category, based on safety and soundness grounds (reclassification to lower category) (§702.101(b)).
  
- Examination verification. Quarter-end net worth ratio calculations provide the basis for PCA requirements because credit unions are only required to compute their net worth ratio at quarter-end.

To verify accuracy, examiners should recalculate the net worth ratio reported on the call report using the credit union's chosen "total assets" as of the most recent quarter end.

If the recalculation process discloses a quarter-end calculation error made by the credit union and correcting that error would place the credit union in a lower net worth category, the effective date of the lower net worth classification will be the date the examiner gives the final examination report to the officials. However, the corrected net worth category effective date cannot precede the quarter-end effective date. For example, if the examiner delivers the examination report with the new corrected year-end net worth ratio on January 15, the effective date of the net worth classification

would be January 31. If the examiner delivers the report on February 15, the effective date will be February 15.

In addition, if the examiner discovers errors, omissions or other findings that would result in a lower net worth ratio, but the source of these events took place after the most recent quarter-end net worth ratio measurement period, the net worth ratio will not reflect these modifications until the credit union's next quarter-end measurement date.

When an examiner computes a net worth ratio as of the effective date of the exam, and that date follows the most recent quarter-end effective date, the net worth ratio only indicates what the credit union's net worth ratio and corresponding net worth classification might be as a result of the credit union's next quarter-end measurement.

- Assigning a capital component rating. For examinations other than quarter end, examiners should also calculate the net worth ratio using the month-end balance of net worth to the month-end balance of total assets as of the examination date. If the examination date falls on a quarter end, then the examiner should use the same total asset calculation as the credit union.

If a material difference exists between the credit union's chosen method at the quarter end and the calculation made by the examiner as of the examination date, the examiner should discuss in the examination report the reasons for the difference and assign an appropriate capital component rating.

- Safety and soundness classification. Examiners may not reclassify a credit union to a lower net worth category for safety and soundness reasons. Only the NCUA Board may reclassify the credit union based on safety and soundness concerns (§702.101(b)(3)).

**Statutory Net Worth Categories**

<b>Other Than New Credit Unions</b>		<b>New Credit Unions</b>	
<b>Net Worth Category</b>	<b>Net Worth Ratio</b>	<b>Net Worth Category</b>	<b>Net Worth Ratio</b>
Well Capitalized	7% or greater*	Well Capitalized	7% or greater
Adequately Capitalized	6% to 6.99%*	Adequately Capitalized	6% to 6.99%
Undercapitalized	4% to 5.99%	Moderately Capitalized	3.5% to 5.99%
First Tier	5% to 5.99%	Marginally Capitalized	2% to 3.49%
Second Tier (and failed RBNW)	4% to 4.99%	Minimally Capitalized	0% to 1.99%
Significantly Undercapitalized	2% to 3.99%	Uncapitalized	Less than 0%
Critically Undercapitalized	Less than 2%		

\*Also must meet applicable risk-based net worth requirements

**Illustration 17-A**

Illustration 17-A shows the net worth categories for all credit unions. The left side illustrates net worth categories for credit unions other than those defined as new. The right side shows net worth categories for credit unions defined by statute as new (in operation for less than 10 years and assets of \$10 million or less.)

**Reasonable Timetable to Build Net Worth**

<b>Within # of Years in Operation</b>	<b>Net Worth Ratio</b>
3 Years	0% to 1.99%
5 Years	2% to 3.49%
7 Years	3.5% to 5.99%
10 Years	6% to 6.99%

**Illustration 17-B**

New credit unions initially have no net worth and, as such, need reasonable time in which to accumulate it. Illustration 17-B is a reasonable timetable for building net worth and serves only as a guide to show the anticipated time for a new credit union to reach the net worth classification of adequately capitalized.

**Net Worth Category Change**

All credit unions complete a call report each quarter. Therefore, other than filing a call report, a federally insured credit union need not notify the NCUA Board of a change in its net worth ratio that places the credit union in a lower net worth category.

**Reclassification** The NCUA Board has the discretion to reclassify a credit union to the next lower category if the credit union has an unsafe or unsound condition or engages in material unsafe and unsound practices. The NCUA Board may reclassify a well-capitalized credit union as adequately capitalized, and may require an adequately capitalized or undercapitalized credit union to comply with certain mandatory or discretionary supervisory actions as if it were in the next lower category. The NCUA Board may apply this same discretionary authority to reclassify new credit unions that are well, moderately, or marginally capitalized. The NCUA Board alone has this authority; they may not delegate it. However, credit unions may apply to the NCUA Board for reconsideration of its decision.

PCA requires reclassification to significantly undercapitalized if a credit union in the second-tier undercapitalized category (4.00 percent to 4.99 percent net worth ratio) fails to (1) submit a NWRP within the regulatory timeframes, or (2) implement an approved NWRP.

**Mandatory Supervisory Actions**

**Mandatory Supervisory Actions**

MSA	Adequately Capitalized NW Ratio = 6% to 6.99%	Under Capitalized NW Ratio = 4% to 5.99%	Significantly Under Capitalized NW Ratio = 2% to 3.99%	Critically Under Capitalized NW Ratio = Less than 2%
Earnings Transfer	X	X	X	X
Net Worth Restoration Plan		X	X	X
Restrict Asset Growth		X	X	X
Restrict MBLs		X	X	X

**Illustration 17-C**

**Credit unions other than those defined as new.** Well-capitalized credit unions are those with net worth ratios equal to, or above, 7 percent and meet applicable RBNW requirements. No MSAs or DSAs apply to these credit unions. However, less than well-capitalized credit unions must comply with the mandatory and discretionary actions prescribed by CUMAA.

Illustration 17-C shows the MSAs and the categories of credit unions to which each applies. The same MSAs apply to undercapitalized, significantly undercapitalized, and critically undercapitalized categories.

- **Earnings transfer.** For credit unions that are less than well capitalized, CUMAA requires annual earnings retention of 0.4 percent or more of their total assets. Credit unions will use the regular reserve account as an appropriation of undivided earnings for the earnings retention. Beginning with the effective date of net worth classification below well capitalized, the credit union will do the following until it reaches the well-capitalized category (§702.201(a)):
  - Increase the dollar amount of net worth quarterly by at least 0.1 percent of total assets; and
  - Transfer that amount to regular reserve.

Reserve transfers in the absence of an increase in the dollar amount of net worth do not satisfy the requirement. (Also, the credit union will not credit undivided earnings to recover the provision for loan and lease losses expense.)

NCUA may permit, on a case-by-case basis, a reduction in earnings transfer to avoid significant redemption of shares and to further the purpose of PCA (§702.201(b)). However, only under exceptional circumstances should NCUA allow a reduction below zero (resulting in net losses) for more than four consecutive calendar quarters. In these cases, documentation should include how NCUA expects the credit union to return to profitability in the near-term following this period.

NCUA cannot accept requests received after the quarter-end for reductions in the minimum earnings transfer requirement.

- **NWRP.** Credit unions must submit a NWRP (described later in this chapter.)
- **Restrict increase in assets.** Beginning with the effective date of the net worth classification, the credit union cannot increase its

assets beyond its total assets for the preceding quarter, except in the following circumstances:

- The credit union's asset growth and net worth are increasing consistent with an approved NWRP, or
- If NCUA has not yet approved the credit union's NWRP (the credit union may be awaiting initial approval) and the credit union's total assets are increasing as a result of increases in the following accounts used in normal operations:
  - i. Total accounts receivable and accrued income on loans and investments;
  - ii. Total cash and cash equivalents; and
  - iii. Total loans outstanding, not to exceed the sum of total assets plus the quarter-end balance of unused commitments to lend and unused lines of credit.

These exceptions to the asset growth restriction are available to the credit union while waiting for approval of its initial NWRP, provided the credit union does not offer rates on shares in excess of prevailing rates on shares and deposits in its relevant market area and does not open any new branches. However, the credit union may not retroactively restrict dividend rates already declared on shares acquired before imposing the restriction.

- **Restrict member business loans.** Beginning with the effective date of net worth classification, the credit union cannot increase the total dollar amount of its member business loans (MBLs), defined as loans outstanding and unused commitments to lend, as of the prior quarter-end, unless the credit union:
  - Was chartered for the purpose of making MBLs;
  - Has a history of primarily making MBLs;
  - Has a low income designation; or
  - Is a community development credit union.

The restriction applies to the total dollar amount of MBLs. Thus, the credit union may make new MBLs provided the total dollar amount of MBLs does not increase (§702.202(a)(3)(ii)(c)).

**New credit unions.** New credit unions that have less than 6 percent net worth, or were reclassified to moderately capitalized or lower, are subject to MSAs. In addition, MSAs apply to a new credit union that either (1) remains uncapitalized beyond the time period provided in its initial business plan (approved at the time the credit union was chartered); or (2) subsequently declines to uncapitalized from a higher category after expiration of the time period originally approved in its initial business plan for the credit union to operate in the uncapitalized category. The MSAs for new credit unions differ slightly from those prescribed for other credit unions:

- **Earnings transfer.** New credit unions must increase net worth and make quarterly earnings transfers to the regular reserve account in an amount reflected in the credit union's previously approved initial or revised business plan (may be less than the equivalent of 0.4 percent of assets per year.)
- **Submit a revised business plan.** New credit unions will submit a revised business plan if any of the following apply:
  - The credit union's net worth ratio has not increased consistent with its currently approved business plan;
  - The credit union has no currently approved business plan; or
  - The credit union has failed to undertake any mandatory actions (§702.304.)
- **Restrict member business loans.** New credit unions may not increase the total amount of member business loans (defined as loans outstanding and unfunded commitments to lend) unless it meets one of the exceptions of §702.202(a)(4.)

**Discretionary  
Supervisory  
Actions**

CUMAA required NCUA to develop DSAs to complement the CUMAA-prescribed mandatory actions. To further the purpose of PCA, NCUA developed fourteen DSAs, which are comparable to the discretionary safeguards in the banks' system of PCA. (For a detailed explanation of the internal DSA implementation process, please see Instruction entitled Discretionary Supervisory Actions (DSAs) under Prompt Corrective Action (PCA)).

**Discretionary Supervisory Actions**

<b>DSA</b>	<b>Under Capitalized<sup>1</sup> First Tier NW Ratio = 5% to 5.99%</b>	<b>Under Capitalized Second Tier NW Ratio = 4% to 4.99%</b>	<b>Significantly Under Capitalized NW Ratio = 2% to 3.99%</b>	<b>Critically Under Capitalized NW Ratio = Less than 2%</b>
Approval for acquisitions		X	X	X
Restrict transactions with CUSO		X	X	X
Restrict dividend		X	X	X
No or reduce asset growth		X	X	X
Terminate risky activity		X	X	X
No non-member deposits		X	X	X
Dismiss officer or director		X	X	X
Employ qualified officers		X	X	X
Restrict or require other actions		X	X	X
New election of directors			X	X
Restrict compensation			X	X
Require merger			X	X
Restrict payments on secondary capital				X
NCUA approval for operations				X

**Illustration 17-D**

Illustration 17-D displays the DSAs available in the undercapitalized (the first nine DSAs apply to second tier undercapitalized credit unions), significantly undercapitalized, and critically undercapitalized

<sup>1</sup> No DSAs will apply to first-tier undercapitalized credit unions as long as the credit union is in compliance with all MSAs and is implementing an approved NWRP.

net worth categories for credit unions other than those defined as new. One or more of the fourteen actions may apply to new federally insured credit unions with a net worth of less than 6 percent if they (1) fail to meet their quarterly net worth targets, or (2) fail to undertake any MSAs, regardless of their net worth classification (§702.304(b)).

The undercapitalized category is divided into two tiers. First-tier undercapitalized credit unions have a net worth ratio of 5 percent to 5.99 percent. Nine of the fourteen discretionary actions are available against second-tier undercapitalized credit unions, which have net worth ratios of 4 percent to 4.99 percent. Credit unions classified as first-tier undercapitalized are subject to the second tier DSAs only if they (1) fail to comply with any of the MSAs, (2) fail to implement an approved NWRP in a timely manner, or (3) fail to meet the timetable of net worth targets in the plan for increasing net worth.

All of the DSAs applicable to the second-tier undercapitalized, significantly undercapitalized, and critically undercapitalized credit unions give NCUA authority to require the actions described below. The DSAs are indexed to specific net worth categories described below and shown on Illustration 17-D. (Examiners should review the delegations of authority to determine who can take the action.)

- **Require prior approval for acquisitions, branching, or new lines of business.** NCUA can prohibit a credit union from (directly or indirectly) acquiring an interest in a business entity or financial institution, establishing or acquiring an additional branch office, or engaging in a new line of business. However, these prohibitions will not go into effect if NCUA has approved the credit union's NWRP, the credit union is implementing its plan, and NCUA determines that the proposed action is consistent with and will further the objectives of that plan.
- **Restrict transactions with and ownership of CUSOs.** NCUA can restrict the credit union's transactions with a CUSO or require the credit union to reduce or divest its ownership interest in a CUSO.
- **Restrict dividends or interest the credit union pays to market rates.** NCUA can restrict a credit union's dividend or interest rates

on shares to the prevailing rates for comparable accounts and maturities in the relevant market area, as determined by NCUA. However, dividend rates already declared on shares acquired before imposing the restriction may not be retroactively restricted.

- **Prohibit asset growth or reduce the assets generally or in a particular asset category.** NCUA can prohibit any growth in the credit union's assets or in a category of assets, or require the credit union to reduce its assets or a category of assets.
- **Alter, reduce, or terminate excessively risky activity by the credit union or CUSO.** NCUA can require the credit union or its CUSO to alter, reduce, or terminate any activity that poses excessive risk to the credit union.
- **Prohibit non-member deposits.** NCUA can prohibit the credit union from accepting all or certain nonmember deposits.
- **Dismiss directors or senior executive officers.** NCUA can require the credit union to dismiss from office any director or senior executive officer. However, a dismissal under this clause shall not be construed to be a formal administrative action for removal under 12 U.S.C. §1786(g.)
- **Employ qualified senior executive officers.** NCUA can require the credit union to employ qualified senior executive officers (who, if NCUA so specifies, shall be subject to its approval.)
- **Implement other actions to carry out the purpose of PCA.** NCUA can restrict or require such other action by the credit union if that action will carry out the purpose of PCA better than the actions mentioned in this section.
- **Require a new election of directors.** NCUA can order a new election of the credit union's board of directors.
- **Require prior approval for senior executive officers' compensation and bonus.** Unless the credit union obtains the prior written approval of the NCUA Board, NCUA can impose the following:

- Limit compensation for any senior executive officer to that officer's average rate of compensation (excluding bonuses and profit sharing) during the four quarters preceding the effective date of classification as significantly or critically undercapitalized; and
  - Prohibit payment of a bonus or profit share to such officer.
- **Require a merger if grounds exist for conservatorship or liquidation.** NCUA can require the credit union to merge with another financial institution if one or more grounds exist for placing the credit union into conservatorship pursuant to 12 U.S.C. §1786(h)(1)(F), or into liquidation pursuant to 12 U.S.C. §1787(a)(3)(A)(i.)
  - **Restrict payment of principal or interest on uninsured secondary capital of low-income designated credit unions.** Beginning 60 days after the effective date of classification of a low-income credit union as critically undercapitalized, NCUA can prohibit payments of principal, dividends, or interest on the credit union's uninsured secondary capital accounts established after August 7, 2000. However, unpaid dividends or interest shall continue to accrue under the terms of the account to the extent permitted by law.
  - **Approve certain operational level activities.** NCUA can require a critically undercapitalized credit union to obtain NCUA's prior written approval before doing any of the following:
    - Entering into any material transaction not within the scope of an approved NWRP (or approved revised business plan);
    - Extending credit for transactions deemed highly leveraged by the NCUA Board or, if state-chartered, by the appropriate state official;
    - Amending the credit union's charter or bylaws, except to the extent necessary to comply with any law, regulation, or order;
    - Making any material change in accounting methods; and
    - Paying dividends or interest on new share accounts at a rate exceeding the prevailing rates of interest on insured deposits in its relevant market area.

**Appeals  
Process**

NCUA has implemented an independent appeals process by which credit unions and dismissed officials, affected by PCA, can challenge material supervisory decisions by NCUA staff. DSAs qualify as such material supervisory decisions (§747.2002 and §747.2004.)

CUMAA requires that the NCUA Board provide advance notice and an opportunity for a credit union to be heard before imposing a DSA, unless such an action is necessary to further the purpose of PCA. The credit union could challenge the proposed DSA in writing and request that the action be modified or not imposed. The credit union is not entitled to a hearing before the NCUA Board. The NCUA Board, or an independent person designated by the Board, may then decide not to issue the directive or to issue it as proposed or modified (§747.2002.) The credit union may seek the NCUA ombudsman's recommendation regarding a proposed DSA.

When a credit union must dismiss a director or senior executive officer, the NCUA Board must serve the dismissed person with a copy of the directive issued to the credit union accompanied by a notice of the person's right to seek reinstatement by the NCUA Board. Only that person may then challenge the dismissal and request reinstatement. That person also may request an informal hearing and the opportunity to present witness testimony. The dismissal remains in effect while the request for reinstatement is pending (§747.2004.) While the credit union may challenge the proposed DSA, the credit union may not seek reinstatement after the person is dismissed.

**Discretionary  
Conservator-  
ship or  
Liquidation**

The NCUA Board has the discretionary authority to place a significantly undercapitalized federally-insured credit union or a credit union meeting the definition of new that is classified as moderately capitalized or lower into conservatorship or liquidation, provided the credit union has no reasonable prospect of becoming adequately capitalized (§702.203(c) and §702.304 (c)). This includes the NCUA Board's reclassification of a credit union to significantly undercapitalized on safety and soundness grounds (§702.102(b)).

A credit union placed into conservatorship retains the right to challenge the decision in court within 10 days. A credit union placed

into liquidation under PCA can directly appeal to the NCUA Board; however, CUMAA gives the credit union no right to judicial review.

**Mandatory Conservatorship, Liquidation, or Other Corrective Action (OCA)**

**Non-new credit unions.** Following are mandatory conservatorship and liquidation requirements for credit unions that do not meet the definition of a new credit union:

- The NCUA Board must place a credit union into conservatorship or liquidation within 90 calendar days after being classified critically undercapitalized, regardless of the credit union's prospect of becoming adequately capitalized; or
- The NCUA Board may take other corrective action (OCA) in lieu of conservatorship or liquidation. §702.204(c.)

Generally, OCA will consist of adherence to quarterly steps and targets in an approved NWRP. The OCA plan should pose the least possible long-term loss to the NCUSIF. OCA may also consist of allowing the credit union time to arrange and complete a merger under NCUA supervision.

**OCA Renewal**

OCA can range from a period of 1 to 180 days, and will expire unless renewed prior to expiration, regardless of the time limit of any previously approved NWRP. If the credit union remains critically undercapitalized and NCUA does not renew OCA, the NCUA Board generally will immediately place the credit union into conservatorship or liquidation. §702.204(c)(2.)

The statutory 18-month maximum period for OCA to succeed effectively limits renewals of OCA that extend the full 180-day period (§702.204(c)).

**Limitation on OCA Renewals**

The NCUA Board must conserve or liquidate a surviving critically undercapitalized credit union, regardless of the impact of OCA, if that credit union is critically undercapitalized (less than 2 percent net worth ratio) on average for a full calendar quarter beginning 18 months from the effective date it first was classified critically undercapitalized. This

is true even if the credit union surpasses a 2 percent net worth ratio for any preceding period during the 18-month period. The effective date when a credit union first becomes critically undercapitalized almost always falls one month after the end of a calendar quarter.

Thus, the last possible day for OCA will be no more than 23 months (23 months x 30 days =690 days) from the effective date the credit union first became critically undercapitalized (18 calendar months from the effective date, plus two months to the end of the calendar quarter at the end of the 18-month period, plus the subsequent three months of the next calendar quarter), absent an exception. (See Illustration 17-E for an example of a mandatory conservatorship or liquidation timetable.)

**Sample Mandatory Conservatorship or Liquidation**

Action	Date	Event
	12/31/X0	Credit union becomes critically undercapitalized (net worth<2%)
	1/31/X1	Effective date of net worth classification
Option of Liquidation or Conservatorship	2/1/X1	18 months begins- First 90 days, Then 180 day periods
	7/31/X2	18 months ends
	10/1/X2	Full calendar quarter after 18 months begins
	12/31/X2	Full calendar quarter ends-credit union still critically undercapitalized
Mandatory Liquidation Only	1/1/X3	23 months after effective date of net worth classification

**Illustration 17-E**

Because of this statutory deadline, NWRP and Plans for Special Assistance to return the credit union to a 2 percent net worth ratio cannot extend beyond a total of 23 months from the effective date of classification as critically undercapitalized.

As legally authorized, the NCUA Board delegated authority to regional directors to initiate and renew OCA in lieu of conservatorship or liquidation for credit unions with assets less than \$5 million. The NCUA Board cannot delegate OCA authority for credit unions of \$5 million in assets or greater. Therefore, if a credit union has assets of \$5 million or greater, the regional director first must obtain concurrence

for OCA from the Office of Examination and Insurance and then approval from the NCUA Board.

**OCA  
Documentation**

Support for the approval of OCA should include the following items:

- Board Action Memorandum (BAM), or memo to the NCUA Board Secretary (if applicable);
- Memo to the Director of the Office of Examination and Insurance recommending OCA approval (if applicable);
- Memo to the regional director recommending OCA approval;
- Regional summary;
- NWRP;
- Regional Director Letter to the credit union informing them of OCA approval; and
- Other supporting financial information at the regional director's discretion such as Financial Performance Reports (FPRs), examination workpapers; financial statements, consolidated balance sheets, time frames, etc.

**Exception to  
Mandatory  
Liquidation**

NCUA may avoid mandatory liquidation of a credit union only if, after the 23 months, the NCUA Board certifies that the credit union has met the following three criteria for an exception to liquidation:

- The credit union has, since the date of approval, substantially complied with a NWRP requiring improvement in net worth;
- The credit union has positive net income or a sustainable upward trend in earnings; and,
- The credit union is viable and not expected to fail.

NCUA will not routinely grant this exception. In helping credit unions develop NWRPs and in reviewing NWRPs, examiners should not assume the granting of this exception.

Since the NCUA Board must recertify the three exception criteria quarterly, examiners will review the status of critically undercapitalized credit unions at least quarterly. If NCUA cannot recertify the credit union, the NCUA Board must then place the credit union into liquidation (§702.204(c)(3)(iii)).

**New credit unions.** The NCUA Board must place a new credit union classified as uncapitalized into conservatorship or liquidation based on either of the following criteria:

- The credit union failed to submit a revised business plan within 90 days of the effective date of its classification as uncapitalized; or,
- The credit union remains uncapitalized 90 days after the NCUA Board approved the revised business plan submitted by the credit union as required above, unless, the credit union documents to the NCUA Board why it is viable and has a reasonable prospect of becoming adequately capitalized. Generally, the credit union's success in meeting the plan's financial goals will support this exception.

**Consultation  
with SSA**

NCUA will work cooperatively with the appropriate SSA before imposing any DSAs on a federally insured, state chartered credit union (FISCU), and will provide the SSA with prompt notice of its decision.

Before placing a FISCU into conservatorship, NCUA will contact the appropriate SSA and will give that SSA the opportunity to place the credit union into conservatorship or liquidation. If the SSA requests, NCUA will provide, in writing, the reasons for the proposed conservatorship or liquidation along with a reasonable time period for the SSA to respond. If the SSA responds within the time period and disagrees with the proposed conservatorship or liquidation and gives reasons for that disagreement, NCUA will not place the credit union into conservatorship or liquidation unless the NCUA Board determines that the credit union poses a significant risk of loss to the NCUSIF and NCUA expects conservatorship or liquidation to reduce the risk of loss or the expected loss.

**Net Worth  
Restoration  
Plan**

**Credit unions that do not meet the definition of new.** The NWRP serves as a blueprint to the credit union's officials and staff for restoring the credit union's net worth ratio to 6 percent or greater. Undercapitalized federally insured credit unions (net worth ratio less than 6 percent or less than the RBNW requirement) must submit their

NWRPs to the appropriate regional director and, if state chartered, concurrently to their SSA (§702.206.)

Responsibility for developing a NWRP rests with the credit union's officials and staff. In developing its NWRP, the credit union must state specific goals and objectives based on reasonable assumptions, financial trends, and projections. The officials must propose the length of time they will need to implement the plan and obtain the intended results. To receive approval, the plan must meet the minimum criteria set forth in §702.206(c) including:

- A quarterly timetable of steps necessary to increase the credit union's net worth ratio to adequately capitalized by the end of the NWRP's term, and to remain adequately capitalized for an additional four consecutive quarters;
- The projected earnings transfer to the regular reserve each quarter during the term of the NWRP. This transfer must equal at least 1/10th of one percent (0.1 percent) of the credit union's total assets, or such lesser amount as the regional director may permit, provided that on an annual basis the transfer must not be less than zero (§702.201(a) and §702.201(b));
- Plans for complying with the MSAs and DSAs imposed on the credit union by the regional director under Subpart B;
- Types and levels of activities in which the credit union will engage;
- Steps necessary to correct the unsafe and unsound practices or conditions if the credit union has been reclassified to a lower category (§702.102(b));
- Pro forma financial statements including any off-balance sheet items covering a minimum of the next two years; and
- Any additional information that the regional director or the SSA may require.

An undercapitalized credit union must file an NWRP within 45 days of becoming undercapitalized (net worth less than 6 percent or less than

the RBNW requirement), unless it was reclassified as undercapitalized solely on safety and soundness grounds. If a credit union has an approved NWRP in place, and the credit union's net worth category changes (e.g., slips to a lower net worth category), it need not submit a new NWRP unless required to do so by the regional director.

The regional director may extend a filing deadline. If a credit union's net worth category changes and the regional director requires that it file a new NWRP, the credit union has 30 calendar days in which to do so, unless the regional director extends that period. The regional director will provide notification to credit unions that fail to file a required NWRP within the required timeframes. The credit union must file its NWRP within 15 calendar days of receiving the notification (§702.206(a)).

The regional director has 45 calendar days to review the NWRP and to provide written notice of approval or disapproval of the plan. If the credit union receives no decision within 45 days, the NWRP is deemed approved. If the regional director disapproves the plan, it will provide the credit union with its reasons. The credit union must then submit a revised NWRP within 30 days of receiving the regional director's notice of disapproval unless the regional director sets a different period. The regional director must respond within 30 days regarding its approval or disapproval of the credit union's revised NWRP (§§702.206(f) and 702.206(g)).

Appendix 17B contains a sample NWRP format.

**Revised  
Business Plans**

**New credit unions.** New credit unions categorized as moderately, marginally, or minimally capitalized must file a revised business plan with the appropriate regional director and SSA, if state chartered, for review and approval. The credit union must file the plan within 30 calendar days of the effective date that (1) it fails to meet a quarterly net worth target of its current approved business plan, (2) it has no current approved business plan, or (3) it has failed to undertake any MSAs.

If a new credit union becomes uncapitalized or remains uncapitalized beyond the period approved in its initial business plan, it must file a

revised business plan within 90 days, or a shorter timeframe prescribed by NCUA. The revised business plan must provide for an alternative means of funding the credit union's earnings deficit. In either case, NCUA can extend the filing deadlines by providing notice to the credit union of a different period (§702.305(a)(2)).

The following requirements apply to the revised business plan:

- It must be based on realistic assumptions;
- It must have the expected result of restoring the credit union's net worth; and
- It must not expose the credit union to an unreasonable increase in risk.

To meet the minimum criteria receive approval set forth in §702.306(b), the plan must:

- Analyze changes since the new credit union's current business plan was approved in any of the business plan elements required for charter approval under Chapter 1, Section IV.D, of NCUA's Chartering and Field of Membership Manual, IRPS 99-1, as amended, or for state chartered credit unions under applicable state law;
- Establish a timetable of quarterly targets for net worth during each year in which the revised business plan is in effect, so that the credit union becomes adequately capitalized and remains so for four consecutive quarters;
- Specify the projected amount of earnings that the credit union will transfer quarterly to its regular reserve (§702.304(a)(1) or §702.305(a)(1));
- Explain how the new credit union will comply with the MSAs and DSAs;
- Specify the types and levels of activities in which the credit union may engage;

- Specify the steps a new credit union, reclassified to a lower category, will take to correct the unsafe or unsound condition or practice (§702.302(d)); and
- Include such other information as the NCUA Board may require.

The regional director must provide notification to a new credit union that fails to file a required revised business plan within the timeframes allowed. The credit union must then file its revised plan within 15 calendar days of receiving the notification.

The regional director must review the revised business plan and provide written notice within 30 calendar days regarding its approval or disapproval. In the event of disapproval, the notice must provide the reasons for disapproval. If the regional director makes no decision within 30 days, the revised business plan is deemed approved. If disapproved, the credit union must submit a revised plan within 30 days from receiving the regional director's notice of disapproval, unless the regional director sets a different period.

The regional director then has 30 days to approve or disapprove the revised plan. In addition, a credit union may amend a previously approved revised business plan. Until the regional director approves the amended plan, the credit union must implement its previously approved revised business plan. The regional director will consult with the SSA regarding the approval or disapproval of new, revised, or amended revised business plans for state chartered credit unions ((§§702.306(e)-(g)).

**NWRP and  
Revised  
Business Plan  
Approval**

The regional director, in consultation with the SSA (for state chartered credit unions), must approve the credit union's NWRP or revised business plan. During the approval process, the regulatory authority will consider the following:

- Compliance with minimum criteria;
- Probability of meeting realistic assumptions; and
- Probability of unreasonably increasing exposure to risk, including credit risk, interest rate risk, or other risks.

**Examiners' On-Going Review of NWRP**

After the regional director has approved the NWRP and the credit union has implemented it, regional policy will dictate review and monitoring of the plan. The NWRP questionnaire in AIREs provides guidance on areas that require the examiners' review. Examiners should discuss the credit union's progress with management during the examination and, if necessary, during on- and off-site supervision of the credit union. For as long as a credit union has an NWRP in place, examiners should document the credit union's progress in meeting the terms of the NWRP, as well as any changes made to the NWRP, in the examination report (e.g., Supplementary Facts section.)

During the review, examiners should assess the plan's adequacy and implementation and should discuss with the officials any of the goals or objectives that the credit union did not meet. If examiners continue to have concerns about the credit union's ability to meet its NWRP goals, they should document the concerns and recommend corrective action in the examination report.

**Plan Changes**

A credit union may also amend a previously approved NWRP. The officials must submit the revised plan to the regional director and SSA (if a state-chartered credit union) for re-approval. The credit union need not submit an additional NWRP due solely to a change in net worth category (including reclassification under §702.102(b)), unless the regional director notifies the credit union that it must submit a new NWRP. The regional director will consult with the appropriate SSA regarding the approval or disapproval of new, revised, or amended NWRPs in state chartered credit unions (§702.206(f)(3)). Until NCUA approves the proposed amended NWRP, the credit union must implement the previously approved plan.

When a credit union receives notification from NCUA that it must submit a new or revised NWRP, the credit union must file the new NWRP, in writing, with the appropriate regional director and SSA within 30 calendar days of receiving the notice. However, the regional director can notify the credit union in writing that the credit union may file the NWRP within a different period.

**Assistance In  
Preparing Plan**

Responsibility for developing a NWRP rests with the credit union's officials and staff. However, NCUA can assist a credit union in preparing an NWRP or, for new credit unions, a revised business plan. By statute, a credit union having assets less than \$10 million and net worth less than 6 percent will receive NCUA's assistance in preparing its NWRP, if it requests such assistance. This extends to other than new credit unions that were reclassified under §702.102(b) to a lower category if the regional director has required the credit union to develop a NWRP. (Examiners can provide similar assistance during the examination and supervision contacts to credit unions that do not meet these criteria, if so directed by regional policy.) Credit unions needing assistance must submit their requests to the applicable regional director in ample time for the process to meet the regulatory timeframes (§702.206 and §702.306.)

NCUA or SSA examiners may provide guidance to the credit union's officials and staff in preparation of the NWRP. The NCUA Board intends that the NCUA or SSA examiners will be the primary resource for providing this guidance.

When the credit union requests examiner assistance, the request must document the credit union's eligibility for the assistance requested. Also, if the credit union needs additional time to complete and submit its NWRP, it must request an extension of the regulatory timeframe (§702.206 and §702.306.)

**New credit unions.** NCUA will not provide assistance for preparing the initial business plan required for new credit unions applying for initial charter approval; however, NCUA's economic development specialists often aid credit unions in developing their initial business plans. New credit unions must meet the following criteria to qualify for NCUA assistance in providing guidance in the preparation of their revised business plans:

- They are not meeting the net worth goals set forth in their current business plans; and
- They have a net worth ratio of less than 6 percent.

**Examiner  
Assistance**

While the examiner may facilitate discussion about the assistance needed by the credit union, the examiner will not make business decisions for the credit union regarding the NWRP. Examiners will provide assistance by answering the credit unions' questions, providing guidance, and giving support.

Regional policy dictates the procedures credit unions may use to obtain examiner assistance for preparing the NWRP. Clearly, however, the request should come from the credit union. For this reason, the chairman of the credit union's board of directors should sign the request. State chartered credit unions will make their requests to the regional director through their SSAs, again allowing ample time to meet necessary timeframes.

**References  
and  
Workpapers**

References

- *Federal Credit Union Act*
  - Part 216
  - Part 208
  - Part 206
- *NCUA Rules and Regulations*
  - Part 702
  - Section 741.3
  - Section 701.34
  - Section 747.2002
  - Section 747.2004
- NCUA 5300 Call Report
- Guidelines for Submission of an Application for a PCA Risk Mitigation Credit
- Guidelines for Evaluation of an Applications for a PCA Risk Mitigation Credit
- AIRES Net Worth Restoration Plan Checklist
- NCUA Letter to Credit Unions: 01-CU-01 Prompt Corrective Action (PCA) Implementation Information

## Chapter 17 – Part 2

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### PCA - RISK-BASED NET WORTH REQUIREMENT

#### Examination Objective

- Determine whether the credit union meets the definition of complex and adheres to the applicable risk-based net worth (RBNW) requirement

#### Associated Risks

- Reputation risk may occur when PCA efforts are not successful and the credit union fails.

#### Overview

A credit union is defined as complex and a RBNW requirement is applicable only if the credit union meets both of the following criteria as reflected in its most recent call report:

- Minimum asset size. Its quarter-end total assets exceed \$10 million; and
- Minimum RBNW calculation. Its risk-based net worth requirement as calculated under §702.106 exceeds 6 percent.

Examiners should use the term “applicable RBNW requirement” rather than “complex.”

All credit unions whose net worth ratio initially places them in either the adequately- or well-capitalized net worth category (6 percent net worth ratio and above) must satisfy an applicable RBNW requirement, if the credit union’s quarter-end total assets exceed \$10 million. NCUA will classify a credit union with a 6 percent or higher net worth ratio in the first tier of undercapitalized, if its applicable RBNW requirement exceeds its net worth ratio. If it fails to comply with any MSA or fails to implement a NWRP within the regulatory timeframes, such a credit union is subject to all MSAs and any of the second tier DSAs.

The RBNW requirement also indirectly affects credit unions that have net worth ratios below 6 percent. These credit unions already must operate under an approved NWRP. The NWRP must provide the means and a timetable to reach the adequately-capitalized category.

However, for credit unions in the undercapitalized or lower net worth categories, the minimum net worth ratio to the adequately-capitalized category will be 6 percent or the credit union's RBNW requirement, if higher than 6 percent. If the credit union has an applicable RBNW requirement, the NWRP must prescribe the steps a credit union will take to reach the RBNW requirement (not just 6 percent.)

The 5300 Call Report contains the standard calculation for the RBNW requirement (§702.106.) The burden of calculating the RBNW requirement using alternative components falls on the individual credit union (§702.107.)

AIRES calculates net worth and the RBNW requirement as of the examination date. When the AIRES calculation is not as of a quarter end, the examiner should perform a reasonableness test of the RBNW requirement calculation. Examiners' judgment will be important in determining reasonable accuracy of the RBNW requirement calculation. In most cases, examiners should not cite minor technical omissions.

## **Standard Calculation**

A credit union's risk-based net worth requirement is the aggregate of the standard component amounts shown in Illustration 17-F, each expressed as a percentage of the credit union's quarter-end total assets as reflected in the most recent call report, rounded to two decimal places.

Illustration 17-F contains the following items:

- **Long-term real estate loans.** The sum of:
  - 6 percent of the amount of long-term real estate loans less than or equal to 25 percent of total assets; and
  - 14 percent of the amount in excess of 25 percent of total assets;
- **Member business loans outstanding.** The sum of:
  - 6 percent of the amount of member business loans outstanding less than or equal to 12.25 percent of total assets; and
  - 14 percent of the amount in excess of 12.25 percent of total assets;

**Standard Calculation of RBNW Requirement  
With Risk Portfolios Defined**

<b>Risk portfolio</b>	<b>Assets, liabilities, or contingent liabilities</b>	<b>Amount of risk portfolio (as percent of quarter-end total assets) to be multiplied by risk weighting</b>	<b>Risk weighting</b>
Long-term real estate loans	Total real estate loans and real estate lines of credit (excluding MBLs) with a maturity (or next rate adjustment period, if variable rate) greater than 5 years	0 to 25.00% Over 25.00%	.06 .14
MBLs outstanding	Member business loans outstanding	0 to 12.25% Over 12.25%	.06 .14
Investments	As defined by federal regulation or applicable State law	<i>By weighted average life:</i>	
		0 to 1 year	.03
		>1 year to 3 years	.06
		>3 years to 10 years	.12
	>10 years	.20	
Low-risk assets	Cash on hand and NCUSIF deposit	All %	.00
Average-risk assets	100% of total assets minus sum of risk portfolios above	All %	.06
Loans sold with recourse	Outstanding balance of loans sold or swapped with recourse, except for loans sold to the secondary mortgage market with a recourse period of 1 year or less	All %	.06
Unused MBL commitments	Unused commitments for MBLs	All %	.06
Allowance	Allowance for Loan and Lease Losses limited to equivalent of 1.50% of total loans	Limited to equivalent of 1.50% of total loans (expressed as a percent of total assets)	(1.00)
<p>A credit union's RBNW requirement is the sum of eight standard components. A standard component is calculated for each of the eight risk portfolios, equal to the sum of each amount of a risk portfolio times its risk weighting. A credit union is classified "undercapitalized" if its net worth ratio is less than its applicable RBNW requirement.</p>			

**Illustration 17-F**

**Investments** (also see Appendix 17A.) The sum of:

- 3 percent of the amount of investments with a weighted-average life (as specified in §702.105) of 1 year or less;
  - 6 percent of the amount of investments with a weighted-average life greater than 1 year, but less than or equal to 3 years;
  - 12 percent of the amount of investments with a weighted-average life greater than 3 years, but less than or equal to 10 years; and
  - 20 percent of the amount of investments with a weighted-average life greater than 10 years;
- **Low-risk assets.** Zero percent (0 percent) of the entire portfolio of low-risk assets;
  - **Average-risk assets.** 6 percent of the entire portfolio of average-risk assets;
  - **Loans sold with recourse.** 6 percent of the entire portfolio of loans sold with recourse;
  - **Unused member business loan commitments.** 6 percent of the entire portfolio of unused member business loan commitments; and
  - **Allowance.** Negative one hundred percent (-100 percent) of the balance of the Allowance for Loan and Lease Losses account, not to exceed the equivalent of 1.5 percent of total loans outstanding.

## **Alternative Calculation**

A credit union may substitute one or more alternative components in Illustration 17-G in place of the corresponding standard components in Illustration 17-F, when any alternative component amount, expressed as a percentage of the credit union's quarter-end total assets as reflected in the most recent call report, rounded to two decimal places, is smaller.

Illustration 17-G contains the following items:

**Alternative Components for Standard Calculation**

**Long-term Real Estate Loans**

<b>Amount of long-term real estate loans by remaining maturity</b>	<b>Alternative risk weighting</b>
> 5 years to 12 years	.08
> 12 years to 20 years	.12
> 20 years	.14
The "alternative component" is the sum of each amount of the long-term real estate loans risk portfolio by remaining maturity (as a percent of quarter-end total assets) times its alternative factor. Substitute for corresponding standard component if smaller.	

**Member Business Loans**

<b>Amount of member business loans by remaining maturity</b>	<b>Alternative risk weighting</b>
<i>Fixed-rate MBLs</i>	
0 to 3 years	.06
> 3 years to 5 years	.09
> 5 years to 7 years	.12
> 7 years to 12 years	.14
> 12 years	.16
<i>Variable-rate MBLs</i>	
0 to 3 years	.06
> 3 years to 5 years	.08
> 5 years to 7 years	.10
> 7 years to 12 years	.12
> 12 years	.14
The "alternative component" is the sum of each amount of the member business loans risk portfolio by fixed and variable rate and by remaining maturity (as a percent of quarter-end total assets) times its alternative factor. Substitute for corresponding standard component if smaller.	

**Investments**

<b>Amount of investments by weighted-average life</b>	<b>Alternative risk weighting</b>
0 to 1 year	.03
>1 year to 3 years	.06
>3 years to 5 years	.08
>5 years to 7 years	.12
>7 years to 10 years	.16
> 10 years	.20
The "alternative component" is the sum of each amount of the Investments risk portfolio by weighted-average life (as a percent of quarter-end total assets) times its alternative factor. Substitute for corresponding standard component if smaller.	

**Illustration 17-G**

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

- 8 percent of the amount of such loans with a remaining maturity of greater than 5 years, but less than or equal to 12 years;
- 12 percent of the amount of such loans with a remaining maturity of greater than 12 years, but less than or equal to 20 years; and
- 14 percent of the amount of such loans with a remaining maturity greater than 20 years;

• **Member business loans outstanding.** The sum of:

- *Fixed rate.* Fixed-rate member business loans outstanding as follows:
  - (a) 6 percent of the amount of such loans with a remaining maturity of 3 or fewer years;
  - (b) 9 percent of the amount of such loans with a remaining maturity greater than 3 years, but less than or equal to 5 years;
  - (c) 12 percent of the amount of such loans with a remaining maturity greater than 5 years, but less than or equal to 7 years;
  - (d) 14 percent of the amount of such loans with a remaining maturity greater than 7 years, but less than or equal to 12 years; and
  - (e) 16 percent of the amount of such loans with a remaining maturity greater than 12 years; and
- *Variable-rate.* Variable-rate member business loans outstanding as follows:
  - (a) 6 percent of the amount of such loans with a remaining maturity of 3 or fewer years;
  - (b) 8 percent of the amount of such loans with a remaining maturity greater than 3 years, but less than or equal to 5 years;
  - (c) 10 percent of the amount of such loans with a remaining maturity greater than 5 years, but less than or equal to 7 years;
  - (d) 12 percent of the amount of such loans with a remaining maturity greater than 7 years, but less than or equal to 12 years; and

(e) 14 percent of the amount of such loans with a remaining maturity greater than 12 years.

- **Investments.** The sum of:
  - 3 percent of the amount of investments with a weighted-average life (as specified in §702.105) of 1 year or less;
  - 6 percent of the amount of investments with a weighted-average life greater than 1 year, but less than or equal to 3 years;
  - 8 percent of the amount of investments with a weighted-average life greater than 3 years, but less than or equal to 5 years;
  - 12 percent of the amount of investments with a weighted-average life greater than 5 years, but less than or equal to 7 years;
  - 16 percent of the amount of investments with a weighted-average life greater than 7 years, but less than or equal to 10 years; and
  - 20 percent of the amount of investments with a weighted-average life greater than 10 years.

### **Risk Mitigation Credit**

Under §702.108, the NCUA board may grant a risk mitigation credit, which is a credit to reduce an RBNW requirement for a credit union that fails the standard and alternative calculations for its RBNW, but can demonstrate mitigation of interest rate risk or credit risk through other means.

The credit union starts the process for a risk mitigation credit by applying first to the NCUA regional office and to the SSA (if a state chartered credit union.) The credit union must demonstrate that the level of risk exposure to the NCUSIF is less than that indicated by the RBNW requirement of either the standard or alternative calculations.

The examiner will assess the effectiveness of the reduction of risk using the NCUA staff publication, "*Guidelines for Evaluation of an Application for a PCA Risk Mitigation Credit*" available on NCUA's Internet website.

The review should cover the effect of quantitative factors on interest rate risk and credit risk. Measures that indicate mitigation of risk include, but are not limited to, net economic value (NEV) analysis or levels of collateral for loans.

**References  
and  
Workpapers**

References

- Federal Credit Union Act
  - Part 216
  - Part 208
  - Part 206
- *NCUA Rules and Regulations*
  - Part 702
  - Section 741.3
  - Section 701.34
  - Section 747.2002
  - Section 747.2004
- NCUA 5300 Call Report
- Guidelines for Submission of an Application for a PCA Risk Mitigation Credit
- Guidelines for Evaluation of an Applications for a PCA Risk Mitigation Credit
- AIRES Net Worth Restoration Plan Checklist
- NCUA Letter to Credit Unions: 01-CU-01 Prompt Corrective Action (PCA) Implementation Information

## WEIGHTED AVERAGE LIFE-APPENDIX 17A

The risk based net worth (RBNW) requirement rule specifies NCUA will categorize all investments according to weighted-average life. Weighted-average life may be used to measure all investment types. For example, the weighted-average life of a bullet maturity instrument is the time remaining to maturity. The following table is part of the call report instructions. This table does provide for some exceptions NCUA employs to calculate the RBNW requirement, e.g., corporate credit union membership capital.

<b>Investment</b>	<b>Weighted average life for PCA RBNW Calculation</b>
Fixed-rate, non-callable, non-amortizing debt obligations and deposits (e.g., bullet maturity instruments)	Period remaining to maturity date
Fixed-rate amortizing debt obligations or deposits (investments with periodic principal paydowns, e.g., mortgage backed securities)	Weighted average-life according to industry standard calculations. (For example, industry-recognized information providers make available weighted average-life calculations of mortgage related securities based on current prepayment estimates.)
Cash on deposit and cash equivalents	Less than one (1) year
Mutual funds (registered investment companies) and common trust investments (collective investment funds)	(a) Mutual funds (registered investment companies) and common trust investments (collective investment funds): Use maximum weighted average life as disclosed in prospectus or trust instrument, but if not disclosed, report in the 3-10 year range (as greater than 3 years, but less than or equal to 7 years for the alternative component) (b) Money market funds and Short-term investment funds (STIFs): 1 year or less
Callable fixed-rate debt obligations and deposits	Period remaining to maturity date
Variable-rate debt obligations and deposits (regardless if investment amortizes)	Period remaining to next rate adjustment date
Capital in mixed-ownership Government corporations and corporate credit unions	Greater than 1 year, but less than or equal to 3 years
Investments in CUSOs	Greater than 1 year, but less than or equal to 3 years
Other equity securities	Greater than 10 years

**Sample  
Weighted-  
Average Life  
Calculation**

Weighted-average life is defined as the weighted-average time to the return of a dollar of principal. It is calculated by the following:

- Multiply each portion of principal received by the time at which it is received (Column C = A \* B, below).
- Sum the totals of Time \* Principal (Column C) and Principal (Column B)
- Divide the totals of Time \* Principal (Column C) by total Principal (Column B)

**Weighted Average Life Calculation  
Amortizing Debt Obligation or Deposit**

A	B	C
Time (Years)	Principal	Time*Principal C=(A*B)
1	40	40
2	30	60
3	20	60
4	10	40
<b>Total</b>	100	200

$$\text{Weighted-Average Life} = \frac{\text{Sum of (Time*Principal)}}{\text{Total Principal}} = \frac{200}{100} = 2 \text{ Years}$$

**Weighted Average Life Calculation  
Non-Amortizing Debt Obligation or Deposit**

A	B	C
Time (Years)	Principal	Time*Principal C=(A*B)
1	0	0
2	0	0
3	0	0
4	100	400
<b>Total</b>	100	400

$$\text{Weighted-Average Life} = \frac{\text{Sum of (Time*Principal)}}{\text{Total Principal}} = \frac{400}{100} = 4 \text{ Years}$$

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# NET WORTH RESTORATION PLAN (NWRP) SAMPLE FORMAT - APPENDIX 17B

## NWRP

*Credit Union Name:* \_\_\_\_\_

*Charter Number:* \_\_\_\_\_

We, the Board of Directors of [CREDIT UNION NAME] submit for NCUA approval the following Net Worth Restoration Plan (NWRP) and its attachments.

The NWRP is filed because (choose the applicable provision):

- Our net worth ratio declined as of the end of the [1<sup>st</sup>, 2<sup>nd</sup>, 3<sup>rd</sup>, or 4<sup>th</sup>] calendar quarter of [YEAR];
- Our net worth ratio was recalculated as a result of the examination report received on [DATE RECEIVED] by the officials;
- We received notice we must submit a new NWRP within 30 days of [DATE NOTICE RECEIVED];
- We received written notice of reclassification on safety and soundness grounds on [DATE NOTICE RECEIVED]; or
- We received notice we failed to file a plan on [DATE NOTICE RECEIVED].

Our net worth category is [CLASSIFICATION CATEGORY] as of [EFFECTIVE DATE]. Our net worth totals \$[DOLLARS] and quarter-end assets total \$[DOLLARS]. Using the [CALCULATION METHOD], our total assets are \$[DOLLARS] and our net worth ratio is [PERCENT] percent, calculated to two decimal places.

We understand our net worth ratio must be restored to six percent, or an applicable risk-based net worth (RBNW) requirement, for the credit union to become adequately capitalized. As of the date of our most recent call report, we [DO NOT] have an applicable RBNW requirement [OF \_\_\_\_\_ PERCENT].

This plan includes the seven components listed below that:

1. Specifies a quarterly timetable of steps to become adequately capitalized (and must likely result in the credit union's remaining adequately capitalized for four consecutive calendar quarters beyond the end of the term);
2. Establishes projected quarterly earnings transfers [*AND REQUESTS A REDUCTION IN THE REQUIREMENT TO TRANSFER TO THE REGULAR RESERVE NOT LESS THAN 1/10 PERCENT OF TOTAL ASSETS*];
3. Sets forth how we will comply with the mandatory supervisory actions we must take [*AND ANY DISCRETIONARY SUPERVISORY ACTIONS IMPOSED UPON US*];
4. Identifies the types and levels of activities in which we will engage;
5. Specifies the steps we will take to correct (or notes the absence of) unsafe or unsound practices or conditions;
6. Incorporates pro forma financial statements; and
7. Includes other information as required by NCUA.

**Quarterly timetable of steps to become adequately capitalized**  
**(§702.206(c)(1)(i))**

The term of the plan will end at the earlier of either [*END OF PLAN DATE*] or the expiration of four consecutive quarters of "adequate capitalization." We plan to become adequately capitalized by the end of the term of this NWRP. If the plan terminates before achieving "adequate capitalization," a new plan will be required to reach that objective. We understand we may not cancel our plan without NCUA approval. We understand that once we are operating under this approved NWRP, after prior written notice to, and approval by the Regional Director, we may amend our plan to reflect a change in circumstance. We understand that we must carry out the approved plan pending approval of an amended plan.

During the term of our plan, we will take quarterly steps to improve our net worth as follows:

**Quarterly Steps to Improve Net Worth**

Quarter for Implementation	Plan of Action	Responsible Person Completion Date

Based on these steps, we believe it is likely the credit union will remain adequately capitalized for four consecutive calendar quarters beyond the end of the term for the following reasons:

[OUR PRO FORMA FINANCIAL STATEMENTS (INCLUDED AS AN ATTACHMENT UNDER COMPONENT SIX, BELOW) PROJECT OUR NET WORTH TO BE AT LEAST SIX PERCENT FOR THAT TIME PERIOD]

**Projected Quarterly Earnings Transfers (§702.206(c)(1)(ii))**

We plan to increase net worth by at least 1/10th percent of total assets in each quarter (except as noted below) and to transfer at least that amount to the regular reserve according to the following schedule:

**Schedule for Projected Quarterly Earnings Transfer**

Quarter Ending	Projected						
	Total Assets	Gross Income	Operating Expense	Net Income	Reserve Transfer	Net Worth	Net Worth Ratio

[WE PLAN TO TRANSFER LESS THAN 1/10<sup>th</sup> PERCENT OF TOTAL ASSETS DURING \_\_\_\_\_ QUARTERS AND REQUEST NCUA APPROVAL. OUR CURRENTLY-OFFERED RATES ON SHARES ARE ATTACHED. WE HAVE SURVEYED THE FOLLOWING DEPOSITORY INSTITUTIONS IN OUR RELEVANT MARKET AREA: [LIST]. THEIR PREVAILING RATES ON SHARES AND DEPOSITS ARE INCLUDED IN THE ATTACHMENT. OUR ANALYSIS OF HOW THE DECREASE IN THE REQUIREMENT WILL PERMIT US TO AVOID CURTAILING OUR DIVIDENDS TO SUCH A DEGREE THAT WE WOULD SUFFER A SIGNIFICANT REDEMPTION OF SHARES IS ALSO ATTACHED. BY AVOIDING A SIGNIFICANT REDEMPTION IN SHARES, WE WILL FURTHER THE PURPOSE OF PROMPT CORRECTIVE ACTION BY RESTORING OUR NET WORTH RATIO BECAUSE WE WILL \_\_\_\_\_ (AVOID HIGHER COST OF BORROWED FUNDS, AVOID HAVING TO SELL ILLIQUID ASSETS, OR ANY OTHER AVOIDANCE OF LOSS). WE DO NOT PLAN TO OFFER RATES ON SHARES IN EXCESS OF PREVAILING RATES ON SHARES AND DEPOSITS IN OUR RELEVANT MARKET AREA.]

**Mandatory and Discretionary Supervisory Actions (§702.206(c)(1)(iii))**

Our plan to comply with the mandatory supervisory actions (MSAs) and discretionary supervisory actions (DSAs) imposed on us follows.

The four MSAs are:

- Earnings transfer;
- Submit net worth restoration plan;
- Restrict increase in assets; and
- Restrict member business loans.

***Earnings transfer***

The first MSA is addressed by the first two components of our plan, our quarterly timetable of steps to become adequately capitalized and our projected quarterly earnings transfers.

***Submit net worth restoration plan***

The second MSA is addressed by submission of this plan.

***Restrict increase in assets***

The third MSA is addressed in two time frames: “*plan not approved*” and “*plan approved*.”

“*Plan not approved*.” We expect total assets to increase prior to plan approval. Total assets will increase only by reason of the following three exception categories:

- First, total accounts receivable and accrued income on loans or investments. This exception allows the accrual of income items, increasing our net worth.
- Second, cash and cash equivalents. This exception permits continued receipt of member deposits and collection of cash payments of interest income. We will increase investments only in the form of cash equivalents.
- Third, total loans outstanding, subject to a maximum equivalent to the sum of total assets plus the quarter-end balance of unused commitments to lend and unused lines of credit at the time the credit union is classified undercapitalized or lower. We may continue to make new loans in the normal course of business by reducing liquid investment assets, and to honor unused commitments (such as unused revolving loans or unused commitments for member business loans) existing at the time we were classified undercapitalized or lower. We will monitor total loans outstanding to ensure we do not exceed the maximum.

We will not offer rates on shares in excess of prevailing rates on shares and deposits in our relevant market area and will not open new branches before our plan is approved. Before our plan is approved, we will maintain records of:

- The current offered rates on our shares; and
- The prevailing rates on shares and deposits in our relevant market area.

[WE WILL NOT AVAIL OURSELVES OF THE EXCEPTIONS AND WILL NOT BE SUBJECT TO LIMITATIONS ON RATES AND BRANCHING. WE UNDERSTAND THAT UNTIL OUR PLAN IS APPROVED, WE CANNOT INCREASE TOTAL ASSETS UNDER ANY CIRCUMSTANCES.]

“*Plan approved.*” This MSA is addressed in the first two components of our plan. We understand that our assets may only increase consistent with the approved plan and we must implement our plan’s steps to increase our net worth ratio.

**Restrict member business loans (MBL)**

We will not increase the total dollar amount of member business loans (defined as loans outstanding and unused commitments to lend) as of the preceding quarter-end, in the amount of \$[DOLLARS].

[WE WERE GRANTED AN EXCEPTION TO THE MBL RESTRICTION AS:

- AN INSURED CREDIT UNION CHARTERED FOR THE PURPOSE OF MAKING, OR THAT HAS HISTORY OF PRIMARILY MAKING, MEMBER BUSINESS LOANS TO ITS MEMBERS, AS DETERMINED BY THE NCUA BOARD; OR
- A LOW-INCOME DESIGNATED CREDIT UNION; OR
- A COMMUNITY DEVELOPMENT FINANCIAL INSTITUTION.]

We plan to extend new member business loans or new commitments for member business loans. We will take the following steps to ensure we will comply with the MBL restriction:

**Steps to Comply With MBL Restriction**

Quarter for Implementation	Plan to Control Total Dollars of MBL	Responsible Person Completion Date
		Ongoing

**Discretionary supervisory actions**

The NCUA has not imposed any discretionary supervisory actions on us.

**Types and levels of activities (§702.206(c)(1)(iv))**

We plan to continue to engage in the types and levels of activities undertaken as of the date of our most recent examination, with the exception that we plan to make the changes in the kinds of services provided to our members noted under the first component of our plan and other material changes as follows:

[DESCRIBE]

We are incorporating a copy of our business plan as an attachment.

[OPTIONAL]

**Unsafe or unsound condition or practice (§702.206(c)(1)(v))**

*[THE NCUA BOARD HAS NOT RECLASSIFIED US TO A LOWER NET WORTH CATEGORY.]*

or

*[THE NCUA BOARD HAS RECLASSIFIED US TO A LOWER NET WORTH CATEGORY. WE WILL TAKE THE STEPS TO CORRECT THE UNSAFE OR UNSOUND PRACTICES OR CONDITIONS AS FOLLOWS:]*

or

*[WE HAVE AN UNSAFE OR UNSOUND CONDITION OR PRACTICE IDENTIFIED IN OUR EXAMINATION REPORT RECEIVED ON [DATE RECEIVED] BY THE OFFICIALS. WE VOLUNTEER AS PART OF THIS PLAN TO TAKE THE STEPS TO CORRECT THE PROBLEMS AS FOLLOWS:]*

**Pro forma financial statements (§702.206(c)(2))**

We are incorporating pro forma balance sheets and income statements, including all off-balance sheet items, covering the next two years by quarter *[OPTIONAL: AND THE REMAINDER OF THE TERM OF THE PLAN BY YEAR, AND A SUMMARY OF THE ASSUMPTIONS, AS ATTACHMENTS. WE HAVE EXTENDED THE PRO FORMA ANALYSIS FOR ONE YEAR BEYOND THE TERM OF THE PLAN TO DEMONSTRATE HOW WE PROJECT TO REMAIN ADEQUATELY CAPITALIZED.]* Our pro forma financial statements are consistent with our projected quarterly earnings transfers.

**Other information as required by NCUA (§702.206(c)(3))**

*[OPTIONAL: WE FILE CALL REPORTS QUARTERLY AND THIS DOCUMENT INCLUDES THE INFORMATION FOR THE QUARTER ENDED [MARCH 31 OR SEPTEMBER 30, YEAR] SUPPORTING OUR NET WORTH CLASSIFICATION CATEGORY.]*

**Submitted for the [CREDIT UNION NAME]:**

\_\_\_\_\_  
Chairman  
Board of Directors

\_\_\_\_\_  
Date

\_\_\_\_\_  
Chief Financial Officer  
Board of Directors

\_\_\_\_\_  
Date

\_\_\_\_\_  
Secretary  
Board of Directors

\_\_\_\_\_  
Date

**Approved by the National Credit Union Administration:**

\_\_\_\_\_  
Regional Director

\_\_\_\_\_  
Date

**For the [STATE SUPERVISORY AUTHORITY, if applicable]:**

\_\_\_\_\_  
[TITLE]

\_\_\_\_\_  
Date