CORPORATE CREDIT UNION GUIDANCE LETTER

No. 2003-04 DATE: May 16, 2003

SUBJ: Permissibility of Paying a Gain on Early Withdrawal of Shares

TO: The Corporate Credit Union Addressed

Section 704.8(c) of the National Credit Union Administration's (NCUA) Rules and Regulations requires a corporate credit union that permits early certificate/share withdrawals to assess market-based penalties sufficient to cover the estimated replacement cost of the certificate/share redeemed. The preamble to the final rule, 67 FR 65640, 65646 (October 25, 2002), indicates that a gain is not permissible in conjunction with a penalty for early withdrawal. There is confusion with regard to the regulatory intent, actual practice in corporates, and the existence of any safety and soundness concerns. As such, NCUA's Office of Corporate Credit Unions (OCCU) and Office of General Counsel reviewed the regulation, corporate credit union practices in this regard, and associated safety and soundness concerns. This Letter sets forth NCUA's position as to the permissibility of a corporate credit union paying a gain on early certificate/share withdrawals.

Section 704.8(c) specifically states that a penalty must be assessed to cover the "estimated replacement cost." For example, a member credit union requests the early withdrawal of a certificate. The corporate determines that there would be a higher cost of funds, if it were to replace those funds with an instrument possessing the same characteristics under current market conditions. The estimated difference between the cost of funds on the exiting deposit and the replacement deposit would be the "estimated replacement cost." The corporate would only be permitted to pay the member credit union an amount equivalent to principal and accrued dividends less the estimated replacement cost.

Conversely, the regulation does not require a penalty if there is no replacement cost. For example, a member credit union requests the early withdrawal of a certificate. The corporate determines that there would be a lower cost of funds if it were to replace those funds with an instrument possessing the same characteristics under current market conditions. As such, there is no replacement cost to the corporate. In fact, there would be a benefit to the corporate in paying less on an instrument with the same characteristics. It would be permissible for the corporate to pay a "gain" to the member credit union in an amount up to but not exceeding the estimated savings to the corporate due to the lower cost of funds. In situations where a "gain" is paid to the member, the corporate must retain written documentation to support the determination of the estimated replacement cost.

OCCU is convinced the payment of a gain on the early withdrawal of certificates/shares, within the guidelines set forth in the previous paragraph, does not pose a safety and soundness concern to corporate credit unions. In the cases reviewed by OCCU, safety and soundness was enhanced because the contract between the corporate and its member permits, but does not require, the corporate to actually pay a gain.

It is NCUA's position that the payment of a gain on early withdrawal of certificates/shares when there exists no replacement cost to the corporate is consistent with the requirements of Section 704.8(c) and the clarifying language in the preambles to the revised proposed rule and final rule.

If you have any questions, please contact this office or your state regulator.

Sincerely,

Kent D. Buckham

Kent Buckham
Director
Office of Corporate Credit Unions

cc: State Supervisory Authorities
NASCUS
NAFCU
ACCU

bcc: Reading File
E&I
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