NATIONAL CREDIT UNION ADMINISTRATION

PROMPT CORRECTIVE ACTION

STANDARDIZED APPROACH PROXY

Data as of 12/31/06

Introduction

This document contains an updated impact assessment of the change in the risk-based capital requirement contained in the June 2007 Prompt Corrective Action Reform Proposal released by the NCUA Board. This update is based upon the implementation of the standardized approach under the BASEL II Accord. The original June 2007 reform proposal assessment was based upon the application of the standardized approach under BASEL I-A.

On July 20, 2007, the Federal Reserve, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation reached an agreement regarding the implementation of BASEL II in the United States, which replaces the earlier proposed rule to adopt the BASEL I-A option. The agreement will lead to finalization of a rule implementing the advanced approaches for computing large banks' risk-based capital requirements. The banking agencies also agreed to proceed promptly to issue a proposed rule that would provide all non-core banks with the option to adopt a standardized approach under the BASEL II Accord.

The proxy analysis of the impact on credit unions using the BASEL II standardized approach is comparable to the results obtained utilizing BASEL I-A. Under the standardized approach using BASEL II, the risk-based capital requirement will govern (i.e., require more net worth in relation total assets than the proposed leverage requirement) in 66 percent of credit unions, with an average net worth requirement of 6.49 percent. Utilizing BASEL I-A, the risk-based capital requirement governs 62 percent of the credit unions, with an average net worth requirement of 6.42 percent.

IMPACT ANALYSIS

All statistics presented are based on December 31, 2006, data and included 8,253 active federally insured credit unions.

A. Leverage Ratio Comparison[1]

Aggregate Net Worth to Total Assets = 11.54%

Net Worth (Leverage) Ratio	Current Method	Proposed Method	Average Impact of NCUSIF Deduction
Mean	15.12%	14.42%	0.70%
Median	13.42%	12.70%	0.72%

Range – FICU # and %	Current Method	Proposed Method
Very Well Capitalized (well +2%)	7,479 (90.6%)	7,941 (96.2%)
Well Capitalized	8,155 (98.8%)	8,197 (99.3%)
Adequately Capitalized	44 (0.5%)	17 (0.2%)
Under Capitalized	32 (0.4%)	12 (0.1%)
Significantly Undercapitalized	15 (0.2%)	16 (0.2%)
Critically Undercapitalized	7 (0.1%)	11 (0.1%)

[1] Statistics include credit unions that are defined as new, though new credit unions will continue to have separate requirements reflecting they begin with no capital and need to build capital over time.

B. Risk-Based Ratio Comparison

Risk-Based Requirement	Current Method	Proposed Method
FICUs Subject to Risk-Based Requirement	515 (6.2%)	8,253 (100%)
Mean Risk-Based Ratio	NA	30.5%
Aggregate Risk-Based Ratio	NA	23.0%
Mean Risk Assets to Total Assets	NA	61.2%
Aggregate Risk Assets to Total Assets	NA	56.8%
Average Risk-Based Net Worth Requirement (at 10%) to Total Assets		6.49%
Aggregate Risk-Based Net Worth Requirement (at 10%) to Total Assets	NA	6.01%
# FICUs with Risk-Based Net Worth Requirement > Current Leverage Requirement (7%)	125	2,781 (33.7%)
# FICUs with Risk-Based Net Worth Requirement > Proposed Leverage Requirement (5.25%)	NA	5,447 (66.0%)
Range – FICU # and %		
Well Capitalized	515 (6.2%)	8,170 (99.0%)
Adequately Capitalized	0	45 (0.5%)
Undercapitalized	0	16 (0.2%)
Significantly Undercapitalized	NA	22 (0.3%)
Critically Undercapitalized	NA	NA

Chart 1 – Distribution of Proposed Risk-Based Ratio

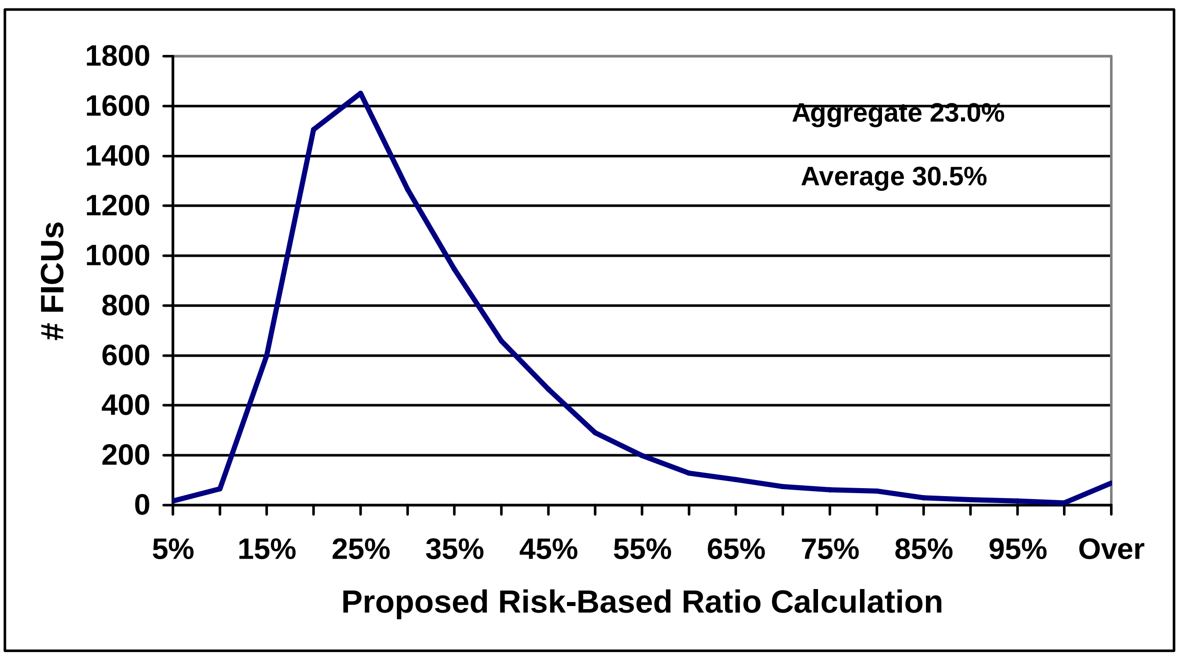


Chart 2 – Distribution of Proposed Risk Assets to Total Assets

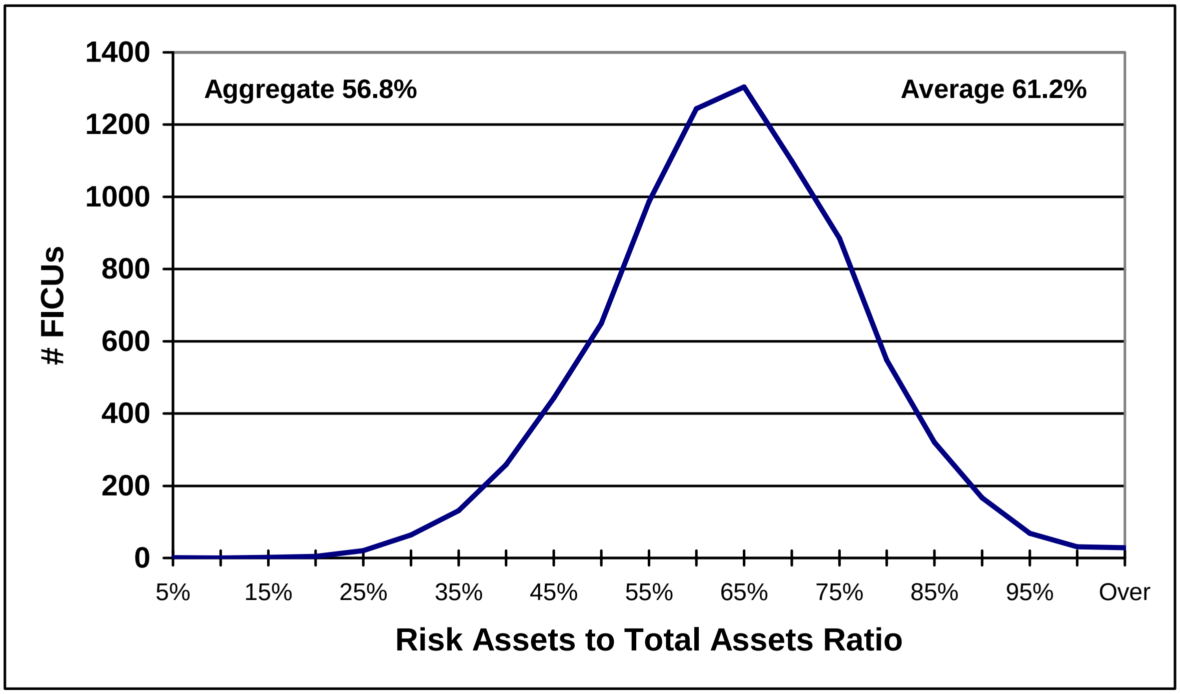
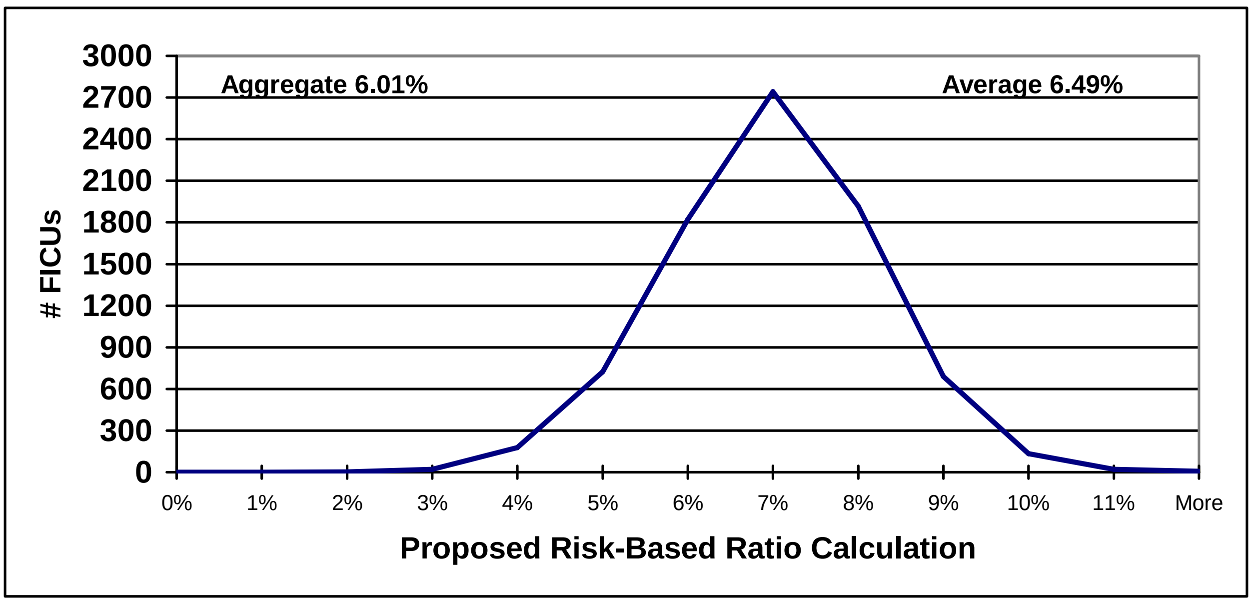


Chart 3 – Net Worth Required Under Proposed Risk-Based to Total Assets



C. Tandem Requirements Comparison

Net Worth Category Comparison - Current vs. Proposed PCA System
Number of Federally Insured Credit Unions
December 31, 2006 Data

		Proposed System					
	PCA Classification	Well Capitalized	Adequately Capitalized	Under Capitalized	Significantly Under-capitalized	Critically Under-capitalized	Total
Current System	Well Capitalized	8,138	16	0	0	1	8,155
	Adequately Capitalized	25	18	0	0	1	44
	Under Capitalized	0	12	13	7	0	32
	Significantly Undercapitalized	0	0	1	11	3	15
	Critically Undercapitalized	0	0	0	0	7	7
	Total	8,163	46	14	18	12	8,253

The red fields represent a reduction in PCA category, the yellow fields represent no change in PCA category, and the green fields represent an increase in PCA category.

APPENDIX 1 – RISK-BASED REQUIREMENT MODEL

A. Risk Weight Categories

Risk Weight	Risk Portfolios
0%	• Cash on hand • Securities, loans, leases unconditionally guaranteed by the United States and U.S. Government agencies or Government sponsored agencies
20%	• AAA or AA rated and A-1 (short-term) rated Investments[2] • Claims on federally insured financial institutions
35%	• A rated and A-2 (short-term) rated investments • Non-delinquent residential real estate loans
50%	• A+ to A- rated investments
75%	• BBB and A-3 (short-term) rated investments • Non-delinquent retail loans (consumer loans)
100%	• BBB+ to BB- rated investments • Unrated claims on corporations • Commercial loans • Investment in fixed assets • Past due residential real estate loans • Membership interests and equity interests in federally-insured financial institution • All other assets
150%	• Below BB- rated investments • Past due other loans
Varies	• Commitments
Operating Risk	• 15% of the three year average annual gross income (net interest income + other income) • Multiply by 12.5 (the inverse of the 8% capital standard) • Added to risk assets • Added an average of 18.76% to the risk weighted assets

[2] With only a few minor exceptions (like mortgage related securities), federal credit unions are not permitted to invest in instruments with any noteworthy credit risk (mostly government, federal agency, and GSE debt instruments). However, state-chartered credit unions in some states are authorized to invest in corporate debt instruments.

B. Other Considerations

Allowance for Loan and Lease Losses (ALLL). This contra account is an offset to assets. Because the ALLL has already been expensed through the income statement, the account represents a cushion against losses and, therefore, is recognized as an additional source of protection for the NCUSIF in calculating the risk-based net worth ratio. The amount of the ALLL that may be added back to Net Worth is limited to 1.25% of risk assets.

NCUSIF Deposit. This balance sheet asset is deducted from net worth for PCA purposes only. Because this account is dollar for dollar deducted from net worth, the account is excluded from risk assets. If the system were to incur losses in excess of retained earnings in the fund, the NCUSIF deposit would be reduced, then replenished by charges to credit unions, resulting in credit unions expensing the deposit.

C. Details of Model Used for Impact Analysis

Account codes are based on the December 31, 2006, Call Report.

1. Leverage Ratio Calculation

Formula = (997-794) / (if(010A>0,010A-794,if(010B>0,010B-794,if(010C>0,010C-794,010-794]))))

2. Risk-Based Ratio Calculation

Numerator	Formula (5300 Account Codes)	Comments
Net Worth	997+ALLL-794	
ALLL	ALLL=If(719<(Risk Assets*0.0125),719,(Risk Assets*0.0125))	ALLL formula adjusts for 1.25% limit.

Denominator for Risk-Based Ratio - Total Risk Assets equals the sum of the following:

Asset Categories	Formula (5300 Account Codes)	Risk Weight	Comments
Cash on Hand	730A	0	
Government Obligations	741C	0	
Federal Agency Securities	742C +(.8*400F)	0	Includes insured portion of SBA loans
Claims on Federally-Insured Financial Institutions	730B+730C+744C+652C+672C	0.2	
Claims on Corporations	743C+784	.2 & .5	20% on mutual funds and 50% on unauthorized investments
Membership Interests	769A+769B	1	
Other Investments	799I-captured investments	1	Capture investments not assigned risk weight. May capture stock in FHLB (20% risk weight)
Non-Delinquent Retail Loans	396+397+385+370+002+698-(400-718)-(041B-(713A-714A-715A-716A))	.75	
Non-Delinquent Residential Real Estate	703+386+003-713A-714A-715A-716A	.35	

Loans			
Past Due Residential RE	713A+714A+715A+716A	1	
Past Due Other	041B-713A-714A-715A-716A	1.5	
All Other Loans	025B-Captured Loans	1	
All Other Assets	798A+007+008+009	1	
Commitments – Business Loans	814+814A	.5*1	Assumes all non-cancelable, over 1 year in original maturity, and apply to loans with a risk weight of 100% with at 50% credit conversion factor
Commitments – Home Equity Loans	811	.2*.35	Risk Weight of 0.35 and with a 20% credit conversion factor
Commitments – Letters of Credit	813	.5*1	50% credit conversion factor for performance-based standby letters of credit with a risk weight of 1
Loans Transferred with Recourse	819	0.35	Assumption related to real estate loans. Lowest RE weight given limited recourse by definition. Will not account for any recourse liability established. 100% credit conversion factor
Other Commitments	816	0.75 *20%	
Borrowing Reverse Repurchase	781	.75	
Operating Risk	115-350+131+659+440	15% x 12.5	