

CORPORATE CREDIT UNION GUIDANCE LETTER

No. 2003-03

DATE: May 13, 2003

SUBJ: Modeling Nonmaturity Shares and Deposits

TO: The Corporate Credit Union Addressed

The Office of Corporate Credit Unions (OCCU) is issuing this guidance to address estimates of the fair value of nonmaturity shares and deposits (NMDs) used in supervisory reporting of net economic value (NEV) measures for regulatory purposes. This guidance does not address assumptions used for internal management reporting of interest rate risk or for liquidity planning.

For regulatory purposes, a corporate credit union should set the fair value of institutional NMDs to book value, or model the deposits as overnight deposits. The fair value of institutional NMDs at corporate credit unions is unlikely to be materially different from book value.

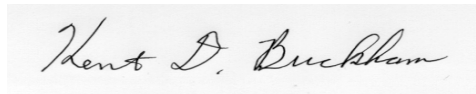
The revised definition of fair value in Section 704.2 requires valuation techniques to incorporate assumptions that market participants would use in their estimates of value, future revenues, and future expenses, including assumptions about interest rates, defaults, prepayment, and volatility. The predominate practice is for institutional NMDs to be valued at book value or treated as overnight accounts. The regulatory NEV limits were recommended to the NCUA Board in light of this predominate practice.

Member credit unions have an alignment of ownership in both their NMDs and the corporate credit union itself. Thus, it is not sufficient to estimate the behavior of institutional NMD account holders at corporate credit unions using analytical techniques designed to estimate the degree of rate insensitivity of depositors in retail NMDs. Such an analysis does not consider the entire economic transaction. Rather, all future revenues and expenses from services and dividends to members, which are not capitalized on the balance sheet, would need to be considered in valuing institutional NMDs, as is the case with institutional compensating balance accounts.

Valuation at book value will provide reliability in application of the regulatory NEV limits. According to a report by international regulators, assumptions employed for retail NMDs are by necessity blunt and judgmental. Such judgmental aspects of interest rate risk modeling may drive the resulting risk measure and conclusion, regardless of the detailed attention paid to other aspects of the risk measure.¹ In order to consistently measure interest rate risk at corporate credit unions and enforce the regulation, OCCU must be able to ensure these judgmental aspects do not materially distort the modeling results.

If you have any questions, please contact the OCCU at (703) 518-6640, or your state regulator.

Sincerely,

A rectangular box containing a handwritten signature in cursive script that reads "Kent D. Buckham".

Kent Buckham
Director
Office of Corporate Credit Unions

OCCU:DAS:ch
Attachment

cc: State Supervisory Authorities
NASCUS
NAFCU
ACCU

¹ Basel Committee on Banking Supervision (2001). The New Basel Capital Accord, Principles for the Management and Supervision of Interest Rate Risk, <http://www.bis.org/publ/bcbsca.htm>, Annex 3, para. 8.