NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION
1775 Duke Street, Alexandria, VA 22314

DATE: **November 1999** **LETTER NO.: 99-CU-18**

TO: **All Federally Insured Credit Unions**

SUBJ: **The NCUA Central Liquidity Facility Expedited Y2K Procedures**

DEAR BOARD OF DIRECTORS:

In response to numerous questions about the Central Liquidity Facility (CLF), this letter reiterates the function of the CLF and details recently established expedited loan procedures in effect for the months surrounding the century date conversion.

WHAT IS THE CLF?

The CLF is a mixed ownership Government corporation within the NCUA. It is an instrumentality of the Federal Government owned by its member credit unions and managed by the NCUA Board. The purpose of the CLF is to improve the general financial stability of credit unions by providing a source of loans to meet their liquidity needs.

WHY DO CREDIT UNIONS NEED THE CLF?

The CLF is a backup contingency funding source for credit unions. Though the CLF does not generally expect credit unions to have extraordinary liquidity needs, circumstances like the unprecedented and unpredictable nature of the upcoming century date change (Y2K) necessitate strong contingency planning on the part of all credit unions. As a contingency resource, the CLF is poised to respond to potential wide-spread or systemic demand for uncommonly large amounts of funds. For fiscal year 2000 (October 1, 1999 to September 30, 2000), the CLF has a borrowing arrangement with the Federal Financing Bank that permits the CLF to obtain total advances of up to $20.7 billion. This is in addition to what credit unions and corporate credit unions have already established for contingency needs. Thus, the CLF represents a significant backup funding source for the credit union system by providing for extraordinary funding demands that might exceed credit unions' own on-hand liquidity.

HOW CAN CREDIT UNIONS ACCESS THE CLF?

A credit union may either belong to the CLF as a Regular member or as a member of a corporate credit union which is an agent of the CLF, as provided for by 12 C.F.R. §725 of NCUA's Rules and Regulations. A Regular member of the CLF has become a member by: a) submitting an application for Regular membership to the CLF and, b) subscribing to capital stock of the CLF as set forth in 12 C.F.R. § 725.3 (a). Credit unions that belong to an agent (i.e., a corporate credit union) do not need to subscribe to CLF capital stock since the agents subscribe on behalf of their member natural person credit unions. The vast majority of credit unions currently qualify for CLF access through membership in a corporate credit union. Regular members submit requests for funds directly to the CLF. All other credit unions who qualify submit requests for funds to their respective corporate credit union under normal lending arrangements.

HOW DOES THE AGENT LENDING PROCESS WORK?

A credit union planning to obtain liquidity loans via an agent of the CLF must communicate directly with the agent (i.e., the corporate that purchased CLF stock on the credit union's behalf). That credit union will submit its request for funds consistent with its standard credit arrangement with that corporate. The corporate, <u>at its discretion</u>, can elect to fund the request out of its own available liquidity or with funds obtained from the CLF. A loan by a corporate to a member natural person credit union becomes an "agent loan" when the corporate's application for a CLF advance is subsequently based on that loan and the request for funds is approved and granted. Thus, the CLF lends to the agent and not directly to the natural person credit union. The natural person credit union is liable for repayment of its liquidity loan to the agent.

WHAT ARE THE FOUR ACTIONS I MUST DO AS A CREDIT UNION TO POSITION MYSELF FOR ACCESS TO CLF FUNDING?

If a member of a corporate is to qualify for a liquidity loan from that corporate, which in turn is funded by CLF-provided liquidity, the credit union must do the following:

- **a.** Execute a line of credit agreement with a corporate credit union that:
  - **1)** is an agent of the CLF; and,

2) has subscribed CLF stock on behalf of the credit union;

b. Obtain from, execute, and return to its corporate a CLF *Liquidity Need Loan Application* ("LNLA", form CLF-10) to confirm the credit union's acknowledgment that the terms provided under 12 C.F.R. § 725 of NCUA's Rules and Regulations are understood and accepted;

c. Provide its corporate with an updated borrowing authorization indicating individuals permitted to borrow on behalf of the credit union; and,

d. Advise its corporate of all lines of credit or alternative secured borrowing arrangements that pose a potential collateral conflict with a CLF advance. By regulation, each CLF advance must be secured by a first priority security interest in assets of the borrowing natural person credit union. Such assets must have a net book value of at least 110% of all amounts due under the applicable CLF advance. **Collateral conflicts may result in a denial of a CLF loan**.

WHY ARE SPECIAL EXPEDITED PROCEDURES NECESSARY?

Despite the commendable job credit unions have done to prepare for the Y2K date conversion, actual circumstances and events are impossible to predict. Unfounded concerns and uncertainty among the public could translate to a sudden need for liquidity on the part of financial institutions, triggered by extraordinarily high cash withdrawals and pre-Y2K purchases by the institutions' member/customers. To prepare for this remote possibility, the CLF has instituted certain expedited procedures during the months surrounding the century date conversion. These procedures are designed to enhance the CLF's ability to respond timely and effectively to any foreseeable liquidity demand and are in effect from now through March 31, 2000 and may be extended if necessary.

WHAT ARE THE EXPEDITED PROCEDURES THAT HAVE BEEN INSTITUTED?

The major procedural changes effective during Y2K contingency period include: delegations of authority given directly to the CLF President and the Director of the Office of Corporate Credit Unions, by the NCUA Board, in order to expedite CLF loan requests. These include:

a. The CLF President shall have the authority to lend up to $5 million dollars to one borrower and to lend amounts above $5 million with the concurrence of the Director of Examination and Insurance;

b. The CLF President shall have the authority to waive the six month waiting period for CLF advances to new members (see 12 C.F.R. § 725.4 (f));

c. Corporate credit unions have been granted temporary forbearance from 12 C.F.R. § 704 as it relates to CLF loans made to member natural person credit unions (borrowing limits, lending limits and minimum capital requirements).

HOW LONG CAN A CREDIT UNION BORROW CLF-BACKED FUNDS?

All CLF-funded loans made through the Agent group (headed by US Central Credit Union) shall be one business day ("overnight") but may be continually renewed for successive days for as long as the credit union has a liquidity need. This will permit credit unions to use their normal credit facility and efficiently and timely adjust their daily funding needs while avoiding the cumbersome and potentially costly effect of loan prepayment charges.

HOW IS A RATE ON A LIQUIDITY LOAN SET?

The rate for CLF loans will be based on the CLF's cost of funds. The CLF intends, subject to availability of funds, to primarily use the Federal Financing Bank (FFB) as its source of borrowed funds. Agent loans to member natural person credit unions will reflect the CLF agent's cost of funds, as determined by the agent, and may be subject to a charge adequate to cover the agent's expenses and to provide for the accumulation of reasonable contingency reserves.

SUMMARY:

The "liquidity need" circumstances of each member natural person credit union (borrower) will be evaluated by the CLF to assure that loans are made consistent with the requirements set forth in 12 U.S.C. § 302 of the FCU Act and 12 C.F.R. § 725.2 of NCUA's Rules and Regulations. All liquidity-need loans funded by the CLF must include a specification of the liquidity need "type" (form completed by the CLF Agent). In order to fund a member natural person credit union loan request with CLF-based funding, the agent needs to be assured that the borrower has a current liquidity need and is not borrowing to expand its portfolios. If the borrower's loan request is not for an immediate liquidity need, the request must be based upon its current liquidity need projections. When CLF-provided funds are involved to meet a loan request that is not for an immediate liquidity need, the credit union's written analysis supporting this projection will be <u>essential</u> for it to address any potential follow-up supervision questions and/or preparation of a liquidity restoration plan[1] if required. It is not necessary that the agent have the written analysis on which the credit union is basing its request.

If your credit union is not a Regular member of the CLF and has not completed the steps specified under the "WHAT ARE THE FOUR ACTIONS I MUST DO AS A CREDIT UNION TO POSITION MYSELF FOR ACCESS TO CLF FUNDING?", and you intend to utilize the CLF as a contingency source of funds, you should immediately contact your corporate credit union and complete any remaining requirements. For additional information on the CLF you should contact your corporate credit union or you may call the CLF directly at 703-518-6391.

Again, this letter reiterates the function of the CLF and details recently established expedited loan procedures in effect for the period surrounding the century date conversion (Y2K). These measures have been taken to further enhance the CLF's ability to respond timely and effectively to any unforeseeable liquidity demand.

For the National Credit Union Administration Board,

Norman E. D'Amours
Chairman

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[1] After the century date change, the CLF will require a liquidity restoration plan from any credit union with outstanding CLF balances beyond a reasonable time (generally 90 days). The liquidity restoration plan will need to detail the credit union's ability and means for restoring its business-as-usual liquidity profile to a non-CLF reliant condition.