

7535-01-U

## NATIONAL CREDIT UNION ADMINISTRATION

Central Liquidity Facility

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final Interpretive Ruling and Policy Statement (IRPS) 01-2, "Central Liquidity Facility Advance Policy."

SUMMARY: This policy statement clarifies the role of the Central Liquidity Facility (CLF) and the circumstances when the CLF will approve a Regular or Agent Member's request for a CLF advance.

DATES: The IRPS is effective May 29, 2001.

ADDRESSES: National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314-3428.

FOR FURTHER INFORMATION CONTACT: J. Owen Cole, Jr., Vice President, CLF, at the above address, or telephone: (703) 518-6360 or Frank S. Kressman, Staff Attorney, at the above address, or telephone: (703) 518-6540.

### SUPPLEMENTARY INFORMATION:

#### A. Background

The CLF operates in accordance with Title III of the Federal Credit Union Act (Act) and Part 725 of NCUA's regulations, which implements Title III. 12 U.S.C. 1795-1795k; 12 CFR part 725. It was created in 1979 to improve the general financial stability of the credit union industry by helping to meet the liquidity needs of individual credit unions. This improved stability encourages savings, supports consumer and mortgage lending, and helps provide basic financial resources to all segments of the economy. In continuing to fulfill this mission, the CLF previously published proposed IRPS 00-2 to clarify its function and limitations in an ever-changing financial services environment. 65 FR 63892, October 25, 2000; 65 FR 65884, November 2, 2000. NCUA has received public comments on the proposal and has incorporated some of those comments into the IRPS. NCUA has renumbered IRPS 00-2 as 01-2 and adopts the below revised IRPS as final. IRPS 01-2 supersedes IRPS 80-4.

#### B. Summary of Comments

NCUA received thirteen comment letters regarding the proposed IRPS. Six from credit union trade associations, four from corporate credit unions, one from a natural person federal credit union, one from a banking trade association, and one from an association of state credit union supervisors. All of the commenters generally supported the proposed IRPS, except for the banking trade association. Some commenters offered suggested revisions.

Seven commenters noted that the proposed IRPS states that a CLF loan officer may require a borrowing credit union to prepare a liquidity restoration plan to detail

the action and time required to restore the credit union's net funds position to the point where it is no longer dependent on CLF advances. These commenters suggested that the IRPS would be more useful if NCUA provided examples of circumstances under which a loan officer might require a plan. The loan officer's decision to require a plan is greatly dependent on the unique circumstances of the borrowing credit union. Factors that may contribute to this decision include: 1) the credit union consistently provides incomplete, vague, or untimely information needed to approve or monitor an advance; 2) the loan officer develops concerns about the borrowing credit union's financial condition and ability to repay; 3) the credit union appears to have used an advance for inappropriate purposes; and 4) the credit union appears to be unreasonably dependent on advances without making progress towards implementing programs to manage its liquidity risk. These factors are only a few of many that a loan officer may consider before requiring a liquidity restoration plan. This clarification has been incorporated into the final IRPS.

Four commenters noted that the proposed IRPS lists examples of appropriate circumstances for seeking CLF advances. These commenters suggested that NCUA should more clearly indicate that there may also be other appropriate circumstances for seeking CLF advances in addition to those listed. NCUA acknowledges that the list is meant to be illustrative, not exhaustive. NCUA has incorporated this clarification into the final IRPS.

The association of state credit union supervisors suggested that NCUA should adopt a policy not to advance funds to a state chartered, federally insured credit union without first consulting with the credit union's state supervisory authority (SSA). NCUA does not believe this is an appropriate action for it to take, but recognizes that an SSA may wish to require its regulated credit unions to notify it before making application to CLF.

The banking trade association suggested that NCUA withdraw the IRPS and re-issue it as a regulation so that it would have the force of law. We note that the IRPS was issued in compliance with the Administrative Procedure Act (APA) and has the same force of law as a regulation. 5 U.S.C. 551. The banking trade association also stated that CLF should not provide financial assistance to financially troubled credit unions. We agree. CLF is intended only as a liquidity provider and that is how it functions. Finally, the banking trade association stated that CLF is prohibited from making advances the intent of which is to expand credit union portfolios and therefore can not make advances to address an unexpected surge of credit demands. We agree that CLF is prohibited from making advances the intent of which is to expand credit union portfolios, but believe that an unexpected surge of credit demands is a legitimate liquidity need for the CLF to meet.

## Regulatory Procedures

### Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact agency rulemaking may have on a substantial number of small credit unions. For purposes of this analysis, credit unions under \$1 million in assets are considered small credit unions.

This final IRPS clarifies the role of the CLF and the circumstances when the CLF will approve advances. This final IRPS imposes no additional financial, regulatory, or other burden whatsoever on credit unions transacting business with the CLF. The NCUA has determined and certifies that this final IRPS will not have a significant economic impact on a substantial number of small credit unions. Accordingly, the NCUA has determined that a Regulatory Flexibility Analysis is not required.

#### Paperwork Reduction Act

NCUA has determined that this final IRPS does not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

#### Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This final IRPS applies to all credit unions doing business with the CLF, but does not have substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this final IRPS does not constitute a policy that has federalism implications for purposes of the executive order.

#### Assessment of Federal Regulations and Policies on Families

NCUA has determined that this final IRPS will not affect family well-being within the meaning of Section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

#### Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104-121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the APA. 5 U.S.C. 551. The Office of Management and Budget has determined that this final IRPS is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

By the National Credit Union Administration Board, on April 19, 2001.

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Becky Baker  
Secretary of the Board

For the reasons stated above, IRPS 01-2 is revised to read as follows:

1. Authority: 12 U.S.C. 1795-1795f.
2. IRPS 01-2 is revised to read as follows:

## Interpretive Ruling And Policy Statement No. 01-2

### Central Liquidity Facility Advance Policy

#### PURPOSE

Congress established the Central Liquidity Facility (CLF) in 1979 and authorized the NCUA Board, acting as the CLF Board, to prescribe the manner in which the general business of the CLF is to be conducted. The CLF was created to improve the general financial stability of the credit union industry by meeting the liquidity needs of individual credit unions. This improved stability encourages savings, supports consumer and mortgage lending, and helps provide basic financial resources to all segments of the economy. This policy statement is intended to clarify the role of the CLF and the circumstances under which the CLF will approve a Regular or Agent Member's request for a CLF advance.

#### LIQUIDITY NEEDS

The liquidity needs of natural person credit unions for which CLF advances are appropriate are limited to:

- A. short-term adjustment credit available to assist in meeting temporary requirements for funds or to cushion more persistent outflows of funds pending an orderly readjustment of credit union assets and liabilities;
- B. seasonal credit available for longer periods to assist in meeting seasonal needs for funds arising from a combination of expected patterns of movement in share and deposit accounts and loans; and
- C. protracted adjustment credit available in the event of unusual or emergency circumstances of a longer-term nature resulting from national, regional or local difficulties.

Short-term adjustment credit advances generally are available for maturity periods of up to 90 days. Seasonal credit advances are available for periods of up to 270 days. Seasonal credit is generally restricted to institutions that can demonstrate a pattern of recurring need. Seasonal credit advance requests must be supported by an analysis that includes at least two years of detailed seasonal flow of funds data. Protracted adjustment credit advances that are available for periods in excess of 270 days are only made when exceptional circumstances are adversely affecting an individual institution. CLF loan officers exercise considerable discretion in extending protracted adjustment credit and may consult with NCUA supervisory authorities to address any concerns over the credit union's ability to restore liquidity and remain viable. As is the case with short-term adjustment credit and seasonal credit, CLF may decline a credit union's request for protracted adjustment credit for creditworthiness reasons. It may also refer the credit union to the appropriate NCUA Regional Director for possible NCUSIF special assistance under Section 208 of the Act. 12 U.S.C. 1788.

#### ROLE OF THE CLF

Historically, CLF advances have been intended only to help maintain financial stability for credit unions that were experiencing liquidity difficulties or expected to experience liquidity difficulties in the immediate future. In most instances, CLF makes advances when the borrower's primary sources of liquidity are inadequate, impracticable or otherwise unavailable at the time of need. CLF is prohibited by statute from making an advance the intent of which is to expand credit union portfolios. 12 U.S.C. 1795e(a)(1).

NCUA acknowledges the need for the CLF to operate in a flexible manner. While NCUA recognizes that CLF is not to be considered the "lender of last resort," NCUA also understands that CLF is not to be used as a conventional funding facility or standard market alternative for borrowing credit unions. Rather, NCUA's long-standing position is that the CLF was established to be used sparingly as a stabilizing agent in times when liquidity needs threaten to disrupt credit unions' ability to provide basic financial resources to their members. Accordingly, NCUA's long-held policy that the CLF is a backup liquidity provider remains unchanged.

Although CLF advances are available when appropriate, NCUA emphasizes the importance of liquidity planning and contingency funding. NCUA expects credit unions to have in place adequate programs and procedures to manage their liquidity risk. Each credit union's liquidity management program should be appropriate for the overall level of risk incurred, considering its asset size, complexity, capital adequacy, and products or services offered. Inadequate liquidity can cause disruptions in member services and diminish public confidence. It can also increase a credit union's vulnerability to other market and operational risks. The failure to understand and manage liquidity risk adequately could easily place a credit union in an unsafe and unsound financial position.

As part of normal contingency planning, credit unions are expected to develop funding plans that include credit lines that are accessible on a timely basis. This may be accomplished with a corporate credit union or other source. The appropriateness of granting a CLF advance depends on the circumstances of the credit union at the time of the liquidity need. Appropriate circumstances for seeking CLF advances may include, but are not limited to, borrowing:

- to meet an unexpected loss in shares or nonmember funds;
- to address an unexpected surge of credit demands within the credit union's membership; and
- to meet liquidity needs due to forces beyond the immediate control of the credit union such as an internal operating problem or a natural disaster.

Among other circumstances, borrowing from CLF is not appropriate:

- to take advantage of a differential between the rate of a CLF advance and the rate of alternative sources of funds known as spread arbitrage;
- to substitute CLF credit for normal, short-term, interest-sensitive shares such as certificates or money market shares; or
- to support a planned increase in loans or investment holdings or new loan product offerings.

CLF will monitor, as necessary, the frequency and duration of a credit union's CLF borrowings to make certain that the credit union is taking appropriate measures to diminish reliance on CLF advances and verify that a more serious liquidity problem does not exist. Borrowers are expected to initiate appropriate actions to restore adequate liquidity within a reasonable period of time. Facility loan officers, at their discretion, may require a borrowing credit union to prepare a liquidity restoration plan to detail the action and time required to restore its net funds position to the point where it is no longer dependent on CLF advances. A loan officer's decision to require a plan is greatly dependent on the unique circumstances of the borrowing credit union. Factors that may contribute to this decision include: 1) the credit union consistently provides incomplete, vague, or untimely information needed to approve or monitor an advance; 2) the loan officer develops concerns about the borrowing credit union's financial condition and ability to repay; 3) the credit union appears to have used an advance for inappropriate purposes; and 4) the credit union appears to be unreasonably dependent on advances without making progress towards implementing programs to manage its liquidity risk. These factors are only a few of many that a loan officer may consider before requiring a liquidity restoration plan.