

to absorb the difference between the penalty and the replacement cost. While members may not behave in a perfect economic fashion (calculating the break-even point), the risk exposure is still significant. The incorporation of mark-to-market penalties is consistent with the principle of running a matched book.

Permanent Capital Share Account (PCSA)

The Board recognizes that it may be difficult for some corporate credit unions to reach the capital levels required under proposed Section 704.12 in the timeframes provided. The reports of the General Accounting Office and the Corporate Credit Union Study Committee both propose the use of a form of nonredeemable membership shares to assist, in the short-term, corporate credit unions to attain minimum capital goals. Accordingly, the Board is proposing to create a type of membership share that would be at risk, would not be redeemable without written concurrence of NCUA, and would pay non cumulative dividends. Because of these elements of permanency, up to 50 percent of primary capital could consist of PCSAs. The Board requests comment on the criteria NCUA should use to determine when PCSAs may be redeemed.

PCSAs would be limited to credit unions within the corporate credit union's field of membership, would not be subject to insurance by the NCUSIF or other deposit insurer, and could not be used to collateralize borrowings. PCSAs would be available to absorb losses in the event of a deficit in the corporate credit union's other primary capital accounts. In the event of liquidation of a corporate credit union, PCSAs would be payable only after satisfaction of all liabilities.

A corporate credit union would be required to adequately disclose the terms and conditions of PCSAs to each subscriber. A standard form for such disclosure is provided in the regulation.

Primary Capital

Currently, primary capital is defined as all corporate statutory and regular reserves and undivided earnings. The Board is proposing to amend the definition to have primary capital consist of statutory reserves, undivided earnings, other reserves (excluding the allowance for loan losses and

accumulated gains/losses on available-for-sale securities), net income/loss, and permanent capital share accounts (PCSAs). No more than 50 percent of primary capital would be permitted to be comprised of PCSAs. The proposed regulation would provide for several benchmarks that are tied to the level of the corporate credit union's primary capital.

Rated

Section 704.6 of the current regulation frequently requires that a security be rated at a certain level "by an SEC-recognized rating agency," which is defined in § 704.2. In the interests of simplifying the regulation, the proposed rule would simply define "rated" to mean "rated by an SEC-recognized rating agency," which would then be defined.

Secondary Capital Share Account (SCSA)

The current regulation introduced the concept of membership capital share deposits (MCSDs), which are subject to certain restrictions in order to qualify as secondary capital. The Board is proposing to retain this concept in a new form called secondary capital share accounts (SCSAs). As with PCSAs, SCSAs would be limited to credit unions within the corporate credit union's field of membership, would not be subject to insurance by the NCUSIF or other deposit insurer, could not be used to collateralize borrowings, and in the event of liquidation of a corporate credit union, would be payable only after satisfaction of all liabilities.

In order for an SCSA to count as capital, it would have to have a minimum notice of withdrawal of two years. The Board weighed several options in establishing the notice period. The Board believes that the one year notice that currently exists for MCSDs is too short. If a corporate credit union experienced problems, all of its secondary capital could be depleted in 12 months. This is often not enough time to resolve problems, and a total depletion of secondary capital could threaten a corporate credit union's continued viability. The Board believes that a two year notice period would serve to preserve capital, yet allow maneuverability on the part of member credit unions. Individual corporates would be free to set longer notice periods if they wished.

The Board also proposes that SCSAs be available to absorb losses in the event of a deficit in the corporate credit union's primary capital. SCSAs could be used not only if a corporate credit union were liquidated, but also to cover any losses in a continuing corporate credit union that has depleted its level of primary capital.

The Board is concerned that all the requirements and conditions of SCSAs are adequately disclosed to each member credit union. Therefore, specific disclosure at the time of the opening of an SCSA, and annual disclosure thereafter, is provided in the regulation, along with standard forms that may be used by the corporate credit unions.

The Board notes that SCSAs are the only permitted form of secondary capital in the proposed rule. Currently, secondary capital consists of MCSDs and term subordinated debt. A review of the corporate credit unions determined that none had in fact used term subordinated debt as a way to build secondary capital. In light of this, and the Board's belief that it is more appropriate to build capital through a corporate credit union's members, the proposed rule would not include term subordinated debt in secondary capital and would delete any reference to it in the regulation. Since SCSAs would be the only component of secondary capital, the proposed rule would simply refer to SCSAs instead of secondary capital.

Undivided Earnings

The Board is proposing to revise the definition of "undivided earnings" to remove the term "corporate reserves," as that term is not used in the proposed rule.

United States Government or its Agencies; United States Government-Sponsored Corporations and Enterprises

The Board is proposing to delete the reference to Appendix C from these definitions and to delete current Appendix C. Rather than having a fixed list of agencies and enterprises, which may become erroneous as entities are created, dissolved, or changed, the Board wishes to simply present the definition of government agencies and enterprises and place the responsibility of determining an entity's status on the corporate credit union.