

By the Office of Thrift Supervision.
Ellen Seidman,
Director.
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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 722 and 742

Regulatory Flexibility Program

AGENCY: National Credit Union Administration.

ACTION: Proposed rule.

SUMMARY: The NCUA Board is proposing a new rule that would permit credit unions with advanced levels of net worth and consistently strong supervisory examination ratings to be exempt, in whole or in part, from certain NCUA regulations that are not specifically required by statute. The NCUA Board is also proposing an amendment to the appraisal regulation to increase the dollar threshold from \$100,000 to \$250,000 for when an appraisal is required. This proposed rule and proposed amendment would reduce regulatory burden.

DATES: Comments must be postmarked or received by May 14, 2001.

ADDRESSES: Comments should be directed to Becky Baker, Secretary of the Board. Mail or hand deliver comments to: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428. Fax comments to (703) 518-6319. E-Mail comments to regcomments@ncua.gov. Please send comments by one method only.

FOR FURTHER INFORMATION CONTACT: Michael J. McKenna, Senior Staff Attorney, Office of General Counsel, 1775 Duke Street, Alexandria, Virginia 22314 or telephone (703) 518-6540; or Lynn K. McLaughlin, Program Officer, Office of Examination and Insurance, 1775 Duke Street, Alexandria, Virginia, or telephone (703) 518-6360.

SUPPLEMENTARY INFORMATION: On March 16, 2000, the NCUA Board issued an advance notice of proposed rulemaking on a regulatory flexibility and exemption (RegFlex) program with a sixty-day comment period. 65 FR 15275 (March 22, 2000). The comment period ended on May 22, 2000. Seventy-four comments were received. Comments were received from 42 federal credit unions, 11 state-chartered credit unions, 13 state leagues, five national credit union trade associations, one bank trade association, one community action

group and one law firm. The commenters were generally supportive of the proposal, with most commenters suggesting ways they would structure such a regulation.

A. Background

NCUA is proposing to exempt qualifying credit unions from certain regulatory provisions. The proposed regulatory provisions under consideration are not specifically required by statute, and an exemption from which would permit these credit unions greater flexibility in managing their operations. As part of this proposal, the NCUA Board has identified five regulations for RegFlex. The identified regulations are: fixed assets (section 701.36), investment and deposit activities (various provisions of part 703), charitable donations (section 701.25), payment on shares by public unit and nonmembers (section 701.32(b) and (c)) and the purchase, sale and pledge of eligible obligations (section 701.23). It is estimated currently that 3,999, or 63 percent of credit unions qualify for RegFlex, and of those 2,203 or 55 percent are less than \$10 million in assets.

B. Comments and Analysis

1. The RegFlex Concept

Last year, the NCUA Board asked for comments on whether credit unions with a proven track record of favorable performance should be allowed additional regulatory flexibility since their demonstrated ability mitigates the predominance of what limited safety and soundness concerns, if any, might arise from a reduction of certain regulatory requirements. Seventy commenters supported the general concept of RegFlex. Two commenters stated the proposal was unnecessary. Five of the supporting commenters stated that RegFlex should apply to all federal credit unions.

Nineteen commenters stated this proposal would not increase risk. Some of these commenters believe the eligibility criteria demonstrate that a credit union can manage any safety and soundness concerns. One commenter explained why this proposal was not, as some critics claimed, regulatory forbearance. This commenter states that regulatory forbearance lowers the bar for the entire industry without any consideration as to whether institutions have the proven ability to manage the lower standard. This commenter states further that the RegFlex program would not lower the bar for anyone, rather it would raise the bar by encouraging excellent performance.

The NCUA Board also asked for comment on whether a flexible regulatory approach, which results in the removal of selected regulatory obstacles for those credit unions with strong records of safety and soundness and effective risk management, will encourage them to strive to maintain and enhance those levels of financial performance as well as to better enable them to remain competitive in the financial marketplace, foster innovation in member service, and extend credit to the underserved. Nine commenters stated that RegFlex would help credit unions remain competitive.

The NCUA Board also asked whether providing additional flexibility might result in credit unions reducing service for fear that, with additional risk taking, delinquencies might increase and jeopardize its maintenance of a CAMEL 1 or 2 rating. Six commenters stated it would improve or increase member service. Two commenters stated that the proposal might adversely affect service. One commenter stated that it would not reduce the level of service.

The NCUA Board asked whether establishing this special class of credit unions to receive different regulatory treatment provides a competitive advantage to RegFlex credit unions over ineligible credit unions. Twelve commenters stated that there will be no competitive advantage for RegFlex credit unions. Some of these commenters believe the proposal will provide credit unions incentives to improve and enhance safety and soundness. Six commenters stated that RegFlex credit unions would have a competitive advantage.

2. The RegFlex Proposal

The first criterion for eligibility under this proposal, is that credit unions must have received a composite CAMEL code 1 or code 2 for two consecutive exams, with a CAMEL code 1 or 2 in management. The second criterion is that a credit union must have a net worth ratio of 9% or greater, and be well-capitalized under NCUA's prompt corrective action regulations. 12 CFR part 702. Sixteen commenters stated that the qualifying criteria appear sound. Seventeen commenters stated that the net worth criterion should be lower. One of these commenters suggested 8.5%. Two of these commenters suggested 8%. Nine of these commenters suggested 7%. One commenter stated that the net worth levels should be higher. Two commenters stated that the trigger should simply be the CAMEL rating. The NCUA Board believes the proposed criterion are generally sound but does

not believe a CAMEL 1 or 2 in management needs to be part of the criteria. This belief is principally supported by the ability of the regional director to revoke the regflex authority, in whole or in part, at any time. Except for this change, the NCUA Board is proposing to incorporate the criteria specified in the advanced notice of proposed rulemaking into the regulation for credit unions that are not complex under prompt corrective action. However, in response to the comments, as discussed later in the preamble, the NCUA Board is also proposing an application process for credit unions that do not meet both criterion and is requesting comment on whether the 9 percent net worth requirement is appropriate.

Eleven commenters requested that the rule state what happens if a qualifying credit union takes action under the RegFlex exemption but subsequently loses the exemption. That is, what liability is there for past actions that are no longer permissible. Most of these commenters want past actions grandfathered. The NCUA Board agrees and the proposed rule states that if a credit union loses its RegFlex eligibility its past actions are grandfathered and no divestiture is required. However, this does not diminish NCUA's authority to require a credit union to divest its investments or assets for substantive safety and soundness reasons.

The NCUA Board also requested comment on whether the capital trigger for complex credit unions should be different and if so, what criteria should be used. One commenter stated that the net worth criterion for complex and noncomplex credit unions should be 7%. Eight commenters stated that the trigger should be the same for complex and noncomplex credit unions. One commenter stated that the capital trigger for complex credit unions should be the same as for other credit unions with higher risk-based net worth (RBNW) requirements. This commenter goes on to state that, if a credit union earns a CAMEL 1 or 2 for two consecutive years, meets its RBNW requirement, and is considered well-capitalized, the credit union should be considered to have earned RegFlex. One commenter stated the net worth requirement for complex credit unions should be 200 basis points higher than other credit unions. One commenter stated it should be the greater of 9% or 200 basis points over the required RBNW calculated for that credit union. One commenter recommends that complex credit unions be required to have a capital level equal to 200 basis points above their

calculated RBNW to be eligible for RegFlex.

The NCUA Board is proposing that the capital requirements for complex credit unions be nine percent or 200 basis points over their risk based net worth requirements, whichever is greater. This net worth requirement is beyond the "well-capitalized" threshold established by prompt corrective action. A significant margin of safety for complex credit unions is afforded by net worth ratios exceeding general requirements, especially when combined with stable, high CAMEL ratings. The NCUA Board is requesting comments on whether this capital threshold is appropriate for complex credit unions.

The NCUA Board requested comment on two approaches for granting the RegFlex authority. The first option is that any credit union that meets the criteria would be automatically exempt from all or specified parts of the identified regulatory provisions in the proposed RegFlex regulation. The second option is for a formal approval and designation process by the region before the credit union could engage in these RegFlex activities.

Thirty-eight commenters requested an automatic exemption. Most of these commenters believe an application process would be burdensome and contrary to the spirit of the proposal. Three commenters supported an automatic exemption and a notification process. Six commenters supported requiring formal approval and designation before a credit union could engage in these activities. Two of these commenters stated that a subsequent change in senior management or a material financial event that impacts capital should require a credit union to notify NCUA. In addition, one of these commenters stated there should be a section added to the call report that shows what, if anything, a credit union is doing in the RegFlex areas so that proper supervision is exercised.

The NCUA Board believes that an automatic exemption is within the spirit of the RegFlex concept and will not require any application for those credit unions that meet the criteria. As credit unions become eligible for RegFlex, NCUA will notify credit unions of their eligibility, generally, during the examination process. However, in response to the commenters that requested this authority be extended to more credit unions the NCUA Board is proposing an application process for credit unions that meet only one of the two stated criteria. This will allow more credit unions to have RegFlex authority while maintaining the safety and

soundness considerations that are fundamental to the program. Therefore, if a credit union is a CAMEL 3 (or CAMEL 1 or 2 for less than two consecutive cycles) with a net worth in excess of 9 percent or if the credit union is a CAMEL 1 or 2 with a net worth under 9 percent (or if complex its risk based net worth level is lower than nine percent or 200 basis points over their risk based net worth requirements), it can apply to the regional director for a RegFlex designation. When applying for a RegFlex designation, the credit union should justify how entrance into the program will not affect the safety and soundness of the institution. The regional director will review this response in relation to the criteria that was not met for RegFlex, that is, net worth level or safety and soundness issues that resulted in a lower CAMEL code.

The proposal stated that a regional director, in his or her sole discretion, for substantive and documented safety and soundness reasons, would be authorized to revoke the RegFlex authority in whole or in part at any time and without advance notice. In such cases, the credit union would be able to appeal such a determination to NCUA's Supervisory Review Committee within 60 days of the regional director's determination.

Eight commenters supported the regional director's authority to revoke the exemption although one of these commenters believes the regional director should first discuss it with credit union management. Six of these commenters believe revocation should only occur after a prior written notice and some sort of appeal process. Another commenter stated that, if a credit union is determined for "substantive and documented safety and soundness reasons" to be operating unsafely, the regional director should have the ability to rescind the credit union's eligibility to participate. One commenter approved of the proposed appeal process. One commenter believes the regional director should be able to revoke the RegFlex designation if the credit union falls below the approval process guidelines. Three commenters objected to the regional director having the discretion to revoke RegFlex.

The NCUA Board believes a regional director's authority to revoke the exemption is integral to the success of the program. The revocation will be effective as soon as the regional director notifies the credit union. However, the credit union may appeal the revocation. The appeal process is the same as outlined in the advance notice of proposed rulemaking. If this proposal is finalized, NCUA will need to revise

IRPS 95-1 on the Supervisory Review Committee to include RegFlex issues as an appeal that the Committee is authorized to address.

Three commenters stated that the RegFlex rule should also extend regulatory relief from NCUA regulations to those that apply to state credit unions. One commenter requested that state-chartered credit unions be exempt from NCUA regulations that only apply to state charters, such as § 741.3(a)(3) requiring special reserves for nonconforming investments and § 741.9 prohibiting uninsured membership shares or deposits. The proposed RegFlex rule does not affect state-chartered credit unions. If state-chartered credit unions want to seek relief from regulatory burden, they should petition their state supervisors.

3. The Regulations

(1) Section 701.36—FCU Ownership of Fixed Assets

The NCUA Board stated that some exemption from the fixed asset rule should be included in RegFlex. The NCUA Board also requested comment on whether a credit union's investment in fixed assets should have a regulatory cap. Thirty-nine commenters supported including the entire fixed asset regulation in RegFlex. A few commenters stated the current waiver process is unnecessary and time consuming for credit unions and NCUA staff. Three commenters stated the fixed asset rule should be eliminated. One commenter would not include the fixed asset rule in RegFlex and would instead continue the current waiver process.

The NCUA Board requests comments on additional options with respect to fixed assets, such as, among others, the possibility of incorporating a tiered structure based on a percentage of net worth. For example, a credit union with a higher net worth would be permitted to have a higher fixed asset limit. Finally, the NCUA Board is requesting comment on whether the fixed asset regulation itself could be structured differently so that there is a tiered limit on fixed assets. The NCUA Board also requested comment on whether a credit union should have to apply for the waiver provided for in § 701.36(c) if it meets the requirements of the RegFlex proposal. Sixteen commenters stated there should be no waiver process. The RegFlex proposal does not include a waiver process because a credit union would be exempt from the investment limits of the fixed asset rule.

The NCUA Board also asked whether credit unions as a sound business practice should have their own fixed

asset limit in their written business plan. Seven commenters stated a credit union should be required to put its fixed asset limit in its business plan. Four commenters stated that it should not be required. The NCUA Board encourages, but will not mandate, that a RegFlex credit union incorporate into its business plan the fixed asset limit it plans on establishing.

The NCUA Board noted that an exemption from some of the restrictions on purchasing a building and leasing a portion of the property, until it was fully utilized by the credit union, would also be lifted. However, this would not authorize a credit union to engage in long-term commercial leasing. For safety and soundness and legal reasons a credit union still must comply with § 701.36(d) of the fixed asset rule and have a plan to utilize the property for its own operation. The NCUA Board requested comment on whether a RegFlex credit union must still have a reasonable plan to utilize the property for its own operation. Two commenters stated that a RegFlex credit union should have a plan to fully utilize any fixed assets it leases. One commenter stated that a credit union should not have a plan to fully utilize any fixed assets it leases. Two commenters stated that long-term commercial leasing of credit union property should be permitted. One commenter stated that credit unions have the incidental authority to lease surplus space. The NCUA Board does not believe that federal credit unions have the legal authority to engage in commercial leasing so federal credit unions will still have to comply with section 701.36(d) of the fixed asset rule.

Finally, although the ANPR did not request specific comment on the deletion of the conflict of interest provision in the fixed asset rule, the NCUA Board has determined that RegFlex credit unions should also comply with this provision as set forth in § 701.36(e) of the rule. The Board believes this conflict of interest provision is sound, consistent with the Federal Credit Union Bylaws, and already offers more flexibility than other conflict of interest provisions in NCUA's regulations. The current fixed asset regulation only requires agency approval for long term leases or acquisition of property from insiders. Agency approval is not required for the acquisition of other fixed assets from insiders but paragraph (e) contains in its last subparagraph, (e)(1), the statement that all insider transactions must be at "arms length." Essentially, this is a reminder that echoes the provision in the Federal Credit Union Bylaws that

calls for insiders to recuse themselves from any matter in which they have a pecuniary interest. FCU Bylaws, Article XVI, section 4. By comparison, other conflict of interest provisions entirely prohibit insiders from receiving any remuneration in connection with credit union transactions.

(2) Part 703—Investment and Deposit Activities

The NCUA Board requested comment on whether the investment requirements should be modified for credit unions that meet the criteria in this proposal and demonstrate the ability to manage the increased risk, whether part 703 should be modified to allow all credit unions the authority to have increased flexibility, or whether NCUA should make no regulatory changes. Thirteen commenters supported including all of the identified investment provisions in RegFlex. Eight commenters request more flexibility in the investment area.

Section 703.90(c) requires quarterly stress testing (300 basis point shock) of individual complex securities if the total sum of complex securities, as defined by the investment regulation, exceeds net capital. For those credit unions that measure the impact of interest rate changes on their entire balance sheet as part of its asset liability management program, the NCUA Board asked whether NCUA should waive or modify this regulatory requirement. Seven commenters supported including this section in RegFlex. One of these commenters stated that removing stress test requirements for well-capitalized credit unions for the more complex investments would remove some burden of managing these investments. This commenter also stated that stress testing for the whole balance sheet should suffice, rather than individual investment stress tests. One commenter requested that stress testing be completely eliminated. Seven commenters would not include this provision in the regulation. The NCUA Board has decided to include this investment provision in the proposed RegFlex regulation because this exemption does not pose a significant adverse affect for RegFlex credit unions. RegFlex credit unions should continue to measure, at least quarterly, the impact of a sustained, parallel shift in interest rates of plus and minus 300 basis points on their entire balance sheet as part of its asset liability management monitoring.

Section 703.40(c)(6) limits the discretionary delegation of investments to third parties to 100% of net capital. NCUA asked whether it should waive or modify the 100% limitation and permit

credit unions to set their own limit in a policy adopted by their board of directors. Ten commenters approved of including this in RegFlex. One commenter wanted this authority for all credit unions. One commenter opposed including this provision in RegFlex. The NCUA Board has decided to include this investment provision in the proposed RegFlex regulation because it would not have a significant adverse impact on safety and soundness.

Section 703.110(d) limits zero coupon investments to under 10 years from settlement date. NCUA asked whether it should extend this maturity. Five commenters would extend the maturity. Four commenters opposed including this provision in RegFlex. The NCUA Board has decided to include this investment provision in the proposed RegFlex regulation because it would not have a significant adverse impact on safety and soundness.

Section 703.110 prohibits stripped, mortgage-backed securities, residual interests in CMOs/REMICs, mortgage servicing rights, commercial mortgage-related securities, or small business related securities. NCUA asked whether this section should be part of the proposal or otherwise modified. Six commenters supported this as part of the proposal. One of these commenters stated that NCUA should not completely remove the limitations on a credit union purchasing investment addressed in § 703.110(c). This commenter stated that, while investing in these high-risk investments should be permitted, it should still be limited to a percentage of undivided earnings. Five commenters objected to including this in RegFlex because of the increased risk. Because of the risk associated with these types of investments, the NCUA Board has decided not to incorporate it into the proposed regulation. The NCUA Board has directed the Office of Investment Services to continue to review this section to determine if regulatory relief can be provided to all credit unions in the context of amending part 703.

The NCUA Board asked, if the eligibility for expanded investment authority is limited to credit unions meeting the RegFlex criteria, should that authority be automatic or should an application and approval process be required. This would permit credit union investments in those instruments and transactions specifically prohibited in § 703.110. Six commenters would require an application for this particular authority. Five commenters believe it should be automatic. The NCUA Board does not believe an application process is warranted for expanded powers in the investment area because the provisions

contained in the proposed rule carry less risk than those cited in the advanced notice of proposed rulemaking.

The NCUA Board is only proposing an exemption to § 703.110(d), which pertains to zero-coupon investments with a maturity of more than 10 years and not the entire list of prohibited investments and investment activities listed in § 703.110.

One commenter suggested that NCUA consider eliminating monthly reporting requirements for "change in fair value" of each individual security from month-to-month and, instead, allow a Portfolio Security Report showing the cumulative gain or loss at the end of each month. One commenter recommended that RegFlex credit unions be allowed to increase their discretionary delegation to third party investment management firms. One commenter stated that requirements regarding specific reports to the board of directors on market changes and/or investments considered risky due to prepayment ability or call options be included in RegFlex. One commenter requested that NCUA permit eligible credit unions to utilize financial futures or interest rate swaps to reduce their interest rate risk exposure. The NCUA Board does not believe these issues are pertinent for RegFlex but will consider these comments in the context of amending part 703.

(3) Section 701.25—Charitable Donations

The current rule limits recipients of charitable donations to nonprofit organizations located in or conducting activities in a community in which the FCU has a place of business or to organizations that are tax exempt under § 501(c)(3) of the Internal Revenue Code and operate primarily to promote and develop credit unions. This rule requires the board of directors to approve charitable contributions and the approval must be based on a determination that the contributions are in the best interests of the federal credit union and are reasonable given the size and financial condition of the federal credit union. Under the rule, directors may establish a budget for charitable donations and authorize credit union officials to select recipients and disburse funds.

The NCUA Board asked whether credit unions, meeting the RegFlex criteria, should be completely exempt from the requirements of this regulation. Thirty-one commenters would include the entire regulation in RegFlex. Seven of these commenters believe all credit unions should be exempt from the regulation. Two commenters would

eliminate all requirements except for board of director approval of charitable donations. Four commenters believe the current regulation is reasonable and would not include it in this proposal.

In response to some of the comments received in the Advanced Notice of Proposed Rulemaking, the NCUA Board is requesting comment of whether the charitable donation regulation should be eliminated for all credit unions.

(4) Section 722.3(a)(1)—Appraisals

NCUA's current appraisal regulation is more restrictive than the other financial institution regulators. However, experience has demonstrated that certain credit unions are able to adequately manage a higher degree of risk in making loans without an appraisal. Therefore, the NCUA Board asked whether it should increase the dollar threshold for credit unions meeting the RegFlex criteria from \$100,000 to \$250,000 for requiring an appraisal. Such an increase would be consistent with the regulatory authority set forth by the agencies regulating banks and thrifts. Twenty-nine commenters supported this proposal. Nine of these commenters would allow it for all credit unions. One commenter recommended only increasing the threshold to \$200,000. Four commenters objected to increasing the threshold. One of these commenters stated that increasing the threshold would pose significant risk to the NCUSIF. One commenter would also extend the higher dollar threshold to credit unions that have appropriate capital, management, and expertise.

The NCUA Board also proposed increasing the threshold for an appraisal for a member business loan to \$250,000, if it involves real estate. Three commenters specifically supported the increase for member business loans.

The NCUA Board has been persuaded that the increase in the appraisal threshold would not significantly increase safety and soundness concerns and thus should be applicable to all credit unions so it has been eliminated from the RegFlex proposal. The NCUA Board is issuing a proposed amendment to § 722.3 to make it available to all credit unions.

Credit unions must still make reasonable determinations of value to ensure compliance with loan-to-value requirements. Section 722.3(d) of the appraisal rule requires that a real estate related transaction under the dollar threshold be supported by a written estimate of market value performed by an independent, qualified, and experienced individual. In addition, § 722.3(e) allows NCUA to require an

appraisal whenever necessary to address safety and soundness concerns. The requirements set forth in § 722.3(d), combined with the ability to address safety and soundness issues per § 722.3(e) mitigate potential safety and soundness concerns that could be raised by the proposed change.

(5) Section 701.32(b) and (c)—Payment on Shares by Public Unit and Nonmembers

The current regulation limits the maximum amount of all public unit and nonmember shares to 20% of total shares of the federal credit union or \$1.5 million, whichever is greater. The NCUA Board asked whether credit unions meeting the RegFlex criteria should be exempt from the regulatory restrictions on public unit and nonmember shares. Twenty-two commenters supported including this regulation in RegFlex. One of these commenters would eliminate this regulation for all credit unions. The NCUA Board has not been provided any convincing rationale for excluding these provisions in the RegFlex proposal and, therefore, it is part of the proposed RegFlex rule.

(6) Section 701.23—Purchase, Sale and Pledge of Eligible Obligations

The NCUA Board requested comment on whether to permit credit unions that meet the RegFlex criteria to purchase any auto loan, credit card loan, member business loan, student loan, or mortgage loan from any other credit union as long as they are loans the purchasing credit union is empowered to grant. If authorized, the NCUA Board asked whether to permit the purchasing credit unions to keep these loans in their portfolios. Twenty-seven commenters supported this provision in RegFlex. Most of these commenters would allow credit unions to keep these loans in their portfolios. Nine of these commenters would also allow it for all credit unions. Three commenters requested that this authority to purchase credit union loans be extended to loans made by CUSOs. However, these commenters were not able to provide a compelling legal basis for this extension of authority. One commenter objected to this proposal as an attempt to circumvent field of membership rules.

The authority for this provision is in section 107(14) of the Federal Credit Union Act. The plain language of that section authorizes a federal credit union “to sell all or a part of its assets to another credit union, [or] to purchase all or part of the assets of another credit union.” 12 U.S.C. 1757(14). The Board acknowledges that this is a more

expansive interpretation of this provision than it has made previously but that it is consistent with the other powers granted to federal credit unions in section 107. Specifically, the Board notes that the limitation in section 107(13) restricts the authority of section 107(14) to the extent a credit union purchases the member loans of a liquidating credit union. Under this latter section, the Act limits those purchases to five percent of the unpaired capital and surplus of the credit union. These two sections recognize that the risks involved in the purchase of eligible obligations from a liquidating credit union are different than those risks associated with a financially healthy credit union, hence, the different statutory treatment regarding the purchasing of assets from financially different credits unions. The NCUA Board believes this authority expands the liquidity options for credit unions and enhances the safety and soundness of the credit union system. Therefore, the NCUA Board is incorporating this authority into the proposed regulation, with the only limitation being the statutory limitation regarding the purchase of eligible obligations from liquidating credit unions.

4. *Other Regulations Discussed by NCUA But Not Initially Part of RegFlex*

In connection with RegFlex, the Board requested comment on whether it may be appropriate to permit federal credit unions meeting the RegFlex criteria to engage in certain leasing activities without restrictions that would be generally applicable to other federal credit unions that are not legally required. Six commenters stated that leasing should not be part of the RegFlex proposal. Six commenters requested that leasing be part of the proposal. Some of these commenters requested that RegFlex credit unions be exempt from the 25 percent residual value limit. One of these commenters requested that all credit unions be exempt from the leasing regulation. The NCUA Board has determined that the leasing regulation is not currently a good candidate for RegFlex because of safety and soundness concerns.

The NCUA Board requested whether part 721 should be part of RegFlex. Four commenters stated that RegFlex credit unions should have greater latitude with regard to incidental powers. NCUA is in the process of issuing a final regulation on incidental powers for all credit unions and therefore, does not believe it should be part of RegFlex.

5. *Other Regulations Identified by Commenters*

Two commenters requested the requirements of the member business loan rule on loan-to-value ratios and maturity limits be part of the proposal. One commenter would exempt RegFlex credit unions from the member business loan rule requirements on construction and development lending, loans to one borrower, personal liability, and appraisals. Another commenter requested more flexibility with member business loans.

Two commenters recommended that a RegFlex credit union be given a waiver of the credit union service organization (CUSO) CPA requirement if the parent credit union wholly owns the CUSO and the parent's CPA audited financials are consolidated for effects of CUSO operation. One commenter requested that the list of preapproved activities for a CUSO be deleted and the regulation merely state that, for a federal credit union to participate in a CUSO, the CUSO's activities must be related to the routine operations of federal credit unions.

The NCUA Board does not believe the member business loan regulation and the CUSO regulation are good candidates for RegFlex because of safety and soundness concerns. However, the NCUA Board is again requesting comments on any other regulation that should be part of the RegFlex program. Again, the commenters should not address regulations that are statutorily required.

6. *Miscellaneous Items*

The NCUA Board asked whether the asset base of a credit union that expands into a low-income or underserved area should be frozen for the calculation of the operating fee, and if so, for what amount of time. Nineteen commenters did not support this proposal. Six commenters supported freezing the asset base for calculating the operating fee. One of these commenters suggested a three-year freeze. One of these commenters suggested a ten-year freeze. One commenter proposed that shares of low-income and underserved members be set apart from the total amount of shares and that those shares be subject to a lesser percentage when calculating the operating fee. One commenter stated that expansions into a low-income area should not be grounds to freeze the operating fee unless the credit union's performance in serving low-income members can be documented. One commenter stated that expansion into an underserved area should be addressed in a separate rule or apply to

all credit unions. Many commenters did not want field of membership issues addressed in this rule.

The NCUA Board issued final amendments to NCUA's Chartering Manual that addressed the issue of incentives for credit unions to add underserved areas. Although the NCUA Board deferred any action regarding incentives to credit union's adding underserved areas, it appears that incentives may not be warranted. It appears that the changes to streamline the addition of underserved areas is encouraging credit unions to add them to their field of membership. The Board will continue to monitor this issue and if the increase in service to underserved area begins to diminish, it will review the issue again. Therefore, the NCUA Board believes that field of membership issues should not be part of this RegFlex proposal.

The NCUA Board also requested comment on whether the regulatory flexibility outlined in the advance notice of proposed rulemaking should be used as an incentive to encourage eligible credit unions to continue serving low-income individuals within their field of membership or to add an underserved area or low-income groups to their field of membership. This could be accomplished by requiring a credit union to have a low-income or underserved area as one of the basic eligibility criteria under the proposal. Twenty-two commenters stated that service to low-income and underserved areas should not be a criterion for participating in RegFlex. In general, these commenters do not believe RegFlex relief bears any direct relationship to serving the underserved. The NCUA Board has determined that adding an underserved area should not be part of the criteria for this proposal.

The NCUA Board also requested comment on what changes, if any, might be considered to NCUA's supervision and examination program for credit unions meeting the RegFlex criteria. The NCUA Board noted possible areas of consideration including a different type of exam for RegFlex credit unions or a revised examination schedule for RegFlex credit unions. Eight commenters wanted a longer or different exam cycle for RegFlex credit unions but did not specify a type or time frame. Nine commenters suggested an eighteen-month exam cycle for RegFlex credit unions. Three commenters suggested an 18–24 month cycle. Three commenters suggested a two-year exam cycle. Three commenters requested that RegFlex credit unions have an abbreviated exam and examiners should be allowed to rely on CPA audits for

financial analysis, loan reviews and investment portfolio verifications and reviews. Three commenters recommended a biennial on-site exam and using call report data and other specified data for an off-site exam every other year. Five commenters stated the exam cycle should remain the same. Although the exam cycle is not part of this proposal, the NCUA Board is continuing to review how the exam cycle can be streamlined and improved.

Finally, the NCUA Board asked what guidance should be provided to examiners to ensure that credit unions are not discouraged from responsibly managing additional risk in an effort to provide credit to a broader range of their members. Three commenters stated that peer comparisons should be dropped. Two commenters stated that peer comparisons should not be dropped. Another commenter stated that peer comparisons be revised so that they are not based solely on assets but reflect genuine similarities, such as level of service, single sponsor versus multiple group, and so forth. One commenter believes that delinquency and charge-off ratios should be interpreted based on the nature of the loan and investment product as it relates to risk and pricing for risk. One commenter stated that the delinquencies and charge-off rates should be less important in the exam process for RegFlex credit unions. One commenter stated that delinquency and charge-off ratio levels should be increased for CAMEL calculations. One commenter recommended against liberalizing delinquency and charge-off rates. One commenter stated that examiners should be provided peer ratios for credit unions that serve low-income persons so that they can compare and contrast similar institutions. One commenter stated that, as credit unions seek to take on more risk, examiners should make sure that the policies, procedures and staff address risk measurements, similar to the way corporate credit unions are examined. One commenter stated that examiners should review specific aspects of a credit union's management to ensure that the credit union is not being discouraged from managing additional risk. Further, this commenter suggested that NCUA develop specific criteria from which examiners operate. NCUA is currently reviewing the examiners guide and may incorporate some of these ideas in a revised examiners guide.

C. Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact any proposed regulation may have on a substantial number of small entities (primarily those under 1 million in assets). The NCUA Board has determined and certifies that the proposed rule will not have a significant economic impact on a substantial number of small credit unions. The reason for this determination is that the proposed rule reduces regulatory burden. Accordingly, the NCUA Board has determined that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

The proposed regulation contains a voluntary application. An FCU may apply to the regional director for designation under the Regulatory Flexibility Program if: (1) It is a CAMEL code 3; and (2) has a current net worth ratio of nine percent or higher or meets its applicable risk-based net worth requirement plus 200 basis points, whichever is higher. An FCU may also apply to the regional director for designation under the Regulatory Flexibility Program if: (1) It has received a CAMEL rating of 1 or 2 for the two most recent examinations, and (2) has a current net worth ratio of less than nine percent or does not meet its applicable risk-based net worth requirement plus 200 basis points, whichever is higher. 12 CFR 742.2(b).

The Board estimates it will take an average of 1 hour for an FCU to prepare a voluntary application. The Board also estimates 1,241 FCUs may apply annually for designation under the program. The cumulative total annual paperwork burden is estimated to be approximately 1,241 hours.

NCUA will submit the collection of information requirements contained in the regulation to the OMB in accordance with the Paperwork Reduction Act of 1995, 44 U.S.C. 3507. The NCUA will use any comments received to develop its new burden estimates. Comments on the collection of information should be sent to: Office of Management and Budget, Reports Management Branch, New Executive Office Building, Room 10202, Washington, DC 20503; Attention: Alex T. Hunt, Desk Officer for NCUA. Please send NCUA a copy of any comments you submit to OMB.

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 rule only applies to only federal credit unions, NCUA has determined that this rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act of 1999—Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this proposed rule 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. 26821 (1998).

Agency Regulatory Goal

NCUA's goal is to promulgate clear and understandable regulations that impose minimal regulatory burden. We request your comments on whether the proposed rule is understandable and minimally intrusive if implemented as proposed.

List of Subjects

12 CFR Part 722

Credit unions, Mortgages, Reporting and recordkeeping requirements.

12 CFR Part 742

Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on March 8, 2001.

Becky Baker,
Secretary of the Board.

For the reasons stated in the preamble, it is proposed that 12 CFR chapter VII be amended as follows:

1. Add part 742 to read as follows:

PART 742—REGULATORY FLEXIBILITY PROGRAM

Sec.

742.1 What is NCUA's Regulatory Flexibility Program?

742.2 How do I become eligible for the Regulatory Flexibility Program?

742.3 Will NCUA notify me when I am eligible for the Regulatory Flexibility Program?

742.4 What NCUA Regulations will I be exempt from?

742.5 What additional authority will I be granted?

742.6 How can I lose my RegFlex eligibility?

742.7 What is the appeal process?

742.8 If I lose my RegFlex authority will my past actions be grandfathered?

Authority: 12 U.S.C 1756 and 1766.

§ 742.1 What is NCUA's Regulatory Flexibility Program?

NCUA's Regulatory Flexibility Program (RegFlex) exempts credit unions with a current net worth of nine percent (if a credit union is deemed complex under section 216(d) of the Federal Credit Union Act (12 U.S.C. 1790d(d)), it must be 200 basis points over its risk based net worth level or nine percent, whichever is higher) and a CAMEL rating of 1 or 2, for two consecutive examinations, from all or part of identified NCUA regulations. The Regulatory Flexibility Program also grants eligible credit unions additional powers.

§ 742.2 How do I become eligible for the Regulatory Flexibility Program?

Eligibility is automatic as soon as the credit union meets the net worth and CAMEL criteria. If a credit union is a CAMEL 3 (or CAMEL 1 or 2 for less than two consecutive cycles) with a net worth in excess of 9 percent or if the credit union is a CAMEL 1 or 2 with a net worth under 9 percent (or if a credit union is deemed complex under section 216(d) of the Federal Credit Union Act (12 U.S.C. 1790d(d)), it must be 200 basis points over its risk based net worth level or nine percent, whichever is higher), it can apply to the regional director for a RegFlex designation, in whole or in part.

§ 742.3 Will NCUA notify me when I am eligible for the Regulatory Flexibility Program?

Yes. Once this rule is effective, NCUA will notify all RegFlex eligible credit unions. Subsequent notifications of eligibility will occur after an application for a RegFlex designation or as part of the examination process.

§ 742.4 What NCUA Regulations will I be exempt from?

RegFlex credit unions are exempt from the following NCUA Regulations: § 701.25, § 701.32(b) and (c), § 701.36(a), (b) and (c), § 703.90(c), § 703.40(c)(6), and § 703.110(d) of this chapter.

§ 742.5 What additional authority will I be granted?

Notwithstanding the general limitations in § 701.23 of this chapter, RegFlex credit unions are eligible to purchase any auto loan, credit card loan, member business loan, student loan or mortgage loan from any credit union as long as the loans are loans that the purchasing credit union is empowered to grant. RegFlex credit unions are authorized to keep these loans in their portfolio. If a RegFlex credit union is purchasing the eligible obligations of a liquidating credit union,

the loans purchased cannot exceed 5% of the unimpaired capital and surplus of the purchasing credit union.

§ 742.6 How can I lose my RegFlex eligibility?

Eligibility may be lost in two ways. First, the credit union no longer meets the RegFlex criteria set forth in § 742.1. When this event occurs, the credit union must cease using the additional authority granted by this rule. Second, the regional director for substantive and documented safety and soundness reasons may revoke a credit union's RegFlex authority in whole or in part. The regional director must give a credit union written notice stating the reasons for this action. The revocation is effective as soon as the regional director's determination has been received by the credit union.

§ 742.7 What is the appeal process?

A credit union has 60 days from the date of the regional director's determination to revoke a credit union's RegFlex authority (in whole or in part) to appeal the action to NCUA's Supervisory Review Committee. The regional director's determination will remain in effect unless the Supervisory Review Committee issues a different determination. If the credit union is unsatisfied with the decision of the Supervisory Review Committee, the credit union has 60 days from the issuance of this decision to appeal to the NCUA Board.

§ 742.8 If I lose my RegFlex authority will my past actions be grandfathered?

Any action by the credit union under the RegFlex authority will be grandfathered. Any actions subsequent to losing the RegFlex authority must meet NCUA's regulatory requirements. This does not diminish NCUA's authority to require a credit union to divest its investments or assets for substantive safety and soundness reasons.

PART 722—APPRAISALS

2. The authority citation for part 722 continues to read as follows:

Authority: 12 U.S.C 1766, 1789 and 3339.

§ 722.3 [Amended]

3. Section 722.3(a)(1) is revised by removing the number "\$100,000" and adding in its place "\$250,000" and removing the words "except if it is a business loan and then the transaction value is \$50,000 or less."

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