

### Subpart E—Capital Planning and Stress Testing

SOURCE: 79 FR 24315, Apr. 30, 2014, unless otherwise noted.

EFFECTIVE DATE NOTE: At 80 FR 66722, Oct. 29, 2015, subpart E to part 702 was redesignated as subpart C, effective Jan. 1, 2019. At 83 FR 55467, Nov. 6, 2018, the effective date was delayed until Jan. 1, 2020. At 84 FR 68781, Dec. 17, 2019, the effective date was further delayed until Jan. 1, 2022.

#### § 702.501 Authority, purpose, and reservation of authority.

(a) *Authority.* This subpart is issued by the National Credit Union Administration (NCUA).

(b) *Purpose.* This subpart requires covered credit unions to develop and maintain capital plans and describes stress testing requirements and actions on covered credit union capital plans.

(c) *Reservation of authority.* Notwithstanding any other provisions of this subpart, NCUA may modify some or all of the requirements of this subpart. Any exercise of authority under this section by NCUA will be in writing and will consider the financial condition, size, complexity, risk profile, scope of operations, and level of capital of the covered credit union, in addition to any other relevant factors. Nothing in this subpart limits the authority of NCUA under any other provision of law or regulation to take supervisory or enforcement action, including action to address unsafe and unsound practices or conditions, or violations of law or regulation.

#### § 702.502 Definitions.

For purposes of this subpart—

*Baseline scenario* means a scenario that reflects the consensus views of the economic and financial outlook.

*Capital plan* means a written presentation of a covered credit union's capital planning strategies and capital adequacy process that includes the mandatory elements set forth in this subpart.

*Capital planning process* means development of a capital policy and formulation of a capital plan that conforms to this part.

*Covered credit union* means a federally insured credit union whose assets are

\$10 billion or more. A credit union that crosses the asset threshold as of March 31 of a given calendar year is subject to the applicable requirements of this subpart in the following calendar year.

*Planning horizon* means the period of 3 years over which capital planning projections extend.

*Pre-provision net revenue* means the sum of net interest income and non-interest income, less expenses, before adjusting for loss provisions.

*Provision for loan and lease losses* means the provision for loan and lease losses as reported by the covered credit union on its Call Report.

*Reverse stress test* means a test that defines severely unfavorable outcomes and then identifies events or scenarios that lead to these outcomes. Examples of severely unfavorable outcomes are breaching regulatory capital, failing to meet obligations, or being unable to continue independent operations.

*Scenarios* are those sets of conditions that affect the U.S. economy or the financial condition of a covered credit union that serve as the basis for stress testing, including, but not limited to, NCUA-established baseline, scenarios and stress scenarios.

*Sensitivity testing* means testing the relationship between specific variables, parameters, and inputs and their impacts on analytical results.

*Stress scenario* means a scenario that is more adverse than that associated with the baseline scenario.

*Stress test* means the process to assess the potential impact of expected and stressed economic conditions on the consolidated earnings, losses, and capital of a covered credit union over the planning horizon, taking into account the current state of the covered credit union and the covered credit union's risks, exposures, strategies, and activities.

*Stress test capital* means net worth (less assistance provided under Section 208 of the Federal Credit Union Act, subordinated debt included in net worth, and NCUSIF deposit) under stress test scenarios.

*Stress test capital ratio* means a covered credit union's stress test capital divided by its total consolidated assets less NCUSIF deposit.

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*Tier I credit union* means a covered credit union that has less than \$15 billion in total assets.

*Tier II credit union* means a covered credit union that has \$15 billion or more in total assets but less than \$20 billion in total assets, or is otherwise designated as a tier II credit union by NCUA.

*Tier III credit union* means a covered credit union that has \$20 billion or more in total assets, or is otherwise designated as a tier III credit union by NCUA.

[79 FR 24315, Apr. 30, 2014, as amended at 80 FR 48012, Aug. 11, 2015; 83 FR 17909, Apr. 25, 2018]

### § 702.503 Capital policy.

(a) *General requirements.* The extent and sophistication of a covered credit union's governance over its capital planning and analysis process must align with the extent and sophistication of that process. The process must be consistent with the financial condition, size, complexity, risk profile, scope of operations, and level of capital of the covered credit union. The ultimate responsibility for governance over a covered credit union's capital planning and analysis process rests with the credit union's board of directors. Senior management must establish a comprehensive, integrated, and effective process that fits into the broader risk management of the credit union. Senior management responsible for capital planning and analysis must provide regular reports on capital planning and analysis to the credit union's board of directors (or a designated committee of the board).

(b) *Mandatory elements.* A covered credit union's board of directors (or a designated committee of the board) must review and approve a capital policy, along with procedures to implement it. The capital policy must:

(1) State goals and limits for capital levels and risk exposure.

(2) Establish requirements for reviewing and reporting capital levels and breaches of capital limits, with contingency plans for remedying any breaches.

(3) State the governance over the capital analysis process, including all

the activities that contribute to the analysis;

(4) Specify capital analysis roles and responsibilities, including controls over external resources used for any part of capital analysis (such as vendors and data providers);

(5) Specify the internal controls that govern capital planning, including review by internal audit, control of changes in capital planning procedures, and required documentation;

(6) Describe the frequency with which capital analyses will be conducted;

(7) State how capital analysis results are used and by whom; and

(8) Be reviewed at least annually and updated as necessary to ensure that it remains current with changes in market conditions, credit union products and strategies, credit union risk exposures and activities, the credit union's established risk appetite, and industry practices.

### § 702.504 Capital planning.

(a) *Annual capital planning.* (1) A covered credit union must develop and maintain a capital plan. Tier I and tier II credit unions must complete this plan and their capital policy by December 31 each year, but are not required to submit this plan to the NCUA. For tier I and tier II credit unions, the plan must be based on the credit union's financial data from either of the two calendar quarters preceding the quarter in which the plan is approved by the credit union's board of directors (or a designated committee of the board). A tier III credit union must submit this plan and its capital policy to NCUA by May 31 each year, or such later date as directed by NCUA. For tier III credit unions, the plan must be based on the credit union's financial data as of December 31 of the preceding calendar year, or such other date as directed by NCUA.

(2) A covered credit union's board of directors (or a designated committee of the board) must at least annually, and for tier III credit unions, prior to the submission of the capital plan under paragraph (a)(1) of this section:

(i) Review the credit union's process for assessing capital adequacy;

(ii) Ensure that any deficiencies in the credit union's process for assessing

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capital adequacy are appropriately remedied; and

(iii) Approve the credit union's capital plan.

(b) *Mandatory elements.* A capital plan must contain at least the following elements:

(1) A quarterly assessment of the expected sources and levels of stress test capital over the planning horizon that reflects the covered credit union's financial state, size, complexity, risk profile, scope of operations, and existing level of capital, assuming both expected and unfavorable conditions, including:

(i) Estimates of projected revenues, losses, reserves, and pro forma capital levels, over each quarter of the planning horizon under expected and unfavorable conditions; and

(ii) A detailed description of the credit union's process for assessing capital adequacy;

(2) A discussion of how the credit union will, under expected and unfavorable conditions, maintain stress test capital commensurate with all of its risks, including reputational, strategic, legal, and compliance risks;

(3) A discussion of how the credit union will, under expected and unfavorable conditions, maintain ready access to funding, meet its obligations to all creditors and other counterparties, and continue to serve as an intermediary for its members;

(4) A discussion of any expected changes to the credit union's business plan that are likely to have a material impact on the credit union's capital adequacy and liquidity; and

(5) A program to:

(i) Conduct sensitivity testing to analyze the effect on the credit union's stress test capital of changes in variables, parameters, and inputs used by the credit union in preparing its capital plan;

(ii) Conduct reverse stress testing to identify events and circumstances that cause severely unfavorable outcomes for the credit union; and

(iii) Analyze the impact of credit risk and interest rate risk to capital under unfavorable economic conditions, both

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separately and in combination with each other.

[79 FR 24315, Apr. 30, 2014, as amended at 80 FR 48012, Aug. 11, 2015; 81 FR 7198, Feb. 11, 2016; 83 FR 17910, Apr. 25, 2018]

EDITORIAL NOTE: At 84 FR 1606, Feb. 5, 2019, § 702.504 was amended in paragraph (b)(4) by revising the citation “§ 702.306(c)” to read “§ 702.506(c)”; however, that citation did not exist in the section and the amendment could not be incorporated due to inaccurate amendatory instruction.

EFFECTIVE DATE NOTE: At 80 FR 66722, Oct. 29, 2015, § 702.504 was amended in paragraph (b)(4) by removing the citation “§ 702.506(c)” and adding in its place “§ 702.306(c)”, effective Jan. 1, 2019. At 83 FR 55467, Nov. 6, 2018, the effective date was delayed until Jan. 1, 2020. At 84 FR 68781, Dec. 17, 2019, the effective date was further delayed until Jan. 1, 2022. At 85 FR 62210, Oct. 2, 2020, the regulatory instruction 11. at 85 FR 66722, Oct. 29, 2015 was removed, effective Jan. 1, 2022.

### § 702.505 NCUA action on capital plans.

(a) *Timing*—(1) *Tier I & tier II credit unions.* NCUA will address any deficiencies in the capital plans submitted by tier I and tier II credit unions through the supervisory process.

(2) *Tier III credit unions.* NCUA will notify tier III credit unions of the acceptance or rejection of their capital plans by August 31 of the year in which their plan is submitted.

(b) *Grounds for rejection of capital plan.* NCUA may reject a capital plan if it determines that:

(1) The covered credit union has material unresolved supervisory issues associated with its capital planning process;

(2) The capital analysis underlying the covered credit union's capital plan, or the covered credit union's methodologies for reviewing the robustness of its capital adequacy, are not reasonable or appropriate;

(3) Data utilized for the capital analysis is insufficiently detailed to capture the risks of the covered credit union, or the data lacks integrity;

(4) The plan does not meet all of the requirements of § 702.504;

(5) Unacceptable weakness in the capital plan or policy, the capital planning analysis, or any critical system or process supporting capital analysis;

(6) The covered credit union's capital planning process constitutes an unsafe or unsound practice, or would violate any law, regulation, NCUA order, directive, or any condition imposed by, or written agreement with, NCUA. In determining whether a capital plan would constitute an unsafe or unsound practice, NCUA considers whether the covered credit union is and would remain in sound financial condition after giving effect to the capital plan.

(c) *Notification in writing.* NCUA will notify the credit union in writing of the reasons for a decision to reject a capital plan.

(d) *Resubmission of a capital plan.* If NCUA rejects a tier III credit union's capital plan, the credit union must update and resubmit an acceptable capital plan to NCUA by November 30 of the year in which the credit union submitted its plan. The resubmitted capital plan must, at a minimum, address:

(1) NCUA-noted deficiencies in the credit union's original capital plan or policy; and

(2) Remediation plans for unresolved supervisory issues contributing to the rejection of the credit union's original capital plan.

(e) *Supervisory actions.* Any tier III credit union operating without a capital plan accepted by NCUA may be subject to supervisory actions on the part of NCUA.

(f) *Consultation on proposed action.* Before taking any action under this section on the capital plan of a federally insured, state-chartered credit union, NCUA will consult and work cooperatively with the appropriate State official.

[79 FR 24315, Apr. 30, 2014, as amended at 80 FR 48012, Aug. 11, 2015; 83 FR 17910, Apr. 25, 2018]

EFFECTIVE DATE NOTE: At 80 FR 66722, Oct. 29, 2015, § 702.505 was amended in paragraph (b)(4) by removing the citation “§ 702.504” and adding in its place “§ 702.304”, effective Jan. 1, 2019. At 83 FR 55467, Nov. 6, 2018, the effective date was delayed until Jan. 1, 2020. At 84 FR 68781, Dec. 17, 2019, the effective date was further delayed until Jan. 1, 2022. At 85 FR 62210, Oct. 2, 2020, the instruction was corrected to amend newly redesignated § 702.305, effective Jan. 1, 2022.

### § 702.506 Annual supervisory stress testing.

(a) *General requirements.* Only tier II and tier III credit unions are required to conduct supervisory stress tests. The supervisory stress tests consist of a baseline scenario, and stress scenarios, which NCUA will provide by February 28 of each year. The tests will be based on the credit union's financial data as of December 31 of the preceding calendar year, or such other date as directed by NCUA. The tests will take into account all relevant exposures and activities of the credit union to evaluate its ability to absorb losses in specified scenarios over a planning horizon.

(b) *Credit union-run supervisory stress tests—(1) General.* All supervisory stress tests must be conducted according to NCUA's instructions.

(2) *Tier III credit unions.* When conducting its stress test, a tier III credit union must apply the minimum stress test capital ratio to all time periods in the planning horizon. The minimum stress test capital ratio is 5 percent.

(3) *NCUA tests.* NCUA reserves the right to conduct the tests described in this section on any covered credit union at any time. Where both NCUA and a covered credit union have conducted the tests, the results of NCUA's tests will determine whether the covered credit union has met the requirements of this subpart.

(c) *Potential impact on capital.* In conducting stress tests under this subpart, the credit union, or the NCUA if it elects to conduct the stress test under paragraph (b)(3) of this section, will estimate the following for each scenario during each quarter of the planning horizon:

(1) Losses, pre-provision net revenues, loan and lease loss provisions, and net income; and

(2) The potential impact on the stress test capital ratio, incorporating the effects of any capital action over the planning horizon and maintenance of an allowance for loan losses appropriate for credit exposures throughout the horizon. The credit union, or the NCUA if it elects to conduct the stress test under paragraph (b)(3) of this section, will conduct the stress tests without assuming any risk mitigation actions on the part of the credit union,

except those existing and identified as part of the credit union's balance sheet, or off-balance sheet positions, such as derivative positions, on the date of the stress test.

(d) *Information collection.* Upon request, the credit union must provide NCUA with any relevant qualitative or quantitative information requested by NCUA pertinent to the stress tests under this subpart.

(e) *Stress test results.* A credit union required to conduct stress tests under this section must incorporate the results of its tests in its capital plan. A credit union required to conduct stress tests must submit its stress test results to NCUA by May 31 of each year.

(f) *Supervisory actions.* (1) If a credit union-run stress test shows a tier III credit union does not have the ability to maintain a stress test capital ratio of 5 percent or more under expected and stressed conditions in each quarter of the planning horizon, the credit union must incorporate, into its capital plan, a stress test capital enhancement plan that shows how it will meet that target.

(2) If an NCUA-run stress test shows that a tier III credit union does not have the ability to maintain a stress test capital ratio of 5 percent or more under expected and stressed conditions in each quarter of the planning horizon, the credit union must provide NCUA, by November 30 of the calendar year in which NCUA conducted the tests, a stress test capital enhancement plan showing how it will meet that target.

(3) A tier III credit union operating without an NCUA approved stress test capital enhancement plan required under this section may be subject to supervisory actions.

(g) *Consultation on proposed action.* Before taking any action under this section against a federally insured, state-chartered credit union, NCUA will consult and work cooperatively with the appropriate State official.

[83 FR 17910, Apr. 25, 2018]

APPENDIX A TO PART 702—GROSS-UP APPROACH, AND LOOK-THROUGH APPROACHES

AT 80 FR 66722, OCT. 29, 2015.

AMENDMENT WAS DELAYED UNTIL JAN. 1, 2020, AT 83 FR 55467, NOV. 6, 2018.

DELAYED UNTIL JAN. 1, 2022, AT 84 FR 68781, DEC. 17, 2019.

Instead of using the risk weights assigned in §702.104(c)(2) a credit union may determine the risk weight of certain investment funds, and the risk weight of a non-subordinated or subordinated tranche of any investment as follows:

(a) *Gross-up approach*—(1) *Applicability.* Section 702.104(c)(3)(iii)(A) of this part provides that, a credit union may use the gross-up approach in this appendix to determine the risk weight of the carrying value of non-subordinated or subordinated tranches of any investment.

(2) *Calculation.* To use the gross-up approach, a credit union must calculate the following four inputs:

(i) Pro rata share, which is the par value of the credit union's exposure as a percent of the par value of the tranche in which the securitization exposure resides;

(ii) Enhanced amount, which is the par value of tranches that are more senior to the tranche in which the credit union's securitization resides;

(iii) Exposure amount, which is the amortized cost for investments classified as held-to-maturity and available-for-sale, and the fair value for trading securities; and

(iv) Risk weight, which is the weighted-average risk weight of underlying exposures of the securitization as calculated under this appendix.

(3) *Credit equivalent amount.* The "credit equivalent amount" of a securitization exposure under this part equals the sum of:

(i) The exposure amount of the credit union's exposure; and

(ii) The pro rata share multiplied by the enhanced amount, each calculated in accordance with paragraph (a)(2) of this appendix.

(4) *Risk-weighted assets.* To calculate risk-weighted assets for a securitization exposure under the gross-up approach, a credit union must apply the risk weight required under paragraph (a)(2) of this appendix to the credit equivalent amount calculated in paragraph (a)(3) of this appendix.

(5) *Securitization exposure defined.* For purposes of this paragraph (a), "securitization exposure" means:

(i) A credit exposure that arises from a securitization; or