
MCUL Supplemental Capital Guidebook

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1. Introduction

The Michigan Credit Union League (MCUL) supports Michigan credit unions in many ways. In the current economic environment, the MCUL saw a need for Michigan credit unions to have access to capital to assist them in maintaining solid net worth and provide them the ability to serve their members while gaining financial strength. For this reason, the MCUL researched ways in which they could provide supplemental capital to low-income designated Michigan credit unions. The rules and regulations set forth by National Credit Union Administration (NCUA) and Office of Insurance and Financial Regulation (OFIR) do allow for credit unions to receive supplemental capital. It is outlined in NCUA Rule and Regulation 701.34 and is referred to by NCUA as secondary capital. The MCUL has made supplemental capital available for Michigan low-income designated credit unions (LICU) that qualify under NCUA's rules for secondary capital. While MCUL's program refers to supplemental capital, it is the same as secondary capital as defined by NCUA rule and regulation 701.34.

2. Secondary Capital – General Overview

Secondary capital is a “**subordinated**” loan. This means that, in the event of liquidation, **all other debt owed by a credit union must be repaid before the secondary capital loan is repaid**. Although it is a loan, it counts as net worth for regulatory purposes. It is available to cover any insolvency of the credit union.

2.1. Who can apply for Secondary Capital

Only credit unions designated as low-income by the NCUA may accept secondary capital. A low-income credit union is one in which a majority of its membership (50.01%) qualifies as low-income members as defined in Section 701.34 of the NCUA Rules and Regulations. For state chartered credit unions see **Appendix 1**. Low-income members are those members who earn 80% or less than the median family income for the metropolitan area where they live or the national metropolitan area, whichever is greater. Low income designated credit unions may:

- Accept non-member deposits
- Participate in the Community
- Development Revolving Loan Program
- Offer secondary capital accounts
- Qualify for exception from the aggregate loan limit for member business loans

Once the credit union obtains its low income designation, the NCUA also requires that the credit union file a plan on how it intends to use the secondary capital funds. To apply for MCUL's supplemental capital, the credit union must be headquartered in Michigan in addition to meeting all NCUA requirements.

2.2 Who is eligible to lend Secondary Capital

Organizations, institutions, and corporations, whether non-profit or for-profit, can lend secondary capital to credit unions. This includes other credit unions. Individuals are not permitted to make secondary capital loans to credit unions.

2.3 NCUA Rule and Regulation 701.34

The NCUA Rule and Regulation 701.34 describes the NCUA Low Income Designation process including the ability of Low Income Designated credit unions to accept secondary capital. It also describes the information NCUA requires from a credit union interested in receiving secondary capital. To read the full NCUA Rule and Regulation Part 701.34, please see **Appendix 2**.

2.4 Advantages of Secondary Capital

According to NCUA Rules and Regulations [Section 702.2(f)], a low-income designated credit union may count secondary capital loans as part of Net Worth when calculating the Net Worth-to-Total Assets ratio for compliance with Prompt Corrective Action (PCA). A deposit, on the other hand, will increase assets and not increase net worth, therefore lowering the Net Worth to Total Assets ratio.

2.5 Accounting for Secondary Capital

A secondary capital loan has a minimum term of five years. When you receive a secondary capital loan for more than five years, all of it counts as capital, until the time to maturity decreases to less than five years. When the money is received by the credit union, the accounting entry should be: Debit – Cash; Credit - Uninsured Secondary Capital (an equity account).

When there is less than five years to maturity, you take 20% of the original entry and reverse it from equity. The entry at that time is: Debit - Uninsured Secondary Capital; Credit - Subordinated Debt (a liability account).

As an example, if you receive \$250,000 in secondary capital, once it has five years left to maturity only \$200,000 counts as Net Worth, while the other \$50,000 counts as a subordinated loan. Each year, you repeat this entry. When you have less than one year to maturity, all \$250,000 counts as a subordinated loan, and none counts as secondary capital any longer. See the chart below.

Years Left to Maturity	Uninsured Secondary Capital Account (equity)	Subordinated debt (liability)
5 years	\$250k	\$0
4 years	\$200k	\$50k
3 years	\$150k...to zero	\$100k...at the end the funds will all be in this account

Interest is payable quarterly based on the interest rate and the full amount of the secondary capital note.

As to the lending CU, it is best to treat the funds as lending (Other Asset on the Call Report) rather than an investment. In summary, when the credit union provides the funds, the Call Report

accounting entries for the credit union is Debit Other Assets and Credit Cash. If the credit union incurs a loss, the suggested Call Report accounting entry would be to Debit Other Non-operating Income (Expense) and Credit Other Assets.

3. MCUL Supplemental Capital Process

Applying for supplemental capital through the MCUL is a process that involves the credit union providing both MCUL required information and the information necessary to receive approval to accept secondary capital from NCUA. If the credit union is state chartered, it will also need to also receive approval from OFIR. **Appendix 3** provides the process for the MCUL Supplemental Capital Program. **Appendix 4** provides a sample letter of intent for secondary capital funding that should be sent to MCUL by credit unions that plan to apply for secondary capital.

4. NCUA Secondary Capital Application

The Secondary Capital Plan will be reviewed by the NCUA to determine if a LICU is eligible to receive secondary capital. **Appendix 5** contains a sample cover letter to attach to the secondary capital plan being sent to NCUA. The letter indicates which portions are to be completed by the credit union. The credit union should ensure the letter is specific to their application.

4.1 Checklist of Requirements to Apply for Secondary Capital

When applying for secondary capital it is important to make sure that your application packet to NCUA is complete. The Secondary Capital Checklist found as **Appendix 6** reflects the requirements for secondary capital outlined in NCUA Rule and Regulation 701.34. The requirements are:

- Maximum aggregate amount of uninsured secondary capital the credit union plans to accept
- Proposed use of funds
- How funds will be repaid
- Demonstrate that Secondary Capital use conforms to the credit union's strategic plan, business plan and budget (see **Appendices 7 and 8**)
- Two year financial projections (see **Appendix 9**)

It is recommended that credit unions reference the checklist as they compile their application materials. Upon receipt of a credit union's information, the NCUA may request additional information as necessary. The draft legal documents and the board resolution for the investing institution may also be requested by the NCUA.

4.2 Business Plan

An organized and detailed business plan provides a solid foundation for the successful receipt and use of Secondary Capital. Your business plan should detail your credit union's operations and the market in which it operates. All specific functional areas and tasks should be included in your plan. Your project plan should include how you intend to use secondary capital as well as a plan to repay

the funds. Detailed information regarding both current operations and future changes that your credit union plans to make should be included in the business plan.

Appendix 7 contains business plan drafting guidelines you can use as a template framework. The information is intended as an overall guideline. Each credit union is unique and will therefore be creating a business plan specific to their organization. The key to a successful business plan lies in creating a detailed plan, keeping on track, and executing it well. For a checklist of the types of information to include when preparing the business plan, see **Appendix 8**.

4.3 Financial Projections

Financial projections are a key component to a successful secondary capital plan. It is recommended that credit unions prepare financial projections for five years from the receipt of secondary capital. Credit unions are required to submit at least two years of financial projections to NCUA. Information to assist in preparing financial projections can be found in **Appendix 9**. When preparing financial projections it is important to take into account the terms and repayment requirements in the loan agreement and incorporate them into the projections as well as the full plan.

4.4 Plan for Repayment of Funds

As part of the credit union's application for secondary capital, and in conjunction with preparing financial projections, the credit union should determine a plan for the repayment of secondary capital funds. This should be a narrative in the business plan as well as highlighted in the financial projections.

5. MCUL Supplemental Capital

Upon approval from the NCUA of the credit union's Secondary Capital Plan, the credit union should submit the approved plan along with the MCUL Supplemental Capital Application and supporting documents to MCUL. If the credit union is state chartered, it must receive approval from OFIR as well. As a reminder, supplemental capital from MCUL is only available to credit unions headquartered in Michigan who are low income designated by the NCUA.

5.1 MCUL Supplemental Capital Terms

The MCUL has Supplemental capital available to credit unions that meet the NCUA conditions set forth in NCUA Rule and Regulations 701.34. MCUL Supplemental capital terms are set by the investing organization/institution, but will fall within prudent lending regulations and standards.

5.2 MCUL Supplemental Capital Application

The requirements to apply for Supplemental capital from MCUL are similar to the NCUA and include the following:

- MCUL Supplemental Capital Application, **Appendix 10**.
- Secondary Capital Plan (as approved by NCUA). The Secondary Capital Plan is the major portion of the credit union's application for secondary capital. If, upon review of the application information, the MCUL determines that more information is necessary to make a decision regarding a Supplemental capital request the credit union will be contacted directly.

5.3 Supplemental Capital - Investor Credit Unions

Once the credit union's supplemental capital application is complete, the MCUL will locate an investor credit union(s) for possible LICU investment of a supplemental capital loan. Terms of the supplemental capital loan will be negotiated by the investor credit union(s).

6. Legal

6.1 Disclosure and Acknowledgement

Both the credit union receiving supplemental capital and the investing organization are required to sign and keep on file the Disclosure and Acknowledgement Form per NCUA Rule and Regulation 701.34. See **Appendix 11** for the Disclosure and Acknowledgement Form.

6.2 Secondary Capital - Loan Agreement

Each participating LICU will sign a Loan Agreement with the Investor Credit Union. A sample Loan Agreement is available in Appendix 12 and each credit union should have the Loan Agreement reviewed by its legal counsel. See **Appendix 12** for the sample Loan Agreement document.

6.3 Secondary Capital - Promissory Note

A promissory note will be signed by the LICU receiving supplemental capital. See **Appendix 13** for this document. This document should be reviewed by the credit union's legal counsel prior to signing.

Appendices

Appendix 1 – OFIR Letter 2008-CU-01, Additional Powers for Low Income Designated Credit Unions

Appendix 2 - NCUA Rule and Regulation 701.34

Appendix 3 – MCUL Supplemental Capital Application Process

Appendix 4 – Sample Letter of Intent to MCUL for Supplemental Capital Funding

Appendix 5 – Sample Secondary Capital Letter to NCUA

Appendix 6 – NCUA Secondary Capital Checklist

Appendix 7 – Secondary Capital Business Plan Guidelines

Appendix 8 – Secondary Capital Business Plan Checklist

Appendix 9 – Financial Projections Guidelines

Appendix 10 – MCUL Supplemental Capital Application Form

Appendix 11 – NCUA Disclosure and Acknowledgement Form

Appendix 12 – Secondary Capital - Loan Agreement

Appendix 13 – Secondary Capital - Promissory Note



JENNIFER M. GRANHOLM
GOVERNOR

STATE OF MICHIGAN
OFFICE OF FINANCIAL AND INSURANCE REGULATION
DEPARTMENT OF LABOR & ECONOMIC GROWTH
KEITH W. COOLEY, DIRECTOR

KEN ROSS
COMMISSIONER

DATE: July 3, 2008

LETTER NO.: 2008-CU-01

TO: The Board of Directors and Management of Michigan State-Chartered Credit Unions

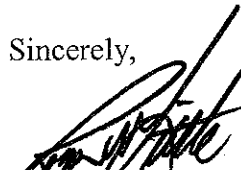
SUBJECT: Additional Powers for Low-Income Designated Credit Unions

On June 20, 2008, Office of Financial and Insurance Regulation (OFIR) Commissioner Ken Ross signed Order No. 08-027-M authorizing Michigan state-chartered credit unions (SCUs) approved for the low-income designation by the National Credit Union Administration (NCUA) to exercise all powers available to low-income designated federally-chartered credit unions (FCUs). A copy of the order is attached for your reference.

OFIR believes the additional powers available to low-income designated FCUs, which include accepting non-member deposits, participation in the Community Development Revolving Loan Program, offering secondary capital accounts, and qualifying for exemption from member business loan aggregate limits are appropriate for Michigan SCUs. Authorizing low-income designated SCUs to exercise these additional powers will provide greater opportunities to meet the financial needs of their membership and communities.

Questions regarding this letter or the referenced Order may be directed to the Credit Union Division at 517-373-6930.

Sincerely,



Roger W. Little, Deputy Commissioner
Credit Union Division

**STATE OF MICHIGAN
DEPARTMENT OF LABOR AND ECONOMIC GROWTH
OFFICE OF FINANCIAL AND INSURANCE REGULATION**

Before the Commissioner of Financial and Insurance Regulation

**In the matter of additional powers
for Michigan chartered
low-income credit unions**

Order No. 08-027-M

**Issued and entered
this 20th day of June 2008
by Ken Ross
Commissioner**

**ORDER AUTHORIZING LOW-INCOME DOMESTIC
CREDIT UNIONS TO EXERCISE ADDITIONAL POWERS**

**I
BACKGROUND**

On January 3, 2008, Communicating Arts Credit Union ("CACU") applied for:

...rights and benefits that a federal credit union that has the low-income designation enjoys, especially the ability to accept non-member shares, share drafts, share certificates, and secondary capital as described in the Federal Credit Union Act.

CACU is a Michigan state-chartered credit union ("SCU"). It was chartered under the Michigan Credit Union Act ("MCUA"), MCL 490.101 *et seq.* CACU was designated a "low income" credit union by the National Credit Union Administration ("NCUA") on August 10, 2007.

The MCUA does not address "low-income" credit unions. However, a low-income credit union is defined in 12 CFR Part 701 (2008) of the NCUA Rules and Regulations ("Rules") as a credit union with a majority of members that either earn less than 80 percent of the average of all wage earners, as established by the Bureau of Labor Statistics, or have an annual household income that falls at or below 80 percent of the median household income for the nation as established by the Census Bureau. 12 CFR §701.34.

Low-income designated credit unions may:

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- Accept non-member deposits. 12 CFR §701.34 (2008).
- Participate in the Community Development Revolving Loan Program. 12 CFR §705.3 (2008).
- Offer secondary capital accounts. 12 CFR §701.34 (2008).
- Qualify for exception from the aggregate loan limit for member business loans. 12 CFR §§723.16 and 723.17 (2008).

NCUA has approved the low-income designation for a number of Michigan SCUs. These credit unions, however, have been unable to exercise all the powers available to low-income designated federally-chartered credit unions ("FCUs") because of various, general MCUA restrictions.

The CACU applies for additional powers for itself. However, as indicated in the discussion below, additional powers will benefit all Michigan low-income SCUs. These powers are appropriate and necessary for these credit unions to compete with other providers of financial services.

II ISSUES

The principal issues are:

1. Is the Commissioner authorized under the MCL 490.208 to grant additional powers to low-income SCUs if those powers are appropriate and necessary to compete with other providers of financial services in this state?
2. Taking into consideration the factors listed in MCL 490.208(2), are the additional powers warranted?

III ANALYSIS

Authority for Granting Additional Powers

MCL 490.208(1) gives the Commissioner the authority to grant additional powers to domestic credit unions where they are "appropriate and necessary" for them to compete with other providers in this state:

If 1 or more domestic credit unions apply for authority to exercise powers not specifically authorized by this act, the commissioner may by rule, order, or declaratory ruling authorize domestic credit unions to exercise those powers if the commissioner finds that those powers are appropriate

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and necessary to compete with other providers of financial services in this state.

Factors the Commissioner shall consider

MCL 490.208(2) specifies factors the Commissioner shall consider in making a determination as to additional powers:

In acting under subsection (1), the commissioner shall consider the ability of the domestic credit unions to exercise the additional power in a safe and sound manner, the authority of the domestic credit unions under state or federal law or regulation, the powers of other competing entities providing financial services, and any specific limitations on domestic credit union powers contained in this act or in any rules or other law of this state.

Competition

The additional powers available to low-income designated FCUs, which include accepting non-member deposits, participation in the Community Development Revolving Loan Program, offering secondary capital accounts, and qualifying for exemption from member business loan aggregate limits, are appropriate for Michigan SCUs.

Authorizing low-income designated SCUs to obtain nonmember deposits and secondary capital will expand funding sources to provide credit and services to their memberships and communities. Explicit authority to access NCUA administered loan and grant programs will have similar benefits. Exemption from NCUA's business lending limits will allow these credit unions to increase small business lending, which can benefit their individual members and the communities in which they operate.

The requested powers are already available to low-income designated FCUs. Authorizing low-income designated SCUs to exercise the powers available to their federally-chartered counterparts will level the competitive playing field among credit unions operating in Michigan. The additional powers will also enable these SCUs to compete more effectively with other financial services providers that already have access to external capital and have fewer restrictions on business lending.

Safety and soundness

Other depository financial institutions exercise the same or similar powers safely and soundly. The requested additional powers are authorized by NCUA, the agency insuring SCU member deposits, for low-income designated FCUs.

The ability to qualify for exemption from aggregate member business lending limits warrants scrutiny. However, any concern in this regard is mitigated by the fact that the Rules do not raise individual borrower exposure limits and they require the NCUA to obtain state regulator concurrence before approving a low-income designation for a SCU.

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Authority of domestic credit unions

MCL 490.361(2) generally permits use of secondary capital other than capital stock if authorized by the federal regulatory authority with jurisdiction, which, in this case, is the NCUA.

The Rules allow a SCU to exercise the powers of a low-income credit union where approved by the Commissioner. The Commissioner is allowed to authorize additional powers by MCL 490.208.

Powers of competing entities

SCUs compete with FCUs, and those FCUs with the low-income designation have the advantage of the additional powers conferred under the Rules. Moreover, several other financial services providers, such as banks, have within their powers to access external capital and have fewer restrictions on business lending.

Specific limitations

No provisions in the MCUA establish any limitations specific to low-income credit union powers. No specific limitations preclude authorization under MCL 490.208 of the requested additional powers.

**IV
FINDINGS OF FACT**

Based upon the foregoing considerations, it is found that:

1. Additional powers are appropriate and necessary for low-income domestic state credit unions to compete with low-income FCUs and other providers of financial services in this state.
2. Low-income domestic credit unions have the ability to exercise the additional powers conferred upon low-income FCUs in a safe and sound manner.

**V
CONCLUSIONS OF LAW**

Based upon a review of applicable laws, it is concluded that:

1. Under MCL 490.208, the Commissioner may authorize, by order, a domestic credit union to exercise powers not specifically authorized under the MCUA if the Commissioner finds that those powers are appropriate and necessary to compete with other providers of financial services in this state.

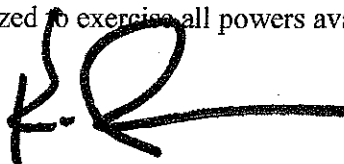
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2. MCL 490.361 generally permits use of secondary capital other than capital stock if authorized by the federal regulatory authority with jurisdiction, which, in this case, is the NCUA. The Rules allow a SCU to exercise the powers of a low-income credit union where approved by the Commissioner. The Commissioner is allowed to authorize additional powers by MCL 490.208.
3. FCUs with the low-income designation have the advantage of the additional powers conferred under the Rules. Several other financial services providers, such as banks, have within their powers to access external capital and have fewer restrictions on business lending.
4. No provisions in the MCUA establish any limitations specific to low-income credit union powers. No specific limitations preclude authorization under MCL 490.208 of the requested additional powers.

**VI
ORDER**

Therefore, it is ORDERED that domestic credit unions that have been approved for the low-income designation by NCUA are authorized to exercise all powers available to low-income designated FCUs.



Ken Ross
Commissioner

§ 701.34

12 CFR Ch. VII (1-1-10 Edition)

union employee who also performs work functions for another entity as part of a sharing arrangement between the federal credit union and the other entity.

[53 FR 29642, Aug. 8, 1988, as amended at 57 FR 54503, Nov. 19, 1992; 66 FR 65629, Dec. 20, 2001; 72 FR 30246, May 31, 2007]

§ 701.34 Designation of low income status; Acceptance of secondary capital accounts by low-income designated credit unions.

(a) *Designation of low-income status.*

(1) Based on data obtained through examinations, a regional director will notify a federal credit union that it qualifies for designation as a low-income credit union if a majority of its membership qualifies as low-income members. A federal credit union that wishes to receive the designation will notify the regional director in writing within 30 days of receipt of the regional director's notification.

(2) Low-income members are those members who earn 80% or less than the median family income for the metropolitan area where they live or national metropolitan area, whichever is greater. A regional director may use total median earnings for individuals instead of median family income if it is more beneficial to a federal credit union when determining if the credit union qualifies for a low-income credit union designation. A regional director will use the statewide or national, non-metropolitan area median family income instead of the metropolitan area or national metropolitan area median family income for members living outside a metropolitan area. Member earnings will be estimated based on data reported by the U.S. Census Bureau for the geographic area where the member lives. The term "low-income members" also includes those members enrolled as students in a college, university, high school, or vocational school.

(3) Federal credit unions that do not receive notification that they qualify for a low-income credit union designation but believe they qualify may submit information to the regional director to demonstrate they qualify for a low-income credit union designation. For example, federal credit unions may provide actual member income from

loan applications or surveys to demonstrate a majority of their membership is low-income members.

(4) If the regional director determines a low-income designated federal credit union no longer meets the criteria for the designation, the regional director will notify the federal credit union in writing, and the federal credit union must, within five years, meet the criteria for the designation or come into compliance with the regulatory requirements applicable to federal credit unions that do not have a low-income designation. The designation will remain in effect during the five-year period. If a federal credit union does not requalify and has secondary capital or nonmember deposit accounts with a maturity beyond the five-year period, a regional director may extend the time for a federal credit union to come into compliance with regulatory requirements to allow the federal credit union to satisfy the terms of any account agreements. A federal credit union may appeal a regional director's determination that the credit union no longer meets the criteria for a low-income designation to the Board within 60 days of the date of the notice from the regional director. An appeal must be submitted through the regional director.

(5) Any credit union with a low-income credit union designation on January 1, 2009 will have five years from that date to meet the criteria for low-income designation under paragraph (a)(1) of this section, unless the regional director determines a longer time is required to allow the low-income credit union to satisfy the terms of a secondary capital or nonmember deposit account agreement.

(6) *Definitions.* The following definitions apply to this section:

Median family income and total median earnings for individuals are income statistics reported by the U.S. Census Bureau. The applicable income data can be obtained via the American FactFinder on the Census Bureau's webpage at http://factfinder.census.gov/home/saff/main.html?_lang=en.

Metropolitan area means an area designated by the Office of Management and Budget pursuant to 31 U.S.C. 1104(d), 44 U.S.C. 3504(c), and Executive

National Credit Union Administration**§ 701.34**

Order 10253, 16 FR 5605 (June 13, 1951) (as amended).

(b) *Acceptance of secondary capital accounts by low-income designated credit unions.* A federal credit union having a designation of low-income status pursuant to paragraph (a) of this section may accept secondary capital accounts from nonnatural person members and nonnatural person nonmembers subject to the following conditions:

(1) *Secondary capital plan.* Before accepting secondary capital, a low-income credit union ("LICU") shall adopt, and forward to the appropriate NCUA Regional Director for approval, a written "Secondary Capital Plan" that, at a minimum:

(i) States the maximum aggregate amount of uninsured secondary capital the LICU plans to accept;

(ii) Identifies the purpose for which the aggregate secondary capital will be used, and how it will be repaid;

(iii) Explains how the LICU will provide for liquidity to repay secondary capital upon maturity of the accounts;

(iv) Demonstrates that the planned uses of secondary capital conform to the LICU's strategic plan, business plan and budget; and

(v) Includes supporting pro forma financial statements, including any off-balance sheet items, covering a minimum of the next two years.

(2) *Decision on plan.* If a LICU is not notified within 45 days of receipt of a Secondary Capital Plan that the plan is approved or disapproved, the LICU may proceed to accept secondary capital accounts pursuant to the plan.

(3) *Nonshare account.* The secondary capital account must be established as an uninsured secondary capital account or other form of non-share account.

(4) *Minimum maturity.* The maturity of the secondary capital account must be a minimum of five years.

(5) *Uninsured account.* The secondary capital account will not be insured by the National Credit Union Share Insurance Fund or any governmental or private entity.

(6) *Subordination of claim.* The secondary capital account investor's claim against the LICU must be subordinate to all other claims including those of shareholders, creditors and the

National Credit Union Share Insurance Fund.

(7) *Availability to cover losses.* Funds deposited into a secondary capital account, including interest accrued and paid into the secondary capital account, must be available to cover operating losses realized by the LICU that exceed its net available reserves (exclusive of secondary capital and allowance accounts for loan and lease losses), and to the extent funds are so used, the LICU must not restore or replenish the account under any circumstances. The LICU may, in lieu of paying interest into the secondary capital account, pay accrued interest directly to the investor or into a separate account from which the secondary capital investor may make withdrawals. Losses must be distributed pro-rata among all secondary capital accounts held by the LICU at the time the losses are realized.

(8) *Security.* The secondary capital account may not be pledged or provided by the account investor as security on a loan or other obligation with the LICU or any other party.

(9) *Merger or dissolution.* In the event of merger or other voluntary dissolution of the LICU, other than merger into another LICU, the secondary capital accounts will be closed and paid out to the account investor to the extent they are not needed to cover losses at the time of merger or dissolution.

(10) *Contract agreement.* A secondary capital account contract agreement must be executed by an authorized representative of the account investor and of the LICU reflecting the terms and conditions mandated by this section and any other terms and conditions not inconsistent with this section.

(11) *Disclosure and acknowledgement.* An authorized representative of the LICU and of the secondary capital account investor each must execute a "Disclosure and Acknowledgment" as set forth in the appendix to this section at the time of entering into the account agreement. The LICU must retain an original of the account agreement and the "Disclosure and Acknowledgment" for the term of the agreement, and a copy must be provided to the account investor.

§ 701.34

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(12) *Prompt corrective action.* As provided in §§ 702.204(b)(11), 702.304(b) and 702.305(b) of this chapter, the NCUA Board may prohibit a LICU classified “critically undercapitalized” or, if “new,” as “moderately capitalized”, “marginally capitalized”, “minimally capitalized” or “uncapitalized”, as the case may be, from paying principal, dividends or interest on its uninsured secondary capital accounts established after August 7, 2000, except that unpaid dividends or interest will continue to accrue under the terms of the account to the extent permitted by law.

(c) *Accounting treatment; Recognition of net worth value of accounts—(1) Equity account.* A LICU that issues secondary capital accounts pursuant to paragraph (b) of this section must record the funds on its balance sheet in an equity account entitled “uninsured secondary capital account.”

(2) *Schedule for recognizing net worth value.* For accounts with remaining maturities of less than five years, the LICU must reflect the net worth value of the accounts in its financial statement in accordance with the following schedule:

Remaining maturity	Net worth value of original balance (percent)
Four to less than five years	80
Three to less than four years	60
Two to less than three years	40
One to less than two years	20
Less than one year	0

(3) *Financial statement.* The LICU must reflect the full amount of the secondary capital on deposit in a footnote to its financial statement.

(d) *Redemption of secondary capital.* With the written approval of the appropriate Regional Director, secondary capital that is not recognized as net worth under paragraph (c)(2) of this section (“discounted secondary capital” recategorized as subordinated debt) may be redeemed according to the remaining maturity schedule in paragraph (d)(3) of this section.

(1) *Request to redeem secondary capital.* A request for approval to redeem discounted secondary capital may be submitted in writing at any time, must specify the increment(s) to be re-

deemed and the schedule for redeeming all any part of each eligible increment, and must demonstrate to the satisfaction of the appropriate Regional Director that:

(i) The LICU will have a post-redemption net worth classification of “adequately capitalized” under part 702 of this chapter;

(ii) The discounted secondary capital has been on deposit at least two years;

(iii) The discounted secondary capital will not be needed to cover losses prior to final maturity of the account;

(iv) The LICU’s books and records are current and reconciled;

(v) The proposed redemption will not jeopardize other current sources of funding, if any, to the LICU; and

(vi) The request to redeem is authorized by resolution of the LICU’s board of directors.

(2) *Decision on request.* A request to redeem discounted secondary capital may be granted in whole or in part. If a LICU is not notified within 45 days of receipt of a request for approval to redeem secondary capital that its request is either granted or denied, the LICU may proceed to redeem secondary capital accounts as proposed.

(3) *Schedule for redeeming secondary capital.*

Remaining maturity	Redemption limit as percent of original balance
Four to less than five years	20
Three to less than four years	40
Two to less than three years	60
One to less than two years	80

APPENDIX TO § 701.34

A LICU that is authorized to accept uninsured secondary capital accounts and each investor in such an account shall execute and date the following “Disclosure and Acknowledgment” form, a signed original of which must be retained by the credit union:

DISCLOSURE AND ACKNOWLEDGMENT

[Name of CU] and [Name of investor] hereby acknowledge and agree that [Name of investor] has committed [amount of funds] to a secondary capital account with [name of credit union] under the following terms and conditions:

1. *Term.* The funds committed to the secondary capital account are committed for a period of ____ years.

National Credit Union Administration

§ 701.36

2. *Redemption prior to maturity.* Subject to the conditions set forth in 12 CFR 701.34, the funds committed to the secondary capital account are redeemable prior to maturity only at the option of the LICU and only with the prior approval of the appropriate regional director.

3. *Uninsured, non-share account.* The secondary capital account is not a share account and the funds committed to the secondary capital account are not insured by the National Credit Union Share Insurance Fund or any other governmental or private entity.

4. *Prepayment risk.* Redemption of U.S.C. prior to the account's original maturity date may expose the account investor to the risk of being unable to reinvest the repaid funds at the same rate of interest for the balance of the period remaining until the original maturity date. The investor acknowledges that it understands and assumes responsibility for prepayment risk associated with the [name of credit union]'s redemption of the investor's U.S.C. account prior to the original maturity date.

5. *Availability to cover losses.* The funds committed to the secondary capital account and any interest paid into the account may be used by [name of credit union] to cover any and all operating losses that exceed the credit union's net worth exclusive of allowance accounts for loan losses, and in the event the funds are so used, (name of credit union) will under no circumstances restore or replenish those funds to [name of institutional investor]. Dividends are not considered operating losses and are not eligible to be paid out of secondary capital.

6. *Accrued interest.* By initialing below, [name of credit union] and [name of institutional investor] agree that accrued interest will be:

- ____ Paid into and become part of the secondary capital account;
- ____ Paid directly to the investor;
- ____ Paid into a separate account from which the investor may make withdrawals; or
- ____ Any combination of the above provided the details are specified and agreed to in writing.

7. *Subordination of claims.* In the event of liquidation of [name of credit union], the funds committed to the secondary capital account will be subordinate to all other claims on the assets of the credit union, including claims of member shareholders, creditors and the National Credit Union Share Insurance Fund.

8. *Prompt Corrective Action.* Under certain net worth classifications (see 12 CFR 702.204(b)(11), 702.304(b) and 702.305(b), as the case may be), the NCUA Board may prohibit [name of credit union] from paying principal, dividends or interest on its uninsured secondary capital accounts established after

August 7, 2000, except that unpaid dividends or interest will continue to accrue under the terms of the account to the extent permitted by law.

ACKNOWLEDGED AND AGREED TO this ____ day of [month and year] by:

 [name of investor's official]
 [title of official]
 [name of investor]
 [address and phone number of investor]
 [investor's tax identification number]

 [name of credit union official]
 [title of official]

[61 FR 3790, Feb. 2, 1996, as amended at 61 FR 50695, 50697, Sept. 27, 1996; 64 FR 72270, Dec. 27, 1999; 65 FR 21131, Apr. 20, 2000; 71 FR 4238, Jan. 26, 2006; 73 FR 71912, Nov. 26, 2008]

§ 701.35 Share, share draft, and share certificate accounts.

(a) Federal credit unions may offer share, share draft, and share certificate accounts in accordance with section 107(6) of the Act (12 U.S.C. 1757(6)) and the board of directors may declare dividends on such accounts as provided in section 117 of the Act (12 U.S.C. 1763).

(b) A Federal credit union shall accurately represent the terms and conditions of its share, share draft, and share certificate accounts in all advertising, disclosures, or agreements, whether written or oral

(c) A Federal credit union may, consistent with this section, parts 707 and 740 of this subchapter, other federal law, and its contractual obligations, determine the types of fees or charges and other matters affecting the opening, maintaining and closing of a share, share draft or share certificate account. State laws regulating such activities are not applicable to federal credit unions.

(d) For purposes of this section, "state law" means the constitution, statutes, regulations, and judicial decisions of any state, the District of Columbia, the several territories and possessions of the United States, and the Commonwealth of Puerto Rico.

[47 FR 17979, Apr. 27, 1982, as amended at 50 FR 4637, Feb. 1, 1985; 59 FR 50445, Sept. 27, 1993]

§ 701.36 FCU ownership of fixed assets.

(a) *Investment in Fixed Assets.* (1) No Federal credit union with \$1,000,000 or

MCUL SUPPLEMENTAL CAPITAL APPLICATION PROCESS

July 2011

The following steps are necessary to apply for Supplemental Capital through the MCUL. Please note that the credit union must be low income designated by the NCUA and have a NCUA approved Secondary Capital Plan prior to applying for and receiving supplemental capital through the MCUL.

1. Low Income Credit Union (LICU) notifies MCUL Supplemental Capital Program Manager of its interest in applying for supplemental capital. See Sample letter in Appendix 3.
2. LICU applies in writing to MCUL's oversight entity using the MCUL Supplemental Capital Application Form found in Appendix 9. The LICU should include their proof of low income designation, financials and NCUA approved Secondary Capital Plan.
3. Oversight entity reviews application for completeness.
4. Once complete, oversight entity will contact potential investor(s).
5. Oversight entity contacts CenCorp and selected potential investor(s) that a complete application has been received.
6. Investor reviews application and related documents and conducts due diligence in order to make investment decision.
7. If Investor decides to invest, it contacts the oversight entity and CenCorp that the supplemental capital investment has been approved.
8. CenCorp notifies the parties and schedules the closing and the appropriate legal documents are signed. CenCorp established the appropriate accounts, completes the funds transfer and provides servicing.

Program correspondence should be sent to:

**Michigan Credit Union League
Attn: Supplemental Capital Program Manager
P.O. Box 8054
Plymouth, MI 48170-8054
Tel: (800) 262-6285 | Fax: (517)482-3762**

Sample Letter of Intent to MCUL for Supplemental Capital Funding
July 2011

Date:

Michigan Credit Union League
Attn: Supplemental Capital Program Manager
PO Box 8054
Plymouth, MI 48170-8054

To Whom It May Concern:

This letter is to confirm [XYZ Credit Union] has sent application to the NCUA on (insert date) for approval to accept Secondary Capital funds.

Please accept this letter that [XYZ Credit Union] would like to apply to MCUL's Supplemental Capital program once receiving approval from NCUA. The secondary capital funding request would be in the amount of [\$XXX]; with an X year maturity.

If any documents are needed to be completed by our credit union at this time in order to begin the MCUL Secondary Capital program process please send to the below address:

XYZ Credit Union
Address
Contact Name at Credit Union: _____

Thank you in advance.

Sincerely,

CEO/Manager

Sample Secondary Capital Letter to NCUA July 2011

Date

NCUA Regional Director – Region 1
9 Washington Square
Washington Avenue Extension
Albany, NY 12205

Dear Regional Director:

The officials of [ABC LICU] request permission to issue a Secondary Capital Account (SCA) agreement with [XYZ Credit Union]. We're making this request to strengthen the credit union's net worth position and (*insert here reason for requesting Secondary Capital*).

During the analysis of how accepting secondary capital will impact our credit union's financial performance, we have considered: Capitalization write-down, recognition of premium assessment, write off of record keeping unrecoverable items, and funding the Allowance for Loan and Lease Loss (ALLL) account.

Attached you will find the Secondary Capital Business Plan and supporting proforma financial statements.

If you require additional information please call me at (XXX) XXX-XXXX.

Sincerely,

Jane Doe

CEO, ABC LICU

Attachments:

1. *Secondary Capital Business Plan*
2. *Proforma Financial Statements*

Cc: NCUA Examiner X. XXX

NCUA Secondary Capital Checklist

July 2011

Please note: This checklist was provided by NCUA and is segregated into three parts, as follows: Secondary Capital Plan Requirements, Secondary Capital Account Requirements and Secondary Capital Accounting Requirements. Each category has its own required elements. For example, a credit union developing a Secondary Capital Plan for submission to the appropriate regional director for approval should carefully review the required elements for Secondary Capital Plans. In addition, during implementation of a Secondary Capital program a credit union should carefully review the Secondary Capital Account and Accounting Requirement sections for required elements and procedures for implementing the credit union's Secondary Capital Plan.

Reference	I. Secondary Capital Plan Requirements	YES / NO
701.34(b)(1)	(i) Does the Secondary Capital Plan state the maximum aggregate amount of uninsured secondary capital the LICU plans to accept?	
701.34(b)(1)	(ii) Does the Secondary Capital Plan identify the purpose for which the aggregate secondary capital will be used, and how it will be repaid?	
701.34(b)(1)	(iii) Does the Secondary Capital Plan explain how the LICU will provide for liquidity to repay secondary capital upon maturity of the accounts?	
701.34(b)(1)	(iv) Does the Secondary Capital Plan demonstrate that the planned uses of secondary capital conform to the LICU's strategic plan, business plan and budget?	
701.34(b)(1)	(v) Does the Secondary Capital Plan include supporting pro-forma financial statements, including any off-balance sheet items, covering a minimum of the next two years? (Please note that while the regulation requires pro-forma financial statements for a minimum of two years, credit unions may provide more than two years of pro-forma financial statements. Additional pro-forma financial statements may help establish a credit union meets all Secondary Capital Plan requirements (i.e. repayment, liquidity, uses of secondary capital, etc.)	
	II. Secondary Capital Account Requirements	
701.34(b)(3)	<i>Non-share account.</i> Are secondary capital account(s) established as uninsured secondary capital account(s) or other form of non-share account(s)?	
701.34(b)(4)	<i>Minimum maturity.</i> Are minimum maturities of secondary capital accounts at least five years?	
701.34(b)(5)	<i>Uninsured account.</i> Are secondary capital accounts clearly identified as not being insured by the National Credit Union Share Insurance Fund or any governmental or private entity?	
701.34(b)(6)	<i>Subordination of claim.</i> Are secondary capital accounts set-up so an investor's claim against the LICU is subordinate to all other claims including those of shareholders, creditors, the National Credit Union Share Insurance Fund?	
701.34(b)(7)	<i>Availability to cover losses.</i> Are funds deposited into a secondary capital account, including interest accrued and paid into the secondary capital account, available to cover operating losses realized by the LICU that exceed its net available reserves (exclusive of secondary capital and allowance accounts for loan and lease losses), and to the extent funds are so used, the LICU shall not restore or replenish the account under any circumstances? (The LICU may, in lieu of paying interest into the secondary capital account, pay accrued interest directly to the investor or into a separate account from which the secondary capital investor may make withdrawals.)	
701.34(b)(8)	<i>Security.</i> Are secondary capital accounts not pledged or provided by the account investor as security on a loan or other obligation with the LICU or any other party?	
701.34(b)(9)	<i>Merger or dissolution.</i> Will the LICU ensure, in the event of a merger or other voluntary dissolution of the LICU, other than merger into another LICU, that the secondary capital accounts will be closed and paid out to the account investor to the extent they are not needed to cover losses at the time of merger or dissolution?	
701.34(b)(10)	<i>Contract agreement.</i> Will the LICU ensure secondary capital account contract agreements are executed by an authorized representative of the account investor and of the LICU reflecting the terms and conditions mandated by NCUA Rules & Regulations §701.34 (et. seq.) and any other terms and conditions not inconsistent with NCUA Rules & Regulations?	
701.34(b)(11)	<i>Disclosure and acknowledgement.</i> Will the LICU ensure that an authorized representative of the LICU and of the secondary capital account investor each shall execute a "Disclosure and Acknowledgment" as set forth in the Appendix to NCUA Rules & Regulations §701.34 at the time of entering into the account agreement?	
701.34(b)(11)	<i>Disclosure and acknowledgement.</i> Will the LICU retain an original of the account agreement and the "Disclosure and Acknowledgment" for the term of the agreement, and provide a copy to the account investor?	
	III. Secondary Capital Accounting Requirements	
701.34(c)	<i>Accounting Treatment.</i> Will the LICU record its secondary capital accounts pursuant to §701.34(c) by ensuring secondary capital funds on its balance sheet are recorded in an equity account titled "uninsured secondary capital"?	
701.34(c2)	<i>Schedule for recognizing new worth value.</i> Will the LICU reflect the net worth value of the accounts in its financial statements in accordance with the schedule set forth in NCUA Rules & Regulations §701.34(2)?	
701.34(c3)	<i>Financial Statement.</i> Will the LICU reflect the full amount of the secondary capital on deposit in a footnote to the LICU's financial statement?	

Secondary Capital Business Plan Guidelines

July 2011

The following is a business plan guideline which is provided in order to assist you in preparing your NCUA Secondary Capital application documents. These guidelines may be used as a template, but each Secondary Capital Business Plan must be tailored for each individual credit union. If your credit union already has a comprehensive business plan, it is recommended you adapt your current plan to incorporate the requirements outlined in **Appendix 5, NCUA Secondary Capital Checklist, Section I. Secondary Capital Plan Requirements.**

I. Executive Summary

The executive summary should be no more than 1 page long and include the highlights of the plan along with why you are requesting the approval to accept secondary capital, the aggregate amount of uninsured secondary capital the credit union plans to accept and the purpose for which the aggregate secondary capital will be used.

II. Mission Statement

Insert Credit Union's Mission

- A. Operating Principles-Insert Credit Union's Operating Principles

III. Assessment of Credit Union's Current Position

- A. Strengths-Provide your Credit Union's Strengths
- B. Weaknesses-Provide your Credit Union's Weaknesses
- C. Market Position-Provide information on the credit union's current market position.
 - Is the credit union the members' primary financial institution?
 - How do your members perceive their credit union?

IV. Assessment of Competition

Provide the credit union's competition. You can also include a strength and weakness analysis to determine your credit union's resulting strategies accordingly.

Ex: Strengths of Banks and Alternative Finance Service Providers

V. Assessment of Environment

Provide an assessment of the external environment that may have resulting implications for credit unions. Ex:

- Decreasing Interchange Income
- Shrinking Profit Margins
- Aging of the Population

VI. Goals

Describe goals as they are stated within the credit union’s strategic plan.

Ex: Following are the (INSERT YEAR) goals established at the credit union’s strategic planning session:

Assets	\$X
Loans	\$X
Reserve to Assets	X%
Delinquency	X%
Net Charged-Off Loans	\$X

When including secondary capital funds, some of the credit union goals have been modified. The revised goals for (INSERT YEAR) are as follows:

Assets	\$X
Loans	\$X
Reserve to Assets	X%
Delinquency	X%
Net Charged-Off Loans	\$X

The goals for (INSERT FUTURE YEARS) are as follows:

Assets	\$X
Loans	\$X
Reserve to Assets	X%
Delinquency	X%
Net Charged-Off Loans	\$X

VII. Strategy

Layout the strategies and corresponding methods used that will allow the credit union to achieve its financial goals.

Ex:

- To Build Capital as a Percentage of Assets
- To Build Member Loyalty
- To Improve Our Relationships with Select Employee Groups

VIII. Financial Health and Viability

This information will be laid out in detail in the credit union's financial projections. **Appendix 8** outlines how your credit union can go about preparing the necessary financial documents; **Appendix 7** provides you a list of items to consider as you work through the financial projections. In addition, please describe in a narrative how the credit union will provide for liquidity to repay secondary capital upon maturity of the accounts. Also provide any other information that is relevant to the financial health and viability of your credit union and not encompassed in the projections included with your Secondary Capital Application to NCUA.

IX. Conclusion

Insert conclusion summarizing, in brief, the credit union's objectives to be met through the business and strategic plan of the credit union by incorporating the secondary capital loan.

**Secondary Capital Business Plan Checklist
July 2011**

This checklist is not all inclusive. It is an attempt to capture a sampling of activities that, if your credit union is planning to undertake in the next few years, should be described in your secondary capital plan.

Your credit union may have other activities which will impact credit union performance and those should be included as well. If you are planning to do any of the below, please include a *detailed plan* with a narrative and all financial projections.

Sample of activities that may impact your secondary capital plan:

- Open a branch
- Close a branch
- Hire new employees
- Upgrade systems
- Upgrade office space
- Start a new loan program
- Start a new partnership
- Introduce a new product
- Discontinue existing products or programs
- Start a new marketing plan
- Expand field of membership
- Upgrade technology

Financial Projections Guidelines

July 2011

Prepared by the NCUA Office of Small Credit Union Initiatives (OSCUI)

The steps below are provided as general guidance on preparing financial projections using Excel and the Financial Performance Reports (FPRs) available through the NCUA. The FPR data is helpful for creating very basic assumptions for your projections. **Note: This information is provided for general guidance only and should not be interpreted as a required format or system for creating financial projections for NCUA.**

1. Download NCUA FPR: Access the NCUA tool for downloading FPRs at <http://webapps.ncua.gov/ncuafpr>:
 - a. Select “I want an FPR emailed to me for one credit union” then click “OK” to open the next screen.
 - b. Enter the email address where you want the Excel file sent.
 - c. Select “Annual” for Interval, enter the charter #, and select the most recent 12/31 report cycle.
 - d. When the Excel file arrives, save and open the file.

2. Create Financial Projection File: Open a new Excel document while still keeping the FPR file open.
 Note – Press Alt-Tab to toggle between two open documents.
 - a. Select the “1) Financial Summary” worksheet from the bottom tabs of the FPR document.
 - b. Copy the financial statement labels column and the last year of data into the new file. You can copy the whole worksheet and delete the extra information or you can simply copy only columns A and I from the FPR document. You may want to copy up to three years of historical data into the new file as reference.

3. Add Columns for Projected Years: Add column headings to the right of the historic data where you will fill in the projected figures, e.g., 12/31/2011, or FY 2011.
 - a. Note – you can also use a downloaded financial report from your accounting system as a starting point for the projections – the key is to pull in at least the last year of financial data as a basis from which to start estimating the projections.
 - b. Note that the Financial Summary in the FPR includes calculations for percentage change for each line item over the last two years. This data can be helpful in estimating future changes.

4. Develop Projection Assumptions: This is the key step in the process and also the most time-consuming. Review each line in the balance sheet and income statement to fill in what the total will be for the projected years. Use one or all of the following to do this for each line item:
 - a. FPR Data: You’ll notice that the FPR includes several pages of detailed entries and calculations based on your 5300 reports. For example there is a section of “Productivity” calculations and % change ratios, both found on the Financial Summary tab.
 - b. Data Processing System Reports: Your DP system should provide you with more detailed figures if the 5300 aggregate data is not enough. For example, you may want to look at the weighted average rates of return on each type of unsecured loan product, whereas the FPR only has two categories of unsecured loans, credit cards and others.
 - c. Strategic and Business Plans: These planning tools are critical in developing projections as they should outline any changes the credit union intends to make such as new product or service offerings, staff changes, etc. These assumptions must be incorporated into the projections.

Note: This information is provided for general guidance only and should not be interpreted as a required format or system for creating financial projections for NCUA.

5. Add Calculated Monitors: It's important to monitor changes in key ratios based on the figures in your projections. To do this it's helpful to add a few rows of monitoring ratios at the bottom of your projections which identify the year end ratios. The most common ones include items such as Net Worth Ratio, Loans/Deposits, and Net Income Ratio, for example.

Addendums A-C: The following guidance and sample pages illustrate the steps outlined above.

Addendum A: Financial Statement Line Item Guidance

The line items below are the key drivers of a credit union's income and expenses, and therefore its financial ratios. The most thought and research should be put into the projections for these figures. The notes below provide suggested questions to consider and resources to use to develop the most accurate projections for these important line items.

Balance Sheet: Assets: Total Loans: Look at the percent change over the last three years to identify the recent trend. Are you going to discontinue any loan products or offer new products? Will demand for a particular loan type increase or decrease? Are you marketing loan products more or less than prior years?

Balance Sheet: Liabilities and Capital: Uninsured Secondary Capital: Remember to reflect the total amount of secondary capital expected. Also note that the cost of these funds will need to be reflected in the "Cost of Funds" line item found under the Income/Expense section of the FPR. You may want to add separate lines to break these costs out including the "Interest on Borrowed Funds," rather than group all Cost of Funds in one line item.

Balance Sheet: Liabilities and Capital: Total Shares and Deposits: Estimate based on assumptions regarding member growth. What's driving the change in this number? Consider using the FPR Ratios page Productivity figure for "Avg. Shares Per Member" as a baseline assumption then consider other factors such as actual member growth in the last year, any changes to your Field of Membership, marketing and outreach plans that will help you to attract new members.

Income Statement: Income: Loan Income: Start by looking at the historical "Yield on Average Loans" under the "Earnings" section found on the FPR Ratios worksheet. Have or will you change the pricing on loan products that will result in a different yield than last year? Will the portfolio composition by product change? For example, if you've discontinued real estate loans and will make more car loans instead, estimate the difference in yield based on the difference between those product interest rates.

Income Statement: Expenses: Salaries and Benefits: Will the credit union hire new staff because of the Secondary Capital investment? Are benefit costs like health insurance increasing or decreasing?

Income Statement: Expenses: Provision for Loan and Lease Losses (PLLL): Look at historical PLLL expense and the credit union's ALLL model. Consider any new information that may result in a different trend than has been shown historically, for example, local or national economic downturns or recoveries.

Balance Your Balance Sheet: You must make sure that your balance sheet balances such that Total Assets = Total Liabilities, Shares and Equity. It may be difficult to estimate every change in the balance sheet, therefore you may need to make a final calculated adjustment to cash, investments, or any other item where you assume the out of balance difference will fall.

Note: This information is provided for general guidance only and should not be interpreted as a required format or system for creating financial projections for NCUA.

Addendum B: Sample Monitoring Ratios and Formulas

These are helpful for ensuring that the projections continue to meet NCUA regulations and guidelines.

- Net Worth Ratio: Total Equity / Total Assets
- Loans/Member Deposits: Total Loans/Member Shares and Deposits
- Loans/Member + Non-Member Deposits: Total Loans/Member + Non-Member Shares and Deposits
- Loans/All Deposits + Secondary Capital: Total Loans/All Member + Non-Member Deposits + Secondary Capital
- Net Income Ratio: Net Income / Total Assets

Addendum C: Projection Assumptions for Secondary Capital Plan

This is a sample format for documenting the detailed explanations for the assumptions used in the projections. You should include an entry for each major line item or section in the plan. Spend the most time explaining any numbers which are different from the historical pattern. The explanation should both explain the calculation of the number and justify why the numbers are changing. **Note – these explanations do not replace the narrative description you will provide in your secondary capital plan explaining how you will use the funds.**

Line Items	Explanation of Assumptions
Balance Sheet	
CASH AND EQUIVALENTS	
TOTAL INVESTMENTS	
TOTAL LOANS	
(Allowance for Loan & Lease Losses)	
TOTAL ASSETS	
Uninsured Secondary Capital	
TOTAL LIABILITIES	
TOTAL SHARES & DEPOSITS	
Income and Expenses	
Loan Income	
Investment Income	
Other Income	
Salaries & Benefits	
Total Other Operating Expenses	
Non-operating Income & (Expense)	
NCUSIF Stabilization Income (Expense)	
Provision for Loan/Lease Losses	
Cost of Funds	
Net Income (Loss)	
Other Assumptions/Explanations	
Member Growth	
Delinquencies	
Net Charge-Offs	
Other:	

Note: This information is provided for general guidance only and should not be interpreted as a required format or system for creating financial projections for NCUA.

**MCUL SUPPLEMENTAL CAPITAL APPLICATION FORM
July 2011**

Date: _____

Credit Union: _____ Charter Number: _____

Contact Person: _____ Title : _____

Telephone: (____) _____ Fax: (____) _____ E-mail _____

Mailing Address: _____

1. LOW-INCOME DESIGNATION.

Have you been officially designated as a "**low-income credit union**" by the National Credit Union Administration or the equivalent State regulatory agency?

___ Yes, please include with this application request: the NCUA and if state chartered, the OFIR document showing approval of the Low Income Designation for your credit union.

___ No, but our application is pending. Expected completion will be _____.

Note: *NCUA regulations only allow credit unions with low-income designation to receive secondary capital. Any credit union that has not yet obtained its low income designation must reapply for the MCUL supplementary capital after it receives low income designation documents from the NCUA/or OFIR offices.*

2. AMOUNT REQUESTED.

(Please consider how the additional funds and associated costs will affect your assets and liability management.)

Amount \$ _____ Rate: _____%
Requested Term: _____ (Minimum is 5 years)

Please answer all of the below questions in detail. Some of the answers may also be useful as you develop your secondary capital plan for NCUA.

3. CREDIT UNION STRUCTURE.

- A. Give a brief description of your field of membership.
- B. Describe in **detail** the community you serve: its needs, and relevant development plans.

C. Describe specific internal and external threats to the credit union.

4. CREDIT UNION MANAGEMENT AND EXPERTISE.

Describe in detail your credit union’s management and expertise. The Investor Credit Union is seeking information to show that your credit union’s leadership is knowledgeable and prepared to accept supplemental capital and implement the Secondary Capital Plan that you will submit to NCUA. Please include upper management bios as an attachment.

5. SECONDARY CAPITAL PLAN.

Within your Secondary Capital Plan describe the impact your receipt of supplemental capital will have on your credit union and how the credit union will use the capital to have an economic impact on the credit union membership. Please include the secondary capital plan submitted to NCUA as an attachment.

6. FINANCIAL CONSIDERATIONS OR CONCERNS.

Describe any financial issues that your credit union is currently facing and how they are being addressed.

7. AUDITED FINANCIAL STATEMENTS.

Please provide copies of audited financial statements for the last three years.

8. FINANCIAL STATEMENTS

Please provide the proforma financial statements that accompany your Secondary Capital Business Plan. Please provide the information from your credit union’s FPR described in Appendix 8 of the MCUL Supplemental Capital Guide.

I certify that the information in this application is accurate to the best of my knowledge.

Name

Title

Date

Attachments

- Regulatory Letters re Low Income Designation
- Secondary Capital Plan
- Audited Financial Statements (last three years)
- Proforma Financial Statements
- Upper Management Bios

Disclosure and Acknowledgement Form
XYZ LICU and the ABC Investor
July 2011

XYZ Federal Credit Union (“XYZ Federal Credit Union”) and the ABC Investor hereby acknowledge and agree that the ABC has committed \$250,000 to a secondary capital account with XYZ Federal Credit Union under the following terms and conditions:

1. **Term.** The funds committed to the uninsured secondary capital (USC) account are committed for a period (minimum of five years required), but not to exceed X).
2. **Redemption prior to maturity.** Subject to the conditions set forth in 12 C.F.R. 701.34, the funds committed to the USC account are redeemable prior to maturity only at the option of XYZ LICU and only with prior approval of the appropriate regional director.
3. **Uninsured, non-share account.** The USC account is not a share account and the funds committed to it are not insured by the National Credit Union Share Insurance Fund or any other governmental or private entity.
4. **Prepayment Risk.** Redemption of the USC prior to the account’s original maturity date may expose the account investor to the risk of being unable to reinvest the repaid funds at the same rate of interest for the balance of the period remaining until the original maturity date. The investor acknowledges that it understands and assumes responsibility for prepayment risk associated with XYZ LICU’s redemption of the investor’s USC account prior to the original maturity date.
5. **Availability to cover losses.** The funds committed to the USC account and any interest paid into the account may be used by XYZ LICU to cover any and all operating losses that exceed the credit union’s Net Worth exclusive of allowance accounts for loan losses. In the event the funds are used, XYZ LICU will, under no circumstances, restore or replenish those funds to ABC. Dividends are not considered operating losses and are not eligible to be paid out of secondary capital.
6. **Accrued Interest.** By initialing below, XYZ LICU and ABC agree that accrued interest will be:

____ Paid into and become part of the secondary capital account;
____ Paid directly to the investor;
____ Paid into a separate account from which the investor may make withdrawals; or
____ Any combination of the above provided the details are specified and agreed to in writing.
7. **Subordination of claims.** In the event of liquidation of XYZ LICU, the funds committed to the secondary capital account will be subordinate to all other claims on the assets of the credit

union, including claims of member shareholders, creditors, and the National Credit Union Share Insurance Fund.

- 8. Prompt Corrective Action.** Under certain Net Worth classifications (see 12 C.F.R. 702.204(b)(11), 702.304(b) and 702.305(b), as the case may be), the NCUA Board may prohibit XYZ LICU from paying principal, dividends or interest on its uninsured secondary capital accounts established after August 7, 2000, except that unpaid dividends or interest will continue to accrue under the terms of the account to the extent permitted by law.

ACKNOWLEDGED AND AGREED TO this ____ day of _____, 20XX by:

Name of Official

Title of Official

Name of Investor

Address & Phone Number of Investor

Investor's Tax ID Number

XYZ

Name of CU Official

Title of CU Official

XYZ LICU

123 Main Street

Main Street, USA

SECONDARY CAPITAL - LOAN AGREEMENT

This agreement is made as of _____ by and between **xxx Credit Union** (the “Credit Union”) having offices at *xxx Street, xxx, MI 99999* and the **xxxx**, (the “Investor”) having offices at *xxxx Street, xxx, MI 99999* pursuant to the terms of Investor **Secondary Capital Program** (the “Program”).

Section 1. The Secondary Capital Loan. Investor agrees to lend to the Credit Union and the Credit Union agrees to repay Investor, pursuant to a promissory note (the “Note”) herewith, the sum of **\$xxx,xxx** (the “Loan”), subject to:

- (a) The terms and conditions of this loan agreement (the “Agreement”); and
- (b) The terms and conditions of the “Disclosure & Acknowledgement” form executed by the parties pursuant to 12 U.S.C. 701.34(b)(11); and
- (c) The terms and conditions of the Secondary Capital Plan approved pursuant to 12 U.S.C. 701.34(b)(1) on _____; and
- (d) The receipt by Investor of the Note and the Agreement duly executed by the Credit Union.

Section 2. Maturity. The Loan shall mature and all unpaid interest and principal shall be payable in full on _____ (the “Maturity Date”).

Section 3. Interest Rate. The Credit Union agrees to pay interest on the outstanding principal balance of the Loan at the rate of *xx%* per annum, payable quarterly, until the date on which the principal amount of the Loan shall be fully paid.

Section 4. Accrued Interest. By initialing below, Credit Union and the Investor agree that accrued interest will be:

- ____ Paid into and become part of the secondary capital account;
- ____ Paid directly to the investor;
- ____ Paid into a separate account from which the investor may make withdrawals; or
- ____ Any combination of the above provided the details are specified and agreed to in writing.

Section 5. Payments. Interest shall be payable quarterly in arrears on January 15, April 15, July 15, and October 15. All payments of principal and interest **shall be made payable to the Investor** and sent to the following address, unless otherwise notified in writing by the Investor:

Investor (insert name)
xxxx Street
xxx, MI 99999

Payments are due no later than 3:00 PM (Eastern Time) on the date when due in lawful money of the United States in Federal, or other immediately available funds.

Section 6. Representations and Warranties of the Credit Union. The Credit Union represents and warrants that:

- a) The Credit Union has the corporate power and authority to own its assets and properties, to conduct its business and other activities as such business and activities are currently being conducted or are contemplated to be conducted and to execute, deliver, and perform this Agreement and the Note (collectively the “Loan Documents”).
- b) The execution, delivery, and performance by the Credit Union of each Loan Document and the Credit Union’s use of the proceeds of the Loan as contemplated hereunder will not:
 - i) violate any provision of any law, order, rule or regulation of any court or governmental or regulatory body or the Articles of Incorporation or By-Laws of the Credit Union,
 - ii) violate, conflict with, result in a breach of, or constitute an event of default in (with due notice or lapse of time or both) any indenture, agreement or instrument to which the Credit Union is a party or by which the Credit Union or its assets or properties are bound.
- c) The Credit Union has insurance coverage in full force and effect, in such amounts and for such risks as is customarily maintained by organizations engaged in similar activities.
- d) None of the information and documents furnished or to be furnished by the Credit Union to Investor in connection with the execution, delivery, and performance of the Loan Documents have contained or will contain any material misstatement of fact, or omitted, or will omit, to state any material fact required to be stated to make the statements therein not misleading.
- e) The execution and delivery of the Loan Documents by the Credit Union will not confer any rights or privileges upon any third person or entity not a party hereto.
- f) The Credit Union is in compliance, in all material respects, with all statutes, rules and regulations of federal, state, and municipal governments applicable to it.

Section 7. Covenants of the Credit Union. The Credit Union covenants and agrees that so long as Investor shall hold the Note and the Loan remains unpaid the Credit Union shall:

- a) Agree that the purpose of this Loan is to fund the Secondary Capital Account: that the Loan proceeds will be used to cover operating losses only to the extent such losses exceed the Credit Union’s net worth exclusive of allowance accounts for loan losses; and that the Loan proceeds may not be used to pay dividends.

- b) Furnish the Investor with a certified copy of the resolutions adopted by the Credit Union's Board of Directors evidencing that the Loan has been accepted for use for the purposes authorized in this Loan Agreement.
- c) Furnish the Investor with documentation from both the National Credit Union Administration (NCUA) Regional Director and the appropriate State Supervisory Authority demonstrating approval of the Loan for at least the entire amount of the Loan as stated in Section 1 combined with any other secondary capital loan agreements to which the Credit Union is a party, or, if 45 days have elapsed from time the plan was submitted to the NCUA and the State Supervisory Authority, evidence of the submission of the plan and the date of that submission.
- d) Furnish the Investor:
 - i) **Semi-Annually:** A narrative report or questionnaire provided by Investor, outlining the performance of the Credit Union and describing in detail the Credit Union's progress in meeting the goals of the Application during the prior period. The reports will also include loan statistics and a discussion of the community outcomes and impact facilitated by the investment.
 - ii) **Periodically:** Copies of annual fiscal financial reports audited by independent accountants, immediate and full disclosure of any debits planned or taken to the secondary capital account, and any such other financial reports and information the Investor may from time to time reasonably request.
- e) [Remove?] Agree that the Investor may publicize its participation in the Secondary Capital Program. The Credit Union agrees to provide the Investor any information such as photographs, news stories and/or articles that the Investor may use to publicize the Secondary Capital Program and the Credit Union's participation in it.
- f) If, at any time, the Credit Union's Net Worth is less than seven percent (7%) of its assets, excluding the dollar amount of this Loan, agree to make regular reserve transfers until the Credit Union's Net Worth is equal to at least seven percent (7%) of its assets. The Credit Union agrees to include a calculation sheet demonstrating the Net Worth ratio with the reports sent to the Investor.

Section 8. Record-keeping for the Loan. The Credit Union will record the Loan in accordance with the NCUA rules and regulations for Secondary Capital or Subordinated Debt.

- a) The Credit Union shall furnish the Investor with a letter from its treasurer or certified public accountant that the Loan has been recorded in accordance with NCUA rules and regulations.

Section 9. Late Payment Rates and Fees. If interest payments are made 15 days or more after the

date due, upon the request of the Investor, the Credit Union shall pay an interest rate of ??[10%]?? p.a. on the face value of the loan balance outstanding. Late fees shall apply on principal payments paid 30 days or more after due date at the rate of 1% of principal due per month.

Section 10. Prepayment Fee. With the approval of The National Credit Union Administration (NCUA) and the State Supervisory Authority, the Credit Union may elect to prepay all or a portion of the Loan. If the Credit Union so elects prepayment, a prepayment fee will be assessed as agreed upon by the Investor and the Credit Union.

Section 11. Events of Default. The following events shall be Events of Default hereunder:

- a) The Credit Union shall fail to pay when due any principal amount of the Loan.
- b) The Credit Union shall fail to pay any sum [other than sums covered in Section 9 due and payable under the Note and this Agreement, including but not limited to interest, fees, and penalties.
- c) The Credit Union fails to comply with any of the covenants in Section 6 of this Agreement.
- d) The Credit Union shall commence a voluntary case or other proceeding seeking liquidation, reorganization, or other relief with respect to itself or its debts under any bankruptcy, insolvency, or other similar law now or hereafter in effect or seeking the appointment of a trustee, receiver, liquidator, custodian or other similar official, of it or any substantial part of its property.
- e) Any representation or warranty made by the Credit Union in this Agreement, the Application or in any document provided to the Investor proves to have been incorrect in any material respect when made.

Section 12. Rights and Remedies on Default. Upon the occurrence of any Event of Default as specified in the Agreement, then, and in every such event, at any time thereafter during the continuance of such Event of Default, the Investor shall have the right to:

- a) To the fullest extent of the law, institute proceedings to recover all unpaid principal and interest.
- b) Attach any unencumbered assets of the Credit Union, and the Credit Union shall pledge such assets to the Investor, if requested.

Section 13. Governing Law. This Agreement, the Note, and the Loan shall be governed by and construed in accordance with the laws of the State of Michigan.

Section 14. Attorneys' Fees, and other Costs of Collection, etc. If after any occurrence of any Event of Default it shall become necessary for the Investor to take any action to secure repayment of the Loan or payment of interest or any other amount due under the Note or hereunder, the Credit Union agrees to pay all costs of collection together with a reasonable sum for attorney's fees.

Section 15. Notices. Any notice or communication given pursuant hereto by either of the parties hereto shall be in writing and delivered, or mailed by courier, express mail or by registered or certified mail, return receipt requested, postage prepaid (mailed notices shall be deemed given three days after mailing), as follows:

(a) if to the Investor, to:

Investor (insert name)

xxx Street

xxx, MI 99999

Attention: xxxx

(b) if to the Credit Union, to:

xxx Street

xxx, MI 99999

or to such other address or addresses as hereafter shall be furnished by either party to the other party hereto.

Section 16. No Waivers. No failure or delay by the Investor in exercising any right, power, or privilege hereunder, or under the Note, shall operate as a waiver thereof, nor shall any single or partial exercise thereof, preclude any other or further exercise thereof, or any exercise of any other right, power, or privilege. The rights and remedies herein provided shall be cumulative and not exclusive of any rights or remedies provided by law.

Section 17. Modification; Amendment. No change, modification, or waiver of any provision hereof shall be valid unless in writing and signed by the party to be bound.

Section 18. Counterparts; Integration. This Agreement may be signed, in counterparts, each of which shall constitute an original, with the same effect as if the signatures thereto and hereto were upon the same instrument. This Agreement, the Notes, the "Disclosure & Acknowledgement" form executed by the parties, and the approved Secondary Capital Plan all constitute the entire agreement and understanding among the parties hereto and supersede any and all prior agreements and understandings, oral or written, relating to the subject matter hereof and thereof.

IN WITNESS WHEREOF the parties hereto have caused this Agreement to be duly executed by their respective authorized officers as of the date first above written.

Insert Name of Credit Union

Insert Name of Investor

Chairperson: _____

Chairperson: _____

Print Name: _____

Print Name: _____

Date: _____

Date _____

Treasurer: _____

President/CEO: _____

(if different from Manager; otherwise: Secretary)

Print Name: _____

Print Name: _____

Date _____

Date _____

Manager _____

Print Name: _____

Date _____