percent of primary capital in fixed assets.

Section 704.12—Corporate Credit Union Reserves

A number of sources (including Congress, the General Accounting Office, and the Corporate Credit Union Study Committee) have expressed concern over the relativity low levels of capital in corporate credit unions. The proposed regulation provides for several very specific changes to the corporate credit union reserve structure. The existing regulation establishes specific levels of capital that corporate credit unions must maintain, based on riskweighted assets. Currently, corporate credit unions must maintain a ratio of 4 percent of primary capital to riskweighted assets and a ratio of 8 percent of total capital to risk-weighted assets.

Under proposed § 704.12(a), corporate credit unions would have to reach capital levels based on primary capital to average daily assets. The Board is proposing the changes to the reserve requirements in order to emphasize the need for stronger primary capital. The regulation provides for incremental increases in the minimum ratio of primary capital to average daily assets until the level of 4 percent is achieved by January 1, 1998. (The increments are 2.5 percent by January 1, 1996 and 3 percent by January 1, 1997.) The regulation does allow for a possible waiver from the requirements at the first two intervals. However, the Board is committed to building primary capital in corporate credit unions. Any waiver request from this requirement must include very specific time frames, with supporting documentation, for reaching the regulatory capital level.

Proposed § 704.12(b) would require that all corporate credit unions maintain a minimum of 10 percent capital to riskweighted assets. Under the existing regulation, corporate credit unions are required to maintain a capital to riskweighted assets ratio of 8 percent. Although the major focus will be on primary capital, the Board sees a continued need to provide a measure of capital compared to risk-weighted assets. Risk-weighting of assets does provide some delineation of the risk in a corporate credit union's balance sheet. The amount of capital available to cover the risks associated with the balance sheet is valuable information to corporate credit union officials as well as NCUA. Currently, all corporate credit unions with the exception of U.S. Central have capital to risk-weighted assets in excess of 10 percent.

Proposed § 704.12(i) would require that each corporate credit union develop a written projection detailing its action plan to achieve the primary capital requirements established in § 704.12(a). As part of the plan, a corporate credit union will need to make reserve transfers at levels that will ensure compliance with the minimum primary capital requirements. At a minimum, corporate credit unions that have already met the minimum 4 percent primary capital requirement, must make reserve transfers as set forth in § 704.12(j).

Section 704.12(j) establishes the required reserve transfers for corporate credit unions. The proposed rule makes certain changes to conform to the proposed definitions of primary capital and capital to risk-weighted asset ratios. There are five reserve transfer categories. All corporate credit unions would be required to maintain minimum primary capital to average daily assets of 4 percent and capital to risk-weighted assets of 10 percent. Therefore, Category 1 begins when these ratios are at 4 percent and 10 percent respectively. Once the primary capital ratio is greater than 6 percent, and the capital to risk-weighted assets ratios is greater than 20 percent, reserve transfers are no longer required. For the purposes of reserve transfers, it is proposed that PCSAs be excluded from primary capital.

The Board is proposing to eliminate the term "risk-based capital." In the current regulation, risk-based capital includes primary capital and secondary capital up to 100 percent of primary capital. Risk-based capital is used in comparison to risk-weighted assets to establish minimum risk-based capital ratios for reserving purposes. In the proposed regulation, reserve transfers are based on primary capital to average daily assets and capital to risk-weighted assets. There would no longer be any specific category of risk-based capital.

Section 704.13—Representation

As noted earlier, the Board amended the representation section of Part 704 last year. In light of the proposed changes to the definition of "member," the Board is proposing to delete certain provisions that were designed to ensure that corporate credit unions were controlled by their member credit unions. These provisions would no longer be necessary if only representatives of member credit unions are permitted to vote and stand for election. The Board is also proposing to specifically state that the provisions of § 701.14 of the Rules and Regulations, governing changes in officials and senior executive officers in credit unions that are newly chartered or in

troubled condition. This provision always was intended to apply to corporate credit unions, as it is not inconsistent with any provision in Part 704. However, the provision refers to NCUA Regional Directors, and in light of the centralization of the corporate credit union program, its application to corporate credit unions may have been unclear. Accordingly, the Board is proposing to specifically include § 701.14 in Part 704, changing the reference from "Regional Director" to "NCUA." As with requests for waivers to the fixed asset limitation, notices required under § 701.14 should be filed, for the time being, with the Director, Office of Corporate Credit Unions.

Section 704.14—Audit Requirements

In the existing regulation, this section deals only with the need for an annual audit. The only change relating to the annual audit in the proposed regulation is the addition of wording to clearly specify that the annual opinion audit will include a letter of reportable conditions.

The Board is proposing to add a new §704.14(b) to include a requirement for an internal auditor function in corporate credit unions with assets in excess of \$100 million. The requirement would also apply to corporates with assets under \$100 million, if so ordered by NCUA. The Board realizes that not all corporate credit unions can readily afford to hire a full-time internal auditor. Based on the asset size and complexity of the institution, the corporate could hire a part-time internal auditor or contract with an outside firm to perform the internal auditor function. The proposed regulation requires that the internal auditor report directly to the chair of the corporate credit union's supervisory committee. The regulation provides specific minimum responsibilities that the internal auditor must perform. Finally, the internal auditor's findings and reports must be documented and made available for review to the outside auditor and NCUA.

Section 704.15—Contracts/Written Agreements

The Board is not proposing any changes to this provision.

Section 704.16—State-Chartered Corporate Credit Unions

The Board is proposing to add new § 704.16(b) to put non federally insured state-chartered corporate credit unions that receive funds from federally insured credit unions on notice that they are considered "institutionaffiliated parties" within Section 206(r)