

**7535-01-U**

**NATIONAL CREDIT UNION ADMINISTRATION**

**12 CFR Part 702**

**RIN 3133-AF21**

**Risk-Based Net Worth – COVID-19 Regulatory Relief**

**AGENCY:** National Credit Union Administration (NCUA).

**ACTION:** Proposed Rule.

**SUMMARY:** The NCUA Board (Board) is issuing this proposal to raise the asset threshold for defining a credit union as “complex” for purposes of being subject to any risk-based net worth requirement in part 702 of the NCUA’s regulations. The proposed rule would amend the NCUA’s regulations to provide that any risk-based net worth requirement will be applicable only to a federally insured natural-person credit union (credit union) with quarter-end assets that exceed \$500 million and a risk-based net worth requirement that exceeds six percent. The COVID-19 pandemic has created a vital need for financial institutions, including credit unions, to provide access to responsible credit and other member services to support consumers. Implementing this regulatory change in advance of January 1, 2022, the effective date of the 2015 final risk based capital (RBC) rule issued by the NCUA, would provide necessary capital relief to a significant number of credit unions without substantially decreasing the safety and soundness of credit unions or the National Credit Union Share Insurance Fund (NCUSIF).

**DATES:** Comments must be received on or before [INSERT DATE 30 DAYS FROM DATE OF PUBLICATION IN THE FEDERAL REGISTER].

**ADDRESSES:** You may submit written comments, identified by RIN 3133-AF21, by any of the following methods (**Please send comments by one method only**):

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- Fax: (703) 518-6319. Include “[Your Name]—Comments on Risk-Based Net Worth—COVID-19 Regulatory Relief” in the transmittal.
- Mail: Address to Melane Conyers-Ausbrooks, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.

**PUBLIC INSPECTION:** You may view all public comments on the Federal eRulemaking Portal at <http://www.regulations.gov> as submitted, except for those we cannot post for technical reasons. The NCUA will not edit or remove any identifying or contact information from the public comments submitted. Due to social distancing measures in effect, the usual opportunity to inspect paper copies of comments in the NCUA’s law library is not currently available. After social distancing measures are relaxed, visitors may make an appointment to review paper copies by calling (703) 518-6540 or e-mailing [OGCMail@ncua.gov](mailto:OGCMail@ncua.gov).

**FOR FURTHER INFORMATION, CONTACT:** *Policy and Analysis:* Kathryn Metzker, Risk Management Division, Office of Examination and Insurance, at (571) 438-0073; *Legal:* Thomas Zells, Staff Attorney, Office of General Counsel, at (703) 518-6540; Rachel Ackmann, Senior Staff Attorney, Office of General Counsel, at (703) 548-2601; or by mail at: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314.

## SUPPLEMENTARY INFORMATION

- I. Introduction
- II. Legal Authority
- III. The Proposed Rule
- IV. Impact of the Proposed Rule
- V. Regulatory Procedures

### **I. Introduction**

In 1998, Congress enacted the Credit Union Membership Access Act (CUMAA).<sup>1</sup> Section 301 of CUMAA added section 216 to the Federal Credit Union Act (FCU Act),<sup>2</sup> which required the Board to adopt by regulation a system of prompt corrective action (PCA) to restore the net worth of credit unions that become inadequately capitalized. The purpose of section 216 of the FCU Act is to “resolve the problems of [federally] insured credit unions at the least possible long-term loss to the [NCUSIF].”<sup>3</sup> To carry out that purpose, Congress set forth a basic structure for PCA in section 216 that consists of three principal components: (1) A framework combining mandatory actions prescribed by statute with discretionary actions developed by the NCUA; (2) an alternative system of PCA to be developed by the NCUA for credit unions defined as “new;” and (3) a risk-based net worth requirement to apply to credit unions the NCUA defines

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<sup>1</sup> Pub.L. 105–219, 112 Stat. 913 (1998).

<sup>2</sup> 12 U.S.C. 1790d.

<sup>3</sup> 12 U.S.C. 1790d(a)(1).

as “complex.”

The Board initially implemented the required system of PCA in 2000,<sup>4</sup> primarily in part 702 of the NCUA’s regulations, and most recently made substantial updates to the regulation in October 2015<sup>5</sup> and October 2018.<sup>6</sup> The risk-based net worth requirement for credit unions meeting the definition of “complex” was first applied on the basis of data in the Call Report reflecting activity in the first quarter of 2001.<sup>7</sup> The NCUA’s risk-based net worth requirement has been largely unchanged since its implementation, with limited exceptions.<sup>8</sup> Currently, the NCUA defines a credit union as complex and thus subject to the requirement only if the credit union has quarter-end assets that exceed \$50 million and its risk-based net worth requirement exceeds six percent.<sup>9</sup>

As described more fully below, while the risk-based net worth requirement remains in place, the NCUA has issued multiple final rules to implement a requirement that utilizes an RBC ratio to replace the current requirement. The RBC requirement is based on the same provisions in the FCU Act, but uses different terminology and standards to distinguish it from the current risk-based net worth requirement. However, the effective date of the RBC amendments has been

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<sup>4</sup> 12 CFR part 702; see also 65 FR 8584 (Feb. 18, 2000) and 65 FR 44950 (July 20, 2000).

<sup>5</sup> 80 FR 66626 (Oct. 29, 2015).

<sup>6</sup> 83 FR 55467 (Nov. 6, 2018).

<sup>7</sup> 65 FR 44950 (July 20, 2000).

<sup>8</sup> The NCUA’s risk-based net worth requirement has been largely unchanged since its implementation, with limited exceptions: revisions were made to the rule in 2003 to amend the risk-based net worth requirement for member business loans, 68 FR 56537 (Oct. 1, 2003); revisions were made to the rule in 2008 to incorporate a change in the statutory definition of “net worth,” 73 FR 72688 (Dec. 1, 2008); revisions were made to the rule in 2011 to expand the definition of “low-risk assets” to include debt instruments on which the payment of principal and interest is unconditionally guaranteed by the NCUA, 76 FR 16234 (Mar. 23, 2011); revisions were made in 2013 to exclude credit unions with total assets of \$50 million or less from the definition of “complex” credit union, 78 FR 4033 (Jan. 18, 2013); and amendments were made in April 2020 to define loans made by credit unions under the Small Business Administration’s Paycheck Protection Program as “low-risk assets,” 85 FR 23212 (Apr. 27, 2020).

<sup>9</sup> 12 CFR 702.103.

delayed until January 1, 2022, and the rule is currently undergoing a holistic review as part of that delay. Further, and of particular relevance to this proposed rule, the prospective RBC requirement applies only if a credit union's quarter-end total assets exceed \$500 million, whereas the current risk-based net worth requirement applies if a credit union has quarter-end assets that exceed \$50 million and its risk-based net worth requirement, as calculated under current part 702, exceeds six percent.

As noted, at its October 2015 meeting, the Board issued a final rule (2015 Final Rule) to amend part 702 of the NCUA's current PCA regulations to require that credit unions taking certain risks hold capital commensurate with those risks.<sup>10</sup> The RBC provisions of the 2015 Final Rule applied only to credit unions with quarter-end total assets exceeding \$100 million. The overarching intent of the 2015 Final Rule was to reduce the likelihood that a relatively small number of high-risk outlier credit unions would exhaust their capital and cause large losses to the NCUSIF. Under the FCU Act, federally insured credit unions are collectively responsible for replenishing losses to the NCUSIF.<sup>11</sup>

The 2015 Final Rule restructures the NCUA's current PCA regulations and makes various revisions, including amending the agency's risk-based net worth requirement by replacing it with a new RBC ratio. The Board originally set the effective date of the 2015 Final Rule for January 1, 2019 to provide credit unions and the NCUA with sufficient time to make the

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<sup>10</sup> 80 FR 66626 (Oct. 29, 2015).

<sup>11</sup> See 12 U.S.C. 1782(c)(2)(A) (The FCU Act requires that each federally insured credit union pay a federal share insurance premium equal to a percentage of the credit union's insured shares to ensure that the NCUSIF has sufficient reserves to pay potential share insurance claims by credit union members, and to provide assistance in connection with the liquidation or threatened liquidation of federally insured credit unions in troubled condition.).

necessary adjustments—such as systems, processes, and procedures—and to reduce the burden on affected credit unions.

At its October 2018 meeting, the Board issued a final rule (2018 Supplemental Rule) to delay the effective date of the 2015 Final Rule for an additional year, moving the effective date from January 1, 2019 to January 1, 2020.<sup>12</sup> Importantly, the 2018 Supplemental Rule also amended the definition of “complex” credit union, adopted in the 2015 Final Rule for RBC purposes, by increasing the threshold level for coverage from \$100 million to \$500 million. Therefore, only credit unions with over \$500 million in assets will be subject to the 2015 Final Rule.<sup>13</sup> These changes provided these covered credit unions and the NCUA with additional time to prepare for the rule’s implementation, and exempted an additional 1,026 credit unions from the RBC requirements of the 2015 Final Rule without subjecting the NCUSIF to undue risk.

In December 2019, the Board issued a final rule (2019 Supplemental Rule) to further delay the effective date of the 2015 Final Rule an additional two years, until January 1, 2022.<sup>14</sup> The Board issued the 2019 Supplemental Rule to allow the Board more time to holistically and comprehensively evaluate capital standards for credit unions<sup>15</sup> and provide covered credit unions and the NCUA with additional time to prepare for the 2015 Final Rule’s implementation.

Under the 2019 Supplemental Rule, the NCUA’s current PCA regulation remains in

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<sup>12</sup> 83 FR 55467 (Nov. 6, 2018).

<sup>13</sup> The risk-based net worth requirement currently in effect applies to a credit union only if it has quarter-end assets that exceed \$50 million and its risk-based net worth requirement exceeds six percent.

<sup>14</sup> 84 FR 68781 (Dec. 17, 2019).

<sup>15</sup> The final rule provided several examples of issues the Board would consider during the delay, including asset securitization, subordinated debt, and a community bank leverage ratio analog.

effect until the 2015 Final Rule's amended effective date, January 1, 2022. The NCUA has enforced, and will continue to enforce, the capital standards currently in place and address any supervisory concerns through existing regulatory and supervisory mechanisms. Until that amended effective date, a credit union that would be exempted from any future RBC requirement because it does not have over \$500 million in total assets remains subject to the current risk-based net worth requirement if it has over \$50 million in total assets and a risk-based net worth requirement that exceeds six percent. The Board now believes that this is an unnecessary restriction and is proposing to increase the threshold for defining a complex credit union for purposes of the current risk-based net worth requirement to \$500 million to match the prospective RBC requirement while retaining the requirement that a credit union's risk-based net worth requirement also exceeds six percent. This capital relief would enable credit unions to provide better service and more loans to their members.

## **II. Legal Authority**

As discussed above, in 1998, Congress enacted CUMAA.<sup>16</sup> Section 301 of CUMAA added section 216 to the FCU Act,<sup>17</sup> which required the Board to adopt by regulation a system of PCA to restore the net worth of credit unions that become inadequately capitalized.<sup>18</sup> Section 216(b)(1)(A) requires the Board to adopt by regulation a system of PCA for credit unions

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<sup>16</sup> Pub. L. 105-219, 112 Stat. 913 (1998).

<sup>17</sup> 12 U.S.C. 1790d.

<sup>18</sup> The risk-based net worth requirement for credit unions meeting the definition of "complex" was first applied on the basis of data in the Call Report reflecting activity in the first quarter of 2001. 65 FR 44950 (July 20, 2000).

“consistent with” section 216 of the FCU Act and “comparable to” section 38 of the Federal Deposit Insurance Act (FDI Act).<sup>19</sup> Section 216(b)(1)(B) requires that the Board, in designing the PCA system, also take into account the “cooperative character of credit unions” (i.e., credit unions are not-for-profit cooperatives that do not issue capital stock, must rely on retained earnings to build net worth, and have boards of directors that consist primarily of volunteers).<sup>20</sup> Among other things, section 216(c) of the FCU Act requires the NCUA to use a credit union’s net worth ratio to determine its classification among five “net worth categories” set forth in the FCU Act.<sup>21</sup> Section 216(o) generally defines a credit union’s “net worth” as its retained earnings balance,<sup>22</sup> and a credit union’s “net worth ratio,” as the ratio of its net worth to its total assets.<sup>23</sup> As a credit union’s net worth ratio declines, so does its classification among the five net worth categories, thus subjecting it to an expanding range of mandatory and discretionary supervisory actions under PCA.<sup>24</sup>

Section 216(d)(1) of the FCU Act requires that the NCUA’s system of PCA include, in addition to the statutorily defined net worth ratio requirement applicable to credit unions, “a risk-

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<sup>19</sup> 12 U.S.C. 1790d(b)(1)(A); see also 12 U.S.C. 1831o (Section 38 of the FDI Act setting forth the PCA requirements for banks).

<sup>20</sup> 12 U.S.C. 1790d(b)(1)(B).

<sup>21</sup> 12 U.S.C. 1790d(c).

<sup>22</sup> 12 U.S.C. 1790d(o)(2).

<sup>23</sup> 12 U.S.C. 1790d(o)(3).

<sup>24</sup> 12 U.S.C. 1790d(c)–(g); 12 CFR 702.204(a)–(b).



based net worth<sup>25</sup> requirement for insured credit unions that are complex, as defined by the Board.”<sup>26</sup> The FCU Act directs the NCUA to base its definition of “complex” credit unions “on the portfolios of assets and liabilities of credit unions.”<sup>27</sup> It also requires the NCUA to design a risk-based net worth requirement to apply to such “complex” credit unions.<sup>28</sup>

In addition to the specific regulatory authority provided to the NCUA by the above-referenced statutory provisions of the FCU Act, the FCU Act also grants the NCUA broad plenary rulemaking authority.

### **III. The Proposed Rule**

The COVID-19 pandemic has created a vital need for financial institutions, including credit unions, to provide access to responsible credit and other member services to support consumers. The Board is working with federal and state regulatory agencies, in addition to credit unions, to assist credit unions in managing their operations and to facilitate continued assistance to credit union members and communities impacted by the coronavirus. As part of these ongoing efforts, the Board is proposing to raise the asset threshold for defining a credit union as “complex” for purposes of the current risk-based net worth requirement. Under the

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<sup>25</sup> For purposes of this rulemaking, the term “risk-based net worth requirement” is used in reference to the statutory requirement for the Board to design a capital standard that accounts for variations in the risk profile of complex credit unions. The term RBC is used to refer to the specific standards established in the 2015 Final Rule to function as criteria for the statutory risk-based net worth requirement. The term “risk-based capital ratio” is also used by the other federal banking agencies and the international banking community when referring to the types of risk-based requirements that are addressed in the 2015 Final Rule. This change in terminology has no substantive effect on the requirements of the FCU Act, and is intended only to reduce confusion for the reader.

<sup>26</sup> 12 U.S.C. 1790d(d)(1).

<sup>27</sup> 12 U.S.C. 1790d(d).

<sup>28</sup> *Id.*

proposal, any risk-based net worth requirement would be applicable to only a credit union with quarter-end assets that exceed \$500 million whose risk-based net worth requirement also exceeds six percent. This would remain in place until the effective date of the above-referenced RBC rule. The Board believes that this increase would provide necessary relief to a significant number of credit unions and their members without substantially increasing the risk to credit unions or the NCUSIF, consistent with the NCUA's responsibility to maintain the safety and soundness of the credit union system.

The NCUA seeks to strike the appropriate balance between providing for the safety and soundness of the credit union industry, while not restricting credit union activities by requiring a credit union to hold excessive levels of capital. Requiring a credit union to hold excess capital above what is necessary to account for risk limits its ability to increase lending or provide necessary services to members. Specifically, potential consequences of the higher capital requirements include: reduced or higher-cost lending, limited products, higher compliance cost, and increased merger activity.

In 2018, the NCUA determined that increasing the applicability threshold for RBC to \$500 million did not pose undue risk to the NCUSIF because credit unions with assets greater than \$500 million account for the majority of industry assets (both total assets and complex assets, as explained below). Based on September 30, 2020 data, credit unions with assets between \$50 million and \$500 million account for 15.9 percent of industry assets and 33.8 percent of credit unions. The average asset size of a credit union in this cohort is \$164 million. Conversely, credit unions with assets greater than \$500 million account for 81.6 percent of industry assets and only 12.4 percent of total credit unions. Therefore, raising the risk-based net

worth requirement threshold to \$500 million would still cover the majority of assets in the credit union system and not pose undue risk to the NCUSIF for the same reasons that the Board found in the 2018 Supplemental Rule. In the 2015 Final Rule and 2018 Supplemental Rule, the NCUA determined a credit union was complex by evaluating whether its portfolios of assets and liabilities were complex based on the products and services in which such credit unions engaged. An asset size threshold was developed as a proxy measure based on a detailed analysis performed by the NCUA.<sup>29</sup> The threshold set forth a clear demarcation line, above which the NCUA determined all credit unions engaged in complex activities, and where almost all such credit unions were involved in multiple complex activities.

The asset threshold adopted in the 2015 Final Rule and revised in the 2018 Supplemental Rule for determining whether a credit union is complex was based on a complexity index.<sup>30</sup> The 2018 Supplemental Rule also used a complexity ratio, a ratio of complex assets and liabilities to total assets, to evaluate the extent to which credit unions are involved in complex activities. The 2018 Supplemental Rule noted that of the \$497 billion in complex assets and liabilities in the credit union system, \$423 billion (85 percent)—the majority of complex assets and liabilities in the credit union system—are held among credit unions with more than \$500 million in assets.<sup>31</sup> In general, two-thirds of credit unions with more than \$500 million in total assets had complex assets and liabilities ratios above 30 percent. Only 11 percent of credit unions with less than

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<sup>29</sup> See the 2015 Final Rule and 2018 Supplemental Rule for reasons the NCUA believes a single asset-size threshold is appropriate for determining whether a credit union is complex for purposes of prompt corrective action. *See* 80 FR 66626 (Oct. 29, 2015) and 83 FR 55467 (Nov. 6, 2018).

<sup>30</sup> The 2015 Final Rule and 2018 Supplemental Rule both used a complexity index, however the original complexity index used in the 2015 Final Rule was amended in the 2018 Supplemental Rule. The 2018 Supplemental Rule used a revised complexity index that amended six of the indicators in the original complexity index so the index more accurately reflected “complexity” in credit unions and took into account certain regulatory changes that were made after the 2015 Final Rule was approved.

<sup>31</sup> This was based on available data at the time of the 2018 Supplemental Rule.

\$500 million had complexity ratios above 30 percent.

Using both the revised complexity index and the complexity ratio, the 2018 Supplemental Rule noted the \$500 million threshold for defining complex credit unions would not represent undue risk to the NCUSIF as approximately 76 percent of the assets held by federally insured credit unions would still be covered. As noted above, credit unions with assets above \$500 million represent 81.6 percent of industry assets as of September 30, 2020.

The Board believes this change would provide relief to many credit unions and help to maintain confidence in the system of cooperative credit, consistent with the NCUA's mission.

#### **IV. Impact of the Proposed Rule**

Increasing the complexity threshold to \$500 million would provide potential relief to 1,737 credit unions. While all complex credit unions meet their risk-based net worth requirement as of September 30, 2020, because their net worth ratio exceeds their risk-based net worth requirement, immediate capital relief can be provided to some of these credit unions. As shown in Table 1, there are 94 complex credit unions with assets totaling \$66 billion which are required to hold capital above 7 percent to be well capitalized based on their risk-based net worth requirement. Of the 94 credit unions, 67 have assets less than \$500 million and would no longer be required to hold more capital to remain well capitalized. Additionally, increasing the complexity threshold now rather than when the 2015 Final Rule goes into effect will not pose undue risk to the NCUSIF as the 67 credit unions provided relief represent less than 1 percent of industry assets.

**Table 1: Complex Credit Unions with a Risk Based Net Worth Requirement Greater than 7 percent**

<b>Asset Category</b>	<b># of Credit Unions</b>	<b>Total Assets</b>	<b>% of Industry Assets</b>
Assets > \$50M <sup>32</sup>	94	\$66.0 million	3.7%
Assets >\$500M <sup>33</sup>	27	\$54.6 million	3.1%
\$50M< Assets <\$500M	67	\$11.4 million	0.6%

Therefore, this proposed rule would provide immediate relief for the 67 credit unions that must currently manage their capital levels to a risk-based net worth requirement above seven percent.<sup>34</sup> Additionally, it would also provide relief to all credit unions with assets between \$50 million and \$500 million, which would be able to expand their portfolios and simply manage their capital levels to meet the seven percent leverage requirement to be well capitalized.

The NCUA invites comments on all aspects of the proposal.<sup>35</sup>

## **V. Regulatory Procedures**

### **A. Regulatory Flexibility Act (RFA)**

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<sup>32</sup> This reflects the current threshold for complex credit unions.

<sup>33</sup> This reflects the proposed threshold for complex credit unions.

<sup>34</sup> This would reduce the amount of capital they are required to hold to be well capitalized by \$82 million in aggregate, based on September 30, 2020 data.

<sup>35</sup> Because of the straightforward nature of the proposed change and the extensive comment period offered on the various RBC rulemakings, the Board is not providing the usual 60-day comment period. *See* NCUA Interpretive Ruling and Policy Statement (IRPS) 87-2, as amended by IRPS 03-2 and IRPS 15-1. 80 FR 57512 (Sept. 24, 2015), available at <https://www.ncua.gov/files/publications/irps/IRPS1987-2.pdf>.

The Regulatory Flexibility Act (RFA) generally requires that, in connection with a notice of proposed rulemaking, an agency prepare and make available for public comment an initial regulatory flexibility analysis that describes the impact of a proposed rule on small entities. A regulatory flexibility analysis is not required, however, if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities (defined for purposes of the RFA to include federally insured credit unions with assets less than \$100 million) and publishes its certification and a short, explanatory statement in the *Federal Register* together with the rule. The proposed rule would only exempt additional credit unions from any risk-based net worth requirement in part 702 of the NCUA's regulations applicable to complex credit unions. As a result, it will not cause any increased burden on credit unions and will not have an impact on small credit unions. Accordingly, the NCUA certifies that the proposed rule will not have a significant economic impact on a substantial number of small credit unions.

## **B. Paperwork Reduction Act**

The Paperwork Reduction Act of 1995 (PRA) applies to rulemakings in which an agency by rule creates a new paperwork burden on regulated entities or modifies an existing burden (44 U.S.C. 3507(d)). For purposes of the PRA, a paperwork burden may take the form of a reporting, recordkeeping, or a third-party disclosure requirement, referred to as an information collection. The NCUA may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a valid OMB control number. This proposed rule contains no provisions constituting a collection of information under the Paperwork Reduction Act of 1995 (44 U.S.C. et seq.).

### **C. Executive Order 13132**

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. The NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order to adhere to fundamental federalism principles.

This proposed rule would not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. The NCUA has therefore determined that this proposed rule does not constitute a policy that has federalism implications for purposes of the executive order.

### **D. Assessment of Federal Regulations and Policies on Families**

The NCUA has determined that this proposed rule will not affect family well-being within the meaning of § 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

### **List of Subjects in 12 CFR Part 702**

Credit, Credit unions, Reporting and recordkeeping requirements.

By the NCUA Board on January 14, 2021.

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Melane Conyers-Ausbrooks

Secretary of the Board

For the reasons discussed in the preamble, the Board proposes to amend part 702 of chapter VII of title 12 of the Code of Federal Regulations as follows:

**PART 702 – CAPITAL ADEQUACY**

1. The authority citation for part 702 continues to read as follows:

**Authority:** 12 U.S.C. 1766(a), 1790d.

**§702.103 Applicability of risk-based net worth requirement. [Amended]**

2. Amend § 702.103 by removing the words “fifty million dollars (\$50,000,000)” and add in their place “five hundred million dollars (\$500,000,000).”