YOUNG, SHERON

From: _Regulatory Comments
Sent: Tuesday, September 27, 2005 2:18 PM
To: YOUNG, SHERON
Subject: FW: National Community Capital Association Comments on Proposed Rule Part 701, Secondary Capital

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From: Cheryl Neas [mailto:Cheryln@communitycapital.org]
Sent: Tuesday, September 27, 2005 1:34 PM
To: _Regulatory Comments
Subject: National Community Capital Association Comments on Proposed Rule Part 701, Secondary Capital

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428
Via email: regcomments@ncua.gov

September 27, 2005

Dear Ms. Rupp:

The National Community Capital Association (NCCA) appreciates the opportunity to comment on the National Credit Union Administration's (NCUA) proposed rule on 12 CFR Parts 701 and 741, concerning secondary capital.

NCCA is a national network of community development financial institutions (CDFIs), including community development credit unions (CDCUs). We have made **$**1.2 million of secondary capital investments in our CDCU members. We recognize the importance of this kind of deeply subordinated investment in supporting CDCUs in their mission of reaching customers and markets outside the economic mainstream; we developed the Equity Equivalent (EQ2) investment, community development loan funds' companion to secondary capital, to meet a similar need in the CDFI industry. Secondary capital investments have allowed CDCUs to create hundreds of millions of dollars in additional lending capacity in communities with limited access to affordable and responsible credit.

In general, we support NCUA's proposal regarding the redemption of accounts that no longer count toward net worth. However, we have concerns about some aspects of the proposal, particularly the proposed requirement that credit unions secure approval of NCUA's Regional Director prior to closing an investment. Because this kind of capital is difficult for CDFIs to attract, we are concerned that the NCUA's proposal would place additional barriers in the way of investors and CDFIs developing partnerships through secondary capital. Specifically, we believe that the proposal:

- Does not strike the appropriate balance between protection of the National Credit Union Share Insurance Fund (NCUSIF) and the interests of the small pool of secondary capital investors; and
- Should not require credit unions to seek pre-approval of secondary capital investments.

Both these issues could reduce the availability of the already scarce resource that secondary capital provides, and the NCUA should withdraw the pre-approval requirement from the proposal.

The National Federation of Community Development Credit Unions (NFCDCU) has significant expertise as an investor in low-income credit unions and as an advocate for the CDCU industry. We support and endorse comments that NFCDCU submits in response to these proposed regulations.

Changes in Discounting and Redemption Rules

NCUA has rightly recognized that its current discounting and redemption regulations can dilute the net-worth ratio and reduce the efficiency with which CDCUs can use secondary capital. We commend NCUA for responding to the requests of low-income credit unions for this regulatory change.

However, we agree with NFCDCU that this change adds prepayment risk to the credit, regulatory, and other risks borne by investors, and continues NCUA's trend toward making secondary capital investment progressively more difficult for investors and magnifying the risk of the product. NCUA should follow the recommendations of the National Federation of CDCUs for striking a more appropriate balance between the needs of credit union regulators and those of secondary capital investors. The interests of CDCUs and the communities where they work—in which they often provide the only option for responsible, affordable credit—are not served by regulations that increase the risk posed by secondary capital and stifle potential investment.

Approval of Secondary Capital Plans

NCUA proposes requiring credit unions to secure approval of secondary capital plans prior to the investment, noting that secondary capital "played a role in masking the magnitude of other problems." The experience of the CDCU industry and its investors suggests that this is not true. Secondary capital is clearly visible on a credit union's balance sheet, and does not "mask" fraud, accounting irregularities, or loan losses—likely contributing causes of the losses that NCUA hopes to prevent with this requirement. Requiring approval of a secondary capital plan would not solve these problems, operational efficiencies, underwriting concerns, or other deficiencies. Requiring pre-approval would add an additional burden to CDCUs without improving safety and soundness.

In addition, in many credit unions in which losses have occurred, the secondary capital investors have absorbed losses that might otherwise have been incurred by the National Credit Union Share Insurance Fund. Secondary capital in this way has protected, not threatened, the soundness of the NCUSIF.

Because of the risk of secondary capital investments, investors—including NCCA—make their decisions carefully. They perform their own due diligence, looking closely at the performance of the credit union and evaluating the factors currently established for secondary capital plans. Creating an additional step in the investment review, including a 45-day waiting period for approval, is unnecessary and could dissuade investors or limit the entrance of potential investors into the market.

Conclusion

Secondary capital is a critical resource for CDCUs, allowing them to expand lending activities in their hard-to-serve markets. National Community Capital commends NCUA for providing low-income credit unions with greater flexibility in managing their balance sheets. We are concerned, however, that other aspects of NCUA's proposal would stifle the already limited opportunities for secondary capital investment and reverse the gains from use of this important tool. We strongly urge NCUA to withdraw the proposed requirement for Regional Director pre-approval of secondary capital plans.

Thank you for the opportunity to comment. Please do not hesitate to contact me at 215.320.4304 or markp@communitycapital.org if you would like more information or additional clarification on these comments.

Sincerely,

Mark Pinsky
President and CEO