appropriately left unrealized gains and losses on available-for-sale securities out of the risk-based capital ratio numerator, and explains NCUA's sound reasoning behind that position, the proposed high risk weights applied to investments would almost completely offset this for many credit unions. These commenters suggested the high risk weights applied to investments would reduce some credit unions' risk-based capital ratios as if they had already sold their entire portfolio at the loss in market values they would expect in an unrealized, instantaneous, ''up 300 basis points'' rate-shock scenario.

As noted earlier, this proposal removes the IRR components contained in the risk weights, so related concerns raised by commenters on the investment risk weights should now be moot.

Due to the changes this proposal would make to the assignment of risk weights for investments, and in response to the comments in agreement with the concerns about volatility in the risk-based capital ratio that can occur with investments, the Board has decided to retain this aspect of the Original Proposal without change. The proposed application of excluding accumulated unrealized gains (losses) on available-for-sale securities; accumulated unrealized losses for OTTI on debt securities; accumulated unrealized net gains (losses) on cash flow hedges, and other comprehensive income also would eliminate the added complication of an opt-in or opt-out approach.

Other Supplemental Forms of Capital

Under the Original Proposal, forms of supplemental capital, other than secondary capital accounts included in net worth (as defined in § 702.2), would not have been included in the risk-based capital ratio numerator. For natural-person credit unions, the only form of supplemental capital the FCUA includes in the definition of ''net worth'' is secondary capital that it authorizes for low-income credit unions.[156] The Board did not propose including other supplemental forms of capital in the risk-based capital ratio numerator.

As a result, the Board received a substantial number of comments expressing concern about the omission of supplemental capital from the risk-based capital ratio numerator.

A number of commenters suggested that the Original Proposal would have regulated only the asset side of the balance sheet, representing the risk-based capital ratio denominator, while depriving credit unions of the flexibility to use supplemental capital to address the newly introduced capital requirement through the risk-based capital ratio numerator. Other commenters stated that, in order for any credit unions but low-income credit unions to use supplemental capital to meet the risk-based net worth requirement, Congress would have to amend the FCUA to give NCUA the authority to permit that use of supplemental capital. In that regard, commenters contended that the Board should have raised the supplemental capital issue with Congress before issuing the proposed rule.

Without being able to include supplemental capital in the risk-based capital ratio numerator, some commenters stated that credit unions would be forced to address capital concerns by increasing profitability (through higher fees and loan rates, etc.), shrinking assets, or both; none of which they suggested would be in a credit union's best interest.

A small number of commenters suggested that credit unions would not need supplemental capital to be effective if the Board were to devise a risk-based capital regulation that enabled credit unions to grow in a manner consistent with safety and soundness.

Other commenters protested that since the Board had altered the definition of capital in the Original Proposal, it therefore should also extend the risk-based capital ratio numerator to include supplemental capital. In making the same argument, others noted that the risk-based capital ratio numerator as proposed already included items that are not part of ''net worth'' as defined by the FCUA.

Commenters generally acknowledged that counting supplemental capital as part of a credit union's net worth requirement (for all but low-income credit unions) would require an authorizing amendment to the FCUA, but they maintain that, in contrast, nothing in the Act *prohibits* the Board from including supplemental capital in the risk-based capital ratio numerator. More expansively, some commenters interpreted the absence of an express prohibition in the Act barring the use of supplemental capital by any credit union for any purpose as implicit *support* for allowing it to be used for risk-based purposes only. Under either interpretation, commenters urged the Board to make supplemental capital a component of the risk-based capital ratio numerator consistent with the proposed definition of capital as ''equity, as measured by GAAP, available to a credit union to cover losses.''[157]

In contrast to the lack of authority for federally chartered credit unions, other than low-income credit unions, to currently accept secondary capital, several commenters suggested that the laws of some states authorize their federally insured state chartered credit unions to raise other supplemental forms of capital. Therefore, the commenters suggested the rule should permit those federally insured state chartered credit unions that are authorized to raise other forms of capital under state law to also count that capital in the risk-based capital ratio numerator.

Commenters suggested that the FCUA already authorizes federally chartered credit unions to issue certificates of indebtedness, which function as loans from the holder to the credit union with interest paid to the holder, as well as to offer subordinated debt instruments to members and non-members. They urged the Board to allow FCUs to count those certificates of indebtedness, and those instruments that meet GAAP capital requirements, in the risk-based capital ratio numerator.

Having considered the comments on supplemental capital, the Board declines to permit credit unions (other than low-income credit unions) to include other supplemental forms of capital in the risk-based capital ratio numerator as part of this proposal, pending potential Congressional action and more specific comments as described below.[158]

Members of Congress have introduced legislation in the past that would authorize all federally insured credit unions to accept supplemental capital.[159] Individual Board members have publicly supported such legislation in the past. At this time the Board prefers to await the outcome of previously proposed legislation that, if passed by Congress, would expressly authorize supplemental capital as a component of net worth,[160] and permit

[156] 12 U.S.C. 1757(6), 1790d(o)(2)(C) (defining ''net worth''), *and* proposed § 702.2 (defining ''net worth'').

[157] *See* 79 FR 11183, 11211 (Feb. 27, 2014) (Proposing to define ''capital'' as ''the equity, as measured by GAAP, available to a credit union to cover losses.'').

[158] 702.104(b)(2)

[159] See, *e.g.,* HR 719, 113th Cong. (2013) (HR 719 would have amended the FCUA to allow the Board to authorize certain forms of supplemental capital that could be counted toward a credit union's ''net worth,'' as that term is defined in section 1790d(o)(2)).

[160] The Capital Access for Small Businesses and Jobs Act, HR 719, was introduced in the House of Representatives and referred to the House Financial Services Committee during the 113th Congress.

the Board to decide whether or how to include such capital in the net worth ratio and the risk-based net worth requirement. Individual Board members have publicly supported such legislation in the past.

Such authority would also raise a host of other complicated issues that would need to be addressed through additional changes to NCUA's regulations, including providing consumer protections, amending NCUSIF payout priorities, and imposing prudent limitations on the ability of non-low-income credit union to offer and include supplemental capital.

Although the FCUA does authorize federally chartered credit unions to issue certificates of indebtedness and subordinated debt instruments to members and non-members, the ability to include them in the risk-based capital ratio numerator depends on whether such supplemental forms of capital are structured to satisfy prudential capital and consumer protection requirements—issues not addressed in this rulemaking.

The Board does, however, specifically request comment on the following questions regarding additional supplemental forms of capital.

1. Should additional supplemental forms of capital be included in the risk-based capital ratio numerator and how would including such capital protect the NCUSIF from losses?

2. If yes, to be included in the risk-based capital ratio numerator, what specific criteria should such additional forms of capital reasonably be required to meet to be consistent with GAAP and the FCUA, and why?

3. If certain forms of certificates of indebtedness were included in the risk-based capital ratio numerator, what specific criteria should such certificates reasonably be required to meet to be consistent with GAAP and the FCUA, and why?

4. In addition to amending NCUA's risk-based capital regulations, what additional changes to NCUA's regulations would be required to count additional supplemental forms of capital in NCUA's risk-based capital ratio numerator?

5. For state-chartered credit unions, what specific examples of supplemental capital currently allowed under state law do commenters believe should be included in the risk-based capital ratio numerator, and why should they be included?

6. What investor suitability, consumer protection, and disclosure requirements should be put in place related to additional forms of supplemental capital?

104(b)(2) Risk-based Capital Ratio Numerator Deductions

Under the Original Proposal, proposed § 702.104(b)(2) would have provided that the elements deducted from the sum of the capital elements of the risk-based capital ratio numerator are: (1) The NCUSIF Capitalization Deposit; (2) goodwill; (3) other intangible assets; and (4) identified losses not reflected in the risk-based capital ratio numerator.

The Board received a significant number of comments, which are outlined in detail below, regarding the capital elements that would have been deducted from the risk-based capital ratio numerator. However, for the reasons explained in more detail below, the Board has decided to retain most of these aspects of the Original Proposal with a few changes that are discussed in more detail below.

NCUSIF capitalization deposit. The Original Proposal would have addressed concerns about the NCUSIF capitalization deposit being reflected on the NCUSIF's balance sheet both as equity to pay losses and as an asset of the insured credit unions. Under the Original Proposal, the NCUSIF capitalization deposit would have been subtracted from both the numerator and denominator of the risk-based capital ratio.[161] This treatment of the risk-based capital ratio would not have altered the NCUSIF capitalization deposit's accounting treatment for credit unions.

The Board received a number of comments expressing concerns about the Original Proposal's treatment of the NCUSIF capitalization deposit. A majority of commenters disagreed with or questioned the treatment of the NCUSIF deposit. Commenters suggested that the NCUSIF deposit should not be deducted from the risk-based capital ratio numerator or denominator.

Commenters stated that if the risk-based capital ratio numerator is intended to reflect ''equity available to cover losses in the event of liquidation,'' then the NCUSIF deposit should be included because it is one of the most reliable assets available to credit unions to cover losses. Commenters suggested that the only condition under which it would not be available is during a system-wide catastrophe, in which case most other credit union assets, other than cash, would similarly be subject to substantial losses. Those commenters argued there is no reason to believe the NCUSIF capitalization deposit would not be available to cover losses or that it should be excluded from the numerator of the risk-based capital ratio.

Other commenters suggested that NCUA has control of these funds so credit unions should be able to count the deposit toward their capital requirement (*i.e.,* the deposit should be included in the risk-based capital ratio numerator and be counted only as a zero-risk item in the risk-based capital ratio denominator).

Other commenters stated that although banks expense their deposit insurance, credit unions treat the deposit as an asset. Commenters stated that while it is true that the bank's deposit insurance premiums have reduced the bank's capital, a credit union's capital has been reduced in real terms by the lost income the credit union would have earned had it placed the funds in an earning asset rather than in a non-interest-bearing deposit to NCUSIF.

Another commenter stated that it appeared that the Board was attempting to make the risk-based capital ratio numerator comparable to banks, which expense their insurance premiums paid by eliminating the NCUSIF capitalization, but that banks pay and expense their premiums for each period due and cannot get those funds back. The commenter stated further that federally insured credit unions, on the other hand, not only pay an upfront deposit of one percent of insured shares and record that as an asset, but also pay for and immediately expense periodic assessments from NCUA needed to bolster the NCUSIF. In addition, the commenter stated that federally insured credit unions can have their deposits returned if, for example, they convert to a bank, elect private insurance (in the nine states where private insurance is permitted), or complete a voluntary liquidation, and the NCUSIF capitalization deposit is an asset as recognized by GAAP, is tangible, and easily measured.

Some commenters suggested that this accounting difference is already captured as part of the higher leverage ratio for credit unions as compared to banks. They believe Congress established a capital level for credit unions two percentage points higher than the capital level for banks because one percent of a credit union's capital is dedicated to the NCUSIF and another one percent of the typical credit union's capital is dedicated to its corporate credit union. Those commenters stated that if the Board excludes the NCUSIF deposit it will create an uneven playing field between banks and credit unions

[161] *See* U.S. Govt. Accountability Office, GAO–04–849, Available Information Indicates No Compelling Need for Secondary Capital (2004), *available at http://www.gao.gov/assets/250/243642.pdf.*