Supplemental Rule
Part 702
Risk-Based Capital
Board Briefing
August 2, 2018
Summary of Changes

• Delay the effective date of the October 29, 2015 risk-based capital rule by 1 year
  – Proposed new effective date: January 1, 2020
  – Provides additional time for credit unions and NCUA to prepare for risk-based capital requirements

• Amend the definition of a complex credit union by raising the asset threshold
  – 2015 Final Rule asset threshold: $100 million
  – Proposed asset threshold: $500 million
  – Exempts an additional 1,026 credit unions, for a total of 90% of all credit unions
Definition of Complex

• 2015 Final Rule used the Complexity Index for defining the complex asset threshold
  – Based on indicators of complex products and services
  – Only considered the number of complex products and services provided by a credit union

• Proposed Rule re-evaluates the definition of complex
  – Eliminates 2 indicators
    • Internet banking
    • Investments with maturities greater than 5 years, where the investments are greater than 1 percent of total assets
  – Revises four of the indicators used
    • Substituted Commercial Loans for Members Business Loans
    • Replaced Participations Loans with Participation Loans Sold
    • Excluded First-Lien Mortgages from Interest Only Loans
    • Narrowed Real Estate Loans to Sold Mortgages
  – Factors in the extent to which a credit union is involved in complex activity (Complexity Ratio)
### Complexity Index by Asset Categories, 2017Q4

<table>
<thead>
<tr>
<th>Asset Category</th>
<th>No. of Credit Unions</th>
<th>Average Index Value</th>
<th>Median Index Value</th>
<th>Index&gt;=1</th>
<th>Index&gt;=2</th>
<th>Index&gt;=3</th>
<th>Index&gt;=4</th>
<th>Index&gt;=5</th>
<th>Index&gt;=6</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;$100M</td>
<td>4,016</td>
<td>0.8</td>
<td>0.0</td>
<td>41%</td>
<td>21%</td>
<td>10%</td>
<td>5%</td>
<td>2%</td>
<td>1%</td>
</tr>
<tr>
<td>$100M-$500M</td>
<td>1,026</td>
<td>4.0</td>
<td>4.0</td>
<td>98%</td>
<td>91%</td>
<td>78%</td>
<td>59%</td>
<td>40%</td>
<td>24%</td>
</tr>
<tr>
<td>&gt;$500M</td>
<td>531</td>
<td>6.5</td>
<td>7.0</td>
<td>100%</td>
<td>98%</td>
<td>96%</td>
<td>92%</td>
<td>82%</td>
<td>68%</td>
</tr>
</tbody>
</table>

- All credit unions >$500M engage in at least one complex activity
- 92% of credit unions >$500M engage in 4 or more complex activities
## Complexity Ratio by Asset Category

<table>
<thead>
<tr>
<th>Asset Category</th>
<th>No. of Credit Unions</th>
<th>Complex Assets &amp; Liabilities ($M)</th>
<th>Total Assets ($M)</th>
<th>Complexity Ratio</th>
<th>Share of Complex A &amp; L</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;$100M</td>
<td>4016</td>
<td>9,906</td>
<td>101,250</td>
<td>10%</td>
<td>2%</td>
</tr>
<tr>
<td>$100M-$500M</td>
<td>1026</td>
<td>64,694</td>
<td>229,295</td>
<td>28%</td>
<td>13%</td>
</tr>
<tr>
<td>&gt;$500M</td>
<td>531</td>
<td>422,553</td>
<td>1,048,289</td>
<td>40%</td>
<td>85%</td>
</tr>
</tbody>
</table>

### Complex Ratio

<table>
<thead>
<tr>
<th>Asset Category</th>
<th>Complex Ratio &gt; 10%</th>
<th>Complex Ratio &gt; 20%</th>
<th>Complex Ratio &gt; 30%</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;$100M</td>
<td>16%</td>
<td>8%</td>
<td>5%</td>
</tr>
<tr>
<td>$100M-$500M</td>
<td>79%</td>
<td>56%</td>
<td>35%</td>
</tr>
<tr>
<td>&gt;$500M</td>
<td>95%</td>
<td>84%</td>
<td>66%</td>
</tr>
</tbody>
</table>

Credit unions >$500 million hold:

- More complex assets and liabilities as a share of their total assets
- 85% of all complex assets and liabilities ($423 billion of $497 billion)
Proposed Threshold of $500 Million

Proposed threshold exempts 1,026 additional credit unions

% of Credit Unions Subject to the Rule

$100 Million Threshold
- Covered, 72%
- Not Covered, 28%

$500 Million Threshold
- Covered, 10%
- Not Covered, 90%

% of Assets Subject to the Rule

$100 Million Threshold
- Covered, 93%
- Not Covered, 7%

$500 Million Threshold
- Covered, 76%
- Not Covered, 24%

Part 702 – Risk Based Capital
Proposed Threshold of $500 Million:

- Covers 85% of complex assets & liabilities, and 76% of total assets
- Includes credit unions that, if they failed, individually present risk of large loss to the NCUSIF
- Total losses to the NCUSIF over the next 10 years would likely be significantly larger for credit unions with more than $500 million in assets than for those with assets between $100 million and $500 million if historical trends continue
### Lower PCA Classification due to RBC

<table>
<thead>
<tr>
<th></th>
<th>2015 Final Rule</th>
<th>Proposed Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td># of Complex Credit Unions with Lower PCA Classification</td>
<td>20 (net)</td>
<td>6 (net)</td>
</tr>
<tr>
<td>Total Assets</td>
<td>$11.5 Billion</td>
<td>$8.8 Billion</td>
</tr>
<tr>
<td>Capital Shortfall</td>
<td>$84 Million</td>
<td>$71 Million</td>
</tr>
</tbody>
</table>

**Under this proposal:**

- 80% of the downgraded credit union assets are covered
- 85% of the capital shortfall is covered
The aggregate risk-weighted assets to total assets ratio is 63% for complex credit unions.
Exempting credit unions with assets between $100 and $500 million represents approximately 16% of the total assets of credit unions bound by risk-based capital under the 2015 Final Rule and 21% of incremental capital required in the credit union system.

Under this proposal, 84% of the risk-based capital bound assets are covered along with 79% of the incremental capital required in the credit union system.
Distribution of Proposed Risk-Based Capital Ratio - FICUs

98.7 percent of all complex credit unions are well-capitalized under the proposed rule.

The aggregate and average risk-based capital ratios for all complex unions are 16.8% and 17.2% respectively.

7 CUs less than 10% with total assets of $10.2B
$208 million in capital needed to reach 10%

12 CUs between 10% and 11%
$22.5B in total assets

0% - 8%  8% - 10%  10% - 10.5%  10.5% - 11%  11% - 11.5%  11.5% - 12%  12% - 12.5%  12.5% - 13%  13% - 13.5%  13.5% - 14%  14% - 14.5%  14.5% - 15%  15% - 15.5%  15.5% - 16%  16% - 16.5%  16.5% - 17%  17% - 20%  20% - 30%  30% - 50%  50% - 75%

# of FICUs
Next Steps

- Publish proposed rule with 30-day comment period
- Analyze comments and prepare final rule
- Finalize Rule