

7535-01-U

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 701, 702, 709, and 741

RIN 3133-AF08

Subordinated Debt

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final Rule.

SUMMARY: The NCUA Board (Board) is amending various parts of the NCUA's regulations to permit Low-income Designated Credit Unions, Complex Credit Unions, and New Credit Unions to issue Subordinated Debt for purposes of Regulatory Capital treatment. The Board issued the proposed Subordinated Debt rule at its January 2020 meeting. The Board is finalizing the rule largely as proposed, except for a few changes to various sections based on comments received. Such changes include amending the definition of Accredited Investor, providing a longer timeframe in which a credit union may issue Subordinated Debt after approval, reducing the required number of years of Pro Forma Financial Statements an Issuing Credit Union must provide with its application, clarifying the prohibition on Subordinated Debt issuances outside of the United States, and clarifying that the Board will publish a fee schedule only if it makes a determination to charge a fee.

DATES: This rule is effective January 1, 2022.

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION

I. HISTORY

At its January 2020 meeting, the Board issued a proposed Subordinated Debt rule (the Proposed Rule) to permit Low-income Designated Credit Unions¹ (LICUs), Complex Credit Unions, and New Credit Unions to issue Subordinated Debt for purposes of Regulatory Capital treatment.² This rule finalizes the Proposed Rule largely as proposed except for several amendments, which are discussed later in this document. The following is a brief history of secondary capital, Risk Based Capital (RBC) for credit unions, and the advent of alternative forms of capital, which ultimately resulted in the development of the Proposed Rule and this final rule.

¹ Terms that are capitalized throughout this document are defined within the document or in the finalized regulatory text.

² 85 FR 13892 (March 10, 2020).

A. Secondary Capital for LICUs

In 1996, the Board finalized § 701.34 of the NCUA's regulations (the Secondary Capital Rule) to permit LICUs to raise secondary capital from foundations and other philanthropic-minded non-natural person members and non-members.³ The Board issued the Secondary Capital Rule to provide an additional way for a LICU to attain Regulatory Capital to serve two specific purposes: (1) support greater lending and financial services in the communities served by the LICU; and (2) absorb losses to prevent the LICU from failing.

In 1998, as part of the Credit Union Membership Access Act (CUMAA),⁴ Congress amended the Federal Credit Union Act (the FCU Act) to institute a system of prompt corrective action for federally insured credit unions based on a credit union's level of Net Worth. Relevant to this final rule, CUMAA specifically defined "net worth" to include, among other things, secondary capital issued by a LICU, provided the secondary capital is uninsured and subordinate to all other claims against the LICU,

³ See 61 FR 50696 (Sept. 27, 1996) (final rule); see also 61 FR 3788 (Feb. 2, 1996) (interim final rule); 12 CFR 701.34.

⁴ Credit Union Membership Access Act of 1998, Pub. L. 105-219, § 301, 112 Stat. 913, 929 (codified at 12 U.S.C.1790d(o)(2)(C) (1998)).

including the claims of creditors, shareholders, and the National Credit Union Share Insurance Fund (NCUSIF).⁵

In 2006, the Board further amended § 701.34 to require regulatory approval of a LICU's secondary capital plan before a LICU could issue secondary capital.⁶ In the preamble to the final 2006 rule, the Board noted that LICUs had sometimes used secondary capital to achieve goals different from those for which it was originally intended. It also highlighted a pattern of "lenient practices" by LICUs that issued secondary capital. These practices contributed to excessive net operating costs, high losses from loan defaults, and a shortfall in revenue.⁷

The Secondary Capital Rule⁸ provides that secondary capital accounts must:

- Be established as an uninsured secondary capital account or another form of non-share account;

⁵ Id.

⁶ 71 FR 4234 (Jan. 26, 2006).

⁷ Id. at 4236. Before 2006, a LICU was required to submit a copy of its secondary capital plan to the NCUA, but it was not required to obtain preapproval.

⁸ 12 CFR 701.34. The last substantive amendment to the Secondary Capital Rule was in 2010 with the addition of language regarding secondary capital received under the Community Development Capital Initiative of 2010. 75 FR 57843 (Sept. 23, 2010).

- Have a minimum maturity of five years;
- Not be insured by the NCUSIF or any governmental or private entity;
- Be subordinate to all other claims against the LICU, including those of shareholders, creditors, and the NCUSIF;
- Be available to cover losses that exceed the LICU's net available reserves and, to the extent funds are so used, a LICU may not restore or replenish the account under any circumstances.⁹ Further, losses must be distributed *pro rata* among all secondary capital accounts held by the LICU at the time the loss is realized;
- Not be pledged or provided by the investor as security on a loan or other obligation with the LICU or any other party;
- Be evidenced by a contract agreement between the investor and the LICU that reflects the terms and conditions mandated by the Secondary Capital Rule and any other terms and conditions not inconsistent with that rule;
- Be accompanied by a disclosure and acknowledgment form as set forth in the appendix to the Secondary Capital Rule;
- Not be repaid, including any interest or dividends earned thereon, if the Board has prohibited repayment thereof under §§ 702.204(b)(11), 702.304(b), or 702.305(b) of the NCUA's regulations because the

⁹ This generally means that, when net operating losses exceed Retained Earnings, a LICU needs to first use the secondary capital funds to cover the excess amount.

LICU is classified as “Critically Undercapitalized”; or, if a LICU is a New Credit Union (as defined under § 702.2 of the NCUA’s regulations), as “Moderately Capitalized,” “Marginally Capitalized,” “Minimally Capitalized,” or “Uncapitalized;”

- Be recorded on the LICU’s balance sheet;¹⁰
- Be recognized as Net Worth in accordance with the schedule for recognizing Net Worth value in subsection (c)(2) of the Secondary Capital Rule;
- Be closed and paid out to the account investor in the event of merger or other voluntary dissolution of a LICU, to the extent the secondary capital is not needed to cover losses at the time of the merger or dissolution (does not apply in the case where a LICU merges into another LICU); and
- Only be repaid at maturity¹¹ except that, with the prior approval of the NCUA and provided the terms of the account allow for early repayment, a LICU may repay any portion of secondary capital that is not recognized as Net Worth.¹²

¹⁰ While the Secondary Capital Rule requires a LICU to record secondary capital accounts on its balance sheet as “equity accounts,” generally accepted accounting principles in the United States generally require financial institutions to record secondary capital accounts as “debt.” *See* FASB (Financial Accounting Standards Board), ASC 942-405-25-3 and 25-4. The instructions to the 5300 Call Report require all federally insured credit unions to report any secondary capital in the Liability section of the Statement of Financial Condition.

¹¹ A LICU may not issue a secondary capital account that amortizes over its stated term.

¹² *See* 12 CFR 701.34(d).

The Secondary Capital Rule also includes requirements related to secondary capital plan submissions and approvals, redemption of secondary capital, disclosures, and Regulatory Capital treatment.

As noted previously, since the passage of CUMAA, the NCUA permits a LICU that issues secondary capital to include the aggregate outstanding principal amount of that secondary capital, in accordance with the schedule for Net Worth,¹³ as part of its Net Worth. Further, pursuant to the NCUA's currently effective risk-based net worth requirements, the NCUA also permits a LICU to include such secondary capital in its risk-based net worth calculation. By contrast, a non-LICU does not have the statutory authority to issue secondary capital and, to the extent a non-LICU issues an instrument that is analogous to secondary capital, to include any such instruments in its Net Worth (or its risk-based net worth) calculation.

B. Subordinated Debt for LICUs and Certain Non-LICUs

1. RBC

In October 2015, the Board finalized a rule to replace the current risk-based net worth requirement with an RBC requirement.¹⁴ Under the revised standard, the NCUA permits a LICU to include secondary capital in its RBC calculations in the same manner

¹³ Id. § 701.34(c)(2).

¹⁴ 80 FR 66626 (Oct. 29, 2015). The Board has delayed the effective date for the final RBC rule two times. First, in 2018, the effective date was delayed by one year, from January 1, 2019, to January 1, 2020. 83 FR 55467 (Nov. 6, 2018). Second, based on Board action at the December 2019 Board meeting, the effective date was delayed two additional years, from January 1, 2020 to January 1, 2022.

as it currently includes secondary capital in its risk-based net worth calculation. Under the Proposed Rule, the Board proposed to grant certain non-LICUs the authority to issue instruments in the form of Subordinated Debt and allow such credit unions to count those instruments in their respective RBC calculations. This new authority, however, would not permit non-LICUs to include Subordinated Debt in their Net Worth calculations.

In the proposed RBC rule issued in 2015,¹⁵ the Board requested stakeholder input on supplemental capital.¹⁶ A majority of commenters that addressed supplemental capital stated it was imperative that the Board consider allowing credit unions to issue additional forms of capital. The commenters suggested this authority was particularly important, as credit unions are at a disadvantage in the financial marketplace because most lack access to additional capital outside of Retained Earnings.

¹⁵ 80 FR 4340 (Jan. 27, 2015).

¹⁶ *Id.* at 4384. The Board notes that when the agency began to consider authorizing non-LICU credit unions to issue instruments analogous to secondary capital instruments issued by LICUs, it used the term “supplemental capital” to refer to those instruments. In 2017, when the Board issued an Advance Notice of Proposed Rulemaking on this topic, the NCUA used the umbrella term “alternative capital” to refer to both supplemental capital and secondary capital. In light of FCUs’ authority only to issue *debt* instruments, however, the Board believes it is more accurate to use the umbrella term “Subordinated Debt” to refer to both secondary capital and what was once referred to as supplemental capital. It is important to note that, unless the context otherwise requires, the term “Subordinated Debt” refers to both types of debt instruments.

While none of the commenters offered specific suggestions on how to implement supplemental capital, a few suggested that the Board promulgate broad, non-prescriptive rules to allow credit unions maximum flexibility in issuing supplemental capital.

2. 2017 Advance Notice of Proposed Rulemaking

On February 8, 2017, the Board published an Advance Notice of Proposed Rulemaking (ANPR) to solicit comments on alternative forms of capital credit unions could use to meet capital standards required by statute and regulation.¹⁷ In response, the Board received 756 comments.

Of the 756 comments received, 688 appeared to be derived from one form letter¹⁸ that opposed the NCUA proceeding with a supplemental capital proposal. In addition to the form letter, the Board received 68 unique comments in response to the ANPR, most of which supported proposing a rule to allow non-LICUs to issue an alternative form of capital. A majority of the commenters in favor of the Board issuing a proposed rule cited compliance with the NCUA's RBC rule¹⁹ as the main reason for their support. Other justifications for support proposed by commenters included credit union growth, protection from economic downturns, and providing services demanded by members.

¹⁷ 82 FR 9691 (Feb. 8, 2017).

¹⁸ While there were slight modifications to some letters, the substance of each was the same.

¹⁹ 80 FR 4340 (Jan. 27, 2015).

In general, the comments lacked specificity, and very few commenters addressed all or even most of the questions posed by the Board. Nevertheless, the comments covered a wide range of topics and offered varying levels of support for provisions suggested in the ANPR. As noted in the Proposed Rule, the Board considered all comments received in response to the ANPR during the Subordinated Debt rulemaking process.

II. PROPOSED RULE

At its January 2020 meeting, the Board issued the Proposed Rule to permit LICUs, Complex Credit Unions, and New Credit Unions to issue Subordinated Debt for purposes of Regulatory Capital treatment.²⁰ Specifically, the Proposed Rule included a new subpart in the NCUA's final RBC rule²¹ to address the requirements for, and Regulatory Capital treatment of, Subordinated Debt. The proposed subpart also contained requirements related to credit union eligibility to issue Subordinated Debt, applying for NCUA authority to issue Subordinated Debt, disclosures, securities laws, the terms of a Subordinated Debt Note, and prepayments.

²⁰ 85 FR 13892 (Mar. 10, 2020).

²¹ 80 FR 4340 (Jan. 27, 2015).

The Proposed Rule also provided for the grandfathering of any secondary capital issued before the effective date of a final Subordinated Debt rule (Grandfathered Secondary Capital) and preserved the Regulatory Capital treatment of Grandfathered Secondary Capital for up to 20 years after the effective date of a final Subordinated Debt rule.²² Under the Proposed Rule, Grandfathered Secondary Capital would generally remain subject to the requirements in the Secondary Capital Rule. For ease of reference, the requirements in the Secondary Capital Rule would be moved from their current location to a section in the new proposed subpart.

Conversely, any issuances of secondary capital not completed by the effective date of this subpart would be subject to the requirements applicable to Subordinated Debt discussed elsewhere in this subpart. This change would not impact a LICU's ability to include such instruments in its Net Worth.

In addition to these changes, the Proposed Rule included additions and amendments to other parts and sections of the NCUA's regulations. Specifically, the Proposed Rule included:

²² Grandfathered Secondary Capital will be considered as Regulatory Capital in accordance with the approved application, terms of the note, and the applicable schedule for recognizing secondary capital as Net Worth, provided that no such term may exceed 20 years.

- A new section that addresses limits on loans to other credit unions;
- An expansion of § 701.38 (“the borrowing rule”) to clarify that federal credit unions (FCUs) can borrow from any source;
- Revisions to the RBC rule²³ and the payout priorities in the NCUA’s involuntary liquidation rule (12 CFR part 709) to account for Subordinated Debt and Grandfathered Secondary Capital; and
- Cohering changes to part 741 to account for other changes that apply to federally insured, state-chartered credit unions (FISCUs).

The Proposed Rule provided for a 120-day comment period, which ended in July 2020.

III. FINAL RULE AND PUBLIC COMMENTS ON PROPOSED RULE

The NCUA received 171 comment letters in response to the Proposed Rule, which included letters from credit union trade associations, credit unions, state and regional credit union leagues, bank trade organizations, corporate credit unions, banks, law firms, securities brokers, and individuals. Of the 171 comment letters, 125 appear to have been generated from one form letter opposing the rule.²⁴

²³ 80 FR 4340 (Jan. 27, 2015).

²⁴ While there were slight modifications to some letters, the substance of each letter was the same.

Nearly all the remaining commenters supported the Proposed Rule, but did offer at least one suggested change. Supporting commenters generally reiterated the need for Subordinated Debt and the NCUA’s legal authority to authorize it. These commenters, however, varied widely on changes requested in a final Subordinated Debt Rule.

The Board notes that, in October 2020, the Board finalized a rule related to corporate credit unions²⁵ in which the Board indicated it would finalize a change related to a corporate credit union’s purchase of Subordinated Debt in a final Subordinated Debt rule. While it is the Board’s intent to finalize the change to the corporate credit union rule, it thought it best to bring that item separately, but in the near future.

A. Comments Opposing Proposed Rule

As noted previously, all of the form letters and a few unique letters opposed the Proposed Rule in its entirety. In summary, these comments contained three general arguments in opposition to the Proposed Rule.

First, these commenters stated that allowing credit unions to issue Subordinated Debt for Regulatory Capital purposes “undermines the foundation of credit unions’ tax exempt status.” In support of this assertion, commenters stated that “credit unions are afforded tax-exempt status in part because they lack access to capital markets to raise

²⁵ 85 FR 71817 (Nov. 12, 2020).

equity. If this rule is adopted, that constraint will be obliterated, giving credit unions fuel to grow well beyond their mission of serving people of small means.” These commenters also stated that the Proposed Rule was concerning in “context of NCUA's methodical work to knock down the other pillars of the credit union tax exemption compact, including the field of membership expansion, the low-income designation expansion, and the proposal to speed credit unions' purchases of banks.”

Second, these commenters generally stated that the Proposed Rule “usurps Congressional authority by approving the use of investor-raised funds to satisfy regulatory capital requirements, an area Congress clearly restricted to retained earnings in the Federal Credit Union Act.” The commenters did not offer further support for this statement.

Finally, these commenters stated that the Proposed Rule would pose significant risk to the NCUSIF. These commenters stated that the NCUA has acknowledged that secondary capital has contributed to rapid growth and higher failure rates in credit unions that issue secondary capital. The commenters went on to state that expanding the authority to issue Subordinated Debt to the largest credit unions will pose significant risk to the NCUSIF and constitutes irresponsible behavior by the NCUA.

The Board disagrees with these commenters on all three assertions. First, as articulated in the Proposed Rule and reproduced later in this document, FCUs have the legal authority to issue Subordinated Debt, and the Board has the authority to include such instruments in the RBC calculation.

With respect to the tax exemption argument, the Board reiterates its statements in the Proposed Rule that, under the FCU Act, FCUs are permitted to borrow from any source.²⁶ The Board was meticulous in crafting this final rule to ensure Subordinated Debt instruments remain squarely in the form of borrowings, as permitted by the FCU Act. The Board, therefore, has no reason to believe that the continuation of an already permissible activity would in any way jeopardize the tax-exempt status of FCUs. Further, the Board will require a FISCO to issue an instrument that meets the same requirements as an instrument issued by an FCU if the FISCO wants such instrument to be included in its RBC calculation. This is described more fully later in this document. The Board was made this intentional decision in part to help preserve FISCOs' tax-exempt status which, as discussed below, differs from that of FCUs.

Finally, the Board has included many safeguards in the final rule to ensure that Subordinated Debt acts as a buffer to reduce risk to the NCUSIF rather than increase risk, as asserted by the aforementioned commenters. The Board is confident that the framework of the final rule will help protect the NCUSIF.

B. Comments Supporting, but Suggesting Changes to, the Proposed Rule

The comments described in this section support the Proposed Rule, but offered suggested changes and amendments. In each section the Board briefly summarizes and responds to comments, with an indication of whether the Board has changed the final rule

²⁶ 12 U.S.C. 1757(9).

or has finalized a section as proposed. The Board notes that the following content is organized by the number of commenters that addressed a particular topic and the impact of a particular section on the rest of the rule. The Board believes this organization will help readers ascertain which topics were the most commented-on and complex. While the Board chose this organization for ease of use, the Board notes that it evaluates all comments and topics equally, regardless of number or the depth of the comments.

1. Subordinated Debt is a Security

The Proposed Rule included a comprehensive description of Subordinated Debt as a security and described general securities law that may apply to Subordinated Debt issued by a credit union. This section of the Proposed Rule stated that the NCUA continues to believe any Subordinated Debt Note would be deemed a security for purposes of federal and state securities law. This section went on to provide the definition of a “security” under the Securities Act of 1933 and interpretations of such term by various courts, including the U.S. Supreme Court.

Twelve commenters disagreed with the NCUA’s assertion that all Subordinated Debt issued under the Proposed Rule would be a security for purposes of federal and state securities laws. The majority of these commenters stated that such a classification would result in an overly complex and expensive set of requirements, including the preparation of an Offering Document and the retention of securities counsel, that would make many small issuances of Subordinated Debt cost-prohibitive for LICUs.

One commenter stated that “currently, the issuance of secondary capital is largely accomplished through what is best described as bilaterally negotiated lending transactions. The NCUA has not suggested that this practice would be discontinued in the case of subordinated debt, and it is reasonable to believe that many market offerings would continue to be conducted in this way.” This commenter went on to state that, because of the use of these bilateral-type agreements, the NCUA should refrain from implementing a blanket approach to securities law compliance.

Other commenters believed a blanket classification of Subordinated Debt as a security would negatively impact LICUs and small issuances. Further, many of these commenters urged the NCUA to consider a more flexible approach that follows the exemptions provided for in the Security and Exchange Commission’s (SEC’s) rules and the Office of the Comptroller of the Currency’s (OCC’s) subordinated debt regulation. Specifically, one commenter stated that the Proposed Rule would require an Issuing Credit Union to prepare and deliver an Offering Document to potential investors “even though there is no SEC-mandated disclosure requirements for offerings of securities pursuant to the section 3(a)(5) exemption, and there generally are no SEC-mandated disclosure requirements for offerings of securities pursuant to the Rule 506 private placement exemption as long as all purchasers in the offering are ‘accredited investors.’” This commenter went on to state that there “already exists a U.S. securities law framework which applies to such exempt issuances, and that framework stipulates that registration and disclosure requirements are not necessary in these cases. It is unnecessary, improper, and unduly burdensome for NCUA to impose such requirements

on exempt credit union issuers when U.S. securities law does not impose these requirements.”

In response to the aforementioned comments, the Board first reiterates that section 2(1) of the Securities Act broadly defines the term “security” to include, among other things, any:

- Stock;
- Note;
- Bond;
- Debenture;
- Evidence of indebtedness;
- Investment contract; or
- Interest or instrument commonly known as a security.²⁷

Further, the U.S. Supreme Court has repeatedly emphasized that the definition of “security” is quite broad. The U.S. Supreme Court, in a variety of cases analyzing the boundaries of the definition, has stressed that the substantive characteristics of the instrument in question and the circumstances surrounding its issuance, rather than the mere name or title of the instrument, are of primary significance in determining whether the instrument, contract, or arrangement in question will be deemed a “security.” While lower federal courts and some state courts have sometimes taken a narrower view than

²⁷ 15 U.S.C. 77b.

the Supreme Court, common factors the courts generally consider in their analysis (particularly in the context of a debt instrument, contract or arrangement) include:

- The terms of the offer;
- The characteristics of the economic inducement being offered to the potential counterparty, and whether the characteristics are consistent with a loan or typical extension of credit, or such that the counterparty would anticipate a potential return on investment in addition to repayment of the obligation and any stated interest;
- The plan of distribution;
- How an instrument is marketed and to whom it is marketed, and whether the potential counterparties are traditional lenders/providers of credit or investors who would anticipate a potential return on investment in addition to repayment of the obligation and any stated interest; and
- The “family resemblance” of the instrument to other instruments or arrangements that have been found to fall within the definition of a “security,” rather than having characteristics more akin to a loan or typical extension of credit.

As the preceding information demonstrates, the definition of a security is quite broad and encompassing. As such, the Board again acknowledges that Subordinated Debt Notes issued under the Subordinated Debt rule, as finalized herein, fit within the definition of a security. Inclusion in such definition may subject issuances to various federal and state laws and regulations.

The Board's statement in both the Proposed Rule and this final rule that Subordinated Debt Notes would be securities is an acknowledgment of such fact and has no bearing on the treatment of such notes by the SEC or state regulators. Rather, after consultation with outside securities law counsel, the Board recognizes that Subordinated Debt Notes issued under this final rule are likely (to some degree) to be subject to the multitude of federal and state securities laws—particularly those related to disclosures and anti-fraud. The Board believes it is prudent and responsible to adopt a framework, as discussed in the Proposed Rule, to aid Issuing Credit Unions in providing Offering Documents to investors. As a prudential regulator, it is incumbent upon the NCUA to include in a rulemaking of this complexity provisions to help ensure credit unions comply with regulatory or statutory requirements, and to help credit unions avoid legal challenges from investors.

The Board reiterates that for all Issuing Credit Unions, the issuance of Subordinated Debt may be a new activity. While LICUs have been issuing secondary capital for several decades, this will be the first time the NCUA has permitted LICUs to issue instruments to qualifying natural persons. Because this is a new and complex activity for all Issuing Credit Unions, in consultation with outside counsel, the Board views the Offering Document process to as helping Issuing Credit Unions navigate complex disclosures and anti-fraud laws. However, the Board notes that the Offering Document is independent of and, in some cases, additive to any requirements imposed by applicable securities laws. The Board reiterates its expectation that credit unions contemplating an issuance of Subordinated Debt Notes retain professional advisors

experienced in securities law disclosure matters to help them prepare related Offering Documents. In short, the Board continues to believe that Subordinated Debt Notes issued under this final rule would be securities. Therefore, the Board is taking a prudential stance by finalizing, as proposed, the various provisions related to securities law that appeared in the Proposed Rule. The Board believes that, in the infancy of Subordinated Debt issuances, such provisions are transparent and will help Issuing Credit Unions navigate and properly issue Subordinated Debt Notes (in consultation with counsel). The Board further notes that the disclosures required by this final rule are akin to those most investors are accustomed to seeing in the marketplace, which may make issuances of Subordinated Debt Notes less costly for some Issuing Credit Unions.

a. Exemptions for Certain Subordinated Debt Issuances

In addition to the aforementioned comments, several commenters stated that the OCC's requirements for national banks offering subordinated debt are less restrictive than what the Board proposed for credit unions. Commenters noted that the OCC requires banks that issue subordinated debt to comply with section 16.5 of the Federal Deposit Insurance Corporation's (FDIC's) Securities Offering Disclosure Rule, which contains several exemptions to the prospectus delivery requirement, including exemptions for nonpublic offerings and small issuances made in conformance with applicable SEC rules.²⁸ To align with regulations issued by the OCC and FDIC, these commenters stated that the NCUA should consider a more flexible approach.

²⁸ 12 CFR 16.5

The Board is aware that the FDIC's Securities Offering Disclosure Rule²⁹ contains exemptions that were not included in the Proposed Rule and are not included in this final rule. First, related to the preceding section of this document, the Board notes that while the OCC and FDIC provide exemptions for certain issuances, the OCC and FDIC still deem such issuances to be securities. Rather, the OCC and FDIC have provided exemptions from registration and delivery of an Offering Document for issuances of securities that satisfy certain requirements.

Second, the Board notes that the OCC has supervised—and banks have engaged in—subordinated debt transactions for many years. As noted previously, this final rule will be, to some degree, a new endeavor for many Issuing Credit Unions. The Board believes it is both prudent and necessary to maintain the proposed guardrails to help Issuing Credit Unions comply with applicable securities laws, particularly those related to anti-fraud. As the NCUA and credit unions move forward with this final rule, the Board will continue to evaluate the rule and may undertake future rulemakings to provide exemptions where they are both warranted and prudent for Issuing Credit Unions.

2. Offering Document

In addition to comments related to the applicability of securities laws and exemptions from submitting an Offering Document, as discussed previously, several commenters offered specific comments on the requirement that an Issuing Credit Union

²⁹ Id.

create an Offering Document for each issuance of Subordinated Debt. Generally, these commenters opposed the Offering Document process, or at least requested an exemption or streamlined process for certain issuances.

One commenter stated that the NCUA should include exemptions for certain issuances of Subordinated Debt, similar to the OCC and FDIC. This commenter contended that such exemptions would lower regulatory burden on smaller institutions and bring the NCUA's regulation more in line with the OCC's, FDIC's, and SEC's disclosure requirements. This commenter went on to state that almost every current issuance of secondary capital would be exempt from the Offering Document process under the OCC's Subordinated Debt regulation.

Another commenter stated that "the NCUA's documentation requirement goes beyond that of the OCC, which permits a bank seeking to issue securities to tailor its approach to the relevant securities registration exemption—and associated market practice—that meets its needs." This commenter went on to state that "the NCUA's requirement could result in credit unions having higher burdens—and less transaction flexibility—than their community bank counterparts." Finally, this commenter argued that the NCUA's requirements would be similar to those imposed by the SEC on public offerings, which, in the commenter's view, would hinder the credit union industry, which would largely be engaging in small, private issuances.

Another commenter suggested that instead of the NCUA's proposed approach to Offering Documents, the NCUA should require a potential credit union issuer—as part of

its initial application to issue Subordinated Debt—to explain how its approach to due diligence, disclosure, and securities law considerations is reasonable given the specifics of an issuance. In support, this commenter stated that this approach would provide flexibility while accounting for the varying types of issuances and varying degrees of investor sophistication.

Another commenter suggested the Board detach the Offering Document from the application process, and instead make approval contingent on the inclusion of an offering circular to comply with 10b-5 and other disclosures the NCUA deems appropriate. This commenter stated that this would allow a credit union to defer the legal costs associated with preparing an Offering Document until the credit union was ready to execute its Subordinated Debt strategy.

Finally, one commenter requested that the NCUA explicitly require issuers to disclose all pending legal or other items that could have a negative impact on the credit union's capital, income, or operating performance. This commenter stated that such information was necessary for an investor to make a well-informed decision.

For the reasons articulated in the Proposed Rule and those discussed previously, the Board is finalizing the sections relating to the Offering Document as proposed. In addition to the previous discussion related to Subordinated Debt as a security, the Board continues to believe that a robust Offering Document is prudent for credit unions that issue Subordinated Debt.

As noted in the Proposed Rule, the Offering Document is designed to provide investors with disclosures that provide the information they need to make an informed decision on purchasing Subordinated Debt. Further, the Board modeled the Offering Document from disclosures common in the marketplace for this type of instrument. Because Subordinated Debt is a security and thus subject to the broad antifraud provisions of the Securities Exchange Act, as codified in the SEC's regulations,³⁰ the Board intends the Offering Document to be an aid for credit unions and an extra level of protection for investors.

In response to commenters seeking an exemption for certain types of Subordinated Debt transactions, the Board may consider such actions in future rulemakings. However, as noted previously, because this is a new endeavor for many Complex and New Credit unions and this is the first time LICUs will be permitted to issue Subordinated Debt to natural persons, the Board believes it is important to take a measured approach to the issuance of these instruments. The Board believes a "walk before you run" approach in this area is both prudent and necessary.

Finally, the Board believes that third parties may produce Offering Document templates to help credit unions issue Subordinated Debt more efficiently, while still complying with this rule and applicable securities laws. The creation of such templates may help defray some of the cost for Issuing Credit Unions. The Board encourages such collaboration in the industry, provided it is compliant with the final rule and all

³⁰ 17 CFR 240.10b-5.

applicable securities laws. The Board notes, however, that the use of any template Offering Document must be customized to a credit union's specific issuance and accurately disclose the specific aspects that are unique to the Issuing Credit Union.

For the reasons discussed above, the Board is finalizing the Offering Document, and sections related thereto, as proposed.

3. Preapproval to Issue Subordinated Debt

The Proposed Rule required that eligible credit unions submit an application and receive written preapproval from the NCUA before issuing Subordinated Debt. The proposed application process consisted of an eligible credit union providing the Appropriate Supervision Office information on 15 topics as part of the initial application. In addition, the Board proposed to amend the NCUA's review time of such application from 45 days with automatic approval (as in the Secondary Capital Rule) to 60 days, with no automatic approval. The Board also proposed to expire any approval granted under the rule one-year from the date of such approval.

Most of the commenters that supported the proposal addressed at least some aspect of the proposed application process. The commenters generally focused on:

- Reducing the complexity of the application process;
- The timing for NCUA approval of an application;
- The requirement to issue Subordinated Debt within one-year from the approval of an application;

- Subordinated Debt Note restrictions; and
- The requirement to provide at least five years of Pro Forma Financial Statements.

a. Application Requirements

Approximately 13 commenters either stated that the preapproval requirements to issue Subordinated Debt were too burdensome or requested that the NCUA streamline the process. While some commenters appreciated the clarity in the proposed preapproval requirements, this subset of commenters felt that the preapproval requirements were too cumbersome and would discourage many credit unions from issuing Subordinated Debt.

Some commenters stated that the preapproval process should not be a one-size-fits-all approach, but should reflect the complexity of the proposed issuance. Several of these commenters stated that the NCUA should retain its current “Secondary Capital Plan” requirements. In addition, two commenters stated that if the NCUA retains the proposed preapproval requirements, the final rule should provide for a streamlined process for subsequent preapproval requests from previously approved credit unions.

As stated in the Proposed Rule, the Board remains dedicated to a requirement for an eligible credit union to obtain written preapproval before issuing Subordinated Debt, as it views this step as an important prudential safeguard. The Board believes a preapproval process is part of a credit union’s sound management plan, and will help the NCUA ensure that a planned issuance of Subordinated Debt is structured in such a manner as to appropriately protect the Issuing Credit Union and the NCUSIF.

While the Board recognizes the many potential benefits that an issuance of Subordinated Debt Notes may confer on an Issuing Credit Union, it also appreciates the complexities and risks of such issuance. The decision to offer and sell Subordinated Debt Notes should be made only after careful consideration, preparation, and diligence by the Issuing Credit Union, including seeking professional advice as warranted. For these reasons, the Board is retaining this important prudential safeguard and will adopt the preapproval requirements as proposed.

b. NCUA Review Time of Application

As noted previously, the Proposed Rule increased the review time of an initial application to 60 days from the Secondary Capital Rule's period of 45 days.³¹ In addition, the Proposed Rule removed the automatic approval that exists in the Secondary Capital Rule if the NCUA fails to respond before the expiration of the 45-day period. Approximately 13 commenters opposed these proposed changes.

Generally, these commenters stated that a longer approval process with no automatic approval would impose unnecessary burdens on credit unions seeking to issue Subordinated Debt. These commenters urged the NCUA to retain the approval timing

³¹ 12 CFR 701.34(b)(2)).

and structure in the Secondary Capital Rule. One commenter stated that the NCUA should concurrently review a credit union's application and Offering Document, asserting that consecutive rather than concurrent reviews could place a credit union at a competitive disadvantage and frustrate a credit union's efforts to issue Subordinated Debt. Further, this commenter stated that an overly long review process could result in "stale" data, which may not be useful to the NCUA or investors.

As stated in the Proposed Rule, the Board believes the expanded requirements for initial applications are broader than the Secondary Capital Rule requirements and that the enhanced description of diligence expectations will require a more thorough review by the Appropriate Supervision Office. While the Board anticipates that the clear, transparent structure of the application requirements will lead to increased efficiency from both credit unions and the agency, the Board believes the extra time is warranted to ensure an application is sufficient for an Appropriate Supervision Office to make a well-informed decision. Further, the Board notes that the complexity of a Subordinated Debt issuance will drive both the veracity of a credit union's application and the NCUA's review time. As such, the Board anticipates that the increased time for review will have little impact on most smaller, simple issuances. Therefore, the Board is retaining, as proposed, the 60-day timeframe for NCUA review of applications.

c. Expiration of Authority

The Proposed Rule included a provision that would require the expiration of an Issuing Credit Union's authority to issue Subordinated Debt Notes one year from the later of:

- The date the Issuing Credit Union received NCUA approval of its initial application (if the proposed offering is to be made solely to Entity Accredited Investors); or
- The "approved for use" date of the applicable Offering Document (if the proposed offering will include any Natural Person Accredited Investors).

The Board included a question in this section of the Proposed Rule preamble asking if a one-year expiration would negatively impact Issuing Credit Unions. Approximately 16 commenters responded to this question and disagreed with the proposed requirement that a credit union complete a Subordinated Debt issuance within one year from the date of receiving NCUA approval. Most of these commenters stated that one year is an arbitrary deadline that may force a credit union to make a rushed decision or not be able to adequately account for the complexities necessary to execute a beneficial offering. Most of the commenters sought an extension of the one-year period, rather than an outright abolishment of it.

In addition, two commenters stated that the NCUA could use the quarterly regulatory reporting to monitor credit unions with Subordinated Debt authority and determine if there had been changes in a credit union's condition that would require a revocation of the NCUA's approval. These commenters stated that such an approach

would account for material changes in a credit union's condition without subjecting all credit unions to an arbitrary deadline.

The Board has considered these comments and will increase the expiration period to two years in the final rule. The Board understands that business and/or economic conditions can change rapidly, as has occurred during the global pandemic of 2020, and that a credit union may need a longer period to meet its strategic goals using Subordinated Debt. The Board believes this change in the final rule will provide credit unions with a longer issuance window and increased flexibility to issue Subordinated Debt. After thorough consideration, the Board has determined that a two-year expiration period strikes an appropriate balance between the competing concerns the Board noted in the Proposed Rule: ensuring that an Issuing Credit Union does not offer and sell Subordinated Debt Notes following a material change in the information on which the NCUA relied in approving the offer and sale of that Issuing Credit Union's Subordinated Debt Notes, and not unduly hindering the marketability of Subordinated Debt Notes.

In addition to expanding the expiration period, the Board is retaining, as proposed, a provision that allows an Issuing Credit Union to file a written request for one or more extensions of the two-year limit with the Appropriate Supervision Office, provided the request is filed at least 30 calendar days before the expiration of authority. The Board believes finalization of this provision, coupled with the expiration extension, will provide Issuing Credit Unions sufficient time to complete a Subordinated Debt issuance.

The Board notes, however, that in the event an Issuing Credit Union's circumstances materially change after the NCUA has approved an initial application but before the closing of the relevant offer and sale of Subordinated Debt Notes, the final rule requires an Issuing Credit Union to submit an amended application before it continues its Subordinated Debt Notes offering. The Board believe this provision is necessary to account for material changes in an Issuing Credit Union's conditions that may occur between approval and the final sale of Subordinated Debt.

d. Pro forma Financial Statements

The Proposed Rule included an extension of the time horizon of the Pro Forma Financial Statements to five years compared to the Secondary Capital Rule's requirement of two years.³² The Board requested comment on this extension and its impact on Issuing Credit Unions. Approximately five commenters addressed the proposed requirement that a credit union submit at least five years of Pro Forma Financial Statements with its application. Three of these commenters disagreed with the proposed increase from two to five years. One commenter stated that the NCUA should request Pro Forma Financial Statements based on the complexity of a proposed transaction rather than implementing a one-size-fits-all approach. Another commenter believed that two years of data was sufficient, as such data is mainly for the benefit of an investor. This commenter stated that an investor could request additional years of Pro Forma Financial Statements if needed.

³² Id.

Two commenters agreed with the proposed increase and sought additional information as part of the application and disclosure process. One commenter agreed with the breadth of the required pro forma data but suggested that the NCUA should also require credit unions to include tables that reflect actual results for the prior three-year period and a detailed narrative on how the issuer intends to secure the level of earnings presented in its Pro Forma Financial Statement. This commenter went on to suggest that such additional data should include a modest level of sensitivity analysis indicating likely performance under stressed conditions.

The Board has considered these comments and is reducing the minimum number of years for the Pro Forma Financial Statement requirement as part of the initial application from five years to two years for the final rule. The Board believes that an extended Pro Forma Financial Statement analysis of five years, which aligns with the minimum maturity of a Subordinated Debt Note, may provide useful information. However, the Board recognizes that the veracity of the analysis is equally important. Further, the quality of the assumptions and range of plausible scenarios used in the projections are as much a priority—and perhaps superior to—the number of years a credit union applied to those assumptions and scenarios. As such, the Board believes a reduction in the number of years from the proposed five to two is appropriate and will provide, in most cases, the necessary information for an Appropriate Supervision Office to render a decision on an initial application. The Board notes, however, that included in both the Proposed Rule and this final rule is a provision that permits an Appropriate

Supervision Office to request additional information, such as additional years of Pro Forma Financial Statements, to support a credit union's application.

e. Filing Fees

Five commenters opposed any filing fees associated with the issuance of Subordinated Debt. These commenters generally stated that such fees may make such issuance cost prohibitive and overly burdensome, particularly in light of the other requirements in the Proposed Rule.

In response, the Board notes that both the Proposed Rule and this final rule do not require a filing fee, but do reserve the right of the Board to charge such a fee if warranted. The Board believes it is important to retain this flexibility to ensure that, if needed, the Board can assess an appropriate fee on applicants to cover the NCUA's cost of reviewing and processing such application. The Board notes that it would not impose a fee without a sufficient justification and may provide exceptions for smaller or low-income credit unions. Therefore, the Board is retaining this provision as proposed. However, the Board is clarifying in this final rule that the Board will publish a fee schedule on the NCUA's website only if the Board institutes a fee in the future.

4. Investors

In the Proposed Rule, the Board limited the investors that could purchase Subordinated Debt to only Accredited Investors as defined by the SEC,³³ except that credit union “insiders” were specifically prohibited from purchasing or holding Subordinated Debt. Further, the Proposed Rule bifurcated the category of Accredited Investors into Natural Person Accredited Investors and Entity Accredited Investors. Finally, the Proposed Rule limited the permissible investor base to only U.S. investors.

Eight commenters addressed the issue of investors. The majority of these commenters sought additional flexibility in determining who may invest in Subordinated Debt. However, three commenters sought additional limitations on the type of investors or solicitation thereof.

Two commenters stated that permissible investors should not be limited to only U.S. investors. These commenters believed this would unduly restrain credit unions from conducting beneficial offerings of Subordinated Debt. Two other commenters, for similar reasons as the preceding commenters, requested that the NCUA allow permissible investors to include those other than Accredited Investors. Finally, one commenter requested the NCUA remove the limit on the number of permissible investors. This commenter felt any limit on the number of investors could limit a credit union’s ability to conduct an issuance that it determines to be in its best interest.

³³ 17 CFR 230.501(a).

Differing from the aforementioned commenters, three commenters sought additional limitations on the permissible investors or the solicitation thereof. Two commenters requested that the NCUA prohibit any federally insured credit union from investing in the Subordinated Debt of other credit unions. These commenters believed this prohibition would remove risk from the credit union system and offer a higher degree of protection for the NCUSIF. The Board notes that it discusses these comments in the section of this document related to FCUs being both an issuer and investor of Subordinated Debt. Finally, one commenter believed that credit unions should be prohibited from soliciting or offering Subordinated Debt at credit union branches. This commenter stated that this practice could introduce unnecessary reputation risk to credit unions that solicit or offer Subordinated Debt to unsophisticated members.

The Board is finalizing the sections on Investors as proposed, with one minor change. As noted in the preamble to the Proposed Rule, at the time, the SEC had proposed amendments to the definition of “Accredited Investor.” The SEC has now finalized these amendments.³⁴ These changes, which are effective December 8, 2020, expand the definition of “Accredited Investor” by adding several new categories of natural persons or entities the SEC considers Accredited Investors. The Board is adopting these changes to the definition of “Accredited Investor” by modifying the definitions of Entity and Natural Person Accredited Investor in this final rule. The Proposed Rule enumerated specific paragraphs of 17 CFR 230.501(a) that the NCUA would consider either Natural Person Accredited Investors or Entity Investors. To

³⁴ 85 FR 64234 (Oct. 9, 2020).

encompass the recent change by the SEC and future changes by the SEC, the Board is removing the specific citation references to 17 CFR 230.501(a). This is largely a technical change and is not intended to change the substantive definition of Entity or Natural Person Accredited Investors.

As noted previously, several commenters sought additional flexibilities for investors or the removal of investor limits completely. The Board does not believe it is prudent to remove the limitations on investors, as such limits were designed to protect investors and credit unions. As discussed in the Proposed Rule, disclosures are largely based on the sophistication of the investor. Therefore, the Board opted to limit investors to those that meet the SEC's definition of Accredited Investor. The Board believes this strikes an appropriate balance between providing credit unions with a wide investor base and helping credit unions avoid additional risks by offering Subordinated Debt to less-sophisticated investors.

Further, in response to the commenter that sought the ability to offer Subordinated Debt to non-U.S. citizens, the Board, as noted in the Proposed Rule, deliberately limited the issuance of Subordinated Debt to only U.S. citizens. This decision is based, in large part, on the additional complexities of issuing to foreign persons, which could subject Issuing Credit Unions to additional risk that could ultimately be passed on to the NCUSIF.

Except as discussed above, the Board is finalizing the sections on investors, as proposed.

a. Prohibition of an Issuing Credit Union's board members, Senior Executive Officers, or Their Immediate Family Members to Purchase or Hold Subordinated Debt Notes

The Board proposed to expand a credit union's current authority for permissible investors by allowing a credit union to issue Subordinated Debt to Natural Person Accredited Investors and Entity Accredited Investors, with the following restrictions on who may purchase or hold a Subordinated Debt Note issued by an Issuing Credit Union:

- Board member or Senior Executive Officer of the Issuing Credit Union;
and
- Immediate Family Member of such board member or Senior Executive Officer of the Issuing Credit Union.

One commenter requested the NCUA reconsider these proposed prohibitions.

The commenter noted that the federal banking regulators do not prohibit related parties and insiders from buying stock in a mutual to stock conversion of a thrift institution. The commenter stated that educating board members, senior officers, and others within the sphere of concern should suffice to mitigate this concern by requiring insider trading policies and procedures regarding the management of material non-public information and related party transactions. The commenter also stated the Offering Document would have disclosures related to investments by related parties and insiders, and would disclose any potential conflict of interests. Given the NCUA's concern, the commenter stated the NCUA may wish to consider adding a requirement to the initial application requiring an applicant credit union to disclose whether any such individuals are anticipated investors.

The commenter stated that a wholesale exclusion unduly limits the marketability and functionality of Subordinated Debt issuances by a credit union.

The Board continues to believe it is inappropriate to permit an Issuing Credit Union's board members, Senior Executive Officers, or their Immediate Family Members to purchase or hold Subordinated Debt Notes. The Board has concerns about potential conflicts of interest and fraud that could arise because such individuals may exercise control over an Issuing Credit Union and could have, or gain, access to material non-public information related to the Issuing Credit Union and/or the Subordinated Debt Notes. Despite commenters' assertions, the Board does not believe disclosures would be sufficient to address these concerns. For these reasons, the Board is retaining the prohibition on an Issuing Credit Union's board members, Senior Executive Officers, or their Immediate Family Members purchasing or holding Subordinated Debt Notes in the final rule, without amendment.

5. Subordinated Debt Note Default Restriction

The Proposed Rule included a restriction on a Subordinated Debt Note including a term or condition that would trigger an event of default based on an Issuing Credit Union's default on other debts. Approximately five commenters opposed this restriction. One commenter suggested that the NCUA adopt a similar provision to the other banking agencies and use a certain threshold to determine when default on other debts would render an Issuing Credit Union in default on its Subordinated Debt. Other commenters

suggested that default clauses are standard in debt obligations to allow parties to restructure deals in the event of material changes to the financial condition of the issuer.

After considering these comments, the Board is finalizing this restriction as proposed. While the Board recognizes that other banking regulators may impose a different requirement, the Board believes this restriction is prudent given the relative newness of the issuance of Subordinated Debt. In conjunction with the other provisions in this final rule, including interest repayment and repudiation safe harbors, the Board does not believe this restriction will cause an overly negative impact on the sale of Subordinated Debt Notes.

6. Minimum Denominations

To provide additional protections to Natural Person Accredited Investors that purchase Subordinated Debt Notes, the Board proposed that Subordinated Debt Notes sold or transferred to a Natural Person Accredited Investor be made in minimum denominations of \$100,000 or \$10,000, respectively. Approximately eight commenters addressed the issue of minimum denominations. The vast majority of these commenters sought lower minimum denomination amounts. One commenter, however, requested a higher minimum denomination amount.

Commenters that favored a lower minimum denomination amount generally agreed that the proposed limit of \$100,000 was too high, particularly given the requirement that all investors qualify as Accredited Investors. The majority of these commenters argued that \$10,000 was an appropriate minimum denomination. Some of

these commenters cited the NCUA's proposed resale minimum denomination of \$10,000 as a basis for selecting this amount as an overall minimum denomination. In addition, other commenters stated that a \$10,000 minimum denomination would benefit small LICUs while being more than sufficient to help a small LICU avoid prompt corrective action.

As noted previously, one commenter sought a higher minimum denomination amount. This commenter urged the NCUA to adopt the OCC's \$250,000 minimum denomination to discourage access by less financially sophisticated investors.

The Board has considered the comments on minimum denomination of a Subordinated Debt note when issued to a Natural Person Accredited Investor(s) and will retain the proposed minimum denomination of \$100,000. As the Board stated in the Proposed Rule, the minimum denomination provides additional protection to Natural Person Accredited Investors that purchase Subordinated Debt Notes. The Board reiterates that such minimum denominations would not apply to Entity Accredited Investors because those purchasers are corporate entities that, in the Board's view, are generally sufficiently sophisticated in financial matters such that the additional protections afforded by minimum denominations are not necessary. The Board will retain no minimum denomination requirements for Subordinated Debt Notes sold to an Entity Accredited Investor.

The Board also stated requiring larger denomination notes will help ensure that the purchasers of the Subordinated Debt Notes are financially sophisticated and have

substantial net worth. The Board disagrees that this provision will overly impact most LICUs. Currently LICUs may only issue secondary capital to entities. This final rule retains LICUs' ability to issue Subordinated Debt to an Entity Accredited Investor in any amount. The minimum denomination would only apply if a LICU sought to issue Subordinated Debt to the newly permissible category of Natural Person Accredited Investors.

7. Prohibition on an FCU Issuing and Investing in Subordinated Debt

The Proposed Rule included a requirement that an FCU investing in Subordinated Debt, Grandfathered Secondary Capital, or in loans and obligations issued by privately insured credit unions that are subordinate to a private insurer must not be an Issuing Credit Union of Subordinated Debt or Grandfathered Secondary Capital, or currently have approval from the NCUA to issue Subordinated Debt or Grandfathered Secondary Capital.

Approximately 12 commenters requested the NCUA reconsider the proposed prohibition on a credit union being both an issuer and investor in Subordinated Debt. The majority of these commenters stated that this type of investment scenario would not increase the magnitude of a loss to the NCUSIF. These commenters contended that the loss may be spread across multiple institutions, thereby mutualizing the risk of a loss. Further, one commenter stated that "the investment of one credit union in the [Subordinated Debt] of another could benefit the credit union system overall because it is

likely, or at least possible, that credit unions with higher net worth ratios will invest in those with lower net worth ratios.”

Commenters in favor of this type of investment scenario stated that concentration limits would serve as protection against extensive loss transfers, because the investing credit unions would only stand to lose the amount invested, which would be prudentially regulated by the NCUA.

Commenters also suggested that the NCUA add a line item to the Call Report to exclude all amounts invested in the Subordinated Debt of other credit unions. These commenters contended that, because this is primarily a reporting issue, adding a new item to the Call Report to reflect such investments would properly reflect the loss-absorbing capacity of the credit union system. Further, these commenters stated that this would address the NCUA’s concern where an FCU issuing and investing in Subordinated Debt causes the appearance of increased net worth in the credit union system, while the actual loss-absorbing capacity of the system remains unchanged.

Conversely, two commenters requested that the NCUA prohibit any federally insured credit union from investing in the Subordinated Debt of other credit unions. These commenters believed this prohibition would remove risk from the credit union system and offer a higher degree of protection of the NCUSIF.

While most these commenters believe an FCU should be able to be an issuer and investor of Subordinated Debt, the Board continues to believe that an Issuing Credit

union should not provide Regulatory Capital to other natural person credit unions. The Board continues to believe the potential to transmit losses between multiple credit unions that have both issued and invested in Subordinated Debt could increase the risk of credit union failure and risk to the NCUSIF. The Board also notes that adding a line in the Call Report, as recommended by some commenters, would not decrease the potential risk of credit union failure due to loss transmission and would not decrease the risk to the NCUSIF. An added line to the Call Report would only provide information, and not risk mitigation. For these reasons, the Board is retaining the prohibition of an FCU issuing and investing in Subordinated Debt in the final rule without amendment.

8. Federally Insured, State-Chartered Credit Unions

The Proposed Rule required FISCUs to be subject to largely the same requirements related to the issuance of Subordinated Debt as FCUs. These include, but are not limited to, requirements related to the features and structure of the instrument. Approximately seven commenters addressed the issue of FISCUs being subject to the requirements of the NCUA's final Subordinated Debt rule. All but one of these commenters opposed the Proposed Rule as overly restrictive on FISCUs.

Commenters opposing this proposal stated that it would be in opposition to the dual-chartering system and could stifle innovation among FISCUs that have authorities beyond those of FCUs. One commenter stated that state regulators are sufficiently equipped to supervise the innovation of FISCUs as it develops.

One commenter also opposed the potential requirement for a FISCU to obtain an opinion that its issuance would not subject the credit union to state and federal income taxes. This commenter stated that it is not clear that such an opinion would be needed under the proposed structure, because FISCUs would be held to the same standard as FCUs. Further, this commenter, in light of the cost of such an opinion, sought assurance from the NCUA that the request for such an opinion would be the exception rather than the norm.

Finally, as noted previously, one commenter was not completely opposed to FISCUs being subject to the same requirements as FCUs. This commenter stated it was unlikely that any instrument other than Subordinated Debt would be of much interest in the marketplace. Further, this commenter argued that all credit unions issuing the same form of instrument would help the market become more familiar with Subordinated Debt, thereby increasing investor interest and reducing the cost of issuing Subordinated Debt. This commenter did state, however, that while they saw benefits to all credit unions issuing the same instrument, they did not believe that a FISCU which was permitted by state law to issue a Subordinated Debt hybrid instrument should be restricted from doing so by the Proposed Rule.

As stated in the Proposed Rule, FISCUs may not be restricted under applicable state law and regulation to issuing only debt instruments. However, as administrator of the NCUSIF the Board continues to believe the framework for the types of instruments that would qualify for Regulatory Capital should be consistent for all credit unions. The

Board notes that such structure may also help FISCUs retain their tax exemption, as debt issuances are likely not to be viewed as capital stock issuances.³⁵

While the Board fully supports the dual-chartering system and innovation among all credit unions, it notes that all LICUs—both federally and state-chartered—are currently subject to the same Secondary Capital (or Prompt Corrective Action) requirements. Further, as articulated in the Proposed Rule, FISCUs may only issue Subordinated Debt if permitted under state law. The Board believes that requiring consistency among the types of instruments issued for Regulatory Capital treatment is in the best interest of both the NCUSIF and FISCUs. As such, the Board is finalizing, as proposed, those provisions that apply to FISCUs without amendment.

9. Prepayment

The Proposed Rule required a credit union to receive prior written approval from the Appropriate Supervision Office before the credit union prepays Subordinated Debt. Approximately five commenters addressed the issue of prepayment. The majority of these commenters sought a removal of the application process to prepay Subordinated

³⁵ State chartered credit unions without capital stock, organized and operated for mutual purposes and without profit are exempt from Federal income tax under IRC 501(c)(14)(A). 26 U.S.C. 501(c)(14)(A).

Debt or a shortening of the timeframe for the NCUA to render a decision on such application.

These commenters stated that an application process was in opposition to the requirements contained in the OCC's regulation and could put credit unions at a competitive disadvantage. These commenters recommend allowing adequately capitalized credit unions to prepay any portion of their Subordinated Debt for which they no longer receive regulatory credit without prior regulatory approval.

In addition, one commenter stated that the NCUA should allow credit unions to draft agreements that allow for the redemption of discounted capital so they could count the remaining balance, in whole, as capital.

Another commenter stated that credit unions should have the flexibility to structure Subordinated Debt agreements with the ability to refinance the debt if the parties agreed to the concept of refinancing within an outlined placement agreement.

Finally, one commenter stated that inclusion of prepayment obligations and acceleration features is common in the capital markets, even for deeply subordinated instruments, and would be expected by many market participants. This commenter went on to recommend the NCUA allow for these features—particularly because the NCUA can protect the issuer and the NCUSIF by requiring an issuer to receive NCUA approval before making any payments.

The Board has reviewed the comments relating to prepayment of Subordinated Debt and will retain the provision of receiving prior approval in the Proposed Rule, with a 45-day timeframe for the NCUA to approve the application. While the 45-day approval timeframe is similar to the Secondary Capital Rule, the Board has eliminated the provision for automatic approval if a credit union is not notified of a decision by the Appropriate Supervision Office within the 45 days. The Board believes the regulatory relief in the Proposed Rule, including the ability to prepay any portion of the Subordinated Debt and a streamlined application (compared to the Secondary Capital Rule), provide sufficient regulatory relief to offset any burden imposed by removing the automatic approval. However, the Board sees the requirement for preapproval for prepayment as an important way to confirm that a credit union has sufficient capital and liquidity to repay Subordinated Debt without unduly increasing risk to the NCUSIF.

10. Limits on Loans to Other Credit Unions

The Proposed Rule included a new single-borrower limit for FCUs that make loans to other credit unions. The single-borrower limit would be the greater of 15 percent of an FCU's Net Worth or \$100,000, plus an additional 10 percent of an FCU's Net Worth if that additional 10 percent is fully secured at all times with a perfected security interest by readily marketable collateral as defined in § 723.2.³⁶ The limit would include Subordinated Debt and Grandfathered Secondary Capital, and would be in addition to the

³⁶ 12 CFR 723.2.

aggregate limit on such loans specified in the FCU Act. One commenter requested the NCUA not impose the proposed additional restrictions on loans to other credit unions.

The Board notes that the proposed single borrower limit is consistent with the single borrower limit in the NCUA's commercial lending and MBL rule.³⁷ Because credit unions share many similarities with traditional corporate borrowers, the Board continues to believe that basing the proposed single-borrower limit in this rule on the commercial and MBL rule limit is appropriate. Furthermore, the 15 percent of Net Worth single-borrower limit for FCUs that make loans to other credit unions would generally limit catastrophic losses to an FCU if the borrower defaults.

For these reasons, the Board is retaining the limits of an FCU making loans to other credit unions in the final rule without amendment.

11. Pooling

The Board did not include a provision for the pooling of Subordinated Debt issuances in the Proposed Rule. The Board notes that pooling generally involves combining more than one issuance in a standalone structure. Approximately three commenters advocated for the NCUA to explicitly permit pooling arrangements in any final Subordinated Debt rule. These commenters stated that allowing for pools of Subordinated Debt could make it easier and less expensive for credit unions to take issuances to the market. These commenters also believed that pools would reduce the

³⁷ Id. § 723.4(c).

risk of loss to investors by spreading loss across multiple credit unions rather than just one. Finally, one commenter argued that pooling would allow for larger issuances that may be able to be rated, thereby providing investors additional confidence in the issuance.

While the Board is not including a specific provision on pooling in this final rule, the Board notes that there is no prohibition in this final rule or the Proposed Rule on Subordinated Debt being pooled and sold to investors. The Board notes, however, that any such pool must comply with all of the NCUA's regulations and any applicable securities laws.

Finally, the Board notes that general investment authority in part 703 only permits FCUs to purchase pooled Subordinated Debt in the form of a registered investment company or collective investment fund, as long as the prospectus of the company or fund restricts the investment portfolio to investments and investment transactions that are permissible for FCUs.³⁸

IV. LEGAL AUTHORITY

A. Authority to Issue Subordinated Debt

³⁸ 12 CFR 703.14(c).

The borrowing authority granted to FCUs by the FCU Act, along with FCUs' statutory authority to enter into contracts and exercise incidental powers necessary or required to enable the FCUs to effectively carry on their business, supports the legal analysis that FCUs are authorized to incur indebtedness through the issuance of debt securities of the type contemplated by this final rule. Section 1757(9) of the FCU Act authorizes FCUs:

“...to borrow, in accordance with such rules and regulations as may be prescribed by the Board, from any source, in an aggregate amount not exceeding, except as authorized by the Board in carrying out the provisions of subchapter III of this chapter, 50 per centum of its paid-in and unimpaired capital and surplus: Provided, That any Federal credit union may discount with or sell to any Federal intermediate credit bank any eligible obligations up to the amount of its paid-in and unimpaired capital.”³⁹

Other than the provisions codified in § 701.38 of the NCUA's regulations, which address borrowed funds from natural persons, the FCU Act does not provide any details

³⁹ 12 U.S.C.1757(9).

regarding the mechanisms FCUs may use to borrow.⁴⁰ Further, section 201(b)(7) of the FCU Act implicitly allows credit unions to issue securities.⁴¹ Conversely, nothing in section 1757(9) or other provisions of the FCU Act impose any specific restrictions or limitations on the mechanisms FCUs may employ to borrow; specific limiting language, examples or illustrative transactions or situations, or otherwise, do not exist to introduce specific restrictions or limitations. This stands in sharp contrast to many other subsections of section 1757 of the FCU Act which, for example, go into significant detail describing the types and terms of loans and extensions of credit that FCUs are permitted to make,⁴² and define the types of investments FCUs are permitted to make.⁴³ In

⁴⁰ In contrast, certain provisions of Title 12 of the United States Code relating to the regulation of other types of financial institutions expand on the institutions' basic authority to borrow money, including through the issuance of securities. For example, a Farm Credit System member is specifically authorized to:

- (a) Borrow money from or loan to any other institution of the System, borrow from any commercial bank or other lending institution, issue its notes or other evidence of debt on its own individual responsibility and full faith and credit, and invest its excess funds in such sums, at such times, and on such terms and conditions as it may determine.
- (b) Issue its own notes, bonds, debentures, or other similar obligations, fully collateralized as provided in section 2154(c) of this title by the notes, mortgages, and security instruments it holds in the performance of its functions under this chapter in such sums, maturities, rates of interest, and terms and conditions of each issue as it may determine with approval of the Farm Credit Administration.

12 U.S.C. 2153(a) (b).

⁴¹ Id. 1781(b)(7).

⁴² Id. 1757(5).

⁴³ Id. 1757(7); (15).

addition, the NCUA’s regulations do not impose any specific restrictions or limitations on the mechanisms an FCU may employ to borrow, through the use of specific limiting language, examples, illustrative transactions, or situations.

Overall, the lack of specific restrictions or limitations on the mechanisms that may be used and the specific authority granted in section 1757(9) to borrow “from any source” indicate that borrowings need not be limited to the types of arrangements typically entered into with banks, other credit unions, and other financial institutions (namely, loans, lines of credit, and similar arrangements). Further, the specific authority provided in section 1757(1) of the FCU Act that empowers FCUs to enter into contracts⁴⁴ further supports the conclusion that FCUs have the power to enter into a variety of different arrangements with respect to borrowing.⁴⁵ In addition, in the absence of specific restrictions and limitations, the “incidental powers” granted to FCUs in section 1757(17) of the FCU Act give significant discretion to FCUs with respect to how borrowings are effectuated.

Further support for the position that FCUs have the authority to issue debt securities may be found in U.S. GAAP treatment of items that fall in the category of

⁴⁴ Id. 1757(1).

⁴⁵ Typical loan and line of credit arrangements entered into with banks, other credit unions, and other financial institutions are clearly contractual in nature. Debt securities are also generally viewed as primarily contractual in nature, in large measure because of the terms of the securities themselves or the terms incorporated into the securities through an indenture, an issuing and paying agent agreement or similar agreement. This view of debt securities has been expressed in a wide variety of court cases. *See, e.g., Katz v. Oak Industries, Inc.*, 508 A.2d 873, 878 (Del. Ch. 1986) (“Under our law—and the law generally—the relationship between a corporation and the holders of its debt securities, even convertible debt securities, is contractual in nature.”).

“borrowings.” Under U.S. GAAP, liabilities relating to borrowed money are presented as indebtedness on an entity’s balance sheet, and the interest paid is presented as interest expense on its income statement whether the borrowings are related to typical loan transactions, advances under lines of credit, or the issuance of debt securities. While the details of the different types of indebtedness for borrowed money are presented as separate line items in an entity’s balance sheet and income statement, the treatment of “straight” indebtedness (indebtedness that does not have equity/residual ownership features, such as convertibility into shares) as liabilities, and interest paid thereon as interest expense, is essentially the same. In addition, while the details of the different types of indebtedness for borrowed money are presented as separate line items in the statement of cash flows, borrowings (whether in the form of loans from financial institutions or from the issuance of debt securities) are all presented in the “cash flows from financing activities” section of the statement.

Throughout this final rule, the Board has included requirements to ensure that any Subordinated Debt issued by an Issuing Credit Union would be properly characterized as debt in accordance with U.S. GAAP. These requirements, include that the Subordinated Debt or the Subordinated Debt Note, as applicable, must:

- Be in the form of a written, unconditional promise to pay on a specified date a sum certain in money in return for adequate consideration in money;

- Have, at the time of issuance, a fixed stated maturity of at least five years and not more than 20 years from issuance. The stated maturity of the Subordinated Debt Note may not reset and may not contain an option to extend the maturity; and
- Be properly characterized as debt in accordance with U.S. GAAP.

The Board notes that a FISCU’s legal authority to issue Subordinated Debt derives from applicable state law and regulation. For the Subordinated Debt issued by a FISCU to qualify as Regulatory Capital under this final rule, however, a FISCU must comply with all of the provisions of this rule, including the FISCU-specific provisions.

B. Board Authority to Design RBC Standards

In addition to credit unions’ authority to issue Subordinated Debt, the FCU Act provides the Board broad discretion to design the risk-based net worth standards.⁴⁶

Specifically, the FCU Act provides, in relevant part:

“The Board shall design the risk-based net worth requirement to take account of any material risks against which the net worth ratio required for an insured credit union to be “Adequately Capitalized” may not provide adequate protection.”⁴⁷

⁴⁶ As discussed previously, in 2015, the Board finalized a rule to replace the regulatory risk-based net worth requirement with an RBC requirement. This rule is effective January 1, 2022.

⁴⁷ 12 U.S.C. 1790d(d).

In designing such a risk-based net worth standard, Congress did not restrict the types of instruments the Board may include in its calculation of risk-based net worth, except that such calculation must take account of material risks that the Net Worth Ratio alone may not protect against. The Board, as discussed in this preamble, is proposing this rule to grant authority to LICUs, Complex Credit Unions, and New Credit Unions to issue Subordinated Debt that will count as Regulatory Capital. Based on the requirements in this final rule, the Board believes Subordinated Debt will be an additional tool that accounts for material risks faced by credit unions against which the Net Worth Ratio alone may not protect.

While the Board has broad discretion to create the risk-based net worth standard, it does not have the authority to amend the statutory definition of Net Worth. The statutory definition of Net Worth currently includes secondary capital issued by a LICU that is uninsured and subordinate to all claims against the LICU.⁴⁸ As such, the Board notes two points with respect to Subordinated Debt and Net Worth. First, Subordinated Debt issued by a non-LICU is not included in that credit union's Net Worth or Net Worth Ratio. Second, Subordinated Debt issued by a LICU after the effective date of this final rule will be included in that credit union's Net Worth and Net Worth Ratio.

V. REGULATORY PROCEDURES

⁴⁸ 12 U.S.C. 1790d(o)(2).

A. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3501 et seq.) requires that the Office of Management and Budget (OMB) approve all collections of information by a Federal agency from the public before they can be implemented. Respondents are not required to respond to any collection of information unless it displays a valid OMB control number. In accordance with the PRA, the information collection requirements included in this final rule have been submitted to OMB for approval under control number 3133-0207.

B. 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 final rule does 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 final rule does not constitute a policy that has federalism implications for purposes of the executive order.

C. Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this 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).

D. Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104-121) (SBREFA) generally provides for congressional review of agency rules. A reporting requirement is triggered in instances where the NCUA issues a final rule as defined by section 551 of the APA. An agency rule, in addition to being subject to congressional oversight, may also be subject to a delayed effective date if the rule is a “major rule.” The NCUA does not believe this rule is a “major rule” within the meaning of the relevant sections of SBREFA. As required by SBREFA, the NCUA will submit this final rule to the Office of Management and Budget for it to determine if the final rule is a “major rule” for purposes of SBREFA. After the Office of Management and Budget makes its determination, the NCUA will file all appropriate reports.

List of Subjects in 12 CFR Part 701

Advertising, Aged, Civil rights, Credit, Credit unions, Fair housing, Individuals with disabilities, Insurance, Marital status discrimination, Mortgages, Religious discrimination, Reporting and recordkeeping requirements, Sex discrimination, Signs and symbols, Surety bonds

List of Subjects in 12 CFR Part 702

Credit unions, Reporting and recordkeeping requirements

List of Subjects in 12 CFR Part 709

Claims, Credit unions

List of Subjects in 12 CFR Part 741

Bank deposit insurance, Credit unions, Reporting and recordkeeping requirements

By the NCUA Board on December 17, 2020.

Melane Conyers-Ausbrooks,

Secretary of the Board.

**PART 701—ORGANIZATION AND OPERATION OF FEDERAL CREDIT
UNIONS**

1. The authority citation for part 701 continues to read as follows:

Authority: 12 U.S.C. 1752(5), 1755, 1756, 1757, 1758, 1759, 1761a, 1761b, 1766, 1767, 1782, 1784, 1785, 1786, 1787, 1788, 1789. Section 701.6 is also authorized by 15 U.S.C. 3717. Section 701.31 is also authorized by 15 U.S.C. 1601 et seq.; 42 U.S.C. 1981 and 3601–3610. Section 701.35 is also authorized by 42 U.S.C. 4311–4312.

2. Add § 701.25 to read as follows:

§ 701.25 Loans to credit unions.

(a) *Limits.* A federal credit union may make loans, including investments in Subordinated Debt, to other credit unions, including corporate credit unions and privately insured credit unions, subject to the following limits:

(1) *Aggregate limit.* The aggregate principal amount of loans to other credit unions may not exceed 25 percent of the federal credit union’s paid-in and unimpaired capital and surplus.

(2) *Single borrower limit.* The aggregate principal amount of loans made to any one credit union may not exceed the greater of 15 percent of the federal credit union’s Net Worth, as defined in part 702 of this chapter, at the time of the closing of the loan or \$100,000, plus an additional 10 percent of the federal credit union’s Net Worth if the amount that exceeds the federal credit union’s 15 percent general limit is fully secured at all times with a perfected security interest by readily marketable collateral as defined in § 723.2 of this chapter.

(b) *Approval and policies.* A federal credit union's board of directors must approve all loans to other credit unions and establish written policies for making such loans. The written policies must, at a minimum, include the following:

(1) How the federal credit union will manage the credit risk of loans to other credit unions; and

(2) The limits on the aggregate principal amount of loans the federal credit union can make to other credit unions. The policies must specify the limits on the aggregate principal amount of loans the federal credit union can make to all other credit unions and the aggregate principal amount of loans the federal credit union can make to any single credit union; provided that any limits included in such policies do not exceed the limits in this section.

(c) *Investment in Subordinated Debt--(1) Eligibility.* A federal credit union may only invest, directly or indirectly, in the Subordinated Debt of federally insured, natural person credit unions, or in loans or obligations issued by a privately insured credit union that are subordinate to the private insurer; provided that the investing federal credit union:

(i) Has at the time of the investment, a capital classification of "Well Capitalized," as defined in part 702 of this chapter;

(ii) Does not have any outstanding Subordinated Debt or Grandfathered Secondary Capital, in each case with respect to which it was the Issuing Credit Union (as defined in part 702 of this chapter); and

(iii) Is not eligible to issue Subordinated Debt or Grandfathered Secondary Capital pursuant to an unexpired approval from the NCUA under subpart D of part 702 of this chapter.

(2) *Aggregate limit--(i) Aggregate limit.* A federal credit union's aggregate investment (direct or indirect) in the Subordinated Debt and Grandfathered Secondary Capital of any federally insured, natural person credit union, and in loans or obligations issued by a privately insured credit union that are subordinate to the private insurer, may not cause such aggregate investment to exceed, at the time of the investment, the lesser of:

(A) 25 percent of the investing federal credit union's Net Worth at the time of the investment; and

(B) Any amount of Net Worth in excess of seven percent (7%) of total assets.

(ii) *Calculation of aggregate limit.* The amount subject to the limit in subsection (A) of this section is calculated at the time of investment, and is based on a federal credit union's aggregate outstanding:

(A) Investment in Subordinated Debt;

(B) Investment in Grandfathered Secondary Capital;

(C) Investment in loans or obligations issued by a privately insured credit union that are subordinate to the private insurer; and

(D) Loans or portion of loans made by the credit union that is secured by any Subordinated Debt, Grandfathered Secondary Capital, or loans or obligations issued by a privately insured credit union that are subordinate to the private insurer.

(3) *Indirect investment.* A federal credit union must determine its indirect exposure by calculating its proportional ownership share of each exposure held in a fund, or similar indirect investment. The federal credit union's exposure to the fund is equal to the exposure held by the fund as if they were held directly by the federal credit union, multiplied by the federal credit union's proportional ownership share of the fund.

3. In § 701.34,

a. Revise the section heading;

b. Remove and reserve paragraph (b); and

c. Remove paragraphs (c) and (d) and Appendix to § 701.34.

The revision reads as follows:

§ 701.34 Designation of low income status.

* * * * *

4. Revise § 701.38 to read as follows:

§ 701.38 Borrowed funds.

(a) Federal credit unions may borrow funds from any source; provided that:

(1) The borrowing is evidenced by a written contract, such as a signed promissory note, that sets forth the terms and conditions including, at a minimum, maturity, prepayment, interest rate, method of computation of interest, and method of payment;

(2) The written contract and any solicitation with respect to such borrowing contain clear and conspicuous language indicating that:

(i) The funds represent money borrowed by the federal credit union; and

(ii) The funds do not represent shares and, therefore, are not insured by the National Credit Union Administration.

(b) A federal credit union is subject to the maximum borrowing authority of an aggregate amount not exceeding 50 percent of its paid-in and unimpaired capital and surplus. *Provided* that any federal credit union may discount with or sell to any federal intermediate credit bank any eligible obligations up to the amount of its paid-in and unimpaired capital (12 U.S.C. 1757(9)).

PART 702—CAPITAL ADEQUACY

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

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

6. In § 702.2:

a. Add a sentence after the first sentence of the introductory text;

b. Add a definition for “Grandfathered Secondary Capital” in alphabetical order;

c. Amend the definition of “Net Worth” by revising the introductory text and paragraphs (1) and (2); and

d. Add a definition for “Subordinated Debt” in alphabetical order.

The additions and revision read as follows:

§ 702.2 Definitions.

* * * All accounting terms not otherwise defined herein have the meanings assigned to them in accordance with United States generally accepted accounting principles (U.S. GAAP). * * *

* * * * *

Grandfathered Secondary Capital means any subordinated debt issued in accordance with § 701.34 of this chapter (recodified as § 702.414) or, in the case of a federally insured, state-chartered credit union, with § 741.204(c) of this chapter before January 1, 2022.

* * * * *

Net Worth means, with respect to any federally insured, natural person credit union, as of any date of determination:

(1) The retained earnings balance of the credit union at the most recent quarter end, as determined in accordance with U.S. GAAP, subject to paragraph (3) of this definition.

(2) With respect to a low-income designated credit union, the outstanding principal amount of Subordinated Debt treated as Regulatory Capital in accordance with § 702.407, and the outstanding principal amount of Grandfathered Secondary Capital treated as Regulatory Capital in accordance with § 702.414, in each case that is:

(i) Uninsured; and

(ii) Subordinate to all other claims against the credit union, including claims of creditors, shareholders, and the National Credit Union Share Insurance Fund.

* * * * *

Subordinated Debt has the meaning as provided in subpart D of this part.

* * * * *

7. In § 702.104, revise paragraph (b)(1)(vii) and add paragraph (c)(2)(v)(B)(9) to read as follows:

§ 702.104 Risk-based capital ratio.

* * * * *

(b) * * *

(1) * * *

(vii) The outstanding principal amount of Subordinated Debt treated as Regulatory Capital in accordance with § 702.407 and the outstanding principal amount of Grandfathered Secondary Capital treated as Regulatory Capital in accordance with § 702.414; and

* * * * *

(c) * * *

(2) * * *

(v) * * *

(B) * * *

(9) Natural person credit union Subordinated Debt, Grandfathered Secondary Capital, and loans or obligations issued by a privately insured credit union that are subordinate to the private insurer.

* * * * *

8. Amend § 702.109 by:

a. Redesignating paragraphs (a)(3) and (4) as paragraphs (a)(4) and (5), respectively;

b. Adding new paragraph (a)(3); and

c. Revising paragraph (b)(11).

The addition and revision read as follows:

§ 702.109 Prompt corrective action for critically undercapitalized credit unions.

(a) * * *

(3) *Restrictions on payments on Subordinated Debt.* Beginning 60 days after the effective date of a federally insured, natural person credit union being classified by the NCUA as “Critically Undercapitalized”, that credit union shall not pay principal of or

interest on its Subordinated Debt, except that unpaid interest shall continue to accrue under the terms of the related Subordinated Debt Note (as defined in subpart D of this part), to the extent permitted by law;

* * * * *

(b) * * *

(11) *Restrictions on payments on Grandfathered Secondary Capital.* Beginning 60 days after the effective date of classification of a credit union as “Critically Undercapitalized”, prohibit payments of principal, dividends or interest on the credit union’s Grandfathered Secondary Capital (as defined in subpart D of this part), except that unpaid dividends or interest shall continue to accrue under the terms of the account to the extent permitted by law;

* * * * *

10. Revise § 702.205(d) to read as follows:

§ 702.205 Prompt corrective action for uncapped new credit unions.

* * * * *

(d) *Discretionary liquidation of an uncapitalized new credit union.* In lieu of paragraph (c) of this section, an uncapitalized new credit union may be placed into liquidation on grounds of insolvency pursuant to 12 U.S.C. 1787(a)(1)(A).

§ 702.206 [Amended]

11. Amend § 702.206 by removing paragraph (d), and redesignating paragraphs (e) through (h) as (d) through (g), respectively.

12. Redesignate §§ 702.207 through 702.210 as §§ 702.208 through 702.211, respectively, and add new § 702.207 to read as follows:

§ 702.207 Consideration of Subordinated Debt and Grandfathered Secondary Capital for new credit unions.

(a) *Exception from prompt corrective action for new credit unions.* The requirements of §§ 702.204 and 702.205 do not apply to a new credit union if, as of the applicable date of determination, each of the following conditions is satisfied:

(1) The new credit union has outstanding Subordinated Debt or Grandfathered Secondary Capital;

(2) The Subordinated Debt or Grandfathered Secondary Capital would be treated as Regulatory Capital under subpart D of this part if the new credit union were a Complex Credit Union or a low income-designated credit union;

(3) The ratio of the new credit union's Net Worth (including the amount of its Subordinated Debt and Grandfathered Secondary Capital treated as Regulatory Capital (as defined in subpart D of this part)) to its total assets is at least seven percent (7%); and

(4) The new credit union's Net Worth is increasing in a manner consistent with the new credit union's approved initial business plan or RBP.

(b) *Consideration of Subordinated Debt and Grandfathered Secondary Capital in evaluating an RBP.* The NCUA shall, in evaluating an RBP under this subpart B, consider a new credit union's aggregate outstanding principal amount of Subordinated Debt and Grandfathered Secondary Capital.

(c) *Prompt corrective action based on other supervisory criteria--(1)*
Application of prompt corrective action to an exempt new credit union. The NCUA Board may apply prompt corrective action to a new credit union that is otherwise exempt under paragraph (a) of this section in the following circumstances:

(i) *Unsafe or unsound condition.* The NCUA Board has determined, after providing the new credit union with written notice and opportunity for hearing pursuant

to § 747.2003 of this chapter, that the new credit union is in an unsafe or unsound condition; or

(ii) *Unsafe or unsound practice.* The NCUA Board has determined, after providing the new credit union with written notice and opportunity for hearing pursuant to § 747.2003 of this chapter, that the new credit union has not corrected a material unsafe or unsound practice of which it was, or should have been, aware.

(2) *Non-delegation.* The NCUA Board may not delegate its authority under paragraph (c) of this section.

(3) *Consultation with state officials.* The NCUA Board shall consult and seek to work cooperatively with the appropriate state official before taking action under paragraph (c) of this section and shall promptly notify the appropriate state official of its decision to take action under paragraph (c) of this section.

(d) *Discretionary liquidation.* Notwithstanding paragraph (a) of this section, the NCUA may place a new credit union into liquidation pursuant to 12 U.S.C. 1787(a)(3)(A), provided that the new credit union's ratio under paragraph (a)(3) of this section is, as of the applicable date of determination, below six percent (6%) and the new credit union has no reasonable prospect of becoming "Adequately Capitalized" under § 702.202.

(e) *Restrictions on payments on Subordinated Debt.* Beginning 60 days after the effective date of a new credit union being classified by the NCUA as “Uncapitalized”, the new credit union shall not pay principal of or interest on its Subordinated Debt, except that unpaid interest shall continue to accrue under the terms of the related Subordinated Debt Note, to the extent permitted by law.

13. Redesignate subparts D and E as subparts E and F, respectively, and add new subpart D to read as follows:

Subpart D—Subordinated Debt, Grandfathered Secondary Capital, and Regulatory

Capital

Sec.

702.401 Purpose and scope.

702.402 Definitions.

702.403 Eligibility.

702.404 Requirements of the Subordinated Debt and Subordinated Debt Note.

702.405 Disclosures.

702.406 Requirements related to the offer, sale, and issuance of Subordinated Debt Notes.

702.407 Discounting of amount treated as Regulatory Capital.

702.408 Preapproval to issue Subordinated Debt.

702.409 Preapproval for federally insured, state-chartered credit unions to issue Subordinated Debt.

702.410 Interest payments on Subordinated Debt.

702.411 Prior written approval to prepay Subordinated Debt.

702.412 Effect of a merger or dissolution on the treatment of Subordinated Debt as Regulatory Capital.

702.413 Repudiation safe harbor.

702.414 Regulations governing Grandfathered Secondary Capital.

Appendix A to Subpart D of Part 702-- Disclosure and Acknowledgement Form

Subpart D—Subordinated Debt, Grandfathered Secondary Capital, and Regulatory Capital

§ 702.401 Purpose and scope.

(a) *Subordinated Debt.* This subpart sets forth the requirements applicable to all Subordinated Debt issued by a federally insured, natural person credit union, including the NCUA's review and approval of that credit union's application to issue or prepay Subordinated Debt. This subpart shall apply to a federally insured, state-chartered credit union only to the extent that such federally insured, state-chartered credit union is

permitted by applicable state law to issue debt instruments of the type described in this subpart. To the extent that such state law is more restrictive than this subpart with respect to the issuance of such debt instruments, that state law shall apply. Any secondary capital, as that term is used in the Federal Credit Union Act, issued after January 1, 2022, is Subordinated Debt and subject to the requirements of this subpart.

(b) *Grandfathered Secondary Capital.* Any secondary capital issued under § 701.34 of this chapter before January 1, 2022, is governed by § 702.414.

Grandfathered Secondary Capital will no longer be treated as Regulatory Capital as of January 1, 2042.

§ 702.402 Definitions.

To the extent they differ, the definitions in this section apply only to Subordinated Debt and not to Grandfathered Secondary Capital. (Definitions applicable to Grandfathered Secondary Capital are in § 702.414.) All other terms in this subpart and not expressly defined herein have the meanings assigned to them elsewhere in this part. For ease of use, certain key terms are included below using cross citations to other sections of this part where those terms are defined.

Accredited Investor means a Natural Person Accredited Investor or an Entity Accredited Investor, as applicable.

Appropriate Supervision Office means, with respect to any credit union, the Regional Office or Office of National Examinations and Supervision that is responsible for supervision of that credit union.

Complex Credit Union has the same meaning as in subpart A of this part.

Entity Accredited Investor means an entity that, at the time of offering and closing of the issuance and sale of Subordinated Debt to that entity, meets the requirements of 17 CFR 230.501(a).

Grandfathered Secondary Capital means any subordinated debt issued in accordance with § 701.34 of this chapter (recodified as § 702.414 of subpart D of this part) or, in the case of a federally insured, state-chartered credit union, with § 741.204(c) of this chapter, before January 1, 2022.

Immediate Family Member means spouse, child, sibling, parent, grandparent, or grandchild (including stepparents, stepchildren, stepsiblings, and adoptive relationships).

Issuing Credit Union means, for purposes of this subpart, a credit union that has issued, or is in the process of issuing, Subordinated Debt or Grandfathered Secondary Capital in accordance with the requirements of this subpart.

Low-income Designated Credit Union (LICU) is a credit union designated as having low-income status in accordance with § 701.34 of this chapter.

Natural Person Accredited Investor means a natural person who, at the time of offering and closing of the issuance and sale of Subordinated Debt to that person, meets the requirements of 17 CFR 230.501(a); *provided* that, for purposes of purchasing or holding any Subordinated Debt Note, this term shall not include any board member or Senior Executive Officer of the Issuing Credit Union or any Immediate Family Member of any board member or Senior Executive Officer of the Issuing Credit Union.

Net Worth has the same meaning as in § 702.2.

Net Worth Ratio has the same meaning as in § 702.2.

New Credit Union has the same meaning as in § 702.201.

Offering Document means the document(s) required by § 702.408, including any term sheet, offering memorandum, private placement memorandum, offering circular, or other similar document used to offer and sell Subordinated Debt Notes.

Pro Forma Financial Statements means projected financial statements that show the effects of proposed transactions as if they actually occurred in a variety of plausible scenarios, including both optimistic and pessimistic assumptions, over measurement horizons that align with the credit union's expected activities.

Qualified Counsel means an attorney licensed to practice law in the relevant jurisdiction(s) who has expertise in the areas of federal and state securities laws and debt transactions similar to those described in this subpart.

Regulatory Capital means:

(1) With respect to an Issuing Credit Union that is a LICU and not a Complex Credit Union, the aggregate outstanding principal amount of Subordinated Debt and, until January 1, 2042, Grandfathered Secondary Capital that is included in the credit union's Net Worth Ratio;

(2) With respect to an Issuing Credit Union that is a Complex Credit Union and not a LICU, the aggregate outstanding principal amount of Subordinated Debt that is included in the credit union's RBC Ratio;

(3) With respect to an Issuing Credit Union that is both a LICU and a Complex Credit Union, the aggregate outstanding principal amount of Subordinated Debt and, until January 1, 2042, Grandfathered Secondary Capital that is included in its Net Worth Ratio and in its RBC Ratio; and

(4) With respect to a New Credit Union, the aggregate outstanding principal amount of Subordinated Debt and, until January 1, 2042, Grandfathered Secondary Capital that is considered pursuant to § 702.207.

Retained Earnings has the same meaning as in United States GAAP.

RBC Ratio has the same meaning as in § 702.2.

Senior Executive Officer means a credit union's chief executive officer (for example, president or treasurer/manager), any assistant chief executive officer (e.g., any assistant president, any vice president or any assistant treasurer/manager) and the chief financial officer (controller). The term "Senior Executive Officer" also includes employees and contractors of an entity, such as a consulting firm, hired to perform the functions of positions covered by the term Senior Executive Officer.

Subordinated Debt means an Issuing Credit Union's borrowing that meets the requirements of this subpart, including all obligations and contracts related to such borrowing.

Subordinated Debt Note means the written contract(s) evidencing the Subordinated Debt.

§ 702.403 Eligibility.

(a) Subject to receiving approval under § 702.408 or 702.409, a credit union may issue Subordinated Debt only if, at the time of such issuance, the credit union is:

(1) A Complex Credit Union with a capital classification of at least “Undercapitalized,” as defined in § 702.102;

(2) A LICU;

(3) Able to demonstrate to the satisfaction of the NCUA that it reasonably anticipates becoming either a Complex Credit Union meeting the requirements of paragraph (a)(1) of this section or a LICU within 24 months after issuance of the Subordinated Debt Notes; or

(4) A new credit union with Retained Earnings equal to or greater than one percent (1%) of assets.

(b) At the time of issuance of any Subordinated Debt, an Issuing Credit Union may not have any investments, direct or indirect, in Subordinated Debt or Grandfathered Secondary Capital (or any interest therein) of another credit union. If a credit union acquires Subordinated Debt or Grandfathered Secondary Capital in a merger or other consolidation, the Issuing Credit Union may still issue Subordinated Debt, but it may not invest (directly or indirectly) in the Subordinated Debt or Grandfathered Secondary Capital of any other credit union while any Subordinated Debt Notes issued by the Issuing Credit Union remain outstanding.

(c) If the Issuing Credit Union is a Complex Credit Union that is not also a LICU, the aggregate outstanding principal amount of all Subordinated Debt issued by that

Issuing Credit Union may not exceed 100 percent of its Net Worth, as determined at the time of each issuance of Subordinated Debt.

§ 702.404 Requirements of the Subordinated Debt and Subordinated Debt Note.

(a) *Requirements.* At a minimum, the Subordinated Debt or the Subordinated Debt Note, as applicable, must:

(1) Be in the form of a written, unconditional promise to pay on a specified date a sum certain in money in return for adequate consideration in money;

(2) Have, at the time of issuance, a fixed stated maturity of at least five years and not more than 20 years from issuance. The stated maturity of the Subordinated Debt Note may not reset and may not contain an option to extend the maturity;

(3) Be subordinate to all other claims in liquidation under § 709.5(b) of this chapter, and have the same payout priority as all other outstanding Subordinated Debt and Grandfathered Secondary Capital;

(4) Be properly characterized as debt in accordance with U.S. GAAP;

(5) Be unsecured, including, without limitation, prohibiting the establishment of any legally enforceable claim against funds earmarked for payment of the Subordinated Debt through:

(i) A compensating balance or any other funds or assets subject to a legal right of offset, as defined by applicable state law; or

(ii) A sinking fund, such as a fund formed by periodically setting aside money for the gradual repayment of the Subordinated Debt.

(6) Be applied by the Issuing Credit Union at the end of each of its fiscal years (or more frequently as determined by the Issuing Credit Union) in which the Subordinated Debt remains outstanding to cover any deficit in Retained Earnings on a pro rata basis among all holders of the Subordinated Debt and Grandfathered Secondary Capital of the Issuing Credit Union; it being understood that any amounts applied to cover a deficit in Retained Earnings shall no longer be considered due and payable to the holder(s) of the Subordinated Debt or Grandfathered Secondary Capital;

(7) Except as provided in §§ 702.411 and 702.412(c), be payable in full by the Issuing Credit Union or its successor or assignee only at maturity;

(8) Disclose any prepayment penalties or restrictions on prepayment;

(9) Be offered, issued, and sold only to Entity Accredited Investors or Natural Person Accredited Investors, in accordance § 702.406; and

(10) Be re-offered, reissued, and resold only to an Entity Accredited Investor (if the initial offering, issuance, and sale was solely made to Entity Accredited Investors) or

any Accredited Investor (if the initial offering, issuance, and sale involved one or more Natural Person Accredited Investors).

(b) *Restrictions.* The Subordinated Debt or the Subordinated Debt Note, as applicable, must not:

(1) Be structured or identified as a share, share account, or any other instrument in the Issuing Credit Union that is insured by the National Credit Union Administration;

(2) Include any express or implied terms that make it senior to any other Subordinated Debt issued under this subpart or Grandfathered Secondary Capital;

(3) Cause the Issuing Credit Union to exceed the borrowing limit in § 741.2 of this chapter or, for federally insured, state-chartered credit unions, any more restrictive state borrowing limit;

(4) Provide the holder thereof with any management or voting rights in the Issuing Credit Union;

(5) Be eligible to be pledged or provided by the investor as security for a loan from, or other obligation owing to, the Issuing Credit Union;

(6) Include any express or implied term, condition, or agreement that would require the Issuing Credit Union to prepay or accelerate payment of principal of or interest on the Subordinated Debt prior to maturity, including investor put options;

(7) Include an express or implied term, condition, or agreement that would trigger an event of default based on the Issuing Credit Union's default on other debts;

(8) Include any condition, restriction, or requirement based on the Issuing Credit Union's credit quality or other credit-sensitive feature; or

(9) Require the Issuing Credit Union to make any form of payment other than in cash.

(c) *Negative covenants.* A Subordinated Debt Note must not include any provision or covenant that unduly restricts or otherwise acts to unduly limit the authority of the Issuing Credit Union or interferes with the NCUA's supervision of the Issuing Credit Union. This includes, but is not limited to, a provision or covenant that:

(1) Requires the Issuing Credit Union to maintain a minimum amount of Retained Earnings or other metric, such as a minimum Net Worth Ratio or minimum asset, liquidity, or loan ratios;

(2) Unreasonably restricts the Issuing Credit Union's ability to raise capital through the issuance of additional Subordinated Debt;

(3) Provides for default of the Subordinated Debt as a result of the Issuing Credit Union's compliance with any law, regulation, or supervisory directive from the NCUA or, if applicable, the state supervisory authority;

(4) Provides for default of the Subordinated Debt as the result of a change in the ownership, management, or organizational structure or charter of the Issuing Credit Union; provided that, following such change, the Issuing Credit Union or the resulting institution, as applicable:

(i) Agrees to perform all of the obligations, terms, and conditions of the Subordinated Debt; and

(ii) At the time of such change, is not in material default of any provision of the Subordinated Debt Note, after giving effect to the applicable cure period described in paragraph (d) of this section.

(5) Provides for default of the Subordinated Debt as the result of an act or omission of any third party, including but not limited to a credit union service organization, as defined in § 712.1(d) of this chapter.

(d) *Default covenants.* A Subordinated Debt Note that includes default covenants must provide the Issuing Credit Union with a reasonable cure period of not less than 30 calendar days.

(e) Minimum denominations of issuances to Natural Person Accredited Investors.

An Issuing Credit Union may only issue Subordinated Debt Notes to Natural Person Accredited Investors in minimum denominations of \$100,000, and cannot exchange any such Subordinated Debt Notes after the initial issuance or any subsequent resale for Subordinated Debt Notes of the Issuing Credit Union in denominations less than \$10,000. Each such Subordinated Debt Note, if issued in certificate form, must include a legend disclosing that it cannot be exchanged for Subordinated Debt Notes of the Issuing Credit Union in denominations less than \$100,000, and Subordinated Debt Notes issued in book-entry or other uncertificated form shall include appropriate instructions prohibiting the exchange of such Subordinated Debt Notes for Subordinated Debt Notes of the Issuing Credit Union in denominations that would violate the foregoing restrictions.

§ 702.405 Disclosures.

(a) An Issuing Credit Union must disclose the following language clearly, in all capital letters, on the face of a Subordinated Debt Note:

- 1 • THIS OBLIGATION IS NOT A SHARE IN THE ISSUING CREDIT UNION AND IS NOT INSURED BY
2 THE NATIONAL CREDIT UNION ADMINISTRATION.
- 3 • THIS OBLIGATION IS UNSECURED AND SUBORDINATE TO ALL CLAIMS AGAINST THE
4 ISSUING CREDIT UNION AND IS INELIGIBLE AS COLLATERAL FOR A LOAN BY THE ISSUING
5 CREDIT UNION.
- 6 • AMOUNTS OTHERWISE PAYABLE HEREUNDER MAY BE REDUCED IN ORDER TO COVER ANY
7 DEFICIT IN RETAINED EARNINGS OF THE ISSUING CREDIT UNION. AMOUNTS APPLIED TO
8 COVER ANY SUCH DEFICIT WILL RESULT IN A CORRESPONDING REDUCTION OF THE
9 PRINCIPAL AMOUNT OF ALL OUTSTANDING SUBORDINATED DEBT ISSUED BY THE ISSUING
10 CREDIT UNION, AND WILL NO LONGER BE DUE AND PAYABLE TO THE HOLDERS OF SUCH
11 SUBORDINATED DEBT. AMOUNTS APPLIED TO COVER ANY SUCH DEFICIT MUST BE
12 APPLIED AMONG ALL HOLDERS OF SUCH SUBORDINATED DEBT PRO RATA BASED ON THE
13 AGGREGATE AMOUNT OF SUBORDINATED DEBT OWED BY THE ISSUING CREDIT UNION TO
14 EACH SUCH HOLDER AT THE TIME OF APPLICATION.
- 15 • THIS OBLIGATION CAN ONLY BE REPAID AT MATURITY OR IN ACCORDANCE WITH 12
16 CFR 702.411. THIS OBLIGATION MAY ALSO BE REPAID IN ACCORDANCE WITH 12 CFR
17 PART 710 IF THE ISSUING CREDIT UNION VOLUNTARILY LIQUIDATES.
- 18 • THE NOTE EVIDENCING THIS OBLIGATION HAS NOT BEEN AND WILL NOT BE REGISTERED
19 UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), OR THE
20 SECURITIES LAWS OF ANY STATE OF THE UNITED STATES OR ANY OTHER JURISDICTION,
21 AND MAY BE ISSUED, SOLD, PLEDGED, OR OTHERWISE TRANSFERRED ONLY (A) AS
22 PERMITTED IN THE NOTE AND TO A PERSON WHOM THE ISSUER OR SELLER REASONABLY
23 BELIEVES IS [AN “ACCREDITED INVESTOR” (AS DEFINED IN 12 CFR 702.402)] [AN “ENTITY
24 ACCREDITED INVESTOR” (AS DEFINED IN 12 CFR 702.402)] (THAT IS NOT A MEMBER OF THE
25 ISSUING CREDIT UNION’S BOARD, A SENIOR EXECUTIVE OFFICER OF THE ISSUING CREDIT

26 UNION (AS THAT TERM IS DEFINED IN 12 CFR 702.402), OR ANY IMMEDIATE FAMILY
27 MEMBER OF ANY SUCH BOARD MEMBER OR SENIOR EXECUTIVE OFFICER), PURCHASING
28 FOR ITS OWN ACCOUNT, (1) TO WHOM NOTICE IS GIVEN THAT THE SALE, PLEDGE, OR
29 OTHER TRANSFER IS BEING MADE IN RELIANCE ON THE EXEMPTION FROM SECURITIES ACT
30 REGISTRATION PROVIDED BY SECTION 3(a)(5) OF THE SECURITIES ACT, OR (2) IN
31 ACCORDANCE WITH ANOTHER EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF
32 THE SECURITIES ACT (SUBJECT TO THE DELIVERY OF SUCH CERTIFICATIONS, LEGAL
33 OPINIONS, OR OTHER INFORMATION AS THE ISSUING CREDIT UNION MAY REASONABLY
34 REQUIRE TO CONFIRM THAT SUCH SALE, PLEDGE, OR TRANSFER IS BEING MADE
35 PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE
36 REGISTRATION REQUIREMENTS OF THE SECURITIES ACT), (B) IN COMPLIANCE WITH THE
37 CERTIFICATION AND OTHER REQUIREMENTS SPECIFIED IN THE [INDENTURE OR OTHER
38 DOCUMENT PURSUANT TO WHICH THE SUBORDINATED DEBT NOTE IS ISSUED] REFERRED
39 TO HEREIN, AND (C) IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY
40 STATE OF THE UNITED STATES AND ANY OTHER APPLICATION JURISDICTION.

41 (b) An Issuing Credit Union must also clearly and accurately disclose in the Subordinated
42 Debt Note:

43 (1) The payout priority and level of subordination, as described in § 709.5(b) of this
44 chapter, that would apply in the event of the involuntary liquidation of the Issuing Credit Union;

45 (2) A general description of the NCUA’s regulatory authority that includes, at a
46 minimum:

47 (i) If the Issuing Credit Union is “Undercapitalized” or, if the Issuing Credit Union is a
48 New Credit Union, “Moderately Capitalized” (each as defined in this part), and fails to submit an

49 acceptable Net Worth restoration plan, capital restoration plan, or revised business plan, as
50 applicable, or materially fails to implement such a plan that was approved by the NCUA, the
51 Issuing Credit Union may be subject to all of the additional restrictions and requirements
52 applicable to a “Significantly Undercapitalized” credit union or, if the Issuing Credit Union is a
53 New Credit Union, a “Marginally Capitalized” New Credit Union;

54 (ii) Beginning 60 days after the effective date of an Issuing Credit Union being classified
55 as “Critically Undercapitalized” or, in the case of a New Credit Union, “Uncapitalized,” the
56 Issuing Credit Union shall not pay principal of or interest on its Subordinated Debt, until
57 reauthorized to do so by the NCUA; provided, however, that unpaid interest shall continue to
58 accrue under the terms of the Subordinated Debt Note, to the extent permitted by law.

59 (3) The risk factors associated with the NCUA’s or, if applicable, the state supervisory
60 authority’s, authority to conserve or liquidate a credit union under the Federal Credit Union Act
61 (FCU Act) or applicable state law.

62 **§ 702.406 Requirements related to the offer, sale, and issuance of Subordinated Debt**
63 **Notes.**

64 (a) *Offering Document.* An Issuing Credit Union or person acting on behalf of or at the
65 direction of any Issuing Credit Union may only issue and sell Subordinated Debt Notes if, a
66 reasonable time prior to the issuance and sale of any Subordinated Debt Notes, each purchaser of
67 a Subordinated Debt Note receives an Offering Document that meets the requirements of

68 § 702.408(e) and such further material information, if any, as may be necessary to make the
69 required disclosures in that Offering Document, in the light of the circumstances under which
70 they are made, not misleading.

71 (b) *Territorial limitations.* An Issuing Credit Union may only offer, issue, and sell
72 Subordinated Debt Notes in the United States of America (including any one of the states thereof
73 and the District of Columbia), its territories, and its possessions. This limitation includes a
74 prohibition on non-U.S. investors holding or purchasing Subordinated Debt Notes.

75 (c) *Accredited Investors.* An Issuing Credit Union may only offer, issue, and sell
76 Subordinated Debt to Accredited Investors, and the terms of any Subordinated Debt Note must
77 include the restrictions in § 702.404(a)(10); provided that no Subordinated Debt Note may be
78 issued, sold, resold, pledged, or otherwise transferred to a member of the board of the Issuing
79 Credit Union, any Senior Executive Officer of the Issuing Credit Union, or any Immediate
80 Family Member of any such board member or Senior Executive Officer. Prior to the offer of any
81 Subordinated Debt Note, the Issuing Credit Union must receive a signed, unambiguous
82 certification from any potential investor of a Subordinated Debt Note. The certification must be
83 in substantially the following form:

84 **CERTIFICATE OF ACCREDITED INVESTOR STATUS**

85 Except as may be indicated by the undersigned below, the undersigned is an accredited
86 investor, as that term is defined in Regulation D under the Securities Act of 1933, as amended (the
87 "Act"). In order to demonstrate the basis on which it is representing its status as an accredited investor,

88 the undersigned has checked one of the boxes below indicating that the undersigned is:

89 Any bank as defined in section 3(a)(2) of the Act, or any savings and loan
90 association or other institution as defined in section 3(a)(5)(A) of the Act whether acting in
91 its individual or fiduciary capacity; any broker or dealer registered pursuant to section 15 of
92 the Securities Exchange Act of 1934; any investment adviser registered pursuant to section
93 203 of the Investment Advisers Act of 1940 or registered pursuant to the laws of a state; any
94 investment adviser relying on the exemption from registering with the Securities and
95 Exchange Commission under section 203(l) or (m) of the Investment Advisers Act of 1940;
96 any insurance company as defined in section 2(a)(13) of the Act; any investment company
97 registered under the Investment Company Act of 1940 or a business development company
98 as defined in section 2(a)(48) of that act; any Small Business Investment Company licensed
99 by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business
100 Investment Act of 1958; any Rural Business Investment Company as defined in section
101 384A of the Consolidated Farm and Rural Development Act; any plan established and
102 maintained by a state, its political subdivisions, or any agency or instrumentality of a state or
103 its political subdivisions, for the benefit of its employees, if such plan has total assets in
104 excess of \$5,000,000; any employee benefit plan within the meaning of the Employee
105 Retirement Income Security Act of 1974 if the investment decision is made by a plan
106 fiduciary, as defined in section 3(21) of such act, which is either a bank, savings and loan
107 association, insurance company, or registered investment adviser, or if the employee benefit
108 plan has total assets in excess of \$5,000,000 or, if a self-directed plan, with investment
109 decisions made solely by persons that are accredited investors; A private business
110 development company as defined in section 202(a)(22) of the Investment Advisers Act of
111 1940;

112 Any organization described in section 501(c)(3) of the Internal Revenue Code,
113 corporation, Massachusetts or similar business trust, partnership, or limited liability company, not
114 formed for the specific purpose of acquiring the securities offered, with total assets in excess of
115 \$5,000,000; Any natural person whose individual net worth, or joint net worth with that

116 person's spouse or spousal equivalent, exceeds \$1,000,000; (excluding the value of the person's
117 primary residence)). For the purposes of calculating joint net worth in this paragraph: joint net
118 worth can be the aggregate net worth of the investor and spouse or spousal equivalent; assets need
119 not be held jointly to be included in the calculation;

120 Any natural person who had an individual income in excess of \$200,000 in each
121 of the two most recent years or joint income with that person's spouse or spousal equivalent in
122 excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same
123 income level in the current year; A trust with total assets in excess of \$5,000,000, not formed
124 for the specific purpose of acquiring the securities offered, whose purchase is directed by a person
125 who has such knowledge and experience in financial and business matters that he or she is capable
126 of evaluating the merits and risks of the prospective investment;

127 An entity in which all of the equity holders are accredited investors by virtue of
128 their meeting one or more of the above standards;

129 Any entity, of a type not listed in paragraphs (a)(1), (2), (3), (7), or (8) of 17
130 CFR § 230.501(a), not formed for the specific purpose of acquiring the securities offered, owning
131 investments in excess of \$5,000,000;

132 Any natural person holding in good standing one or more professional
133 certifications or designations or credentials from an accredited educational institution that the
134 Securities and Exchange Commission has designated as qualifying an individual for accredited
135 investor status;

136 Any natural person who is a "knowledgeable employee," as defined in rule
137 3c5(a)(4) under the Investment Company Act of 1940 (17 CFR 270.3c-5(a)(4)), of the issuer of
138 the securities being offered or sold where the issuer would be an investment company, as defined
139 in section 3 of such act, but for the exclusion provided by either section 3(c)(1) or section 3(c)(7)
140 of such act;

141 Any “family office,” as defined in rule 202(a)(11)(G)-1 under the Investment
142 Advisers Act of 1940 (17 CFR 275.202(a)(11)(G)-1): (i) With assets under management in excess
143 of \$5,000,000, (ii) That is not formed for the specific purpose of acquiring the securities offered,
144 and (iii) Whose prospective investment is directed by a person who has such knowledge and
145 experience in financial and business matters that such family office is capable of evaluating the
146 merits and risks of the prospective investment; and

147 Any “family client,” as defined in rule 202(a)(11)(G)-1 under the Investment
148 Advisers Act of 1940 (17 CFR 275.202(a)(11)(G)-1)), of a family office meeting the requirements
149 in paragraph (a)(12) of this section and whose prospective investment in the issuer is directed by
150 such family office pursuant to paragraph (a)(12)(iii).

151 The undersigned understands that [NAME OF ISSUING CREDIT UNION] (the “Credit
152 Union”) is required to verify the undersigned’s accredited investor status AND ELECTS TO DO ONE
153 OF THE FOLLOWING:

154 Allow the Credit Union’s representative to review the undersigned’s tax returns for the
155 two most recently completed years and provide a written representation of the undersigned’s reasonable
156 expectation of reaching the income level necessary to qualify as an accredited investor during the current
157 year;

158 Allow the Credit Union’s representative to: (1) obtain a written representation from the
159 undersigned that states that all liabilities necessary to make a determination of net worth have been
160 disclosed; and (2) review one or more of the following types of documentation dated within the past three
161 months: bank statements, brokerage statements, tax assessments, appraisal reports as to assets, or a
162 consumer report from a nationwide consumer reporting agency;

163 Provide the Credit Union with a written confirmation from one of the following
164 persons or entities that such person or entity has taken reasonable steps to verify that the undersigned is
165 an accredited investor within the prior three months and has determined that the undersigned is an

166 accredited investor:

- 167 • A registered broker-dealer;
- 168 • An investment adviser registered with the Securities Exchange Commission;
- 169 • A licensed attorney who is in good standing under the laws of the jurisdictions in which such attorney is
170 admitted to practice law; or
- 171 • A certified public accountant who is duly registered and in good standing under the laws of the place of
172 such accountant's residence or principal office.

173 IN WITNESS WHEREOF, the undersigned has executed this Certificate of Accredited Investor Status
174 effective as of _____, 20_____.

175 _____
176 Name of Investor

177 _____
178 [Name of Authorized Representative

179 _____
180 Title of Authorized Representative]

181 _____
182 Signature

183 _____
184 Address

185 _____
186 Address

187 _____
188 Phone Number

189 _____
190 Email Address

191 (d) *Use of trustees.* If using a trustee in connection with the offer, issuance, and sale of
192 Subordinated Debt Notes, the trustee must meet the requirements set forth in the Trust Indenture
193 Act of 1939, as amended, and any rules promulgated thereunder, including requirements for
194 qualification set forth in section 310 thereof, and any applicable state law.

195 (e) *Offers, issuances, and sales of Subordinated Debt Notes.* Offers issuances, and sales
196 of Subordinated Debt Notes are required to be made in accordance with the following
197 requirements:

198 (1) *Application to offer, issue, and sell at offices of Issuing Credit Union.* If the Issuing
199 Credit Union intends to offer and sell Subordinated Debt Notes at one or more of its offices, the
200 Issuing Credit Union must first apply in writing to the Appropriate Supervision Office indicating
201 that it intends to offer, issue, and sell Subordinated Debt Notes at one or more of its offices. The
202 application must include, at a minimum, the physical locations of such offices and a description
203 of how the Issuing Credit Union will comply with the requirements of this subsection;

204 (2) *Decision on application.* Within 60 calendar days (which may be extended by the
205 Appropriate Supervision Office) after the date of receipt of a complete application described in
206 paragraph (e)(1) of this section, the Appropriate Supervision Office will provide the Issuing
207 Credit Union with a written determination on its application to conduct offering and sales
208 activity from its office(s). Any denial of an Issuing Credit Union’s application under this section
209 will include the reasons for such denial;

210 (3) *Commissions, bonuses, or comparable payments.* In connection with any offering
211 and sale of Subordinated Debt Notes (whether or not conducted at offices of the Issuing Credit
212 Union), an Issuing Credit Union shall not pay, directly or indirectly, any commissions, bonuses,
213 or comparable payments to any employee of the Issuing Credit Union or any affiliated Credit
214 Union Service Organizations (CUSOs) assisting with the offer, issuance, and sale of such
215 Subordinated Debt Notes, or to any other person in connection with the offer, issuance, and sale
216 of Subordinated Debt Notes; except that compensation and commissions consistent with industry
217 norms may be paid to securities personnel of registered broker-dealers as otherwise permitted by
218 applicable law;

219 (4) *Issuances by tellers.* No offers or sales may be made by tellers at the teller counter of
220 any Issuing Credit Union, or by comparable persons at comparable locations;

221 (5) *Permissible issuing personnel.* In connection with an offering or sale of
222 Subordinated Debt Notes (whether or not conducted at offices of the Issuing Credit Union), such
223 activity may be conducted only by regular, full-time employees of the Issuing Credit Union or by

224 securities personnel who are subject to supervision by a registered broker-dealer, which
225 securities personnel may be employees of the Issuing Credit Union's affiliated CUSO that is
226 assisting the Issuing Credit Union with the offer, issuance, and sale of the Subordinated Debt
227 Notes;

228 (6) *Issuance practices, advertisements, and other literature used in connection with the*
229 *offer and sale of Subordinated Debt Notes.* In connection with an offering or sale of
230 Subordinated Debt Notes (whether or not conducted at offices of the Issuing Credit Union),
231 issuance practices, advertisements, and other issuance literature used in connection with offers
232 and issuances of Subordinated Debt Notes by Issuing Credit Unions or any affiliated CUSOs
233 assisting with the offer and issuance of such Subordinated Debt Notes shall be subject to the
234 requirements of this subpart; and

235 (7) *Office of an Issuing Credit Union.* For purposes of this subsection, an "office" of an
236 Issuing Credit Union means any premises used by the Issuing Credit Union that is identified to
237 the public through advertising or signage using the Issuing Credit Union's name, trade name, or
238 logo.

239 (f) *Securities laws.* An Issuing Credit Union must comply with all applicable federal and
240 state securities laws.

241 (g) *Resales.* All resales of Subordinated Debt Notes issued by an Issuing Credit Union
242 by holders of such Subordinated Debt Notes must be made pursuant to Rule 144 under the

243 Securities Act of 1933, as amended (17 CFR 230.144) (other than paragraphs (c), (e), (f), (g) and
244 (h) of such Rule), Rule 144A under the Securities Act of 1933, as amended (17 CFR 230.144A),
245 or another exemption from registration under the Securities Act of 1933, as amended.
246 Subordinated Debt Notes must include the restrictions on resales in § 702.404(a)(10).

247 **§ 702.407 Discounting of amount treated as Regulatory Capital.**

248 The amount of outstanding Subordinated Debt that may be treated as Regulatory Capital
249 shall reduce by 20 percent per annum of the initial aggregate principal amount of the applicable
250 Subordinated Debt (as reduced by prepayments or amounts extinguished to cover a deficit under
251 § 702.404(a)(6)), as required by the following schedule:

Remaining maturity	Balance treated as Regulatory Capital
Four to less than five years	80 %
Three to less than four years	60 %
Two to less than three years	40 %
One to less than two years	20 %
Less than one year	0 %

252 **§ 702.408 Preapproval to issue Subordinated Debt.**

253 (a) *Scope.* This section requires all credit unions to receive written preapproval from the
254 NCUA before issuing Subordinated Debt. Procedures related specifically to applications from
255 federally insured, state-chartered credit unions are contained in § 702.409. A credit union
256 seeking approval to offer and sell Subordinated Debt at one or more of its offices must also
257 follow the application procedures in § 702.406(e). All approvals under this section are subject to
258 the expiration limits specified in paragraph (k) of this section.

259 (b) *Initial application to issue Subordinated Debt.* A credit union requesting approval to
260 issue Subordinated Debt must first submit an application to the Appropriate Supervision Office
261 that, at a minimum, includes:

262 (1) A statement indicating how the credit union qualifies to issue Subordinated Debt
263 given the eligibility requirements of § 702.403 with additional supporting analysis if anticipating
264 to meet the requirements of a LICU or Complex Credit Union within 24 months after issuance of
265 the Subordinated Debt;

266 (2) The maximum aggregate principal amount of Subordinated Debt Notes and the
267 maximum number of discrete issuances of Subordinated Debt Notes that the credit union is
268 proposing to issue within the period allowed under paragraph (k) of this section;

269 (3) The estimated number of investors and the status of such investors (Natural Person
270 Accredited Investors and/or Entity Accredited Investors) to whom the credit union intends to
271 offer and sell the Subordinated Debt Notes;

272 (4) A statement identifying any outstanding Subordinated Debt or Grandfathered
273 Secondary Capital previously issued by the credit union;

274 (5) A copy of the credit union's strategic plan, business plan, and budget, and an
275 explanation of how the credit union intends to use the Subordinated Debt in conformity with
276 those plans;

277 (6) An analysis of how the credit union will provide for liquidity to repay the
278 Subordinated Debt upon maturity of the Subordinated Debt;

279 (7) Pro Forma Financial Statements (balance sheet, income statement, and statement of
280 cash flows), including any off-balance sheet items, covering at least two years. Analytical
281 support for key assumptions and key assumption changes must be included in the application.
282 Key assumptions include, but are not limited to, interest rate, liquidity, and credit loss scenarios;

283 (8) A statement indicating how the credit union will use the proceeds from the issuance
284 and sale of the Subordinated Debt;

285 (9) A statement identifying the governing law specified in the Subordinated Debt Notes
286 and the documents pursuant to which the Subordinated Debt Notes will be issued;

287 (10) A draft written policy governing the offer, and issuance, and sale of the
288 Subordinated Debt, developed in consultation with Qualified Counsel, which, at a minimum,
289 addresses:

290 (i) Compliance with all applicable federal and state securities laws and regulations;

291 (ii) Compliance with applicable securities laws related to communications with investors
292 and potential investors, including, but not limited to: who may communicate with investors and
293 potential investors; what information may be provided to investors and potential investors;
294 ongoing disclosures to investors; who will review and ensure the accuracy of the information
295 provided to investors and potential investors; and to whom information will be provided;

296 (iii) Compliance with any laws that may require registration of credit union employees as
297 broker-dealers; and

298 (iv) Any use of outside agents, including broker-dealers, to assist in the marketing and
299 issuance of Subordinated Debt, and any limitations on such use.

300 (11) A schedule that provides an itemized statement of all expenses incurred or expected
301 to be incurred by the credit union in connection with the offer, issuance, and sale of the

302 Subordinated Debt Notes to which the initial application relates, other than underwriting
303 discounts and commissions or similar compensation payable to broker-dealers acting as
304 placement agents. The schedule must include, as applicable, fees and expenses of counsel,
305 auditors, any trustee or issuing and paying agent or any transfer agent, and printing and
306 engraving expenses. If the amounts of any items are not known at the time of filing of the initial
307 application, the credit union must provide estimates, clearly identified as such;

308 (12) In the case of a New Credit Union, a statement that it is subject to either an
309 approved initial business plan or revised business plan, as required by this part, and how the
310 proposed Subordinated Debt would conform with the approved plan. Unless the New Credit
311 Union has a LICU designation pursuant to § 701.34 of this chapter, it must also include a plan
312 for replacing the Subordinated Debt with Retained Earnings before the credit union ceases to
313 meet the definition of New Credit Union in § 702.2;

314 (13) A statement describing any investments the credit union has in the Subordinated
315 Debt of any other credit union, and the manner in which the credit union acquired such
316 Subordinated Debt, including through a merger or other consolidation;

317 (14) A signature page signed by the credit union's principal executive officer, principal
318 financial officer or principal accounting officer, and a majority of the members of its board of
319 directors. Amendments to an initial application must be signed and filed with the NCUA in the
320 same manner as the initial application; and

321 (15) Any additional information requested in writing by the Appropriate Supervision
322 Office.

323 (c) *Decision on initial application.* Upon receiving an initial application submitted under
324 this subsection and any additional information requested in writing by the Appropriate
325 Supervision Office, the Appropriate Supervision Office will evaluate, at a minimum, the credit
326 union's compliance with this subpart and all other NCUA regulations, the credit union's ability
327 to manage and safely offer, issue, and sell the proposed Subordinated Debt, the safety and
328 soundness of the proposed use of the Subordinated Debt, the overall condition of the credit
329 union, and any other factors the Appropriate Supervision Office determines are relevant.

330 (1) *Written determination.* Within 60 calendar days (which may be extended by the
331 Appropriate Supervision Office) after the date of receipt of a complete application, the
332 Appropriate Supervision Office will provide the credit union with a written determination on its
333 application. In the case of a full or partial denial, or conditional approval under paragraph (c)(2)
334 of this section, the written decision will state the reasons for the denial or conditional approval.

335 (2) *Conditions of approval.* Any approval granted by an Appropriate Supervision Office
336 under this section may include one or more of the following conditions:

337 (i) Approval of an aggregate principal amount of Subordinated Debt that is lower than
338 what the credit union requested;

339 (ii) Any applicable minimum level of Net Worth that the credit union must maintain
340 while the Subordinated Debt Notes are outstanding;

341 (iii) Approved uses of the Subordinated Debt; and

342 (iv) Any other limitations or conditions the Appropriate Supervision Office deems
343 necessary to protect the NCUSIF.

344 (d) *Offering Document*. Following receipt of written approval of its initial application,
345 an Issuing Credit Union must prepare an Offering Document for each issuance of Subordinated
346 Debt Notes. In addition, as required in paragraph (f) of this section, an Issuing Credit Union that
347 intends to offer Subordinated Debt Notes to any Natural Person Accredited Investors must have
348 the related Offering Document declared “approved for use” by the NCUA before its first use. At
349 a reasonable time prior to any issuance and sale of Subordinated Debt Notes, the Issuing Credit
350 Union must provide each investor with an Offering Document as described in this section. All
351 Offering Documents must be filed with the NCUA within two business days after their
352 respective first use.

353 (e) *Requirements for all Offering Documents*. (1) *Minimum information required in an*
354 *Offering Document*. An Offering Document must, at a minimum, include the following
355 information:

- 356 (i) The name of the Issuing Credit Union and the address of its principal executive
357 office;
- 358 (ii) The initial principal amount of the Subordinated Debt being issued;
- 359 (iii) The name(s) of any underwriter(s) or placement agents being used for the issuance;
- 360 (iv) A description of the material risk factors associated with the purchase of the
361 Subordinated Debt Notes, including any special or distinctive characteristics of the Issuing
362 Credit Union's business, field of membership, or geographic location that are reasonably likely
363 to have a material impact on the Issuing Credit Union's future financial performance;
- 364 (v) The disclosures described in § 702.405 and such additional material information, if
365 any, as may be necessary to make the required disclosures, in the light of the circumstances
366 under which they are made, not misleading;
- 367 (vi) Provisions related to the interest, principal, payment, maturity, and prepayment of
368 the Subordinated Debt Notes;
- 369 (vii) All material affirmative and negative covenants that may or will be included in the
370 Subordinated Debt Note, including, but not limited to, the covenants discussed in this subpart;
- 371 (viii) Any legends required by applicable state law; and

372 (ix) The following legend, displayed on the cover page in prominent type or in another
373 manner:

374 **None of the Securities and Exchange Commission (the “SEC”), any state securities commission**
375 **or the National Credit Union Administration has passed upon the merits of, or given its approval of, the**
376 **purchase of any Subordinated Debt Notes offered or the terms of the offering, or passed on the accuracy**
377 **or completeness of any Offering Document or other materials used in connection with the offer, issuance,**
378 **and sale of the Subordinated Debt Notes. Any representation to the contrary is unlawful. These**
379 **Subordinated Debt Notes have not been registered under the Securities Act of 1933, as amended (the**
380 **“Act”) and are being offered and sold to [an Entity Accredited Investor][an Accredited Investor] (as**
381 **defined in 12 CFR 702.402) pursuant to an exemption from registration under the Act; however, neither**
382 **the SEC nor the NCUA has made an independent determination that the offer and issuance of the**
383 **Subordinated Debt Notes are exempt from registration.**

384 (2) *Legibility requirements.* An Issuing Credit Union’s Offering Document must comply
385 with the following legibility requirements:

386 (i) Information in the Offering Document must be presented in a clear, concise, and
387 understandable manner, incorporating plain English principles. The body of all printed Offering
388 Documents shall be in type at least as large and as legible as 10-point type. To the extent
389 necessary for convenient presentation, however, financial statements and other tabular data,
390 including tabular data in notes, may be in type at least as large and as legible as 8-point type.
391 Repetition of information should be avoided. Cross-referencing of information within the
392 document is permitted; and

393 (ii) Where an Offering Document is distributed through an electronic medium, the
394 Issuing Credit Union may satisfy legibility requirements applicable to printed documents, such
395 as paper size, type size and font, bold-face type, italics and red ink, by presenting all required
396 information in a format readily communicated to offerees and, where indicated, in a manner
397 reasonably calculated to draw the attention of offerees to specific information.

398 (f) *Offering Documents approved for use in offerings of Subordinated Debt to any*
399 *Natural Person Accredited Investors--(1) Filing of a Draft Offering Document.* An Issuing
400 Credit Union that intends to offer Subordinated Debt Notes to any Natural Person Accredited
401 Investors must file a draft Offering Document with the NCUA and have such draft Offering
402 Document declared “approved for use” by the NCUA before its first use.

403 (i) *Request for additional information, clarifications, or amendments.* Prior to declaring
404 any Offering Document “approved for use,” the NCUA may ask questions, request clarifications,
405 or direct the Issuing Credit Union to amend certain sections of the draft Offering Document. The
406 NCUA will make any such requests in writing.

407 (ii) *Written determination.* Within 60 calendar days (which may be extended by the
408 NCUA) after the date of receipt of each of the initial filing and each filing of additional
409 information, clarifications, or amendments requested by the NCUA under paragraph (f)(1)(i) of
410 this section, the NCUA will provide the Issuing Credit Union with a written determination on the
411 applicable filing. The written determination will include any requests for additional information,
412 clarifications, or amendments, or a statement that the Offering Document is “approved for use.”

413 (2) *Filing of a final Offering Document.* At such time as the NCUA declares an Offering
414 Document “approved for use” in accordance with paragraph (f)(1)(ii) of this section, the Issuing
415 Credit Union may then use that Offering Document in the offer and sale of the Subordinated
416 Debt Notes. The Issuing Credit Union must file a copy of each of its Offering Documents with
417 the NCUA within two business days after their respective first use.

418 (g) *Filing of an Offering Document for offerings of Subordinated Debt exclusively to*
419 *Entity Accredited Investors.* An Issuing Credit Union that is offering Subordinated Debt
420 exclusively to Entity Accredited Investors is not required to have its Offering Document
421 “approved for use” by the NCUA under paragraph (f) of this section before using it to offer and
422 sell the Subordinated Debt Notes. As described in this section, however, the Issuing Credit
423 Union must file a copy of each of its Offering Documents with the NCUA within two business
424 days after their respective first use.

425 (h) *Material changes to any initial application or Offering Document--(1) Reapproval*
426 *of initial application.* If any material event arises or material change in fact occurs after the
427 approval of the initial application by the NCUA, but prior to the completion of the offer and sale
428 of the related Subordinated Debt Notes, then no person shall offer or sell Subordinated Debt
429 Notes to any other person until an amendment to the Offering Document reflecting the event or
430 change has been filed with and approved by the NCUA.

431 (2) *Reapproval of Offering Document.* If an Offering Document must be approved for
432 use under paragraph (f) of this section, and any event arises or change in fact occurs after the

433 approval for use of any Offering Document, and that event or change in fact, individually or in
434 the aggregate, results in the Offering Document containing any untrue statement of material fact,
435 or omitting to state a material fact necessary in order to make statements made in the Offering
436 Document not misleading in light of the circumstances under which they were made, then no
437 person shall offer or sell Subordinated Debt Notes to any other person until an amendment
438 reflecting the event or change has been filed with and “approved for use” by the NCUA.

439 (3) *Failure to request reapproval.* If an Issuing Credit Union fails to comply with
440 paragraph (h)(1) or (2) of this section, the NCUA may, at its discretion, exercise the full range of
441 administrative remedies available under the FCU Act, including:

442 (i) Prohibiting the Issuing Credit Union from issuing any additional Subordinated Debt
443 for a specified period; and/or

444 (ii) Determining not to treat the Subordinated Debt as Regulatory Capital.

445 (i) *Notification.* Not later than 10 business days after the closing of a Subordinated Debt
446 Note issuance and sale, the Issuing Credit Union must submit to the Appropriate Supervision
447 Office:

448 (1) A copy of each executed Subordinated Debt Note;

449 (2) A copy of each executed purchase agreement, if any;

450 (3) Any indenture or other transaction document used to issue the Subordinated Debt
451 Notes;

452 (4) Copies of signed certificates of Accredited Investor status, in a form similar to that in
453 § 702.406(c), from all investors;

454 (5) All documentation provided to investors related to the offer and sale of the
455 Subordinated Debt Note (other than any Offering Document that was previously filed with the
456 NCUA); and

457 (6) Any other material documents governing the issuance, sale or administration of the
458 Subordinated Debt Notes.

459 (j) *Resubmissions.* An Issuing Credit Union that receives any adverse written
460 determination from the Appropriate Supervision Office with respect to the approval of its initial
461 application or any amendment thereto or, if applicable, the approval for use of an Offering
462 Document or any amendment thereto, may cure any reasons noted in the written determination
463 and refile under the requirements of this section. This subsection does not prohibit an Issuing
464 Credit Union from appealing an Appropriate Supervision Office's decision under subpart A of
465 part 746 of this chapter.

466 (k) *Expiration of authority to issue Subordinated Debt.* (1) Any approvals to issue
467 Subordinated Debt Notes under this section expire two years from the later of the date the
468 Issuing Credit Union receives:

469 (i) Approval of its initial application, if the Issuing Credit Union is offering Subordinated
470 Notes exclusively to Entity Accredited Investors; or

471 (ii) The initial approval for use of its Offering Document, if the Issuing Credit Union is
472 offering Subordinated Debt Notes to any Natural Person Accredited Investors.

473 (2) Failure to issue all or part of the maximum aggregate principal amount of
474 Subordinated Debt Notes approved in the initial application process within the applicable period
475 specified in paragraph (k) of this section will result in the expiration of the NCUA's approval.
476 An Issuing Credit Union may file a written extension request with the Appropriate Supervision
477 Office. The Issuing Credit Union must demonstrate good cause for any extension(s), and must
478 file the request at least 30 calendar days before the expiration of the applicable period specified
479 in paragraph (k) of this section or any extensions granted under paragraph (k) of this section. In
480 any such written application, the Issuing Credit Union must address whether any such extension
481 poses any material securities law implications.

482 (l) *Filing requirements and inspection of documents.* (1) Except as otherwise provided
483 in this section, all initial applications, Offering Documents, amendments, notices, or other
484 documents must be filed with the NCUA electronically. The NCUA will publish on its website,

485 <http://www.NCUA.gov>, the web address for electronic filings. Documents may be signed
486 electronically using the signature provision in Rule 402 under the Securities Act of 1933, as
487 amended (17 CFR 230.402).

488 (2) Provided the Issuing Credit Union filing the document has complied with all
489 requirements regarding the filing, the date of filing of the document is the date the NCUA
490 receives the filing. An electronic filing that is submitted on a business day by direct transmission
491 commencing on or before 5:30 p.m. Eastern Standard or Daylight Savings Time, whichever is
492 then currently in effect, would be deemed received by the NCUA on the same business day. An
493 electronic filing that is submitted by direct transmission commencing after 5:30 p.m. Eastern
494 Standard or Daylight Savings Time, whichever is then currently in effect, or on a Saturday,
495 Sunday, or Federal holiday, would be deemed received by the NCUA on the next business day.
496 If an electronic filer in good faith attempts to file a document with the NCUA in a timely
497 manner, but the filing is delayed due to technical difficulties beyond the electronic filer's control,
498 the electronic filer may request that the NCUA adjust the filing date of such document. The
499 NCUA may grant the request if it appears that such adjustment is appropriate and consistent with
500 the public interest and the protection of investors.

501 (3) If an Issuing Credit Union experiences unanticipated technical difficulties preventing
502 the timely preparation and submission of an electronic filing, the Issuing Credit Union may, upon
503 notice to the Appropriate Supervision Office, file the subject filing in paper format no later than
504 one business day after the date on which the filing was to be made.

505 (4) Any filing of amendments or supplements to an Offering Document must include two
506 copies, one of which must be marked to indicate clearly and precisely, by underlining or in some
507 other conspicuous manner, the changes made from the previously filed Offering Document.

508 (m) *Filing fees.* (1) The NCUA may require filing fees to accompany certain filings
509 made under this subpart before it will accept those filings. If the NCUA requires the
510 aforementioned filing fee, the NCUA will publish an applicable fee schedule on its website at
511 <http://www.NCUA.gov>.

512 (2) Filing fees must be paid to the NCUA by electronic transfer.

513 **§ 702.409 Preapproval for federally insured, state-chartered credit unions to issue**
514 **Subordinated Debt.**

515 (a) A federally insured, state-chartered credit union is required to submit the information
516 required under § 702.408 and, if applicable, paragraph (b) of this section to both the Appropriate
517 Supervision Office and its state supervisory authority. The Appropriate Supervision Office will
518 issue decisions approving a federally insured, state-chartered credit union's application only after
519 obtaining the concurrence of the federally insured, state-chartered credit union's state
520 supervisory authority. The NCUA will notify a federally insured, state-chartered credit union's
521 state supervisory authority before issuing a decision to "approve for use" a federally insured,
522 state-chartered credit union's Offering Document and any amendments thereto, under § 702.408,
523 if applicable.

524 (b) If the Appropriate Supervision Office has reason to believe that an issuance by a
525 federally insured, state-chartered credit union under this subpart could subject that federally
526 insured, state-chartered credit union to federal income taxation, the Appropriate Supervision
527 Office may require the federally insured, state-chartered credit union to provide:

528 (1) A written legal opinion, satisfactory to the NCUA, from nationally recognized tax
529 counsel or letter from the Internal Revenue Service indicating whether the proposed
530 Subordinated Debt would be classified as capital stock for federal income tax purposes and, if so,
531 describing any material impact of federal income taxes on the federally insured, state-chartered
532 credit union's financial condition; or

533 (2) A Pro Forma Financial Statement (balance sheet, income statement, and statement of
534 cash flows), covering a minimum of two years, that shows the impact of the federally insured,
535 state-chartered credit union being subject to federal income tax.

536 (c) If the Appropriate Supervision Office requires additional information from a
537 federally insured, state-chartered credit union under paragraph (b) of this section, the federally
538 insured, state-chartered credit union may determine, in its sole discretion, whether the
539 information it provides is in the form described in paragraph (b)(1) or (2) of this section.

540 **§ 702.410 Interest payments on Subordinated Debt.**

541 (a) *Requirements for interest payments.* An Issuing Credit Union is prohibited from
542 paying interest on Subordinated Debt in accordance with § 702.109.

543 (b) *Accrual of interest.* Notwithstanding nonpayment pursuant to paragraph (a) of this
544 section, interest on the Subordinated Debt may continue to accrue according to terms provided
545 for in the Subordinated Debt Note and as otherwise permitted in this subpart.

546 (c) *Interest safe harbor.* Except as otherwise provided in this section, the NCUA shall
547 not impose a discretionary supervisory action that requires the Issuing Credit Union to suspend
548 interest with respect to the Subordinated Debt if:

549 (1) The issuance and sale of the Subordinated Debt complies with all requirements of
550 this subpart;

551 (2) The Subordinated Debt is issued and sold in an arms-length, bona fide transaction;

552 (3) The Subordinated Debt was issued and sold in the ordinary course of business, with
553 no intent to hinder, delay or defraud the Issuing Credit Union or its creditors; and

554 (4) The Subordinated Debt was issued and sold for adequate consideration in U.S.
555 dollars.

556 (d) *Authority, rights, and powers of the NCUA and the NCUA Board.* This section does
557 not waive, limit, or otherwise affect the authority, rights, or powers of the NCUA or the NCUA
558 Board in any capacity, including the NCUA Board as conservator or liquidating agent, to take
559 any action or to exercise any power not specifically mentioned, including but not limited to any
560 rights, powers or remedies of the NCUA Board as conservator or liquidating agent regarding
561 transfers or other conveyances taken in contemplation of the Issuing Credit Union's insolvency
562 or with the intent to hinder, delay or defraud the Issuing Credit Union or the creditors of such
563 Issuing Credit Union, or that is fraudulent under applicable law.

564 **§ 702.411 Prior written approval to prepay Subordinated Debt.**

565 (a) *Prepayment option.* An Issuing Credit Union may include in the terms of its
566 Subordinated Debt an option that allows the Issuing Credit Union to prepay the Subordinated
567 Debt in whole or in part prior to maturity, provided, however, that the Issuing Credit Union is
568 required to:

569 (1) Clearly disclose the requirements of this section in the Subordinated Debt Note; and

570 (2) Obtain approval under paragraph (b) of this section before exercising a prepayment
571 option.

572 (b) *Prepayment application.* Before an Issuing Credit Union can, in whole or in part,
573 prepay Subordinated Debt prior to maturity, the Issuing Credit Union must first submit to the

574 Appropriate Supervision Office an application that must include, at a minimum, the information
575 required in paragraph (d) of this section.

576 (c) *Federally insured, state-chartered credit union prepayment applications.* Before a
577 federally insured, state-chartered credit union may submit an application for prepayment to the
578 Appropriate Supervision Office, it must obtain written approval from its state supervisory
579 authority to prepay the Subordinated Debt it is proposing to prepay. A federally insured, state-
580 chartered credit union must provide evidence of such approval as part of its application to the
581 Appropriate Supervision Office.

582 (d) *Application contents.* An Issuing Credit Union's application to prepay Subordinated
583 Debt must include, at a minimum, the following:

584 (1) A copy of the Subordinated Debt Note and any agreement(s) reflecting the terms and
585 conditions of the Subordinated Debt the Issuing Credit Union is proposing to prepay;

586 (2) An explanation why the Issuing Credit Union believes it still would hold an amount
587 of capital commensurate with its risk exposure notwithstanding the proposed prepayment or a
588 description of the replacement Subordinated Debt, including the amount of such instrument, and
589 the time frame for issuance, the Issuing Credit Union is proposing to use to replace the prepaid
590 Subordinated Debt; and

591 (3) Any additional information the Appropriate Supervision Office requests.

592 (e) *Decision on application to prepay.* (1) Within 45 calendar days (which may be
593 extended by the Appropriate Supervision Office) after the date of receipt of a complete
594 application, the Appropriate Supervision Office will provide the Issuing Credit Union with a
595 written determination on its application. In the case of a full or partial denial, including a
596 conditional approval under paragraph (e)(2) of this section, the written decision will state the
597 reasons for the denial or conditional approval.

598 (2) The written determination from the Appropriate Supervision Office may approve the
599 Issuing Credit Union's request, approve the Issuing Credit Union's request with conditions, or
600 deny the Issuing Credit Union's request. In the case of a denial or conditional approval, the
601 Appropriate Supervision Office will provide the Issuing Credit Union with a description of why
602 it denied the Issuing Credit Union's request or imposed conditions on the approval of such
603 request.

604 (3) If the Issuing Credit Union proposes or the NCUA requires the Issuing Credit Union
605 to replace the Subordinated Debt, the Issuing Credit Union must receive affirmative approval
606 under this subpart and must issue and sell the replacement instrument prior to or concurrently
607 with prepaying the Subordinated Debt.

608 (f) *Resubmissions.* An Issuing Credit Union that receives an adverse written
609 determination on its application to prepay, in whole or in part, may cure any deficiencies noted in
610 the Appropriate Supervision Office's written determination and reapply under the requirements

611 of this section. This subsection does not prohibit an Issuing Credit Union from appealing the
612 Appropriate Supervision Office's adverse decision under subpart A of part 746 of this chapter.

613 **§ 702.412 Effect of a merger or dissolution on the treatment of Subordinated Debt as**
614 **Regulatory Capital.**

615 (a) In the event of a merger of an Issuing Credit Union into or the assumption of its
616 Subordinated Debt by another federally insured credit union, the Subordinated Debt will be
617 treated as Regulatory Capital only to the extent that the resulting credit union is either a LICU, a
618 Complex Credit Union, and/or a New Credit Union.

619 (b) In the event the resulting credit union is not a LICU, a Complex Credit Union, or a
620 New Credit Union, the Subordinated Debt of the merging credit union can either be:

621 (1) If permitted by the terms of the Subordinated Debt Note, repaid by the resulting
622 credit union upon approval by the NCUA under § 702.411; or

623 (2) Continue to be held by the resulting credit union as Subordinated Debt, but will not
624 be classified as Regulatory Capital under this subpart, unless the resulting credit union meets the
625 eligibility requirements of § 702.403.

626 (c) *Voluntary liquidation.* In the event of a voluntary dissolution of an Issuing Credit
627 Union that has outstanding Subordinated Debt, the Subordinated Debt may be repaid in full
628 according to 12 CFR part 710, subject to the requirements in § 702.411.

629 **§ 702.413 Repudiation safe harbor.**

630 (a) The NCUA Board as conservator for a federally insured credit union, or its lawfully
631 appointed designee, shall not exercise its repudiation authorities under 12 U.S.C. 1787(c) with
632 respect to Subordinated Debt if:

633 (1) The issuance and sale of the Subordinated Debt complies with all requirements of
634 this subpart;

635 (2) The Subordinated Debt was issued and sold in an arms-length, bona fide transaction;

636 (3) The Subordinated Debt was issued and sold in the ordinary course of business, with
637 no intent to hinder, delay or defraud the Issuing Credit Union or its creditors; and

638 (4) The Subordinated Debt was issued and sold for adequate consideration in U.S.
639 dollars.

640 (b) This section does not authorize the attachment of any involuntary lien upon the
641 property of either the NCUA Board as conservator or liquidating agent or its lawfully appointed

642 designee. Nor does this section waive, limit, or otherwise affect the authority, rights, or powers
643 of the NCUA or the NCUA Board in any capacity to take any action or to exercise any power not
644 specifically mentioned, including but not limited to any rights, powers or remedies of the NCUA
645 Board as conservator or liquidating agent (or its lawfully appointed designee) regarding transfers
646 or other conveyances taken in contemplation of the Issuing Credit Union’s insolvency or with the
647 intent to hinder, delay or defraud the Issuing Credit Union or the creditors of such Issuing Credit
648 Union, or that is fraudulent under applicable law.

649 **§ 702.414 Regulations governing Grandfathered Secondary Capital.**

650 This section codifies the requirements of §§ 701.34(b), (c), and (d) of this chapter in
651 subpart D, with minor modifications, in effect before January 1, 2022. The terminology used in
652 this section is specific to this section. All secondary capital issued before the effective date of
653 this rule that was issued in accordance with §§ 701.34(b), (c), and (d) of this chapter in subpart D
654 or, in the case of a federally insured, state-chartered credit union, § 741.204(c) of this chapter,
655 that is referred to elsewhere in this subpart as “Grandfathered Secondary Capital,” is subject to
656 the requirements set forth in this section.

657 (a) Secondary capital is subject to the following conditions:

658 (1) *Secondary capital plan.* A credit union that has Grandfathered Secondary Capital
659 under this section must have a written, NCUA-approved “Secondary Capital Plan” that, at a
660 minimum:

661 (i) States the maximum aggregate amount of uninsured secondary capital the LICU plans
662 to accept;

663 (ii) Identifies the purpose for which the aggregate secondary capital will be used, and
664 how it will be repaid;

665 (iii) Explains how the LICU will provide for liquidity to repay secondary capital upon
666 maturity of the accounts;

667 (iv) Demonstrates that the planned uses of secondary capital conform to the LICU's
668 strategic plan, business plan and budget; and

669 (v) Includes supporting pro forma financial statements, including any off-balance sheet
670 items, covering a minimum of the next two years.

671 (2) *Issuances not completed before January 1, 2022.* Any issuances of secondary capital
672 not completed by the effective date of this subpart are, as of the effective date of this subpart,
673 subject to the requirements applicable to Subordinated Debt discussed elsewhere in this subpart.

674 (3) *Nonshare account.* The secondary capital account is established as an uninsured
675 secondary capital account or other form of non-share account.

676 (4) *Minimum maturity.* The maturity of the secondary capital account is a minimum of
677 five years.

678 (5) *Uninsured account.* The secondary capital account is not insured by the National
679 Credit Union Share Insurance Fund or any governmental or private entity.

680 (6) *Subordination of claim.* The secondary capital account investor’s claim against the
681 LICU is subordinate to all other claims including those of shareholders, creditors and the
682 National Credit Union Share Insurance Fund.

683 (7) *Availability to cover losses.* Funds deposited into a secondary capital account,
684 including interest accrued and paid into the secondary capital account, are available to cover
685 operating losses realized by the LICU that exceed its net available reserves (exclusive of
686 secondary capital and allowance accounts for loan and lease losses), and to the extent funds are
687 so used, the LICU must not restore or replenish the account under any circumstances. The LICU
688 may, in lieu of paying interest into the secondary capital account, pay accrued interest directly to
689 the investor or into a separate account from which the secondary capital investor may make
690 withdrawals. Losses must be distributed pro-rata among all secondary capital accounts held by
691 the LICU at the time the losses are realized. In instances where a LICU accepted secondary
692 capital from the United States Government or any of its subdivisions under the Community
693 Development Capital Initiative of 2010 (“CDCI secondary capital”) and matching funds were
694 required under the Initiative and are on deposit in the form of secondary capital at the time a loss

695 is realized, a LICU must apply either of the following pro-rata loss distribution procedures to its
696 secondary capital accounts with respect to the loss:

697 (i) If not inconsistent with any agreements governing other secondary capital on deposit
698 at the time a loss is realized, the CDCI secondary capital may be excluded from the calculation
699 of the pro-rata loss distribution until all of its matching secondary capital has been depleted,
700 thereby causing the CDCI secondary capital to be held as senior to all other secondary capital
701 until its matching secondary capital is exhausted. The CDCI secondary capital should be
702 included in the calculation of the pro-rata loss distribution and is available to cover the loss only
703 after all of its matching secondary capital has been depleted.

704 (ii) Regardless of any agreements applicable to other secondary capital, the CDCI
705 secondary capital and its matching secondary capital may be considered a single account for
706 purposes of determining a pro-rata share of the loss and the amount determined as the pro-rata
707 share for the combined account must first be applied to the matching secondary capital account,
708 thereby causing the CDCI secondary capital to be held as senior to its matching secondary
709 capital. The CDCI secondary capital is available to cover the loss only after all of its matching
710 secondary capital has been depleted.

711 (8) *Security*. The secondary capital account may not be pledged or provided by the
712 account investor as security on a loan or other obligation with the LICU or any other party.

713 (9) *Merger or dissolution.* In the event of merger or other voluntary dissolution of the
714 LICU, other than merger into another LICU, the secondary capital accounts will be closed and
715 paid out to the account investor to the extent they are not needed to cover losses at the time of
716 merger or dissolution.

717 (10) *Contract agreement.* A secondary capital account contract agreement must have
718 been executed by an authorized representative of the account investor and of the LICU reflecting
719 the terms and conditions mandated by this section and any other terms and conditions not
720 inconsistent with this section.

721 (11) *Disclosure and acknowledgement.* An authorized representative of the LICU and of
722 the secondary capital account investor each must have executed a “Disclosure and
723 Acknowledgment” as set forth in the appendix to this section at the time of entering into the
724 account agreement. The LICU must retain an original of the account agreement and the
725 “Disclosure and Acknowledgment” for the term of the agreement, and a copy must be provided
726 to the account investor.

727 (12) *Prompt corrective action.* As provided in this part, the NCUA may prohibit a LICU
728 as classified “critically undercapitalized” or, if “new,” as “moderately capitalized”, “marginally
729 capitalized”, “minimally capitalized” or “uncapitalized,” as the case may be, from paying
730 principal, dividends or interest on its uninsured secondary capital accounts established after
731 August 7, 2000, `except that unpaid dividends or interest will continue to accrue under the terms
732 of the account to the extent permitted by law.

733 (b) *Accounting treatment; Recognition of net worth value of accounts--(1) Debt.* A
734 LICU that issued secondary capital accounts pursuant to paragraph (a) of this section must record
735 the funds on its balance sheet as a debt titled “uninsured secondary capital account.”

736 (2) *Schedule for recognizing net worth value.* The LICU’s reflection of the net worth
737 value of the accounts in its financial statement may never exceed the full balance of the
738 secondary capital on deposit after any early redemptions and losses. For accounts with
739 remaining maturities of less than five years, the LICU must reflect the net worth value of the
740 accounts in its financial statement in accordance with the lesser of:

741 (i) The remaining balance of the accounts after any redemptions and losses; or

742 (ii) The amounts calculated based on the following schedule:

Remaining maturity	Net worth value of original balance (percent)
Four to less than five years	80 %
Three to less than four years	60 %
Two to less than three years	40 %
One to less than two years	20 %
Less than one year	0 %

743 (3) *Financial statement.* The LICU must reflect the full amount of the secondary capital
744 on deposit in a footnote to its financial statement.

745 (c) *Redemption of secondary capital.* With the written approval of NCUA, secondary
746 capital that is not recognized as net worth under paragraph (b)(2) of this section (“discounted
747 secondary capital” re-categorized as Subordinated Debt) may be redeemed according to the
748 remaining maturity schedule in paragraph (c)(3) of this section.

749 (1) *Request to redeem secondary capital.* A request for approval to redeem discounted
750 secondary capital may be submitted in writing at any time, must specify the increment(s) to be
751 redeemed and the schedule for redeeming all or any part of each eligible increment, and must
752 demonstrate to the satisfaction of NCUA that:

753 (i) The LICU will have a post-redemption net worth classification of at least “adequately
754 capitalized” under this part;

755 (ii) The discounted secondary capital has been on deposit at least two years;

756 (iii) The discounted secondary capital will not be needed to cover losses prior to final
757 maturity of the account;

758 (iv) The LICU’s books and records are current and reconciled;

759 (v) The proposed redemption will not jeopardize other current sources of funding, if any,
760 to the LICU; and

761 (vi) The request to redeem is authorized by resolution of the LICU's board of directors.

762 (2) *Decision on request.* A request to redeem discounted secondary capital may be
763 granted in whole or in part. If a LICU is not notified within 45 days of receipt of a request for
764 approval to redeem secondary capital that its request is either granted or denied, the LICU may
765 proceed to redeem secondary capital accounts as proposed.

766 (3) *Schedule for redeeming secondary capital.*

Remaining maturity	Redemption limit as percent of original balance
Four to less than five years	20 %
Three to less than four years	40 %
Two to less than three years	60 %
One to less than two years	80 %

767 (4) *Early redemption exception.* Subject to the written approval of NCUA obtained
768 pursuant to the requirements of paragraphs (c)(1) and (2) of this section, a LICU can redeem all
769 or part of secondary capital accepted from the United States Government or any of its
770 subdivisions at any time after the secondary capital has been on deposit for two years. If the

771 secondary capital was accepted under conditions that required matching secondary capital from a
772 source other than the Federal Government, the matching secondary capital may also be redeemed
773 in the manner set forth in the preceding sentence. For purposes of obtaining NCUA's approval,
774 all secondary capital a LICU accepts from the United States Government or any of its
775 subdivisions, as well as its matching secondary capital, if any, is eligible for early redemption
776 regardless of whether any part of the secondary capital has been discounted pursuant to
777 paragraph (b)(2) of this section.

778 **Appendix A to Subpart D of Part 702-- Disclosure and Acknowledgement Form**

779 A LICU that is authorized to accept uninsured secondary capital accounts and each
780 investor in such an account must have executed and dated the following "Disclosure and
781 Acknowledgment" form, a signed original of which must be retained by the credit union:

782 Disclosure and Acknowledgment

783 [Name of CU] and [Name of investor] hereby acknowledge and agree that [Name of
784 investor] has committed [amount of funds] to a secondary capital account with [name of credit
785 union] under the following terms and conditions:

786 1. *Term.* The funds committed to the secondary capital account are committed for a
787 period of ___ years.

788 2. *Redemption prior to maturity.* Subject to the conditions set forth in 12 CFR 702.414,
789 the funds committed to the secondary capital account are redeemable prior to maturity only at the
790 option of the LICU and only with the prior written approval of NCUA.

791 3. *Uninsured, non-share account.* The secondary capital account is not a share account
792 and the funds committed to the secondary capital account are not insured by the National Credit
793 Union Share Insurance Fund or any other governmental or private entity.

794 4. *Prepayment risk.* Redemption of U.S.C. prior to the account's original maturity date
795 may expose the account investor to the risk of being unable to reinvest the repaid funds at the
796 same rate of interest for the balance of the period remaining until the original maturity date. The
797 investor acknowledges that it understands and assumes responsibility for prepayment risk
798 associated with the [name of credit union]'s redemption of the investor's U.S.C. account prior to
799 the original maturity date.

800 5. *Availability to cover losses.* The funds committed to the secondary capital account and
801 any interest paid into the account may be used by [name of credit union] to cover any and all
802 operating losses that exceed the credit union's net worth exclusive of allowance accounts for
803 loan losses, and in the event the funds are so used, (name of credit union) will under no
804 circumstances restore or replenish those funds to [name of institutional investor]. Dividends are
805 not considered operating losses and are not eligible to be paid out of secondary capital.

806 6. *Accrued interest.* By initialing below, [name of credit union] and [name of
807 institutional investor] agree that accrued interest will be:

808 __Paid into and become part of the secondary capital account;

809 __Paid directly to the investor;

810 __Paid into a separate account from which the investor may make withdrawals; or

811 __Any combination of the above provided the details are specified and agreed to in
812 writing.

813 7. *Subordination of claims.* In the event of liquidation of [name of credit union], the
814 funds committed to the secondary capital account will be subordinate to all other claims on the
815 assets of the credit union, including claims of member shareholders, creditors and the National
816 Credit Union Share Insurance Fund.

817 8. *Prompt Corrective Action.* Under certain net worth classifications (see 12 CFR
818 702.204(b)(11), 702.304(b) and 702.305(b), as the case may be), the NCUA may prohibit [name
819 of credit union] from paying principal, dividends or interest on its uninsured secondary capital
820 accounts established after August 7, 2000, except that unpaid dividends or interest will continue
821 to accrue under the terms of the account to the extent permitted by law.

822 ACKNOWLEDGED AND AGREED TO this ___ day of [month and year] by:

823 _____

824 [name of investor's official]

825 [title of official]

826 [name of investor]

827 [address and phone number of investor]

828 [investor's tax identification number]

829 _____

830 [name of credit union official]

831 [title of official]

832 **PART 709—INVOLUNTARY LIQUIDATION OF FEDERAL CREDIT UNIONS AND**
833 **ADJUDICATION OF CREDITOR CLAIMS INVOLVING FEDERALLY INSURED**
834 **CREDIT UNIONS IN LIQUIDATION.**

835 14. The authority citation for part 709 continues to read as follows:

836 **Authority:** 12 U.S.C. 1757, 1766, 1767, 1786(h), 1786(t), and 1787(b)(4), 1788, 1789,
837 1789a.

838 15. Amend § 709.5 by revising paragraph (b)(8) to read as follows:

839 **§ 709.5 Payout priorities in involuntary liquidation.**

840 * * * * *

841 (b) * * *

842 (8) Outstanding Subordinated Debt (as defined in part 702 of this chapter) or outstanding
843 Grandfathered Secondary Capital (as defined in part 702 of this chapter); and

844 * * * * *

845 **PART 741—REQUIREMENTS OF INSURANCE.**

846 16. The authority citation for part 741 continues to read as follows:

847 **Authority:** 12 U.S.C. 1757, 1766(a), 1781-1790, and 1790d; 31 U.S.C. 3717.

848 17. Amend § 741.204 by revising paragraph (c) and removing paragraph (d) to read as
849 follows:

850 **§ 741.204 Maximum public unit and nonmember accounts, and low-income designation.**

851 * * * * *

852 (c) Follow the requirements of § 702.414 for any Grandfathered Secondary Capital (as
853 defined in part 702 of this chapter) issued before January 1, 2022.

854 18. Add §§ 741.226 and 741.227 to read as follows:

855 **§ 741.226 Subordinated Debt.**

856 Any credit union that is insured, or that makes application for insurance, pursuant to title
857 II of the Act must follow the requirements of subpart D of part 702 of this chapter before it may
858 issue Subordinated Debt, as that term is defined in § 702.402 of this chapter, and to the extent
859 not inconsistent with applicable state law and regulation; and

860 **§ 741.227 Loans to credit unions.**

861 Any credit union that is insured pursuant to Title II of the Act must adhere to the
862 requirements in § 701.25 of this chapter.