

May 4, 2017

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Re: ANPR – Alternative Capital

Dear Mr. Poliquin:

I am writing on behalf of SchoolsFirst Federal Credit Union (SchoolsFirst FCU), which serves school employees in Southern California. We have more than 750,000 Members and over \$13 billion in assets. SchoolsFirst FCU appreciates the opportunity to comment on your Advance Notice of Proposed Rulemaking on Alternative Capital.

Although our credit union does not currently have a need for supplemental capital, nor do we foresee one in the near future, we support the general idea of credit unions being able to raise supplemental capital as needed. It is our opinion that this rule, as proposed, would not benefit or support the majority of our fellow credit unions as reflected in our comments below addressing the question posed in the ANPR. We welcome the Board to implement regulations that not only allow *all* credit unions to implement a supplement capital plan, but allow flexibility and give consideration to the different credit union asset sizes, the complexity of their operations, and the size of the supplemental capital instruments themselves. The subject of alternative capital, whether secondary capital or supplemental capital, should not impact the discussion of taxation, so long as credit unions continue to abide by the model of not-for-profit, Member-owned cooperative financial institutions. We request the Board's consideration in the possibility of allowing credit unions the opportunity of offering supplemental capital instruments.

Supplemental Capital Issuers

The Board alluded to how supplemental capital could most likely be used by credit unions whose risk-based capital ratio is less than well capitalized. With approximately 6,000 credit unions today, this example the Board provided is very limited and only allows for an additional 2% of all credit unions to issue supplemental capital. Instead, we would recommend for the NCUA to allow *all* credit unions, regardless of their net worth or risk-based capital ratios, the opportunity to utilize supplemental capital as a leveraging tool and resource to support greater lending and improve other financial support services, such as enhancements in technology, to ultimately benefit and better serve our Members.

Instrument Maturity

We recommend the Board allow well capitalized, non-low-income credit unions the flexibility to issue supplemental capital instruments that can retain 100% of their balance up to their full maturity. While having the subordinated debt taper off within 5-years of remaining maturity may be appropriate for some credit unions, others can better benefit by issuing securities that *do not* taper off and maintain a 100% balance up to maturity. Furthermore, we recommend maturity terms to be longer than 5 years to allow for a more permanent capital arrangement.

Capital Ratios

The Board proposes the use of subordinated debt as supplemental capital; however, this debt does not affect the net worth ratio. While we understand this is due to limitations in the Federal Credit Union Act, the credit union movement would greatly benefit from issuing supplemental capital that affects both the net worth and risk-based capital ratios. Any losses experienced by credit unions that have developed a higher balance sheet risk strategy would affect their net worth; therefore, we believe that this capital should affect the net worth ratio as well. We recommend that the NCUA examine ways which supplemental capital can be utilized in this manner.

Instrument Standards and Cost

In order for supplemental capital to have liquidity in the secondary market, we believe these instruments should have standards that are comparable to the SEC and OCC requirements. The NCUA should implement regulations that strengthen these supplemental capital instruments being offered, thus broadening the investor pools. In order to lower costs associated with such requirements, a threshold should be imposed for the issuance of the supplemental capital based on the dollar amount. Likewise, these types of instruments can be more lucrative if credit unions were to acquire issuer ratings by a rating agency. However, this rating process can be both timely and costly; therefore, utilizing a rating agency should be optional to credit unions.

Another thing to consider are the costs associated with managing and maintaining a supplemental capital program. Aside from the costs associated with acquiring an issuer rating, investors interested in the performance of the credit union will more than likely generate inquiries and requests. Credit unions will be expected to provide periodic reporting to the investors as part of their due diligence conducted on these investments. Time spent drafting responses to investor requests for information can not only be time consuming, but can negatively impact a credit union's bottom line. We recommend the Board to include requirements within the investment agreement, which would limit the types of requests investors can make as part of their due diligence process. This will assist credit unions with the time and resources allotted for reporting and responding to investors.

Availability of Supplemental Capital

Extending the availability of supplemental capital to all credit unions should not adversely impact low income credit unions, because the pool of investors increases as the rate offerings become more competitive. We recommend limiting the sources of alternative capital that credit unions can utilize regardless of whether they are designated low-income, in prompt corrective action, or otherwise. Well capitalized, non-low-income credit unions should not have access to community development funding such as that offered through one of the following agencies and instead should seek investors from other institutions not included on this list.

- Community Reinvestment Act
- Community Development Block Grant Program
- Community Development Financial Institution Fund
- National Community Investment Fund
- National Federation of Community Development Credit Unions
- Opportunity Finance Network

Potential Taxation Implications

The ANPR also brought up the concern that supplemental capital could have an impact on the credit union tax exemption status. We do not agree that the ability to issue supplemental capital jeopardizes the federal income tax status of credit unions. Federal credit unions are granted our tax status not only by the Federal Credit Union Act but by the Internal Revenue Service, by virtue of being federal instrumentalities.

Credit unions are not-for-profit financial cooperatives operated entirely by and for their Members. Credit unions return income to their Members by offering higher dividends, lower loan rates and a plethora of products and services that not only assist Members/consumers, but strengthen their financial future.

Mutual Ownership Structure of Credit Unions

Ownership of the credit union resides, and will always reside with our Members. We agree that investors can have no ownership or voting rights simply by virtue of purchasing supplemental capital instruments from a credit union. Credit unions can ensure this by including specific language within the investment agreement that explicitly states that the investor will *not* have ownership interest and cannot vote in any credit union affairs. However, such limitations may increase the yield to be paid to investors, making supplemental capital instruments less attractive.

Securities Law Applicability

We believe credit unions issuing securities as supplemental capital should be required to register with the NCUA. The NCUA should have oversight of what credit unions are issuing in order to ultimately protect the National Credit Union Share Insurance Fund (NCUSIF). Credit unions need to have proper disclosures for supplemental capital instruments. These disclosures would encompass, but not be limited to, the non-voting and limits on covenants, but also applicable content that is comparable to those required by SEC and OCC.

Director and Officer Liability

We agree that credit unions should certify that they have evaluated their insurance policies and have sufficient coverage before beginning secondary or supplemental capital activities, so long as this process is not overly burdensome and costly. We recommend that the Board permit credit unions to conduct their own internal evaluation as part of the implementation process of a supplemental capital plan and conduct testing as part of the standard exam process.

Contractual Matters and Communications

The NCUA should require for the board of directors of the credit union to clearly understand the issuance of supplemental capital and develop a board policy accordingly. Such policy should outline its purpose, scope, thresholds, reporting, designation of responsibilities and all other applicable information to support utilizing supplemental capital.

Other Investor Considerations

We believe that the sale of secondary and supplemental capital should include institutional and investors only, but allow the flexibility of the institution to be either accredited or non-accredited. We feel non-accredited investors should not be limited simply because of their status and should receive disclosures that are commensurate with the supplemental capital instrument. However, non-accredited investors may present a need for more robust disclosures to deter fraudulent or misperceived claims based on lack of understanding.

Approval to Issue and Notice

We recommend that regulations include providing the authorization to credit unions to issue supplemental capital instruments as part of their ongoing business practice, should they choose to utilize them. If applied as such, credit unions should not be required to submit an application for approval to the NCUA. Instead, credit unions should be required to register with the NCUA and leave the review of such instruments to be assessed during the examination process and other supervisory contacts to ensure they are issued in accordance with applicable regulations. Still, we feel notification provided to the NCUA

after the credit union issues the security is sufficient. This notification to be performed as part of the quarterly Call Report process.

Subordination

As to not implement regulations that are overly complex, supplemental capital instruments should have only one payment priority and no other options. Similar to secondary capital, supplemental capital should be subordinated to any other debt.

Limit on Amount of Supplemental Capital That Counts as Regulatory Capital

Supplemental capital should be limited to an amount commensurate with the credit union's total capital, with the flexibility to allow credit unions to decide on the amount in order to operate in a manner that makes good business sense, based on the credit union's current situation.

Merger

Upon any merger, credit unions should be allowed the choice to carry forward alternative capital instruments until maturity. This will allow the flexibility for credit unions having sufficient capital to pay off the supplemental capital instrument, if they choose. Additionally, mergers or other change of control rights must be included within the instrument agreements.

Thank you for your time and the opportunity to comment and provide our recommendations regarding the Advance Notice of Proposed Rulemaking on Alternative Capital. We appreciate your consideration to those recommendations.

Sincerely,



Bill Cheney,
President/CEO
SchoolsFirst Federal Credit Union

Cc: Credit Union National Association (CUNA)
California/Nevada Credit Union League (CCUL)