

May 9, 2017

Gerald Poliquin, Secretary of the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314-3428

**Re: Advance Notice of Proposed rulemaking for Supplemental Capital**

Dear Mr. Poliquin:

On behalf of the 2.2 million credit union members we represent, the Heartland Credit Union Association (HCUA) appreciates the opportunity to comment on the National Credit Union Administration's (NCUA) Advanced Notice of Proposed Rulemaking for Supplemental Capital.

HCUA encourages the NCUA to allow credit unions to develop new forms of supplemental capital, within appropriate limits, such that they can demonstrate the viability of supplemental capital for risk-based capital purposes. NCUA's Final Rule on Risk-Based Capital (RBC Rule) may require some credit unions to increase capital beyond the amount necessary under the leverage requirement, which under current rules, can only be accomplished through retained earnings.

In developing this rule, we urge NCUA to create an environment for limited experimentation by credit unions in the creation of supplemental capital instruments, limited in an amount so as to not expose the share insurance fund to undue risk, but flexible so as to allow the development of the most appropriate instruments that will be useful and cost effective for credit unions. We recommend that at this stage the rule should not limit permissible supplemental capital instruments to one or two restrictively defined instruments. Rather, the rule should contain a number of requirements that any capital instrument would have to comply with, without specifying precisely how. Any issuance should be subject to regulatory approval prior to issuance, similar to the initial approach taken by the NCUA with derivatives.

The capital level of a credit union is based on a net worth ratio requirement for all credit unions and a risk-based net worth requirement for complex credit unions. The Federal Credit Union Act (FCUA) defines net worth. The act states that secondary capital is currently only permissible for low-income designated credit unions and may be counted toward the net worth ratio and for the risk-based net worth ratio, but the Board has broad discretion to allow credit unions without a low-income designation to issue alternative capital instruments to satisfy the risk-based net worth requirement, but not the net worth requirement. To allow it for the net worth requirement would require a change to the Act. The Act did not include an express definition of "risk-based net worth" for complex credit unions, thus the NCUA has broad discretion to include alternative capital instruments in the definition.

HCUA recommends that the rule be written so that NCUA would consider for approval any type of supplemental capital instrument that conforms to these principles. Any offering must not alter the fundamental structure of the credit union. If supplemental capital is sourced from members in the form of shares, such shares should grant no additional ownership or voting rights. Supplemental capital from non-members should impart no ownership or governance rights. The specific instrument used whether an equity instrument, paid in capital or another form of subordinated debt should be flexible and not prescribed in rule such that a credit union can best take advantage of the market and have the flexibility to structure the offering in a cost-efficient manner. The instrument will be uninsured and subordinate to other claims and available to cover operating losses and only issued pursuant to regulatory approval. A credit union should have an appropriate policy or plan in place prior to obtaining regulatory approval. The rule should establish appropriate limits on how much and to whom it can be issued with appropriate suitability standards followed.

Alternative capital could be generated from members only in two ways. First, at its option, a credit union could require each member to purchase a modest amount of uninsured membership shares as a condition of membership. Unlike the debt instruments, these membership shares would actually be equity rather than debt. As equity, uninsured membership shares would automatically stand ahead of the share insurance fund in the event of the need to absorb losses. This would spread a small amount of risk over all members, and could be used as an educational tool to remind members of the cooperative nature of their credit union.

The second way to generate secondary capital from members would be to issue certificates of indebtedness to members that are subordinated to all other claimants on the credit union. This is essentially subordinated debt issued to members. Members could choose whether or not to purchase such certificates. Members holding these certificates would not be entitled to any special ownership or voting rights beyond those available to all members.

As always, we appreciate the opportunity to review this issue. We will be happy to respond to any questions regarding these comments.

Sincerely,

A handwritten signature in black ink that reads "Bradley D. Douglas". The signature is written in a cursive, flowing style.

Brad Douglas  
President/CEO