May 9, 2017

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

Delivered Electronically

Subject: Alternative Capital - Advanced Notice of Proposed Rulemaking

Dear Mr. Poliquin,

On Wednesday, February 8, 2017, the National Credit Union Administration (NCUA) board issued an advanced notice of proposed rulemaking to solicit comments on alternative forms of capital that credit unions could use in meeting capital standards required by statute and regulation. The proposal asks two main questions:

1. Should alternative capital be authorized for risk based capital purposes - defined as supplemental capital?
2. How can the current alternative capital structure for Low Income Designated Credit Unions (LICUs) be improved - defined as secondary capital?

The Northwest Credit Union Association (The Association) would like to thank the NCUA board for working to modernize credit union's access to capital. This effort will facilitate growth credit unions need to survive in today's competitive marketplace. Alternative capital gives credit unions more flexibility to help members achieve their dreams. In addition, members could earn higher yields on savings. Alternative capital gives credit union boards and management more flexibility to define their mission and market rather than having decisions determined by Congress or a regulatory agency.

On behalf of more than 150 credit unions and their 6.5 million members, The Association is pleased to be able to offer our support for alternative capital, and would like to express our appreciation for the inclusive process that the NCUA is employing.

To assist the NCUA in their effort to create a modern capital system we sought input from our members through several different avenues including our NWCUA Regulatory Advisory Subcommittee.

Background

For credit unions, the only way to raise capital is through retained earnings. What this means is when liabilities/deposits grow faster than assets/loans, the credit union's net worth drops which can result in efforts to deter deposits and slow growth. Alternatively, if assets/loans grow more quickly relative to liabilities/deposits, credit unions may have to slow or shut down lending. This situation creates instability during economic cycles and results in capital inefficiencies for credit unions, whose members ultimately suffer.

Other types of financial institutions can create capital through equity ownership offerings, subordinated debt, and retained earnings, which allows them to grow the asset side of the balance sheet, giving them the ability to expand lending, continue deposit growth, create stability, predictable growth, and efficiently use capital.

The majority of Northwest credit unions that shared thoughts about the NCUA's alternative capital proposal support expanded access to capital. Northwest credit unions felt strongly that access to capital should be aligned with the not-for-profit cooperative model, meaning that credit union capital offerings would not imply ownership. While Northwest credit unions felt that access to alternative capital is needed, nearly all credit unions indicated that even with expanded authority, they were not planning to raise alternative capital.

Currently 100 credit unions, making up more than 50% of all Northwest credit unions, can access alternative capital due to their LICU designation. The rest are unable to access alternative forms of capital.

Under the current regulatory framework, only two LICU designated Northwest credit unions, Newrizons CU and Point West CU, currently have alternative capital. They have leveraged the capital to benefit underserved rural communities and underserved minority populations. They are good examples of mission driven credit unions that might seek alternative capital from a community development loan fund, another credit union, a foundation, or a philanthropist. Alternatively, some of the larger LICUs or credit unions could put together capital offerings that fund strategic growth. This type of offering could be marketed to accredited investors, or high-net worth individuals seeking yield and investor protections.

Based on the input we have received it is apparent that credit unions need flexibility. Disclosure requirements should be scaled and based on the type of offering. We strongly support a merit based, non-prescriptive approach, where the NCUA outlines expectations and has broad authority to approve or deny alternative capital plans.

Supplemental Capital

The Federal Credit Union Act (FCUA) sets forth two capital requirements. The first is the leverage ratio and the second is a risk based capital requirement based on the makeup of the balance sheet. The FCUA has a prescriptive formula for net worth as it pertains to the leverage ratio, but gives the NCUA broad authority to define risk based net worth. Risk based capital assigns risks to products and offerings but does not contemplate supplemental capital to offset those risks. In order to create a comparable risk-based framework to other prudential financial regulators, the NCUA must recognize supplemental capital for risk based purposes.

Currently, a complex credit union could meet the 7% leverage ratio to be well capitalized, but have balance sheet risk that puts them below the risk based threshold for being well capitalized. By allowing supplemental capital to count for risk based purposes the credit union could increase their risk based net worth through a capital offering causing their risk based net worth to rise and their leverage ratio to drop. This inverse relationship between the leverage ratio and the risk based ratio creates an effective limit on the supplemental capital offering for non-LICU credit unions.

Secondary Capital

The Association appreciates the critical updates that the NCUA has made to the secondary capital rules in 701.34 in recent years. Specifically, we appreciate the NCUA allowing credit unions to redeem portions of secondary capital that has a maturity that is less than five years.

We support healthy credit unions access to secondary capital to support planned growth, diversify capital sources and provide member benefit. We have credit unions who have taken capital from a variety of sources including banks interested in CRA credits, other credit unions, and the National Federation of Community Development Credit Unions. Unfortunately, non-natural persons are unable to purchase secondary capital. Suitable investors and high net worth individuals should be able to make at-risk uninsured capital investments to fund the mission of the credit union or because they are interested in yield, as long as the investment characteristics are clearly disclosed and understood.

The Association would strongly encourage the NCUA to consider utilizing the Community Development Revolving Loan Fund (CDRLF) as a source of secondary capital for LICUs. Currently the CDRLF is funded by congressional appropriation. The fund provides low interest loans to LICUs over a five-year minimum term and is historically undersubscribed to. This arrangement allows a credit union to fund loans proportionally like a deposit. However, if the CDRLF provided these same funds as secondary capital at double or even triple the interest rate, it would be far more attractive to credit unions and would give small credit unions a great option to fund growth. The CDRLF benefits by being able to charge a higher rate of interest and the small credit union benefits by a sustainable path to growth. Currently, the CDRLF is not funded by assessments and cannot be used to fund the NCUA operations or insurance activities. By providing CDRLF funds in the form of capital it provides greater protection to the SIF.

The Association would also strongly encourage the NCUA to leverage the partnership with the Treasury CDFI Fund to reinstitute the Community Development Capital Initiative program that was sunset in 2011. Funds from this program continue to support growth and capital formation in low income communities. Both Self Help CU and Hope FCU provide supporting evidence. The proposal asks a question about limits on the percentage of total capital that can be secondary capital. Limits would be prudent. Credit unions that currently fall outside limits should be grandfathered and Community Development Capital Initiative funds should be exempted.

As larger, more complex credit unions achieve their LICU designations their need for secondary capital looks different. These credit unions need flexibility to develop supplemental capital offerings that meet market demand. For example, a large insurer such as CUNA Mutual Group might put together a private placement through an organized investment pool. This is just one potential example but demonstrates the need for flexibility.

Conclusion

In conclusion, The Association appreciates the NCUA's commitment to improving the regulatory landscape for credit unions. Thank you again for the opportunity to comment on this issue. We would be pleased to answer any questions that you may have.

We believe that all capital offerings at credit unions should have a minimum maturity requirement to ensure permanence, should be subordinated debt protecting the share insurance fund, are recognizable as capital under GAAP, and do not convey ownership.

Respectfully,