PENNSYLVANIA
CREDIT UNION
ASSOCIATION

4309 North Front Street
Harrisburg, PA 17110-1618
800-932-0661 • 717-234-3156 • Fax 717-234-2695

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:

The Pennsylvania Credit Union Association (PCUA) on behalf of its member credit unions, submits these comments on the Advance Notice of Proposed Rulemaking for Supplemental Capital. PCUA is recommending a framework for the issuance of supplemental capital that will provide credit unions the opportunity to raise supplemental capital in a manner that will not jeopardize the safety and soundness of the issuing credit union, the reputation of the issuing credit union and the credit union income tax exemption; as well as providing an additional level of capital in the credit union system to preserve the integrity of the Share Insurance Fund.

The Use of Supplemental Capital

Credit unions face increased capital demands to meet the risk-based capital requirements and the rising costs of compliance, technology and staff expertise. In the cooperative model, the raising of capital through retained earnings is a slow process. We need to explore other methods to raise capital that are not inconsistent with the cooperative model. We believe the use of supplemental capital in the right circumstances can be a valuable tool for credit unions.

We encourage NCUA to permit supplemental capital to be included in its risk-based capital framework and that risk-based capital calculations include supplemental capital. Supplemental capital is just as effective in offsetting losses as other types of capital. This position is consistent with the discretion provided to the bank regulatory agencies. We anticipate that credit unions will use supplemental capital for specific projects such as branch expansion and technology upgrades and preserve their other capital for general operations.

We encourage NCUA to review the limits on the borrowing authority for federal credit unions but as a separate study and not part of this supplemental capital analysis. As we state later, the use of supplemental capital by credit unions will be limited. Additional borrowing authority would be more widely used by credit unions.

The Procedures for Issuing Supplemental Capital

We advocate that the use of supplemental capital be part of a supplemental capital plan that is reviewed and approved by NCUA and the state regulator, if applicable, prior to the offering. This will be new territory for credit unions and one that should require careful deliberation and consent of the regulator.

The credit unions that raise supplemental capital must be financially qualified to do so with competent advice for an achievable purpose set forth in a well-conceived plan. All will be well served if the credit union's management, directors and regulators are all working together on the same plan.

We also encourage a limit on the amount of supplemental capital that a credit union can raise as a percentage of its capital from retained earnings. Supplemental capital is just that and should never be a substitute for a solid capital base from retained earnings.

The Form of Supplemental Capital

While mandatory or voluntary membership capital instruments are being mentioned, we believe that regulatory issues and practical issues will limit the form of supplemental capital to subordinated debt. This means that anyone who invests in a subordinated debt takes the greatest risk. All obligations to members, vendors and other lenders take precedence over the subordinated debt holders. This is a sobering fact to a potential investor.

By limiting the form of supplemental capital to subordinated debt, there is no chance that credit unions could offer an investment instrument that has an equity component that would be inappropriate for a cooperative and put the tax exemption at risk.

The Permitted Investors in Supplemental Capital

We are concerned that some supplemental capital investors may not understand the financial risks or be able to afford a loss if it occurs. We recommend that the regulations address this concern with clear disclosures that must be acknowledged in writing by the investors even to the point of stating that if the investor cannot afford to lose this investment, the investor should not invest. Credit unions are not organizations that sell people a high risk investment who cannot afford to lose their investment.

We encourage NCUA not to restrict the type of investor. Potential investors can be natural persons, associations and business entities. Likewise, we do not see a need to limit the potential investors to members of the credit union. We are not persuaded that the issuance of subordinated debt to a non-member will compromise the cooperative model or adversely affect the credit unions' income tax exemption status. Credit unions have borrowing authority now and it is not limited to borrowing from members.

The Practical Issues of Supplemental Capital

The practical issue for credit unions desiring to raise supplemental capital is that plan approvals will take a great deal of staff time and possibly expert costs. There will be costs to issue the subordinated debt in compliance with securities laws and NCUA regulations that will be incurred. The yields may not be attractive in today's low yield economy. The risks to investors will be more than other investment opportunities that are not subordinated. The investment is in a credit union that does not have the ability to issue a round of stock offerings to raise significant capital in a short period of time.

This means that only credit unions that are financially strong will be able to present a reasonable risk profile. Only credit unions with sufficient scale will be able to afford the time and money expenses to profitably issue supplemental capital offerings. While NCUA cannot do anything about the low yield economic conditions, NCUA can be mindful of excessive regulation. We ask that NCUA scale its oversight to keep the regulatory burden of the process as low as possible and commensurate with the size of the respective offerings. There could be safe harbor rules for offerings under a certain amount that are less onerous than the larger offerings. While NCUA can and should look at the rules of their sister bank regulatory agencies and the SEC for guidance on best practices, we ask that NCUA carefully assess the application of the rules in a cooperative system and make adjustments accordingly.

The regulations should also address merger situations where the issuing credit union is merged into another credit union. The continuing credit union should have the option of assuming the obligation or paying off the obligation. If the merger is an emergency merger that may mean the investment is lost. Whatever the rules are, NCUA needs to clearly state the rules so investors know the risk.

Conclusion

We believe that considering all the practical limitations mentioned supplemental capital is worth pursuing. While not all credit unions are likely to use the power, it can be a very effective means to raise capital for a specific purpose that will enhance the ability of a credit union to serve its members and buffer losses to the share insurance fund. When the low yield interest environment changes, it is likely that more credit unions will use this power.

Thank you for the opportunity to comment.

With best regards,

Patrick C. Conway

Patrick C. Conway
President & CEO

cc: Association Board
Government Relations Committee
Regulatory Review Committee
State Credit Union Advisory Committee