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Credit Union National Association

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September 1, 2017

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

Re: Corporate Credit Union Proposed Rule; RIN 3133–AE75

Dear Mr. Poliquin:

On behalf of America's credit unions, I am writing regarding the National Credit Union Administration's (NCUA) proposed rulemaking regarding its corporate credit union regulation, *Part 704—Corporate Credit Unions*. The Credit Union National Association (CUNA) represents America's credit unions and their 110 million members.

Proposed Changes

In 2010, in response to the financial crisis, NCUA revised the corporate credit union regulation to "establish a regulatory framework that provides a foundation for a healthy corporate system." The 2010 rule curtailed several of the practices that led to corporate failures. Most relevant to this proposal, the 2010 rule also implemented a prompt corrective action (PCA) regime stipulating capital adequacy for corporates.

Given the improved financial condition among remaining corporates, as well as an improved economy overall, NCUA is proposing to amend the capital standards of the 2010 rule. The proposed amendments to the corporate rule primarily affect the calculation of capital after corporates consolidate and set a retained earnings ratio target in meeting PCA standards.

Corporate Consolidations and Capital

In Part 704, "Tier 1 capital" includes retained earnings acquired through a merger. Given that retained earnings acquired through a merger are currently not recorded on the continuing corporate's financial statements, the amount must be recorded outside of the financial statements, which is inconsistent with Generally Accepted Accounting Principles (GAAP). To correct this, NCUA is proposing to amend the definition of "retained earnings" to incorporate "GAAP equity acquired in a merger" as a component of retained earnings. This proposed amendment to the definition of "retained earnings" will, in turn, affect the definition of "Tier 1 capital," which includes retained earnings as one of the components of Tier 1 capital.

We agree with NCUA that expressly including such equity acquired in a merger as retained earnings and referencing GAAP will clarify that this capital is available to cover losses, enhance transparency, and reduce ambiguity. While we encourage NCUA to use its authority to deviate from GAAP when appropriate, we believe this instance does not call for such deviation, and we believe the proposed change will in fact better align Part 704 with GAAP.

We support the proposed change to incorporate "GAAP equity acquired in a merger" as a component of retained earnings, as we believe doing so will increase the transparency of a corporate's capital adequacy.

Retained Earnings Ratio

NCUA is also proposing to add a definition of "retained earnings ratio" to Part 704. The 2010 rule's PCA provisions require corporates to meet a leverage ratio. The leverage ratio primarily consists of retained earnings and perpetual contributed capital (PCC). Prior to the 2010 rule, corporates could, and did, rely on PCC comprised primarily of investments by federally insured natural person credit unions (credit unions). However, to address a potential issue where depletions of corporate capital led to corresponding investment impairments at credit unions, the 2010 rule limited the amount of contributed capital permitted to be included in calculating the corporate's leverage ratio. The limitation on PCC was phased in over a period of ten years.

Until October 2016, all PCC was included in the leverage ratio. Effective October 2016, Part 704 requires corporates to deduct the amount of PCC exceeding retained earnings by 200 basis points. Effective October 2020, corporates must deduct the amount of PCC exceeding retained earnings.

We believe the 2010 amendments to Part 704 have resulted in the intended effect. Specifically, corporates have accumulated sufficient retained earnings to meet or exceed the adequate capitalization threshold under PCA through the October 2016 phase-in adjustment. We agree with NCUA that the limitation on PCC for regulatory capital purposes does not recognize the full value of PCC that stands to absorb losses.

Therefore, we agree with the proposal to remove the requirement effective October 2020 to limit PCC counted as Tier 1 capital to the amount of retained earnings. In addition, we support the proposed change that would permit a corporate to include in its Tier 1 capital all PCC that is sourced from an entity not covered by federal share insurance.

CUNA appreciates NCUA's willingness to listen to industry concerns and adjust its regulations accordingly. In response to NCUA's 2014 corporate proposal, CUNA urged NCUA "to reconsider PCC as part of Tier 1 capital since the deductions [beginning in 2016 would] adversely impact working capital available to corporates." We repeat our support for removing the restrictions on PCC counted as Tier 1 capital, as we believe the deduction of PCC from Tier 1 calculations is potentially creating uncertainty regarding the financial stability of a corporate credit union simply due to the deduction of PCC which creates the appearance of lower capital. Further, we support such change because the current deduction causes confusion for credit union auditors when evaluating potential impairment of PCC.

Conclusion

On behalf of America's credit unions and their 110 million members, thank you for the opportunity to share our views regarding the proposed amendments to NCUA's regulation on corporate credit unions under Part 704. If you have questions about our comments, please do not hesitate to contact me at (202) 508-6743.

Sincerely,

Luke Martone

Luke Martone
Senior Director of Advocacy & Counsel