NASCUS
National Association of State Credit Union Supervisors

September 7, 2018

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

Re: NASCUS Comments on Proposed Rule: Risk-Based Capital – Supplemental Proposal

Dear Mr. Poliquin:

The National Association of State Credit Union Supervisors (NASCUS)[1] submits the following comments in response to the National Credit Union Administration's (NCUA's) request for comments on proposed changes to NCUA's October 29, 2015, final rule implementing a new regulatory framework for risk-based capital.[2] Given the breadth of comments submitted prior to the original finalization of the risk-based capital rule, it is laudable that NCUA has used the time since publication to revisit several key provisions. As discussed in more detail below, NASCUS supports NCUA's proposed changes. We also urge NCUA to utilize the additional time provided by the proposed delayed effective date to revisit additional elements of the risk-based capital rule that remain problematic in their current form. Furthermore, it is imperative NCUA promulgate a supplemental capital rule to provide credit unions the necessary tools to manage risk-based capital requirements.

NASCUS and state regulators remain committed to consulting and cooperating with NCUA in the rulemaking process to ensure final prompt corrective action rules are effective and efficient. Although risk-based capital rules are not without controversy, NASCUS recognizes their utility for enhancing safety and soundness.

- **NASCUS supports delay of the effective date of the risk-based capital rule**

NCUA proposes delaying the effective date of the 2015 final risk-based capital rule (2015 RBC rule) for another year, until January 1, 2020.[3] In some respects, delay of the effective date of the rule might disappoint those credit unions that have spent the past two years preparing to manage their balance sheets to the new regulatory framework, as well as those that have awaited the supplemental capital rulemaking NCUA assured would be completed prior to the effective date of risk-based capital. However,

[1] NASCUS is the professional association of the nation's 45 state credit union regulatory agencies that charter and supervise over 2,100 credit unions.
[2] 80 Fed. Reg. 66625 (October 29, 2015).
[3] 83 Fed. Reg. 38997 (August 8, 2018).

supervisory guidance has yet to be issued to examiners and industry to assist in implementing the rules and uncertainty remains related to fields 22-46 on the 5300 Call Report intended to capture risk-based capital related information.[4]

Given the need for supervisory guidance and clarification of the Call Report changes, it would be prudent to delay the effective date of the rule. Furthermore, a delayed effective date would provide NCUA an opportunity to address supplemental capital rulemaking.

- **NASCUS supports raising the asset threshold for defining a complex credit union**

Part 702.103 of NCUA's 2015 RBC rule defines a "complex credit union", subject to the risk-based capital requirements, as a natural person credit union with quarter end assets that exceed $100 million.[5] Upon review of the final rule, NCUA now proposes to raise the threshold definition for "complex credit union" to a credit union that has quarter end assets of more than $500 million. NCUA believes that a $500 million threshold better represents the asset size at which an individual credit union might pose a material risk to the share insurance fund.

NASCUS agrees the threshold should be raised, and we support NCUA's proposal to raise it to $500 million. Congress's directive to NCUA for implementing risk-based capital was to limit its application to those risks for which the standard leverage ratio was insufficient.[6] However, we reiterate our concerns, first raised during the proposed rulemaking in 2015, that while an asset threshold makes for ease of administration, it oversimplifies the complexities of a balance sheet and may cover more credit unions than Congress intended.[7] NCUA should work with state regulators to more precisely define a "complex credit union."

While it is true complexity could be found at various asset sizes, it is unlikely Congress envisioned that nearly 30 percent of credit unions would be complex, as would be the case with a $100 million asset threshold. At $500 million, or even $1 billion, as a complexity threshold, the rule would more closely align with the spirit of § 1790 of the Federal Credit Union Act.

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[4] 83 Fed. Reg. 4518 (January 31, 2018). See NASCUS Comments on Proposed Call Report Modernization, available at http://nascus.org/regulatory-resources/04.03.18%20comment%20call%20report%20profile.php.
[5] 80 Fed. Reg. 66639 (October 29, 2015).
[6] 12 U.S.C. § 1790d(d)(2).
[7] See NASCUS comments on Proposed Risk-Based Capital (April 27, 2015). Available at https://www.ncua.gov/Legal/CommentLetters/CLRisk20150427LIto.pdf.

- **NASCUS agrees that changes were needed to the Original Complexity Index (OCI)**

NCUA bases its asset threshold for determining a "complex credit union" on a "complexity index" that measures the products and services offered by credit unions based on fifteen indicators. NCUA now proposes amending six of the indicators (the Revised Complexity Index or "RCI"). Changes proposed include replacing the indicator for "member business loans" with an indicator for commercial loans, limiting the participation loan indicator to participation loans sold, and removing the indicators for internet banking and investments with maturities greater than five years.

NASCUS agrees with NCUA's proposed changes to the complexity indicators. In particular, we concur that several indicators from the OCI in 2015 represent activities that are either common place among virtually all credit unions, or common enough so as to defy characterization as complex. Real estate loans, including interest only loans, internet banking, and extended maturity limits are all staples of financial services.

- **NCUA should use this delay to finalize a supplemental capital rule for natural person, non-low-income credit unions**

NASCUS has long noted that NCUA has the authority to define the elements of the risk-based capital ratio. Because Congress did not speak directly to the calculation of risk-based capital, NCUA need not be limited by §1790d(o)(2) in defining what constitutes the ratio elements.[8] Including supplemental forms of capital in the risk-based capital numerator could help protect the NCUSIF from losses by encouraging credit unions to attract additional loss-absorbing forms of capital that they would otherwise forego. So doing provides several tangible benefits to the credit union movement:

1) Providing for supplemental capital would benefit credit unions by allowing for measured expansion of products and services without the dilution of regulatory capital. This could be especially beneficial to modest sized credit unions seeking to modernize and enhance member services to maintain competitiveness with larger financial institutions.

2) Authorizing supplemental capital also empowers a credit union's members by allowing those members to recapitalize, or augment the capitalization, of their credit union. NCUA has often sought ways to "empower" members. Providing for members' ability to directly recapitalize their credit union would be consistent with NCUA's approach in that regard.[9]

3) Incentivizing credit unions to attract additional capital provides a buffer for the share insurance fund, absorbing credit union losses in a first position and

[8] 12 U.S.C. 1790d(o)(2)
[9] See NCUA final Voluntary Merger Rule, 83 Fed. Reg. 30301 (June 28, 2018).

> mitigating potential share insurance losses. The point of the risk-based capital rulemaking is to increase the capital buffer standing before the share insurance fund. Supplemental capital is wholly consistent with that goal.

Of course, NCUA has assured stakeholders that supplemental capital rulemaking would accompany final implementation of risk-based capital. In its preamble to the 2015 final RBC rule, NCUA wrote "[t]he Board plans to address comments supporting additional forms of supplemental capital in a separate proposed rule, **with the intent to finalize a new supplemental capital rule before the effective date of this risk-based capital final rule**."[10] In a November 2015 report to Congress, NCUA assured Congress that "[a]s part of modernizing NCUA's risk-based capital rule, the NCUA Board was unanimous in its commitment to move forward with a separate rulemaking to allow supplemental capital to be counted toward the risk-based capital ratio. The effective date of this proposed change would coincide with implementation of NCUA's modernized risk-based capital rule scheduled for January 1, 2019."[11] We urge NCUA to move forward expeditiously to work with state regulators on completing a framework for the use of supplemental capital in meeting risk-based capital requirements before the effective date of the risk-based capital rule.[12]

- **In refining the risk-based capital rule, and developing the supplemental capital component of prompt corrective action, NCUA should consult and cooperate with state regulators**

Congress recognized the expertise of state regulators in supervising federally mandated leverage ratios in state banks when it directed NCUA to implement Prompt Corrective Action (PCA) for credit unions in 1998.[13] That is why Congress directed NCUA to consult and work cooperatively with state regulators when implementing the PCA framework of Part 702.[14] Indeed, NCUA has worked well with NASCUS and state regulators in developing the original implementing rules of Part 702, as well as the 2015 Final RBC rule and many aspects of the foundational work on supplemental capital. However, it would be unfortunate to neglect the need for a contemporary consultation on both risk-

[10] 80 Fed. Reg. 66665 (October 29, 2015). Emphasis added.
[11] NCUA, *Report to the House Financial Services Committee on the Final Risk-Based Capital Rule*, November 2015. Available at https://www.ncua.gov/regulation-supervision/Documents/RBC/final-risk-based-capital-rule-report.pdf. (accessed August 27, 2018). See also NCUA's *Frequently Asked Questions about NCUA's Risk-Based Capital Final Rule*, October 2015. Available at https://www.ncua.gov/Legal/Documents/RBC/RBC-Final-Rule-FAQs.pdf. (accessed August 27, 2018). Question #10 reads in full:

> Q10. Will credit unions be authorized to raise supplemental capital for purposes of risk-based net worth? Yes. The NCUA Board plans in a separate proposed rule to address comments supporting additional forms of supplemental capital. As the risk-based capital final rule does not take effect until January 1, 2019, there is ample time for the NCUA Board to finalize a new rule to allow supplemental capital to be counted in the risk-based capital numerator before the effective date.

[12] For more information on the importance of supplemental capital, and how such a framework might be implemented, see NASCUS' comments on Advanced Notice of Proposed Rulemaking for Supplemental Capital, (May 9, 2017). Available at https://www.ncua.gov/Legal/CommentLetters/cl-altcap-20170515LIto.pdf.
[13] Risk-weighted capital standards for banks have existed since the 1980s.
[14] 12 U.S.C. §1790(l).

based capital's final implementation as well as on supplemental capital rulemaking. As evidenced by NCUA's thoughtful, and convincing, preamble to this proposal, much has changed since 2015. NCUA should leverage state regulator expertise, as mandated by Congress, in reviewing comments to this proposal before issuing a final supplemental rule. We also urge NCUA to use the time during the delayed implementation to review other elements of the 2016 Final RBC rule to ensure they are rightsized for the changing credit union landscape.

- **NCUA should consider developing an "off-ramp" for complex credit unions that choose to hold higher capital**

NCUA should use the delayed effective date to consider whether it would be appropriate, from both a supervisory perspective and a credit union operational perspective, to create an alternative leverage ration for complex credit unions (sometimes referred to as an "off-ramp"). Under this regulatory theory, certain qualifying "complex credit unions" subject to the risk-based capital rule could choose to hold capital in an amount pre-determined by NCUA to be a sufficient alternative to risk-weighting the credit union's balance sheet. By so doing, the credit unions would be exempted from the risk weighting requirements. This streamlined option would reduce regulatory burden for some lower risk, well capitalized, complex credit unions.

Of course, NASCUS is aware that even well capitalized credit unions can, and unfortunately historically have, experienced rapid loss of capital.[15] However, it is worth noting that Congress recently authorized an "off-ramp" approach for some banks in Title II, §201, of the recently enacted Economic Growth, Regulatory Relied, and Consumer Protection Act.[16] It is worth considering whether such an "off-ramp" might be appropriate for credit union risk-based capital rulemaking.

- **NCUA should revisit the risk weightings themselves during the delay in the effective date**

Finally, we urge NCUA to use the extended delay in effective date to revisit the final rule's risk-weightings themselves. As noted above, much has changed since the final rule's development and publication in 2015. Mismatching an activity's true risk, and its risk-based weighting, can have a profound impact on the products and services credit unions offer as some credit unions draw down activity in more heavily weighted product lines. In light of changes in the credit union system, it would be prudent to re-evaluate risk-weightings to ensure proper balance. For example, the risk-weighting for commercial loans were developed prior to the promulgation and implementation of

[15] NCUA emphasized this point, and we agree, in charts accompanying the 2015 Final RBC rule. See 80 Fed. Reg. 66632 (October 29, 2015).
[16] Economic Growth, Regulatory Relied, and Consumer Protection Act, Pub. Law 115-174, S. 2155, May 2018.

NCUA's 2016 Commercial Loan rule that enhanced supervisory expectations for management of credit union commercial lending portfolios.[17]

In addition, as was noted in 2015 prior to finalization of the rule, some risk weightings for credit unions are higher than for similar activities for banks. This, despite the fact that credit unions are required to carry more "pure" capital than banks.

Just as NCUA recognized the definition of "complex credit union" was in need of refinement, we believe too that the original risk-weightings of the final rule should be carefully reviewed to determine what adjustments are appropriate given the changes in the credit union system in the past three years.

NASCUS appreciates the opportunity to submit comments regarding changes to the risk-based capital rule. We are aware that some of our recommendations are beyond the scope of specific request for comments covered by this proposal. We offer all of our comments in the spirit of cooperation with NCUA to achieve the best supervisory environment for the credit union system. The complexity of administering, and managing, a risk-based capital regime for both regulators and credit unions necessitates the rule be carefully calibrated to balance regulatory burden with supervisory benefit. The proposed changes are positive steps in the direction of a better rule. We would be pleased to discuss our additional recommendations in more detail at NCUA's convenience.

Sincerely,

- signature redacted for electronic publication -

Brian Knight
General Counsel

[17] 81 Fed. Reg. 13530 (March 14, 2016).