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May 10, 2021

Ms. Melane Conyers-Ausbrooks
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Re: Simplification of Risk-Based Capital Requirements; RIN 3133–AF35

Dear Ms. Conyers-Ausbrooks:

On behalf of America's credit unions, I am writing to the National Credit Union Administration (NCUA) regarding the advance notice of proposed rulemaking (ANPR) on simplifying the risk-based capital (RBC) requirements. The Credit Union National Association (CUNA) represents America's credit unions and their more than 120 million members.

The NCUA is seeking input on two approaches to simplify its RBC requirements.[1] The NCUA's RBC requirements are set forth in a final rule adopted in 2015 (2015 RBC Rule).[2] The first approach would replace the 2015 RBC Rule with a "risk-based leverage ratio" (RBLR) requirement, which uses relevant risk attribute thresholds to determine which complex credit unions would be required to hold additional capital (buffers). The second approach would retain the 2015 RBC Rule but provide eligible complex credit unions with the option to instead comply with a "complex credit union leverage ratio" (CCULR) framework to meet all regulatory capital requirements.

Background

Section 216 of the Federal Credit Union (FCU) Act directed the NCUA to adopt a regulation to establish a system of prompt corrective action (PCA) to restore the net worth of all federally insured credit unions if they become inadequately capitalized.[3] Section 216 requires supervisory actions indexed to five statutory net worth categories, ranging from well capitalized to critically undercapitalized. The mandatory actions and conditions triggering conservatorship and liquidation are expressly prescribed by statute. To supplement the mandatory actions, section 216 charged the NCUA with developing

[1] 86 Fed. Reg. 13,498 (Mar. 9, 2021).
[2] 80 Fed. Reg. 66,626 (Oct. 29, 2015).
[3] 12 U.S.C. § 1790d.

discretionary actions which are comparable to the discretionary safeguards available under section 38 of the Federal Deposit Insurance Act.[4]

Section 216(d)(1) of the FCU Act requires the NCUA's PCA system to include "a risk-based net worth requirement" for credit unions that are complex, as defined by the NCUA.[5] The 2015 RBC Rule restructured the NCUA's current capital adequacy regulations and made various revisions, including amending the agency's risk-based net worth requirement by replacing a credit union's risk-based net worth ratio with an RBC ratio. The RBC provisions of the 2015 RBC Rule apply only to complex credit unions. Through subsequent revisions, the 2015 RBC Rule is currently scheduled to become effective January 1, 2022.

Lack of Justification for RBC Rule

Before addressing the potential revisions to the RBC requirements, we reiterate our long-held position that the 2015 RBC Rule is functionally unnecessary.[6] The data continues to clearly show that the rule is a solution looking for a problem. If in place prior to the financial crisis, the 2015 RBC Rule would have done almost nothing to prevent the dislocations that occurred—most capital and liquidity issues were confined to the corporate credit union arena, where the agency had already effectively addressed relevant concerns. The requirements imposed by the 2015 RBC Rule place significant unnecessary burdens on credit unions and needlessly coerce credit union asset allocations—all at a significant cost to credit union members. The fact that the original effective date of the 2015 RBC Rule has been delayed multiple times and the credit union system remains strong shows that such a disruptive rule change is clearly unnecessary.[7]

ANPR to Simplify RBC Requirements

The NCUA has issued this ANPR to potentially reduce the complexity and burden of the capital requirements. The RBLR approach would replace the 2015 RBC Rule in its entirety; it would use relevant risk attribute thresholds to determine which complex credit unions would be required to hold an additional capital buffer above what is currently specified in the PCA regulations. The CCULR approach would retain the 2015 RBC Rule but would enable eligible complex credit unions to opt into a framework to meet all regulatory capital requirements. Accordingly, the two approaches outlined are mutually exclusive, and the CCULR would not be available under the RBLR.

[4] 12 U.S.C. § 1831o.
[5] "Complex" credit unions include those with total assets greater than $500 million.
[6] *See* CUNA Comment Letter to NCUA re RBC Proposed Rule (Apr. 17, 2015), *available at* https://www.ncua.gov/files/comment-letters/2015/CLRisk20150416JNussle.pdf.
[7] 83 Fed. Reg. 55,467 (Nov. 6, 2018); 84 Fed. Reg. 68,781 (Dec. 17, 2019).

Risk-Based Leverage Ratio (RBLR)

As an alternative to the 2015 RBC Rule, the NCUA is seeking comment on a simplified capital framework that satisfies the risk-based net worth requirement for complex credit unions.

The RBLR approach would utilize certain risk characteristics to determine the required capital level. This approach differs from the 2015 RBC Rule, where all assets and certain off-balance sheet activities are categorized into risk groups and then risk-weighted to produce a risk-based ratio. The NCUA is also considering using the net worth ratio as the RBLR measurement. The net worth ratio would be supplemented with mandatory capital buffers when certain risk factors are triggered. This approach would require an extra cushion of capital buffers over and above the 7% net worth ratio standard for classification as well capitalized when certain characteristics inherent in a credit union's balance sheet exceed specified thresholds. The amount of the capital buffer would be a discreet percentage of net worth-to-total assets over 7% and would be a mandatory capital requirement.

The NCUA's intention is that the RBLR would streamline compliance with capital requirements without sacrificing the safety and efficacy of the overall capital regime. As envisioned, the greater simplicity would come from converting the current computational framework for complex credit unions into a three-tiered system of minimum leverage ratios. The minimum leverage ratio necessary to be well capitalized under RBLR would remain at 7%, with two higher tiers applied to those complex credit unions exhibiting quantified amounts of higher relative risk. The defining risk attributes would be a function of the types and concentration of underlying assets.

We do not support this potential approach. We agree that basing the RBLR on the net worth ratio would significantly reduce the Call Report requirements and utilize a measurement that credit unions are already familiar with. However, while an RBLR approach would be simpler, it would likely result in higher capital requirements for credit unions holding certain assets compared to the RBC framework. Further, assuming capital changes are inevitable, completely replacing the 2015 RBC Rule with new, unknown requirements is not ideal at this stage of the rulemaking process.

We find the implicit tradeoff under the RBLR approach between a reduction in the complexity and burden of the capital requirements in exchange for holding potentially higher amounts of mandatory capital above the 7% net worth ratio is unwarranted. For example, the loans held by an agricultural-focused credit union could easily be considered riskier and thus require additional capital under the RBLR approach. We disagree with such a potential result, given the intent of the rule (to simplify) would come at a real cost (of having to hold additional capital).

Further, as addressed in the timing section below, the time constraints an entirely new regulation would place on credit unions would not be feasible, particularly if the agency maintains a January 1, 2022, effective date as suggested in the ANPR.

Complex Credit Union Leverage Ratio (CCULR)

Section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act directed the Office of the Comptroller of the Currency, Federal Reserve Board, and Federal Deposit Insurance Corporation (banking agencies) to propose a simplified, alternative measure of capital adequacy for certain federally insured banks. The banking agencies implemented this statutory requirement in a "community bank leverage ratio" (CBLR) rule in 2019.[8]

The CBLR is an optional framework to the RBC requirements for depository institutions and depository institution holding companies that meet the following criteria:

1) A leverage ratio (equal to tier 1 capital divided by average total consolidated assets) of greater than 9%.
2) Total consolidated assets of less than $10 billion.
3) Total off-balance sheet exposures of 25% or less of its total consolidated assets.
4) Trading assets plus trading liabilities of 5% or less of its total consolidated assets.
5) Not an advanced approaches banking organization. (Advanced approaches banking organizations are generally those with at least $250 billion in total consolidated assets or at least $10 billion in total on-balance sheet foreign exposure, and includes the depository institution subsidiaries of those firms.)

Qualifying community banking organizations that opt into the CBLR framework are considered to be in compliance with the banking agencies' generally applicable risk-based and leverage capital requirements. Further, for the purposes of section 38 of the Federal Deposit Insurance Act, these qualifying banking organizations will have met the well-capitalized ratio requirements. In exchange, the qualifying banking organizations must maintain a greater amount of capital than normally required to be deemed well capitalized. Qualifying community banking organizations may opt into or out of the CBLR framework at any time.

The CBLR rule includes a two-quarter grace period during which a qualifying community banking organization that temporarily fails to meet any of the qualifying criteria, including the greater than 9% leverage ratio requirement, will still be deemed well capitalized. However, the qualifying community banking organization must maintain a leverage ratio greater than 8%.[9] At the end of the grace period, the banking organization must meet all qualifying criteria to remain in the CBLR framework or otherwise must comply with and report under the generally applicable risk-based and leverage capital requirements.

The CCULR approach would be based on the principles of the CBLR framework and, for complex credit unions that meet specified qualifying criteria and have opted into the

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[8] 84 Fed. Reg. 61,776 (Nov. 13, 2019).
[9] A banking organization that fails to maintain a leverage ratio greater than 8% will not be permitted to use the grace period and must comply with the generally applicable capital requirements and file the appropriate regulatory reports. 86 Fed. Reg. 13,501.

approach, would provide relief from the requirement to calculate an RBC ratio, as implemented by the 2015 RBC Rule. In exchange, the qualifying complex credit union would be required to maintain a higher net worth ratio than is otherwise required for the well-capitalized classification. This is a similar trade-off to the one made by qualifying community banking organizations under the CBLR.

We support the second option provided in the ANPR: give complex credit unions the option to comply with the 2015 RBC Rule or with the CCULR. While the requirements of the 2015 RBC Rule are complex and compliance may be onerous for some, it is helpful that credit unions know exactly how they will be impacted under the upcoming Rule. Further, though the effective date of the 2015 RBC Rule has been delayed until 2022, credit unions have made numerous changes over the years to prepare for the new requirements. With that said, we believe providing complex credit unions with an alternative choice is the preferred approach.

The CCULR would further the FCU Act's PCA requirements by requiring that complex credit unions continue to hold capital commensurate with their risks, while minimizing the burden associated with complying with the requirements of the 2015 RBC Rule. We believe the CCULR could benefit complex credit unions that would otherwise be required to comply with the 2015 RBC Rule. We support an approach that provides maximum flexibility for impacted credit unions.

The CBLR qualifying criteria that is relevant to credit unions appears reasonable. However, it is critical that the NCUA propose specific criteria appropriate for credit unions—which may or may not overlap entirely with that for the CBLR—and allow the industry to offer input on such criteria. In addition, we ask the agency to provide specific information on what the CCULR will mean for complex credit unions in terms of capital based on asset size. Without such information, we believe it is premature to speculate on an asset threshold—such as $10 billion in total assets—for credit unions to be eligible for the CCULR.

<u>Timeline</u>

As noted above, the 2015 RBC Rule is scheduled to become effective January 1, 2022. The NCUA expects that any final rule developed in response to this ANPR would be issued before the effective date of the 2015 RBC Rule. Accordingly, the NCUA expects that any proposed rulemaking issued in response to this ANPR would be issued by midyear of 2021. Once comments are received, the NCUA will evaluate the comments and direct NCUA staff to move forward in drafting any proposed rule to meet this timeline.

We believe any changes to the RBC requirements, including those contemplated by this ANPR, would require a delay of the January 1, 2022, effective date, whether that effective date is for the 2015 RBC Rule or some alternative approach discussed above.

While the second approach considered under the ANPR—which we support—would maintain the 2015 RBC Rule as an option for complex credit unions, the introduction of the CCULR as a choice would require considerable time for credit unions to understand

and implement. Further, the ANPR includes information on the criteria of a qualifying community banking organization under the CBLR but it lacks detail on what the CCULR would look like. This lack of information makes it difficult for credit unions to understand the extent to which the CCULR would potentially benefit them over the 2015 RBC Rule. While greater detail will of course be included in the proposed rulemaking phase, credit unions will not have access to such information until a final rule is adopted. And, a final rule would be many months down the road, potentially even conflicting with the January 1 effective date, making compliance challenging, if not, impossible.

Thus, if the agency pursues changes contemplated under either approach of the ANPR, we believe it is critical that the January 1, 2022, effective date be delayed at least six months to allow complex credit unions to determine the best available option for their operation and implement the required changes.

Conclusion

On behalf of America's credit unions and their more than 120 million members, thank you for considering our comments on simplifying the RBC requirements. If you have questions about our comments, please do not hesitate to contact me at (202) 508-6743 or LMartone@cuna.coop.

Sincerely,

Luke Martone
Senior Director of Advocacy & Counsel