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National Association of Federally-Insured Credit Unions

October 15, 2021

Melane Conyers-Ausbrooks
Secretary
National Credit Union Administration
1775 Duke Street
Alexandria, VA. 22314-3428.

RE: Capital Adequacy: The Complex Credit Union Leverage Ratio; Risk-Based Capital; NCUA-2021-0072

Dear Ms. Conyers-Ausbrooks:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing to share comments regarding the the National Credit Union Administration's (NCUA) proposal to adopt a complex credit union leverage ratio (CCULR) as an alternative measure of risk-based capital (RBC) adequacy. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 127 million consumers with personal and small business financial service products. NAFCU supports reevaluation of the NCUA's 2015 Risk Based Capital Rule (RBC rule) and consideration of simplified measures of risk-based capital adequacy. However, the proposed CCULR, which adopts a significantly higher leverage ratio than the comparable Community Bank Leverage Ratio (CBLR), will provide only marginal relief to qualifying complex credit unions. Furthermore, in recognition of the industry's demonstrated capital strength and resiliency through the pandemic, the NCUA should also reevaluate its handling of certain risks under the RBC Rule.

General Comments

NAFCU appreciates the NCUA's willingness to explore simplification of risk-based capital requirements and we are pleased that certain recommendations, such as focusing near-term attention on the CCULR (versus the Risk Based Leverage Ratio), using a simple net worth calculation, and avoiding asset-based eligibility criteria, have informed the scope of the current proposal. NAFCU also supports proposed technical changes, such as a more flexible calculation of the member business loan (MBL) cap under the CCULR and clarification that Paycheck Protection Program loans will receive a zero percent risk weight under the RBC Rule. While these changes are positive, they are overshadowed significantly by the decision to propose a CCULR ratio that is excessively high relative to the CBLR.

Ultimately the NCUA's decision to adopt a 10 percent CCULR ratio stands in contrast with straightforward adoption of bank standards elsewhere in the proposal, such as in the context of asset securitizations and defining off-balance sheet exposures. If the NCUA's concern is consistency with bank regulation, then the CCULR ratio should be set to no more than 9 percent. Other factors, of course, also warrant reconsideration of the 10 percent CCULR. The character of credit union capital, resiliency of the credit union system through the pandemic, and conduct of the industry relative to banks in the period before the Great Recession, are all signs that risk within the credit union system has been and continues to be well managed, even without the guiding hand of Basel-inspired capital standards. The CCULR should reflect these historical lessons and important distinctions. Accordingly, we ask that the NCUA prioritize several important changes to ensure the CCULR offers meaningful capital relief.

Lowering of CCULR Ratio is Necessary

The hypothetical compliance savings associated with the CCULR are hard to envision at a 10 percent, fully phased-in CCULR ratio. Set at this threshold, most prospective credit union adopters would likely calculate their RBC ratio anyway to determine whether there is any advantage to using a more stringent, albeit streamlined, measure of risk-based capital adequacy, or else as a hedge if it proves difficult to maintain a comfortable capital buffer at 10 percent net worth.

As NAFCU noted in its May 2021 response to the NCUA's advanced notice of proposed rulemaking (ANPR) regarding simplification of risk-based capital requirements, the appropriate leverage ratio for the CCULR should at least be comparable to the CBLR, and in fact should be lower. In terms of the share of credit unions that would see capital standards ease by adopting the CCULR, the analogous threshold which provides greatest parity with the CBLR would be a leverage ratio *less than* 9 percent.

The Federal Deposit Insurance Corporation's (FDIC) 2020 study of the CBLR found that under the 9 percent leverage ratio, only 3 percent of banks would see their capital buffers shrink by taking the off-ramp option.[1] The chart below illustrates that for credit unions, a comparable measure of capital relief would be accomplished with a leverage ratio set between 8 and 8.5 percent.

Stringency of CCULR

	Percent of FICUs where binding standard is...		Maximum Potential Capital Release	
CCULR	Leverage Ratio	Risk-Based Capital Ratio	Amount ($millions)	As % of Capital Held
8.0%	95.3%	4.7%	+$322.9	+0.6%
8.5%	97.8%	2.2%	+$110.9	+0.2%
9.0%	99.0%	1.0%	+$44.4	+0.1%
9.5%	99.7%	0.3%	+$14.2	+0%
10.0%	99.9%	0.1%	+$6.3	+0%

Figures reflect analysis of 2021q2 call report data for complex CUs (those with over $500 million in assets)
Source: NCUA call report data, NAFCU analysis

[1] FDIC, Corporation Staff Studies - Report No. 2020-03 Analyzing the Community Bank Leverage Ratio (May 2020).

While the 9 percent ratio provides nominal parity in terms of the percent reduction in the capital buffer, accelerated asset growth in the last year driven by the pandemic should favor an even lower CCULR to ease capital pressure during a period of economic recovery.

By contrast, the proposed 10 percent CCULR takes an extreme view of overall risk among complex credit unions and falls short of comparable relief offered to community banks. As noted previously, the 10 percent ratio also risks chilling CCULR adoption. The CBLR already suffers from low adoption due to its perceived stringency at a lower leverage ratio of 9 percent and community banks have urged the federal banking agencies to consider further, downward adjustments. As of June 30, 2021, only 39% of banks under $10 billion in total assets had opted into the CBLR. If the NCUA does not target a more reasonable CCULR ratio, complex credit unions will be at a disadvantage relative to banks.

The CCULR's proposed transition provisions, although well intentioned, do little to alleviate lack of parity with the CBLR. From January 1, 2022, to December 31, 2022, a complex credit union may opt into the CCULR framework if it has a CCULR of 9 percent or greater. From January 1, 2023 until December 31, 2023, a credit union that has opted into the CCULR framework must have a CCULR of 9.5 percent or greater to meet the eligibility criteria, and beginning January 1, 2024, a CCULR of 10 percent is fully effective. NAFCU believes that the NCUA should not only consider lowering the fully phased-in CCULR ratio, but also adjust the transitional CCULR ratio to start at 8 percent. Doing so will provide more meaningful capital relief to healthy complex credit unions that have prudently managed risk under the agency's current risk based net worth regulation.

The NCUA should also commit to future retargeting of a fully phased-in CCULR once additional data is collected during the transition period. Given the uncertain the trajectory of the nation's economic recovery and expected disruption associated with the Current Expected Credit Loss (CECL) standard in 2023, the NCUA should first assess the impact of CECL implementation on credit union reserves before locking in a final CCULR.

The NCUA has also solicited comment on whether it should adopt additional eligibility criteria if it targets a lower CCULR ratio. NAFCU believes that at a CCULR of 9 percent, the agency should generally conform the eligibility criteria to analogous CBLR criteria (i.e., eliminate the goodwill limitation). Consideration of additional criteria, such as limits on investments in CUSOs or consideration of mortgage service assets, would not only discourage otherwise healthy investment and lending activity, but risk such minimal CCULR participation among qualifying complex credit unions as to call into question the value of the proposal in relation to its administrative cost to the agency.

Longer Transitional Period

As credit unions continue to deal with the economic disruption caused by the pandemic, including accelerated asset growth, the NCUA should aim to offer a more gradual transition to a fully phased-in CCULR ratio. While NAFCU appreciates the proposed, two-year transition timeframe, the expiration of pandemic related regulatory relief measures in 2022, mandatory implementation of

CECL in 2023, and continued uncertainty regarding the trajectory of economic recovery warrant a longer period. NAFCU recommends the agency adopt a transition period of four years to mitigate the substantial disruption the pandemic continues to inflict.

A longer transition period would also permit the agency to better assess the impact of CECL on complex credit unions and afford an opportunity to solicit industry input on whether the CCULR should be retargeted based on the interaction of CECL and RBC compliance. Separately, the NCUA should consider appropriate adjustments to CCULR implementation plans to give credit unions sufficient time to adapt and respond to corresponding changes in Call Reports.

More Flexible Opt-Out Framework

Under the proposed rule, a qualifying complex credit union with a CCULR of 10 percent or greater, subject to the transition provisions, may opt into the CCULR framework at the end of each calendar quarter. After a qualifying complex credit union has adopted the CCULR framework, it may voluntarily opt out of the framework by providing written notice to the appropriate Regional Director or the Director of the Office of National Examinations and Supervision (ONES). The notice must be provided at least 30 days before the end of the calendar quarter and include several items, including a statement of intent explaining why the qualifying complex credit union is opting out of the CCULR, a completed call report with the risk-based capital ratio calculated for the prior quarter, and a copy of board minutes approving the opt-out.

NAFCU believes that the proposed transitional requirements are unnecessary and will further discourage use of the CCULR as an alternative to the RBC calculation. Credit unions should be permitted to opt into and out of the CCULR without needing to provide advance notice. The other federal banking agencies have not adopted any comparable requirement for banks and the rationale for the advance notice suggests the NCUA may require a credit union to continue using the CCULR if it cannot demonstrate that it "has acquired the necessary systems and processes to be capable of calculating and reporting its risk-based capital ratio accurately."[2]

NAFCU believes it is highly unlikely a credit union would opt-out of the CCULR if it had no ability to calculate its RBC ratio and asks that the NCUA remove the advance notice requirement so that credit unions can decide, based on their own business judgment, which capital framework makes the most sense without having to jump through administrative hoops. If the NCUA is deeply concerned that qualifying complex credit unions have not given enough thought to how they will calculate their RBC ratio in the time since the 2015 RBC Rule was proposed, an alternative may be for the agency to only require advance notice in the first year of the CCULR's implementation, since that will provide ample time to assess the industry's overall RBC preparedness.

Reservation of Authority

[2] See NCUA, Capital Adequacy: The Complex Credit Union Leverage Ratio; Risk-Based Capital, 86 Fed. Reg. 45824, 45836 (August 16, 2021)

Similar to the RBC Rule's provision regarding supervisory assessments of RBC adequacy,[3] the proposal includes a reservation of authority for what the NCUA regards as potential "limited instances in which the CCULR framework would be inappropriate and not require sufficient capital to adequately protect the [National Credit Union Share Insurance Fund]."[4] Under the proposed reservation of authority, credit unions would be entitled to a two-quarter grace period before being required to comply with the RBC framework. While this reservation of authority matches the design of the CBLR, NAFCU is concerned that subjective evaluation of a credit union union's CCULR eligibility could create pressure to adopt conservative, internal net worth targets, perhaps in excess of what the CCULR itself demands. NAFCU believes such an outcome would be counterproductive to the goal of offering broad capital relief and recommends the NCUA either eliminate this reservation or else offer a mechanism for qualifying complex credit unions' to promptly appeal a determination that use of the CCULR is inappropriate.

Treatment of Goodwill

The NCUA should permit credit unions to include goodwill in the numerator portion of risk based capital calculations. As expressed in prior comments, NAFCU believes deducting goodwill from the RBC numerator presents two significant issues. First, it penalizes credit unions who have recently gone through a merger. Second, it discourages new merger activity, which could discourage future combinations of unhealthy credit unions with stronger ones. Requiring deduction of goodwill from regulatory capital could also pose long term challenges for the SIF if larger credit unions are reluctant to merge with struggling credit unions. If the regulatory capital cost of a prospective merger is too high, voluntary credit union combinations that would otherwise reduce or avert risk to the SIF may become more expensive or less commonplace.

With respect to CCULR eligibility, the NCUA should eliminate restrictions on complex credit unions that recognize goodwill on their balance sheets. The proposed limit on the amount of goodwill and other intangible assets that a qualifying complex credit union may hold as a share of total assets goes further in terms of limiting credit union participation than the CBLR's eligibility criteria for banks. While the banking agencies deduct goodwill from "tangible equity" under the CBLR framework, there is no comparable qualifying criteria for community banks based on the share of goodwill or other intangible assets on balance sheets.[5] By contrast, under the NCUA's proposal, a qualifying complex credit union would be required to have the sum of total goodwill and other intangible assets be two percent or less of its total assets if it elects to use the CCULR.

To avoid penalizing credit union combinations, NAFCU asks that the NCUA remove consideration of goodwill from the CCULR's eligibility criteria. In the alternative, the NCUA should, at the very least, maintain consistency with the 2015 RBC Rule and allow credit unions to deduct from the 2 percent limit the amount of excluded goodwill and excluded other intangible assets. Although the proposal claims that the number of credit unions affected by the inclusion of excluded goodwill and other intangible assets in the CCULR eligibility determination would be relatively small, the

[3] See NCUA, Risk Based Capital, 80 Fed. Reg. 66625 (October 29, 2015), proposed § 702.101(b).
[4] 86 Fed. Reg. 45839.
[5] *See* OCC, Regulatory Capital Rule: Capital Simplification for Qualifying Community Banking Organizations, 84 Fed. Reg. 61776 (November 13, 2019).

NCUA should not presume (as it appears to) that this group would be better off calculating the RBC ratio rather than using the CCULR, particularly if appropriate adjustments are made to the proposed leverage ratio.[6]

Unrelated to the eligibility criteria for the CCULR, the NCUA is also requesting comment on whether to extend the December 28, 2015, date for excluded goodwill and other intangible assets given previous delays to implementation of the 2015 RBC Rule. The 2015 RBC rule grandfathers goodwill originating from a supervisory merger or combination that was completed on or before December 28, 2015. NAFCU believes that this date should be extended to match the effective date of the RBC rule: January 1, 2022. Given the confusion surrounding the cutoff date for recognizing excluded goodwill and other intangible assets in relation to subsequent delays of the RBC rule's effective date, the cutoff should be extended to provide maximum relief for credit unions that have absorbed struggling credit unions and to account for more recent, pandemic-related disruption. Furthermore, the benefit of the excluded goodwill write-down (originally assumed to be 13 years from the date of RBC implementation) would be marginal at this stage absent an extension of the cutoff date given that the NCUA is not considering any change to the January 1, 2029 sunset for excluded goodwill and other intangible assets.

Without appropriation recognition of goodwill, healthy credit unions will be less likely to take on a troubled credit union as a partner, which will make it more difficult and expensive for the NCUA to rehabilitate troubled credit unions before they become liabilities to the SIF. Credit unions that recognize goodwill on their balance sheets should be penalized under either the RBC Rule or the CCULR framework.

Asset Securitizations

The proposed rule requires credit unions that issue securitizations to use the other banking agencies' capital rules when determining whether assets transferred in connection with a securitization are excluded from risk-based capital. The proposal also includes a specific risk weight for certain exposures associated with securitization activities. The NCUA notes that "capital treatment for credit union-issued securitizations should be similar to bank-issued securitizations, for simplicity," but later adopts what the agency describes as "a more conservative risk weight overall than the other banking agencies' approach" for retained non-security beneficial interests. The agency's rationale for this departure is that the number of credit union securitizations to date has been limited. While this is true, NAFCU recommends granting complex credit unions the option to use the gross-up approach for risk weighting non-security beneficial interest of a securitization.[7] This would ensure that credit unions have at least the same flexibility as non-advanced approaches banks.

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[6] See 86 Fed. Reg. 45832 ("[A] two percent threshold only would exclude a small portion of otherwise qualifying complex credit unions, an estimated four credit unions as of December 31, 2020, from the CCULR framework.").
[7] See 12 CFR § 324.43(e) (setting fort the FDIC's gross-up approach for assigning an alternative risk weight to securitization exposures).

Aspects of the RBC Rule Requiring Further Attention

As NAFCU has observed in separate comments, the RBC Rule overstates the risk of certain types of assets. As described below, NAFCU encourages the agency to reconsider certain risk weights and, more generally, the agency's approach for assessing risk-based capital adequacy.

Supervisory Assessment of Capital Adequacy

The RBC rule requires complex credit unions to maintain comprehensive written strategies appropriate for their level of capital and risk profiles. During the supervisory process, NCUA will assess whether these written plans adequately address a credit union's activities and risk profile, as well as risks and other factors that can affect its financial condition. NAFCU is concerned about the subjective nature of the capital adequacy provision, and about whether the agency has the statutory authority to adopt a provision that would require individual credit unions to hold capital above those required by the rule or the Federal Credit Union Act.[8]

Mortgage Servicing Assets (MSAs)

The agency should reevaluate its 2015 assessment of MSA risk and reduce the 250 percent risk weighting to 150 percent in recognition of credit unions' demonstrable record of compliance and prudent management of these assets. In recalibrating MSA risk weight, the NCUA should also consider whether the loan is a recourse or nonrecourse loan and treat loans sold without recourse but serviced by the credit unions as lower risk.

NAFCU believes that a risk weight of 100 percent is appropriate for non-recourse loans serviced by the credit union because credit unions have a strong track record of maintaining personal member relationships throughout the life of the loan in a safe and sound manner. This commitment has been especially evident throughout the pandemic, and credit unions continue to offer flexible loss mitigation options to borrowers. In one NAFCU survey, a majority of respondents said they would offer at least some type of assistance until a federal declaration states that the pandemic emergency has ended and the type of assistance most likely to persist until that event would be loan deferrals and skip-a-payment options.[9]

Conclusion

NAFCU appreciates the opportunity to comment on the NCUA's proposed CCULR and amendments to the 2015 RBC Rule. For the CCULR to offer meaningful relief and a viable alternative to the agency's imperfect RBC Rule, the CCULR ratio must be set no higher than 9 percent. While the CCULR ratio should, in fact, be closer to 8 percent, a 9 percent ratio would provide parity with the CBLR and at least avoid putting credit unions at a distinct disadvantage relative to community banks.

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[8] See NCUA, Risk Based Capital, 80 Fed. Reg. 66625 (October 29, 2015), proposed § 702.101(b).
[9] NAFCU, Economic & CU Monitor Survey (April 2021).

The NCUA should also reconsider its punitive treatment of goodwill, both in the context of CCULR eligibility and the calculation of the RBC ratio, adopt a more gradual phase-in for the CCULR given continued pandemic related disruption, and reevaluate the RBC Rule's treatment of certain perceived risks within the credit union system. Lastly, to facilitate future implementation of the CCULR, the NCUA should give credit unions sufficient time to adapt and respond to any corresponding changes to Call Reports.

Should you have any questions or require additional information, please do not hesitate to contact me at (703) 842-2266 or amorris@nafcu.org.

Sincerely,

Andrew Morris
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