

Cooperative Credit Union Association

Delaware • Massachusetts • New Hampshire • Rhode Island

Creating Cooperative Power

October 15, 2021

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

Docket number: NCUA-2021-0072
RIN 3133-AF12

Re: Cooperative Credit Union Association Inc.'s Comments on Capital Adequacy: The Complex Credit Union Leverage Ratio; Risk-Based Capital

BY ELECTRONIC MAIL: <http://www.regulations.gov>

Dear Ms. Conyers-Ausbrooks:

On behalf of the member credit unions of the Cooperative Credit Union Association, Inc. (“Association”), please accept this letter relative to the request for comments issued by the National Credit Union Administration Board (“NCUA”) for its proposed rule (“Rule”) on the Complex Credit Union Leverage Ratio (“CCULR”). The Association is the state trade association representing approximately 200 state and federally-chartered credit unions located in the states of Delaware, Massachusetts, New Hampshire, and Rhode Island, which further serve over 3.6 million consumer members.

A. Executive Summary

The Association supports most aspects of the proposed CCULR, however, the Board is urged to set the CCULR leverage requirement at 9% permanently so that credit unions have a level playing field with community banks that adopt the Federal Deposit Insurance Corporation’s (FDIC) Community Bank Leverage Ratio (“CBLR”). The Association believes that Congress intended for Section 216(b)(1)(d) of the Federal Credit Union Act, the statutory provisions on which this proposed regulation is based, to ensure that the risk-based capital framework for federally-insured credit unions (“FICUs”) is “comparable” to the risk-based capital rules applicable FDIC-insured banks, which includes the CBLR. 12 U.S.C. §1790d(b)(1)(d).

Accordingly, the Board is strongly urged to finalize the CCULR with the same 9% leverage ratio adopted by the federal banking agencies for the CBLR to establish a comparable risk-based capital framework for FICUs under the CCULR.

NCUA Proposal on Capital Adequacy: The Complex Credit Union Leverage Ratio; Risk-Based Capital

October 15, 2021

Page 2

Finally, if the NCUA adopts the proposed Rule, then the Association requests that an extended period for compliance be considered to permit complex credit unions sufficient time to analyze and implement final provisions.

The remainder of this comment letter provides further detailed comments on the CCULR as raised by the NCUA in its Rule.

1. The Board invites comment on the qualifying criteria.

The Board is urged to set a permanent 9% leverage ratio for the CCULR and to remove the proposed 2% limitations on goodwill and other intangible assets qualifying criteria for the CCULR. As proposed, a “complex” FICU, those with more than \$500 million in total assets, would be permitted to opt-in to the CCULR if it: (1) had a minimum net worth of 9% in 2022, a minimum net worth of 9.5% in 2023, and a minimum net worth of 10% from January 2024 on; (2) had total off-balance sheet exposures of 25% or less of its total assets; (3) had a sum of total trading assets and total trading liabilities of no more than 5% of its total assets; and (4) had a sum of goodwill, including “excluded goodwill,” and other intangible assets, including “excluded other intangible assets,” of 2% or less.

The Association urges the Board to adjust the CCULR qualifying criteria so that the CCULR leverage ratio is permanently set a 9% to ensure parity with the CBLR. In addition, the Board is also urged to remove the proposed maximum 2% limitation on goodwill and other intangibles, which is not a requirement for community banks to adopt the CBLR. See 12 C.F.R. §324.12(a)(2). The federal banking agencies also do not deduct goodwill and other intangibles from the CBLR’s leverage ratio calculation. See 12 C.F.R. §324.12(b).

2. The Board invites comment on the proposed off-balance sheet exposures qualifying criterion.

The proposed CCULR off-balance-sheet exposures qualifying criteria is supported because they appear to be substantively equivalent to the criteria used by the federal banking agencies for the CBLR.

3. The Board invites comment on the proposed trading activity criterion.

The proposed CCULR’s trading activity limitations are supported because they are consistent with the federal banking agencies’ CBLR rules.

4. The Board invites comment on the proposed qualifying criterion for the sum of total goodwill and other intangible assets.

The Association does not support the proposed limits for goodwill and other intangible assets. The Board is urged to remove limits on goodwill and other intangible from the CCULR qualifying criteria, in order to be consistent with the federal banking agencies’ CBLR rules.

NCUA Proposal on Capital Adequacy: The Complex Credit Union Leverage Ratio; Risk-Based Capital

October 15, 2021

Page 3

5. *Should the NCUA choose a date later than December 28, 2015 for the grandfathering of goodwill issued in connection with a supervisory merger (i.e. supervisory merger goodwill issued after that date will be “excluded goodwill”) and for the grandfathering of core deposit intangibles, member relationship intangibles and trade name intangibles (i.e. those recorded after that date will be “excluded intangibles”)?*

Yes. The Association believes that the Board should choose a later date than December 28, 2015 for grandfathering goodwill and other intangibles. Further, the Board is urged to establish the effective date of the CCULR regulation as the date for grandfathering goodwill and other intangibles with respect to the CCULR and the NCUA’s Risk-Based Capital Rule (“RBC”).

6. *Please comment on whether the Board should consider qualifying criteria for other categories of exposures that are subject to heightened risk weights under the 2015 Final Rule.*

No. The Association does not support expanding the “heightened risk” asset categories. To the extent that the Board believes that the heightened risk categories should be revisited, the Board is urged to eliminate the concentration limits for first-lien mortgages, junior-lien mortgages and commercial loans that result in a higher risk-weighting for these assets after an arbitrary concentration limit threshold is crossed. These concentration limits are not generally comparable to the risk-based capital rules of the federal banking agencies or the Basel Framework because the regulations of the federal banking agencies and the Basel Framework do not include such concentration limits. See 12 C.F.R. §324.32.

Within the design of the Basel Framework and the federal banking agencies’ rules implementing the Basel Framework, the riskiness of an asset is reflected in its risk-weighting. Higher concentrations of such assets do not generally increase the risk-weighting of those assets because the riskiness of the asset has already been incorporated in the risk-weighting itself. In this Framework, risk increases as risky assets are accumulated, with risk increasing on an essentially straight-line basis. These assets do not suddenly become riskier in an exponential fashion when an arbitrary threshold has been crossed. In essence, they maintain the same level of risk on a per asset basis, but there is simply more of it.

In contrast, the NCUA RBC rule does step up the level of perceived risk of mortgages and commercial loans after an arbitrary threshold is crossed. While the Association recognizes the NCUA’s concerns about concentration risk, the increased risk associated with higher concentration limits is already reflected in the risk-weightings simply by having more of that type of asset. The imposition of concentration limits in NCUA’s Risk-Based Capital Rule that step-up risk levels beyond those applicable to community banks therefore is not “comparable” to the rules of the federal banking agencies within the meaning of Section 216 of the Federal Credit Union Act (“Act”).

Accordingly, the Board is urged to eliminate the risk-weighting step-ups for first-lien mortgages, junior-lien mortgages and commercial loans that occur after a concentration threshold is crossed,

so that the NCUA's Risk-Based Capital Rule is more comparable to the risk-based capital rules of the federal banking agencies.

7. Should the NCUA Board consider limiting the eligibility of FICUs to use the CCULR to those with less than \$10 billion in total assets?

No. The Association believes that the NCUA Board should finalize the CCULR without an asset-size limitation. The portfolio-shaping rules applicable to FICUs under the Federal Credit Union Act, NCUA regulations, and/or state law, severely restrict FICUs' permissible investment compared to the investment powers of commercial banks. FICUs' stringent portfolio-shaping rules also eliminate many of the risks that community banks are allowed to expose themselves to under the banks' rulebooks. While community banks with less than \$10 billion in total assets may be restricted, as a practical matter, from engaging in more complex financial activities because of operational realities and their relatively small size compared to America's largest banks, FICUs instead face legal restrictions on their business activities and investment regardless of their asset-size. Taken holistically, if the NCUA finalizes the CCULR without a maximum asset-size limitation, then such action is comparable to the CBLR because FICUs' stringent portfolio-shaping rules make the asset-size limitations found in the CBLR superfluous as compared to FICU risk-based capital and operations.

8. Should the NCUA Board add a limitation on a FICU's maximum exposure to Mortgage Servicing Assets ("MSAs") for it to be eligible to use the CCULR, such as that the FICUs' total MSA carrying values cannot exceed 25 percent of its net worth?

No. The Association does not support adding a maximum exposure limit to MSAs. While it is agreed that a FICU with a high proportion of MSAs would be unusual, the CBLR does not have a comparable restriction. In addition, NCUA's Risk-Based Capital Rule is primarily designed to address credit risk and does not include the Basel Framework's approaches to operational risk or market risk.

The Association notes that according to the Office of the Comptroller of the Currency:

"MSA values are economically represented as the discounted present value of estimated future net cash flows over the life of the underlying mortgage loans. MSAs expose servicers to interest rate, price, compliance, and operational risks. The risk of changes in the fair value of MSAs due to changes in interest rates is normally considered interest rate risk. It could be considered price risk, however, if the bank is actively buying and selling its MSAs. MSAs pose operational risk because the servicing and valuation functions are operations intensive and model dependent."¹

¹ OCC, *Comptroller's Handbook for Mortgage Banking*, version 1 Feb. 2014 at p. 67, available at <https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/mortgage-banking/index-mortgage-banking.html>.

NCUA Proposal on Capital Adequacy: The Complex Credit Union Leverage Ratio; Risk-Based Capital

October 15, 2021

Page 5

The NCUA's Risk-Based Capital rule is designed to address credit risk and the Association urges the NCUA to keep its Risk-Based Capital and CCULR rules comparable to the federal banking agencies' by continuing to focus the asset risk-weightings of the NCUA Risk-Based Capital rule on credit risk. To the extent that the NCUA has concerns about high concentrations of MSAs, the NCUA's reservation of authority to restrict specific FICUs from using the CCULR on a case-by-case basis should be sufficient to address such concerns.

9. What are the advantages and disadvantages of using the net worth ratio as the measure of capital adequacy under the CCULR? Should the Board consider alternative measures for the CCULR?

The Association believes that the NCUA Board can use an expanded definition for purposes of the numerator of the CCULR that goes beyond "net worth" and could likely include subordinated debt or other capital items in the CCULR's numerator even if the FICU is not a low-income designated credit union ("LICU").

Section 107(6) of the Act grants to the NCUA broad discretion to authorize federal credit unions to issue "shares" which are defined as "representing equity" within a regulatory framework "prescribed by the [NCUA] Board."² This statutory authority could be used to authorize all federal credit unions to issue capital shares similar to the Perpetual Contributed Capital (PCC) issued by corporate credit unions. See 12 C.F.R. §704.3. Under Section 107(6), credit union members, other credit unions, Federal, Indian tribal, State, or local governments and, in the case of LICUs, nonmembers could invest in these PCC-style investment shares. Credit unions and similar cooperative depository institutions in other jurisdictions, such as Australia, Canada, the United Kingdom, and the European Union, already have legal authority to issue perpetual capital shares similar to corporate credit union PCC instruments. The federal banking agencies' risk-based capital rules include PCC-style capital instruments and subordinated debt, among other capital items, meaning that by NCUA including equivalent capital instruments in its Risk-Based Capital Rule and CCULR, such action is comparable to the federal banking agencies' risk-based capital rules within the meaning of Section 216(b).

The NCUA authorizing natural-person federal credit unions to issue PCC-style investment shares could also serve to authorize some state-chartered credit unions to issue PCC-style investment shares pursuant to state credit union "wildcard" provisions that grant state-chartered credit unions parity with federal credit unions.³

² 12 U.S.C. § 1757(6).

³ NH RSA 383-E:4-411 Advantageous Federal Powers. – A credit union shall have and may exercise any power, right, benefit or privilege, now or hereafter authorized for federal credit unions by federal legislation, regulation or ruling, provided that, if federal law requires a federal credit union to apply to the National Credit Union Administration before exercising a power, the

NCUA Proposal on Capital Adequacy: The Complex Credit Union Leverage Ratio; Risk-Based Capital

October 15, 2021

Page 6

Congress intended for the NCUA to have broad discretion with respect to the regulation of natural-person federal credit union shares by stating expressly in Section 107(6) that federal credit union shares are subject to “limitations prescribed by the [NCUA] Board.”⁴ This means that an NCUA regulation on natural-person federal credit union PCC-style capital shares issued pursuant to Section 107(6) would receive significant judicial deference because the Board would be filling a legislative “gap” in the statute under the *Chevron* Doctrine. The U.S. Supreme Court has held that such legislative delegations of authority for administrative agencies to fill a “gap” in the statute give an agency’s statutory interpretations “controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute.”⁵

Section 207(k)(1)(C) of the Act also grants to the Board broad authority make exceptions from share insurance coverage under which the Board can exempt such PCC-style investment shares from federal share insurance coverage so that they would be able to absorb losses on a going-concern basis.⁶

Congress has provided to the NCUA broad authority to define the instruments that qualify as regulatory capital under its Risk-Based Capital Rules because the Act’s Section 216(d) provisions on risk-based capital grant to the NCUA another legislative “gap” to fill. Most courts will view the NCUA’s interpretations concerning which instruments qualify as regulatory capital for risk-based capital purposes “controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute” under the *Chevron* Doctrine⁷ because Section 216(d) states that federally-insured credit union risk-based capital rules will be “defined by the Board based on the portfolios of assets and liabilities of credit unions.”⁸

10. The Board invites comment on the proposed CCULR calibration. What are the advantages and disadvantages to the Board considering a CCULR of 8, 9 or 10 percent?

The Association supports a 9% minimum CCULR ratio and urges the Board to make the 9% minimum leverage ratio permanent. The CBLR’s permanent leverage ratio is 9% and the NCUA

credit union shall make the same application to the commissioner for permission to exercise such power.

⁴ *Id.*

⁵ *Chevron U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 843-44 (1984).

⁶ 12 U.S.C. § 1787(k)(1)(C) (“The Board may define, with such classifications and exceptions as it may prescribe, the extent of share insurance coverage provided for member accounts, including member accounts in the name of a minor, in trust, or in joint tenancy.”).

⁷ *Chevron*, 467 U.S. at 843-44.

⁸ 12 U.S.C. §1790d(d).

NCUA Proposal on Capital Adequacy: The Complex Credit Union Leverage Ratio; Risk-Based Capital

October 15, 2021

Page 7

should also adopt a 9% permanent leverage ratio under the CCULR in order to ensure a level playing field between FICUs and community banks.

11. Do you believe that the trend of natural person credit unions reducing their investments in corporate credit union capital, compared to before 2010, will continue?

The Association believes that the question may be misleading as the level of balances held by natural person credit unions in corporate credit unions is the same as before 2010. The use of the term “investments” is broad.

12. The Board invites comment on the proposed procedure a qualifying complex credit union would use to opt into the CCULR framework.

The Association does not believe that there should be limits on how frequently a complex FICU can opt-in to the CCULR. In many cases, the CCULR will likely result in a higher capital requirement for a FICU than under the Risk-Based Capital rule. A FICU should be able to opt-into and out of the CCULR freely.

13. The Board invites comment on the proposed procedure a complex credit union would use to opt out of the CCULR framework.

The Association does not believe that there should be limits on how frequently a complex FICU can opt-out of the CCULR. The Risk-Based Capital rule provides greater granularity and precision with respect to capital requirements than the CCULR. FICUs opting for greater granularity and precision in their regulatory capital requirements should be encouraged, even if the total amount of capital required by the Risk-Based Capital rule will, in many cases, be less than that required by the CCULR.

14. The Board invites comment on the proposed treatment for a complex credit union that no longer meets the definition of a qualifying complex credit union after opting into the CCULR framework.

The Association supports the proposed two-quarter grace period, which is comparable to the federal banking agencies’ approach under the CBLR. The two-quarter grace period also seems reasonable in terms of providing a FICU with sufficient time to transition away from the CCULR.

15. What are the advantages and disadvantages of permitting a two-quarter grace period? Should the Board consider including the CCULR in the PCA framework similar to the other banking agencies’ CBLR proposed rule?

No. The Association does not support integrating the CCULR into the NCUA’s Prompt Corrective Action (“PCA”) framework. The Board should follow an approach comparable to the federal banking agencies’ approach, which did not include the proposed PCA proxy in their final

rule. In addition, the Association believes that the greater granularity and precision of the Risk-Based Capital rule would generally be provide useful information in the context of supervision of undercapitalized credit unions.

16. What are the advantages and disadvantages of the transition provision starting at nine percent and permitting a transition period to a CCULR of 10 percent? Should the Board consider a transition period longer or shorter than two years?

The Association urges the NCUA to make the proposed initial 9% minimum CCULR ratio permanent.

17. The Board invites general comment on the reservation of authority in the proposed rule.

NCUA's proposed reservation of authority under the CCULR is similar to the federal banking agencies' reservation of authority under the CBLR. In essence, the finalization by NCUA of the reservation of authority as proposed would be comparable to the federal banking agencies' rules.

18. What are the advantages and disadvantages of relying on the other banking agencies' risk-based capital rule for determining whether a credit union has transferred the credit risk associated with a securitization?

The Association believes that by adopting a securitization exposures framework which relies on the other banking agencies' risk-based capital rules, which in turn rely on the Basel Framework, is the most "comparable" approach for NCUA's CCULR and RBC rules. The Basel Framework international standard has been adopted by bank and credit union regulators around the world and NCUA is strongly encouraged to remain in-step with both the federal banking regulators and international standards. This action will provide FICUs with the fairest, most level playing field going forward.

19. What are the advantages and disadvantages of deducting MSAs from the risk-based capital numerator? Should the Board consider a higher or lower deduction threshold? Why or why not?

The Association does not support deducting MSAs from the risk-based capital numerator as set forth in response to Question 8. The Association notes that the federal banking agencies do not deduct MSAs from banks' capital. See 12 C.F.R. §324.22.

20. Are there any supranational entities that should be included in the zero percent risk weight category?

Yes. The Association believes that obligations of multilateral development banks in which the U.S. Government is a shareholder, such as the World Bank (i.e. the International Bank for Reconstruction and Development and the International Finance Corporation), the Inter-American Development Bank, and others, should receive the same 0% risk weight as obligations backed by

NCUA Proposal on Capital Adequacy: The Complex Credit Union Leverage Ratio; Risk-Based Capital

October 15, 2021

Page 9

the full faith and credit of the United States. In other words, no risk-based capital would be required to be held against these assets.

B. Risk Based Capital

The Association would also like to take this opportunity to reiterate its previous positions relative to the implementation of risk-based capital rules by the NCUA and requests those views to be incorporated into this comment letter:

- April 27, 2015: The Association unequivocally asked the NCUA to withdraw the risk-based capital proposal in its entirety due to the absence of authority or need.
- June 27, 2018: Association request letter to NCUA relative to risk-based capital rule delay.
- September 7, 2018: The Association reminded NCUA of member concerns about the considerable effect a final RBC rule will have on credit unions, their business portfolios, plans for growth, and strategic vision.
- May 10, 2021; Association comment letter to NCUA on advance notice of proposed rulemaking: simplification of risk-based capital requirements.

C. Conclusion

The Association appreciates the opportunity to comment on the Board's proposed Rule relative to the CCULR. If you have any questions or require further information, then please do not hesitate to contact the Association at govaff-reg@ccua.org.

Sincerely,



Ronald McLean
President/CEO
Cooperative Credit Union Association, Inc.

RM/MAC/KB