May 10, 2021

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

RIN 3133-AF35

Re: Cooperative Credit Union Association Inc.'s Comments on Advance Notice of Proposed Rulemaking: Simplification of Risk Based Capital Requirements

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") on its Advanced Notice of Proposed Rulemaking ("ANPR"), *Simplification of Risk Based Capital ("RBC") Requirements*.[1] 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.

I. Overview

The Association conducted a survey of its members on the provisions of the proposed rule and member views provide the basis for this comment letter. All survey respondents unanimously support the efforts of the NCUA to establish a simplified alterative to the RBC rule.[2]

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[1] Advance Notice of Proposed Rulemaking on Risk Based Capital Requirements, 86 Fed. Reg. 13498 (Mar. 9, 2021), available at [Federal Register: Simplification of Risk Based Capital Requirements]

[2] While supportive, one member noted that a summarized, simpler approach can become a blunt instrument and be overly restrictive with respect to a credit union's abilities, hampering its growth and profitability. With any approach, erring on the side of complexity and ensuring that credit unions have the ability to effectively serve members and compete in the industry is recommended. Another member commented that as a wicked small credit union that only makes auto, boat and personal loans, their investment portfolio is comprised of 90% certificates of deposit and therefore, keeping rules simple is best.

The ANPR proposes two mutually exclusive, simplified risk-based capital alternatives for "complex" federally-insured credit unions[3] ("FICUs"): (1) the Risk-Based Leverage Ratio ("RBLR"), which would replace the Basel framework-based RBC rule with a system based on the existing Net Worth Ratio ("NWR") with additional capital "Buffer" add-on requirements under which a FICU triggers "risk thresholds" that are conceptually similar to NCUA's currently applicable Risk-Based Net Worth ("RBNW") rules; or (2) an optional Complex Credit Union Leverage Ratio ("CCULR") simplified alternative that is modeled on the federal banking agencies' optional Community Bank Leverage Ratio, under which a FICU could either choose to opt-into the CCULR framework or could choose to remain under the existing NWR and Basel framework-based RBC rules.

Finally, the Association respectfully seeks to remind NCUA about the most important financial services distinction, supporting the backbone of the entire credit union system, as it considers the ANPR and evaluates comments received. The basis of a credit union cooperative financial system, often distinguished as the purest form of such a cooperative, is different from the broader banking system. Credit unions serve consumers as members defined by the scope of their fields-of-membership. Its express purpose, by structure, operation and authorities granted, is to enhance member value. Accordingly, credit union decisions by boards of directors, and their delivery of products and services, are made in a manner most appropriate to members. In contrast, stock form banks actively manage their risk-based capital ratios to maximize shareholder returns on equity.

The pending simplification of RBC through the ANPR by NCUA could have unintended consequences and result in credit unions shifting to a for-profit model thereby evaluating marginal returns from different asset classes and managing investments and loans outside the context of member needs. The Association believes that this is not why credit unions as cooperatives were established or how they were intended to perform. Caution should be exercised by NCUA to preserve the cooperative model at every opportunity to avoid the treatment of different kinds of member loans or other products based on national, standardized risk ratings of asset classes, rather than on each credit union's own performance.

II. NCUA Should Move Forward with the CCULR Approach

The Association supports an optional CCULR that FICUs can choose to opt-into and urges the NCUA to propose guidance, upon further industry comment, to implement the CCULR simplified approach.

The Association believes that a CCULR opt-in framework would provide FICUs with greater regulatory flexibility than a mandatory RBLR. Developing an optional simplified risk-based capital approach for FICUs is a tested, safe and sound option, as well as comparable to other federal banking agencies' risk-based capital rules.

[3] Complex credit unions are defined to include federally-insured credit unions possessing more than $500 million in assets.

Most importantly, however, the CCULR's opt-in approach will provide individual FICUs with the choice to utilize either the simplified CCULR or the more granular RBC regulations and the traditional NWR. Based on the experiences of others, FICUs that opt-into the CCULR will likely, in effect, trade simplicity for a higher overall capital requirement than under the existing NWR and RBC rules in many scenarios. This is a business choice that should be afforded to credit unions while preserving capital.

A brief review of the experience of other financial institutions in this arena is informative. It is estimated that fewer than half of community banks eligible to adopt the conceptually similar Community Bank Leverage Ratio have done so to date. While each institution is unique, any limited usage may be attributed to the fact that many of these banks find continuing to use the more complex Federal Deposit Insurance Corporation risk-based capital framework and traditional FDIC leverage ratio results in a more granular, and therefore lower, risk-based capital requirement than the Community Bank Leverage Ratio. Others who have chosen <u>not</u> to adopt it have likely prioritized the need to better compare their performance to their peers or because high influxes of deposits have strained their leverage ratios without appreciably increasing the riskiness of their balance sheets. In addition, some banks may have concerns that adopting the Community Bank Leverage Ratio could limit their access to interbank markets or have a negative impact on cross-border operations.

An opt-in CCULR framework that retains the possibility for a FICU to continue to follow Basel framework-based RBC rules, if it prefers, would also allow better comparison between FICUs and other insured institutions as well as provide FICUs with similar regulatory flexibility. Comparability between NCUA's risk-based capital rules and the rules applicable to federally-insured banks is consistent with Sections 216(b)(1) and 216(d) of the Federal Credit Union Act which requires NCUA's Prompt Corrective Action rules to be "comparable" to the risk-based capital rules applicable to banks pursuant to Section 38 of the Federal Deposit Insurance Act. For capital purposes, more standard rules across the financial services industry would be available.

Greater regulatory comparability between FICUs and others should help FICUs that engage in more advanced financial activities maintain access to interbank lending and derivatives markets at fair rates and/or prove helpful to FICUs with cross-border operations. Domestic and foreign money center banks often assess the creditworthiness of FICUs and other financial counterparties using risk-based capital calculations such as the RBC rule. Large banks may penalize depository institutions that do not follow Basel framework-style risk-based regulatory capital approaches including the RBC rule, either by offering inferior rates or by refusing to do business with FICUs. Some FICUs may therefore choose to use the RBC rule because it improves their access at fair rates to interbank loans, interest rate derivatives and/or the correspondent bank accounts and treasury services needed to facilitate cross-border operations and foreign branches serving overseas US military personnel in the Eurozone.

As some well-capitalized, complex FICUs will welcome the simplicity of CCULR's calculations and be eager to exchange simplicity for holding additional capital. Other well-capitalized FICUs will prefer to perform the more standard RBC calculations that result in a more precise and generally lower overall capital requirement than is likely to occur under a CCULR approach and which may make it easier for FICUs to access interbank lending and derivatives markets or conduct cross-border operations. Accordingly, the Association supports the CCULR structure to ensure that members have the options best suited for their credit union strategic plans and operations.

III. NCUA's ANPR Questions and Responses

Question 1: The Board invites comments on the merits of incorporating the RBLR approach as an alternative to the risk-based capital framework under the 2015 Final Rule. What risk characteristics should be incorporated into the RBLR? Are the higher risk-weighted asset categories from the risk-based capital framework the correct starting point, or should the Board consider a different approach?

The Association believes that the CCULR is a recommended approach over than the RBLR because the CCULR is an optional approach that gives FICUs the flexibility to use the CCULR or the RBC based on the needs of credit unions.[4]

For purposes of this inquiry, however, the appropriate starting point for the RBLR would be combining the traditional non-risk-based NWR with the currently applicable RBNW rules in Part 702 of NCUA regulations to create the RBLR as a single capital ratio for FICUs that would be a leverage ratio with risk-based add-on buffers.[5] It appears that the proposed RBLR is an evolution of the NCUA's current RBNW rules. The Association suggests that an effective RBLR would be a combination of the NWR and the RBNW rule with principles taken from the RBNW to establish the buffer requirements that would operate similarly to up to two prompt corrective action levels above "well capitalized" if the FICU were more risky than the baseline.[6]
Like the RBNW rule, the ANPR's description of the RBLR focuses on the increased risks posed by specific types of assets and by concentrations of those assets. The RBC rule and the Basel framework on which RBC is based, in contrast, focus more on the risks posed by individual

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[4] In preferring a RBLR approach, one member survey respondent stated that any solution needs to satisfy three requirements: (i) adhere to the spirit of the RBC framework for all financial institutions to ensure stability and prudential management; (ii) be more detailed in nature to provide financial industry managers the latitude to create differentiated business models to better serve their member base; and (iii) be consistent with the Basel risk-based capital approach to mitigate claims of unfair advantages among financial services institutions and ensure that scarce resources are being allocated relative to similar risk parameters among financial institutions in the U.S. and global economies.

[5] One member noted that risk-weighted assets are the best starting point. As each credit union makes decisions based on a variety of elements, the fairest approach is to have a standard point to begin.

[6] One member survey respondent commented that the proposed two buffer level approach for the RBLR is workable. Perhaps, additional levels would be necessary to accurately distinguish risk levels and capital requirements. Starting with the RBC risk-weighting levels and grouping them into two buffer categories is proposed. Working with current RBC risk-weightings, appropriate groupings may be the following: (i) 100%-250%; and (ii) 300%-1250%. Keeping the approach similar to the RBC framework would be a prime consideration.

types of assets and weighting those risks accordingly, rather than on direct concentration levels. Basel framework style approaches, found within the RBC rule, also cannot be divorced from quantitative risk-weighted analyses of assets, which are integral to their approach, even though the main regulatory burden reduction of the RBLR would presumably be the elimination of exactly such quantitative asset risk-weighting.

The Association continues to believe that the CCULR is a better approach than the RBLR. However, in the alternative, if NCUA chooses to move forward with the RBLR, then the Association recommends the adoption of an approach which combines the NWR with elements of the RBNW rule into a single ratio.[7]

Question 2: The Board invites comments on what risk thresholds should be used for the risk factors. What measurements should be used and how would the measurement be reported and monitored? Should there be more than one capital buffer for a risk factor based on the measurement? How would multiple measurements be combined or weighted to determine the threshold?

The Association believes that the thresholds and risk factors currently utilized for the RBNW framework in Section 702.104 through 702.108 of NCUA rules, including the Risk Mitigation Credit, are the appropriate starting point. NCUA has more than twenty years of experience applying the RBNW factors and considerable data concerning the safety and soundness of the RBNW rules as compared to various real time risks. Quantitative data analyses of past FICU performance can inform how best multiple measurements can be combined or weighted. For example, if the NCUA were to establish two capital buffers of 1 percent relative to total assets each, then data analysis can establish what combinations of risk factors and mitigants would be commensurate for a FICU in need of an additional 1 or 2 percent of capital.[8]

One member survey respondent noted that each of the two categories would have metrics with thresholds such as junior real estate loans > 20%. If the majority of metrics are triggered in each category, then the capital buffer would be triggered. For example, if there were seven metrics, each with thresholds, in Buffer Level A and four of those metrics were above threshold, then a credit union would need to cover the 7% plus the additional buffer to remain well capitalized.

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[7] One member survey respondent noted that RBLR is easier to understand as it is somewhat consistent with the calculation of "well-capitalized." The idea that any category should have allocations in excess of 100% seems odd.

[8] One member commented that one additional capital buffer should be adequate and questioned how much riskier a credit union's balance sheet is just because it is looked at differently. NCUA is encouraged to use its historical data to assess what a "riskier" balance sheet looks like.

Question 3: The Board invites comments on what capital buffers over the well-capitalized seven percent threshold should be used?

A reasonable buffer amount is 1 percent relative to total assets for each buffer, which would be 2 percent total when both buffers are engaged.[9] This approach would be consistent with NCUA's existing Prompt Corrective Action ("PCA") rules, which establish PCA categories based on FICU's total assets and establishes a one percent buffer between "Adequately Capitalized" and "Well Capitalized", as well as comparable to Basel framework-based capital buffer concepts used for the risk-based capital rules applicable to other financial institutions.

The "capital buffers" concept being considered for the RBLR is similar to the Basel framework's "Capital Conservation Buffer" add-on that applies to larger FDIC-insured banks. The Capital Conservation Buffer is an add-on capital requirement that is split into five levels that total to 2.5 percent relative to the institution's risk-weighted assets when all five levels are met. The RBLR, as proposed, would have a two-step buffering approach that would be analogous to the Capital Conservation Buffer having two steps instead of five or two buffers of 1.25 percent relative to risk-weighted assets each.

In contrast, the Association notes that risk-weighting of assets would not be used under the RBLR. For many FICUs, 1.25 percent of risk-weighted assets would be less than 1 percent of total assets based on the FICUs' relatively low-risk balance sheets using the risk-weights in the RBC rule.

The Association recommends that establishing each of the two buffers at 1 percent of total assets would be consistent with industry practices and found with the Basel framework-based rules under Section 38 of the Federal Deposit Insurance Act.[10]

Question 4: The Board invites comments on how a non-LICU complex credit union may be able to apply subordinated debt towards an RBLR capital calculation.

The Association urges the NCUA to allow non-low income complex credit unions to count subordinated debt against the RBLR's buffer requirements since the RBLR implements the risk-based capital requirements in Sections 216(d) and 216(b)(1) of the Federal Credit Union Act that require "comparability" with the federal banking agencies' risk-based capital rules. These provisions allow banks to count subordinated debt as regulatory capital. Although Section 216(o) defines "net worth" restrictively for purposes of the "net worth ratio" found in that subsection and Section 216(c), the risk-based buffers would be based on the independent statutory requirement for "Risk-Based Net Worth Requirement for Complex Credit Unions" in Sections 216(d) and 216(b)(1) that do not include the limitations found in Section 216(o).

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[9] One member survey respondent suggested a slightly different threshold: Base Net Worth Ratio=7.00%. Buffer A=+1.00%. Buffer B=+1.50%. As such, if both buffers were triggered, then the well capitalized minimum would be 9.50%.
[10] One member recommended just one additional buffer for higher risk practices.

Question 5: The Board invites comments on the merits of incorporating the CCULR in its capital adequacy regulations. Should the NCUA capital framework be amended to adopt an "off-ramp" such as the CCULR to the risk-based capital requirements of the 2015 [RBC] Final Rule?

Yes, the framework should include an ability to opt-in to the CCULR before the RBC regulation takes effect so that the FICUs that prefer to adopt the simplified approach do not have to undertake the compliance burdens associated with RBC adoption. It is the observation of the Association that credit unions often automate their risk-based capital calculations which results in having many of the costs and regulatory burdens associated with phase-in of the RBC regulation occur at the beginning of RBC implementation. Once those initial costs are invested, the relative regulatory burden reduction associated with a simplified approach under CCULR diminishes.

One survey respondent suggested that instead of entertaining or employing another risk-based framework, a non-risk-based alternative should be permitted, under which the calculation would simply be net worth divided by average assets. If a credit union maintains a NWR of 8.00% or 100 basis points above the well capitalized base level and opts-out of the risk-based program, then the RBLR does not need to be maintained. However, if a credit union drops below the 8.00% threshold for some period of time, then the RBLR would be initiated.

Another member observed that by adopting the CCULR, the NCUA is making credit unions more like banks subject to their overall for-profit status.

Question 6: The Board invites comment on the criteria for CCULR eligibility. Should the Board adopt the same qualifying criteria as established by the other banking agencies for the [Community Bank Leverage Ratio]? In recommending qualifying criteria regarding a credit union's risk profile, please provide information on how the qualifying criteria should be considered in conjunction with the calibration of the CCULR level under question 7, below.

The Association believes that it would be reasonable to adopt three of the federal banking agencies' limitations for Community Bank Leverage Ratio eligibility: (1) a leverage or NWR of at least 9 percent[11]; (2) total trading assets plus liabilities of no more than 5 percent; and (3) total off-balance sheet exposures of no more than 25 percent of consolidated assets. One member survey respondent suggested that NCUA should tailor criteria to the uniqueness of credit unions.

The Association believes that a 9 percent NWR is comparable to the 9 percent leverage ratio requirement under the Community Bank Leverage Ratio. Accordingly, a 9 percent NWR would be comparable with the federal banking agencies risk-based capital rules pursuant to Sections 216(b)(1) and 216(d) of the Act and also promote measurable and consistent capital standards. FICUs with large and complex trading positions or significant off-balance-sheet exposures

[11] The Association notes that the current Community Bank Loan Requirement should be used and may be lower than 9 percent, as experienced during the Covid-19 period.

would also be good candidates for the more granular risk-based analyses found in the RBC rules as their more complex business activities justify more detailed supervisory analysis.

Finally, the Association does not believe that an arbitrary asset threshold such as $10 billion in assets should be applied with the CCULR because FICUs' are generally subject to more stringent portfolio shaping regulations than are federally-insured banks. In addition, the prohibition on FDIC-insured "advanced approach institutions" being ineligible to use the Community Bank Leverage Ratio is not applicable to FICUs because NCUA's RBC rule has never included the Basel framework's "advanced approaches" that use internally created computer models and are intended for the world largest and internationally active banks.

Question 7: What assets and liabilities on a FICU's Call Report should the Board consider in determining the net worth threshold? How should each of these items be weighted?

The Association requests clarification from NCUA concerning the "net worth threshold" with respect to the CCULR because the ANPR's preamble primarily uses the term "threshold" with respect to the RBLR. Given, however, that the statutory authority for CCULR is found within Sections 216(b)(1) and 216(d) of the Act, which do not involve the NWR but require comparability with the federal banking agencies' risk-based capital rules, netting out assets that are considered to have no credit risk under the federal banking agencies' risk-based capital rules, such as US Treasury securities and other exposures guaranteed by the full faith and credit of the United States, would likely be a reasonable interpretation of the Act.

As NCUA considers this issue, one survey member suggested that guidance promulgated by the Federal Deposit Insurance Corporation in this area be reviewed. Another member noted that balance sheet data on the Call Report will need to be more detailed in nature and conform to specific metric and thresholds.

Question 8: 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? For example, instead of the existing net worth definition, the CCULR could use the risk-based capital ratio numerator from the 2015 [RBC] Final Rule, similar to the "Tier 1 Capital" measure used for banking institutions [which includes retained earnings as well as other types of capital items].

One member who responded to the survey emphasized that without a risk-based approach, the NCUA and state regulators cannot compare the inherent operational risks of credit unions.

The Association suggests that NCUA has broad discretion under Sections 216(b)(1) and 216(d) of the Act to define the CCULR differently from the NWR. The NWR is defined by independent statutory provisions in Section 216(o) and implemented by Section 216(c). Although using the NWR for CCULR could be a reasonable interpretation of the Act, other approaches are potentially more reasonable because Section 216(d)'s requirement for NCUA to establish risk-based capital rules expressly references the statutory requirement for comparability with the federal banking regulators' risk-based capital rules but does <u>not</u> specifically reference the NWR.

The Association is reminded that whenever Congress has explicitly left a gap for an agency to fill, such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute. *Chevron U.S.A., Inc. v NRDC*, 467 U.S. 837, 843-44 (1984).

Question 9: Should all complex credit unions be eligible for the CCULR, or should the Board limit eligibility to a subset of these credit unions? For example, the Board could consider limiting eligibility to the CCULR approach to only complex credit unions with less than $10 billion in total assets.

All complex credit unions should be eligible for the CCULR. FICUs are typically subject to more stringent portfolio-shaping rules, which significantly reduces the risks on a FICU's balance sheet compared to many similarly sized financial institutions.[12] One member survey respondent observed that the use of a subset make sense.

While some large FICUs may choose not to opt-in to CCULR because of the increased granularity of RBC or because other concerns, such as access to interbank markets, the Association believes that the CCULR will generally result in a FICU holding more capital than under RBC when considering that a FICUs' assets primarily include exposures that are viewed as lower risk under the Basel framework[13].

A large credit union holding more capital under CCULR than it would otherwise be required to hold under the RBC rule does not present safety and soundness concerns because the credit union would have more capital available to absorb losses than would otherwise be the case.

Question 10: The Board invites comment on the procedures a qualifying complex credit union would use to opt into or out of the CCULR approach. What are commenters' views on the frequency with which a qualifying complex credit union may opt into or out of the CCULR approach? What are the operational or other challenges associated with switching between frameworks?

FICUs who choose to opt-in to the CCULR and then potentially opt-out at a later date should be liberally permitted to do so by the next financial reporting period. Other institutions have already opted-out after having earlier opted-in because they felt that the more complex risk-based capital rules were a better fit for their institutions. The main challenges associated with entering and exiting from CCULR are related to the transition in tracking risk-based assets required by the RBC rule. Once the initial data tracking is in place, then most RBC calculations can be

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[12] One member respondent suggested that NCUA should limit eligibility to credit unions possessing less than $10 billion in assets. Another suggested that to start, NCUA should limit the CCULR to $10 billion in assets and subsequently reevaluate the threshold and impact.
[13] Lower risk exposures include non-mortgage loans to consumers and small businesses, mortgage exposures, and investments in government-guaranteed debt and bonds issued by government-sponsored enterprises.

automated. A FICU transitioning from RBC to CCULR would likely have limited transition costs.[14]

Question 11: The Board invites comment on the treatment for a complex credit union that no longer meets the definition of a qualifying complex credit union after opting into the CCULR approach. Should the Board consider requiring complex credit unions that no longer meet the qualifying criteria to begin to calculate their assets immediately according to the risk-based capital ratio? Should the Board provide a grace period for these credit unions to come back into compliance with the CCULR and, if so, how long of a grace period is appropriate? What other alternatives should the Board consider with respect to a complex credit union that no longer meets the definition of a qualifying complex credit union and why? Is notification that a credit union will not meet the qualifying criteria necessary?

The Association believes that a grace period of one or two financial quarters would be reasonable in the context of a qualifying complex FICU no longer meeting one of the requirements to use the CCULR. The transition away from CCULR may not be easy to implement instantaneously for a FICU that has never implemented RBC previously. A FICU coming back into compliance with qualifying criteria quickly may also be reasonably simple in some scenarios.

IV. Other Comments

One member underscored that credit unions play an important role in the broad financial system to provide a source of credit and deposits to individuals and businesses that are often overlooked by commercial banks. Accordingly, it is important to apply the same regulatory standards to credit unions in order to support a vibrant and healthy industry. From a regulatory standpoint, much has been learned from the financial crisis and, as a result, a healthier banking system exists today. In this instance, NCUA should apply the same general lessons and resulting systems and approach to the credit union industry as learned from and adapted to other industry segments.

Finally, the Association notes that its members believe that the current economic cycle that resulted mainly from an unprecedented global pandemic provides the impetus for NCUA to again postpone the implementation of any new RBC rule. This action will address the continued increase in share growth experienced by credit unions resulting from government stimulus payments and changes in consumer spending and savings habits. In addition to the requested PCA relief, the Association also respectfully requests that NCUA temporarily exclude certain assets from the net worth ratio by considering an amendment to the definition of “total assets” to exclude certain zero- and low-risk assets as savings growth, once again, is rooted in the current marketplace environment in comparison to direct credit union actions.

[14] One member survey respondent suggested that credit unions should have to do both calculations and monitor the trends of the two over time. This practice might help identify changes in the risk profile.

V. Conclusion

The Association appreciates the opportunity to comment on NCUA's ANPR on the Simplification of RBC Requirements. If you have any questions about the recommendations set forth in this comment letter 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