# CUNA COMMENT CALL

## Proposed Rule:
## Complex Credit Union Leverage Ratio

NCUA issued a proposed rule that would provide a simplified measure of capital adequacy for complex credit unions (those with total assets greater than $500 million). Under the proposed rule, a complex credit union that maintains a minimum net worth ratio, and that meets other qualifying criteria, will be eligible to opt into the complex credit union leverage ratio (CCULR) framework. The minimum net worth ratio would initially be 9% on January 1, 2022, and then gradually increased to 10% by January 1, 2024. A complex credit union that opts into the CCULR framework would not be required to calculate a risk-based capital (RBC) ratio under the 2015 Final Rule. A qualifying complex credit union that opts into the CCULR framework and that maintains the minimum net worth ratio would be considered well capitalized.

The proposed rule would also make several amendments to the 2015 Final Rule, including addressing asset securitizations issued by credit unions, clarifying the treatment of off-balance sheet exposures, deducting certain mortgage servicing assets from a complex credit union's RBC numerator, updating several derivative-related definitions, and clarifying the definition of a consumer loan.

*Comments on the proposal are due to NCUA by 10/15/2021.*

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### (1) Overview of the CCULR Framework

The proposed rule, a qualifying complex credit union that meets the minimum CCULR, which is equal to its net worth ratio, would be eligible to opt into the CCULR framework and would be considered well capitalized. The proposed CCULR framework is based on the principles of the banking regulators' community bank leverage ratio (CBLR) framework. The CCULR would allow credit unions to avoid calculating a RBC ratio, as implemented by the 2015 Final 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.

The 2015 Final Rule is scheduled to take effect on January 1, 2022.

### (2) Qualifying Complex Credit Unions

Under the proposal, to be considered a *qualifying complex credit union*, a complex credit union must meet the following qualifying criteria:

A) Has a CCULR (net worth) of 10% or greater (subject to the initial transition period described);
B) Has total off-balance sheet exposures of 25% or less of its total assets;
C) Has the sum of total trading assets and total trading liabilities of 5% or less of its total assets; and
D) Has the sum of total goodwill and total other intangible assets of 2% or less of its total assets.

NCUA believes that complex credit unions that do not meet any one of the qualifying criteria should remain subject to RBC to ensure that such credit unions hold capital commensurate with the risk profile of their activities.

> **Question 1:** What are the advantages and disadvantages of each qualifying criterion? What is the burden associated with determining whether a complex credit union meets the proposed qualifying criteria? What other criteria should NCUA consider in the proposed definition? What are commenters' views on the tradeoffs between simplicity and having additional qualifying criteria? In specifying any alternative qualifying criteria regarding a credit union's risk profile, please provide information on how alternative qualifying criteria should be considered in conjunction with the calibration of the CCULR level and why NCUA should consider such alternative criteria. For example, if NCUA were to consider a CCULR of less than 10% to be well

capitalized, should additional qualifying criteria be incorporated? NCUA may consider qualifying criteria related to mortgage servicing assets, investments in CUSOs, or investments in corporate credit unions if a permanent CCULR of less than 10% is considered.

**Qualifying Criteria: *A) CCULR of 10% or Greater***

The proposal includes a transition provision to phase in the 10% CCULR over two years to give complex credit unions time to adjust and adapt to the new requirements. The transition provision provides for full effectiveness of the 10% CCULR on January 1, 2024. 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% or greater. Therefore, a qualifying complex credit union that opts into the CCULR framework and maintains a CCULR of 9% would be considered well capitalized. Beginning January 1, 2023, a complex credit union that has opted into the CCULR framework must have a CCULR of 9.5% or greater to meet the eligibility criteria and be considered well-capitalized. After January 1, 2024, a complex credit union would need to maintain a CCULR of 10% to be considered well-capitalized. Accordingly, the proposed rule provides a complex credit union two years to meet a CCULR of 10% or greater.

**Qualifying Criteria: *B) Off-Balance Sheet Exposures***

A qualifying complex credit union would be required to have total off-balance sheet exposures of 25% or less of its total assets. NCUA is including these qualifying criteria in the CCULR framework because the CCULR includes only on-balance sheet assets in its denominator and thus would not require a qualifying complex credit union to hold capital against its off-balance sheet exposures. This qualifying criterion is intended to reduce the likelihood that a qualifying complex credit union with significant off-balance sheet exposures would be required to hold less capital under the CCULR framework than under the risk-based capital ratio.

The other banking agencies' definition of off-balance sheet exposures, however, has several differences from the current definition of off-balance sheet exposures in the 2015 Final Rule. Therefore, to make the CCULR framework more comparable to the CBLR and to improve the effectiveness of the 2015 Final Rule, the proposed rule would amend the NCUA's definition of off-balance sheet exposures. The proposed amendments to the definition of off-balance sheet exposure would apply to both the proposed CCULR framework and the RBC framework.

Under the proposed CCULR framework, off-balance sheet exposures would mean:

1) For unfunded commitments, excluding unconditionally cancellable commitments, the remaining unfunded portion of the contractual agreement. The current definition of off-balance sheet exposures in the 2015 Final Rule includes all unfunded commitments.
2) For loans transferred with limited recourse, or other seller-provided credit enhancements, and that qualify for true sale accounting, the maximum contractual amount the credit union is exposed to according to the agreement, net of any related valuation allowance. The current definition of off-balance sheet exposures in the 2015 Final Rule includes all other loans transferred with limited recourse or other seller-provided credit enhancements and that qualify for true sales accounting.
3) For loans transferred under the FHLB mortgage partnership finance program, the outstanding loan balance as of the reporting date, net of any related valuation allowance. The current definition of off-balance sheet exposures in the 2015 Final Rule includes loans transferred under the FHLB mortgage partnership finance program.
4) For financial standby letters of credit, the total potential exposure of the credit union under the contractual agreement. These exposures are not explicitly included in the current definition of off-balance sheet exposure in the 2015 Final Rule; however, they are included as off-balance sheet items.
5) For forward agreements that are not derivative contracts, the future contractual obligation amount. Forward agreements are not explicitly included in the current definition of off-balance sheet exposure in the 2015 Final Rule; however, forward agreements are included as off-balance sheet items. Similar to the other banking agencies, NCUA is also clarifying that typical mortgage lending activities such as forward loan delivery commitments between credit unions and investors

are typically derivative contracts, and therefore, would be excluded from the off-balance sheet exposure definition.

6) For sold credit protection through guarantees and credit derivatives, the total potential exposure of the credit union under the contractual agreement. These exposures are not explicitly included in the definition of off-balance sheet exposure in the 2015 Final Rule; however, guarantees are included as off-balance sheet items. At this time, FCUs are not permitted to have credit derivatives and NCUA is unaware of any FISCUs engaging in credit derivatives. NCUA is including this provision for consistency with the other banking agencies and to ensure that the proposed rule is flexible should credit unions hold credit derivatives in the future.
7) For off-balance sheet securitization exposures, the notional amount of the off-balance sheet credit exposure (including any credit enhancements, representations, or warranties that obligate a credit union to protect another party from losses arising from the credit risk of the underlying exposures) that arises from a securitization. Off-balance sheet securitizations are not included in the current definition of off-balance sheet exposure or off-balance sheet items, but are included in the other banking agencies' CBLR framework as part of the off-balance sheet threshold.
8) For securities borrowing or lending transactions, the amount of all securities borrowed or lent against collateral or on an uncollateralized basis. Securities borrowing or lending transactions are not included in the current definition of off-balance sheet exposure or off-balance sheet items, but are included in the other banking agencies' CBLR framework as part of the off-balance sheet qualifying criterion.

Collectively, the above eight elements comprise the proposed definition of off-balance sheet exposures that would apply to both the proposed CCULR framework and the RBC framework under the 2015 Final Rule. By applying the proposed changes to both frameworks, NCUA would establish consistency between the 2015 Final Rule and the proposed CCULR framework. Without these conforming amendments to the definition of off-balance sheet exposures, a credit union might be required to hold less capital under the CCULR framework than under the RBC framework of the 2015 Final Rule.

NCUA proposes a 25% threshold for off-balance sheet exposures, as this threshold is similar to the CBLR framework and would provide enough flexibility for complex credit unions to engage in normal lending practices. NCUA does not believe that traditional banking activities, such as extending loan commitments to members, should necessarily preclude a complex credit union from qualifying to use the CCULR framework. The 25% threshold will also ensure that complex credit unions engaging in substantial off-balance sheet activity will also have the commensurate regulatory capital requirement.

> Question 2: What aspects of the off-balance sheet exposures qualifying criterion, including the related definition, requires further clarity? What other alternatives should NCUA consider for purposes of defining the proposed qualifying criterion? What impact would the proposed qualifying criterion have on a complex credit union's business strategies and lending decisions? Is a 25% threshold appropriate?

**Qualifying Criteria: *C) Trading Assets and Liabilities***

A qualifying complex credit union would be required to have the sum of its total trading assets and total trading liabilities be 5% or less of its total assets, each measured as of the end of the most recent calendar quarter. The proposed rule would include new definitions for the terms trading assets and trading liabilities. Trading assets would be defined as securities or other assets acquired, not including loans originated by the credit union, for the purpose of selling in the near term or otherwise with the intent to resell to profit from short-term price movements. Trading assets would not include shares of a registered investment company or a collective investment fund used for liquidity purposes. Trading assets, however, would include derivatives recorded as assets on a credit union's balance sheet that are used for trading purposes. NCUA notes that FCUs do not currently have the authority under part 703 to enter into derivative transactions for trading. Trading liabilities would be defined as the total liability for short positions of securities or other liabilities held for trading purposes.

The other banking agencies noted that elevated levels of trading activity can produce a heightened level of earnings volatility, which has implications for capital adequacy. The other banking agencies also expressed concerns about making the CBLR framework available to banking organizations with material market risk exposure. For similar reasons, NCUA believes it is important to have a qualifying criterion based on the sum of total trading assets and trading liabilities.

Based on NCUA's analysis of currently available Call Report data and permissible activities for FCUs, NCUA believes the vast majority of complex credit unions do not have material amounts of trading assets and trading liabilities. NCUA has included a trading activity criterion, despite the general lack of credit union trading activity, because NCUA recognizes the potential elevated levels of risk and complexity that can be associated with certain trading activities even if is not applicable to most complex credit unions. In addition, NCUA recognizes that the level of credit union trading activity could increase in the future.

> Question 3: What other alternative measures of trading activity should NCUA consider for purposes of defining a qualifying complex credit union and why?

**Qualifying Criteria: *D) Goodwill and Other Intangible Assets***

A qualifying complex credit union would be required to have the sum of total goodwill and other intangible assets of 2% or less of its total assets. Qualifying complex credit unions would be required to include excluded goodwill and excluded other intangible assets in this calculation.[1] However, for purposes of the CCULR, complex credit unions would be required to include in the proposed threshold excluded goodwill and excluded other intangible assets, even though excluded goodwill and excluded other intangible assets are not included in the goodwill deduction under the 2015 Final Rule. The 2015 Final Rule established an implementation period for deducting goodwill and other intangible assets acquired by certain supervisory mergers prior to the publication of the 2015 Final Rule. This approach ensured credit unions were not treated punitively for goodwill and other intangible assets acquired before the publication of the 2015 Final Rule. However, the CCULR framework is voluntary and the same fairness concerns are not present. Therefore, NCUA has chosen to include the full amount of goodwill and other intangible assets for this criterion.

NCUA is proposing a qualifying criterion related to goodwill and other intangible assets because goodwill and other intangible assets contain a high level of uncertainty regarding a credit union's ability to realize value from these assets, especially under adverse financial conditions. Due to the uncertainty of recognizing value from goodwill and other intangible assets, the other banking agencies require insured banks to deduct goodwill and intangible assets from tier 1 capital. NCUA believes it is prudent to assess the credit union's balance of goodwill and other intangible assets to ensure comparability with the banking industry. Without this proposed criterion, a qualifying credit union could use the CCULR despite substantial goodwill and intangible assets, which would be inconsistent with the principles of the CBLR framework.

NCUA believes that complex credit unions with 2% or less of their assets in goodwill and other intangibles assets would not hold less capital under the CCULR framework than under the RBC ratio. In addition, a 2% 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. Therefore, NCUA believes a 2% threshold balances regulatory relief for most qualifying complex credit unions, while still recognizing the uncertainty and volatility of goodwill and other intangible assets. NCUA believes that complex credit unions with substantial goodwill and other intangible assets should calculate their capital adequacy using the RBC ratio, as their portfolios may require higher capital levels.

> Question 4: What are commenters' views on the inclusion of such a qualifying criterion? Should qualifying complex credit unions be required to include excluded goodwill and excluded other intangible assets that would have been excluded under the 2015 Final Rule?

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[1] Goodwill is defined as an intangible asset, maintained in accordance with GAAP, representing the future economic benefits arising from other assets acquired in a business combination (for example, a merger) that are not individually identified and separately recognized. Other intangible assets mean intangible assets, other than servicing assets and goodwill, maintained in accordance with GAAP. Other intangible assets do not include excluded other intangible assets. These are the same definitions as in the 2015 Final Rule.

**Qualifying Criteria:** ***Other CBLR Eligibility Criteria – Total Assets of Less Than $10 Billion***

Under the other banking agencies' CBLR framework, only depository institutions with total consolidated assets of less than $10 billion are eligible to use the CBLR. The $10 billion limitation was included in the Economic Growth, Regulatory Relief, and Consumer Protection Act.

NCUA is not proposing to include this qualifying criterion in the proposed rule. NCUA believes that the CCULR framework would appropriately capture the risk for all complex credit unions regardless of asset size. Therefore, NCUA believes permitting all complex credit unions regardless of asset size to opt into the CCULR framework is prudent and does not present a risk to the NCUSIF. Permitting credit unions with total assets over $10 billion would only include 18 additional credit unions, with total assets of over $438 billion, or 27% of all complex credit union assets as of March 31, 2021.

> Question 7: Should NCUA consider limiting eligibility to the CCULR framework to only complex credit unions with less than $10 billion in total assets? NCUA seeks comments on a potential $10 billion asset limitation and whether it is appropriate for the CCULR framework.

## (3) The CCULR Ratio

The CCULR would be the net worth ratio, which is defined under the 2015 Final Rule as the ratio of the credit union's net worth to its total assets. Therefore, any amendments to the definition of the net worth ratio would also be applicable to the calculation of CCULR.

The proposed denominator of the CCULR would be a complex credit union's total assets, consistent with the net worth ratio.

NCUA is proposing to use the net worth ratio for the CCULR for its simplicity. Complex credit unions are required to calculate their net worth ratio regardless of whether they opt into the CCULR framework. Therefore, complex credit unions would not be required to calculate a unique ratio for purposes of opting into the CCULR framework.

NCUA considered using the RBC ratio numerator from the 2015 Final Rule. NCUA believes that the numerator to the 2015 Final Rule is a more conservative measure of capital compared to the net worth ratio because it includes several deductions, including deductions for the NCUSIF capitalization deposit, goodwill, other intangible assets, and identified losses not reflected in the RBC ratio numerator. The 2015 Final Rule, however, is not yet effective, and complex credit unions are not familiar with calculating and implementing the definition of capital. Therefore, NCUA believes it is preferable to base the CCULR on the net worth ratio.

Several commenters to the ANPR requested that all complex credit unions be permitted to use Subordinated Debt under any proposed CCULR framework. Under the proposed rule, however, the CCULR is defined as net worth; therefore, Subordinated Debt would not be eligible for inclusion as capital under the CCULR framework unless the complex credit union is also a low-income designated credit union. NCUA could consider alternative definitions of capital, for example, the RBC numerator, such that Subordinated Debt is included as capital for purposes of the CCULR framework. However, NCUA notes that the RBC numerator also includes deductions that are not included in the definition of net worth.

> Question 9: What are the advantages and disadvantages of using the net worth ratio as the measure of capital adequacy under the CCULR? Should NCUA consider alternative measures for the CCULR? Instead of the existing net worth definition, the proposed rule could use the RBC ratio numerator from the 2015 Final Rule. NCUA could also consider drafting a new numerator for purposes of the CCULR. For example, NCUA could use net worth as the basic framework for the CCULR numerator, but then make additional deductions.

## (4) Calibration of the CCULR

Under the proposal, a qualifying complex credit union may opt into the CCULR framework if it meets the minimum CCULR at the time of opting into the CCULR framework.

In proposing 10% as the fully phased-in well-capitalized ratio requirement for qualifying complex credit unions, NCUA considered several factors. The proposed calibration of the CCULR, in conjunction with the qualifying criteria, seeks to strike a balance among several objectives, including maintaining strong capital levels in the credit union system, ensuring safety and soundness, and providing appropriate regulatory burden relief to as many credit unions as possible. The CCULR framework is designed to generally require credit unions to hold more capital than would be required for a credit union under the 2015 Final Rule.

NCUA also considered comparability to the other banking agencies' CBLR framework, which established a CBLR of 9% (that is, if an insured bank has a CBLR of 9% it is considered well capitalized).

NCUA estimates that as, of December 31, 2020, the majority of complex credit unions would constitute qualifying complex credit unions and would meet a proposed CCULR well capitalized standard of 9%. Based on reported data, approximately 73% of complex credit unions would qualify to use the CCULR framework and be well capitalized under a 9% calibration. Of the 649 complex credit unions, 472 have net worth greater than 9% as of December 31, 2020, and would be well capitalized under a 9% CCULR standard. Of those 472 credit unions, it is estimated that two credit unions would not meet the proposed qualifying criteria, and thus would not be eligible to opt into the CCULR. The total minimum capital required for these 470 credit unions under the 2015 Final Rule to be well capitalized is estimated at $82 billion. Under the proposed CCULR, if all estimated 470 credit unions opted into the CCULR and held the minimum 9% to be well capitalized, the total minimum net worth required would be estimated at $104.6 billion, an increased capital requirement of $22 billion.

Based on reported data as of December 31, 2020, approximately 48% of complex credit unions would qualify to use the CCULR framework and be well capitalized under a 10% calibration. Of the 649 complex credit unions, 313 have net worth greater than 10% as of December 31, 2020, and would be well capitalized under a 10% CCULR standard. Of those 313 credit unions, it is estimated that one credit union would not meet the proposed qualifying criteria, and thus would not be eligible to opt into the CCULR framework. The total minimum capital required for those 312 credit unions under the 2015 Final Rule to be well capitalized is estimated at $57.5 billion. Under the proposed CCULR, if all estimated 312 credit unions opted into the CCULR and held the minimum 10% net worth required to be well capitalized, the total minimum net worth required would be estimated at $81.7 billion, and increased capital requirement of $24 billion.

A 9% CCULR would allow more credit unions to opt into the CCULR framework but could incentivize some qualifying complex credit unions to hold less regulatory capital than they do today. In contrast, a 10% well-capitalized standard would ensure strong capital levels and more certainty that qualifying complex credit unions are holding greater levels of capital than under the 2015 Final Rule. NCUA has proposed a 10% well-capitalized threshold for the CCULR framework. A 10% well-capitalized standard for the CCULR would be 300 basis points above the well-capitalized threshold for the net worth ratio, and 400 basis points above a 6% well-capitalized standard for the net worth ratio when considering credit unions decreased holdings in corporate credit unions. In addition, a 10% well-capitalized threshold for the CCULR would be 100 basis points higher than the 9% threshold established by the other banking agencies for the CBLR. As discussed previously, the total minimum capital required to be well capitalized under the 2015 Final Rule is $57.5 billion for credit unions that also meet the CCULR qualifying criteria and would be well capitalized under a 10% calibration for the CCULR. If all those credit unions meeting the qualifying criteria opted into the CCULR and held the minimum 10% net worth required to be well capitalized, the total minimum net worth required would be estimated at $81.6 billion. This figure is approximately $24.2 billion in excess of the RBC requirement under the 2015 Final Rule. NCUA believes that the proposed 10% CCULR requirement strikes the right balance between maintaining strong capital levels and providing a simpler option to comply with RBC requirements.

> Question 10: What are the advantages and disadvantages to NCUA considering a CCULR of 8, 9 or 10%? Should NCUA consider further modifications to its methodology in calibrating the CCULR? What other factors should NCUA consider in calibrating the CCULR and why? NCUA requests that commenters include a discussion of how the proposed CCULR level should be affected by potential changes to other aspects of the proposed framework, such as the definition of CCULR and the definition of a qualifying complex credit union.

## (5) Opting Into the CCULR Framework

Under the proposal, a qualifying complex credit union with a CCULR of 10% or greater, subject to the transition provisions, may opt into the CCULR framework at the end of each calendar quarter. Similar to the other banking agencies' CBLR framework, a qualifying complex credit union may only opt into the CCULR framework if it would be well capitalized. A qualifying complex credit union choosing to opt into the CCULR would indicate its decision by completing a CCULR reporting schedule in its Call Report.

> Question 12: What are commenters' views on the frequency with which a qualifying complex credit union may opt into the CCULR framework? What other alternatives should NCUA consider for purposes of qualifying complex credit unions' opt in elections to use and report the CCULR and why?

## (6) Voluntarily Opting Out of the CCULR Framework

Under the proposal, 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 ONES. The notice must be provided at least 30 days before the end of the calendar quarter that the credit union will begin reporting its RBC ratio. The notice must include several items:

- A statement of intent explaining why the credit union is opting out of the CCULR framework.
- A copy of board meeting minutes showing that the credit union's board of directors was notified of the opt out election.
- The calendar quarter that the qualifying complex credit union will begin calculating its RBC.
- A completed Call Report schedule as if the credit union had calculated its RBC ratio the prior quarter. For example, if a credit union seeks to begin using a RBC ratio in the second quarter, it would have to provide notice by June 1 and would have to include a Call Report with data as of March 31.

Under the other banking agencies' CBLR framework, banks that have opted into the CBLR may opt out of the framework at any time. NCUA believes, however, that qualifying complex credit unions should not opt out of the CCULR framework at any time because, in contrast to qualifying community banks, qualifying complex credit unions are not currently calculating RBC under the 2015 Final Rule.

NCUA notes that qualifying community banks had been complying with their revised RBC requirements for several years when the CBLR was implemented. Banks had systems and processes in place to implement RBC, staff had acquired experience calculating their capital ratios under RBC, and qualifying complex banks had been examined for compliance with RBC standards. In contrast, complex credit unions will be subject to the RBC ratio requirement established in the 2015 Final Rule for the first time when they are eligible to opt into the CCULR framework. It is likely that a qualifying complex credit union opting out of the CCULR framework would not have any experience calculating a RBC ratio under the 2015 Final Rule.

NCUA does not believe it is prudent to allow qualifying complex credit unions opting out of the CCULR framework the same flexibility as provided to banks under the CBLR. Instead, NCUA believes a qualifying complex credit union opting out of the CCULR framework should notify NCUA of its intentions to begin calculating a RBC ratio. Following notification, NCUA may, through the supervisory process, monitor whether the credit union has acquired the necessary systems and processes to be capable of calculating and reporting its RBC ratio accurately.

> Question 13: What are commenters' views on the frequency with which qualifying complex credit unions may opt out of the CCULR framework? Do qualifying complex credit unions anticipate frequent switching between the CCULR framework and the RBC requirements, and if so, why? What are the operational or other challenges associated with switching between frameworks?

## (7) Compliance With the Proposed Criteria to Be a Qualifying Complex Credit Union

Under the proposal, a qualifying complex credit union that has adopted the CCULR framework and then subsequently no longer meets the qualifying criteria, would be required, within a limited grace period of two calendar quarters, either to once again meet the qualifying criteria or comply with the RBC ratio requirements. NCUA believes that this limited grace period is appropriate to mitigate potential volatility in capital and associated regulatory reporting requirements based on temporary changes in a credit union's risk profile from quarter to quarter, while capturing more permanent changes in risk profile.

The two-quarter grace period is similar to the other banking agencies' CBLR framework. However, unlike the CBLR framework, under the proposed rule, a qualifying complex credit union that is likely to not meet the requirements to be a qualifying complex credit union by the end of the grace period must submit written notification to the appropriate Regional Director or the Director of ONES. The notification must be submitted at least 30 days before the end of the grace period and state that the credit union may cease to meet the requirements to be a qualifying complex credit union.

NCUA believes that it would be rare for a credit union to not provide the notice when required. The notice would be submitted only 30 days before the end of the grace period and a credit union that is being prudently managed should be able to accurately predict whether it would be likely to meet the qualifying criteria. NCUA believes that if a credit union does not provide the required notice, it raises supervisory concerns and the credit union may be subject to a lower management rating as a result.

The notification would be similar to the notification required for credit unions voluntarily opting out of the CCULR framework. First, the notification must provide the reason for the potential disqualification. The notification would also be required to include a copy of meeting minutes showing that the credit union's board of directors was notified that the credit union might cease to meet the qualifying criteria. Finally, the notification also would be required to include a Call Report schedule completed as if the credit union calculated its RBC ratio the previous calendar quarter.

Under the CBLR Final Rule, a bank that ceases to meet the qualifying criteria as a result of a business combination is not provided a grace period. The proposed rule would include a similar limitation. Therefore, under the proposed rule a qualifying complex credit union that has opted into the CCULR framework and that ceases to meet the qualifying criteria as a result of a business combination would receive no grace period and would be required to revert to a RBC framework immediately. NCUA believes this approach is appropriate, as complex credit unions should consider the regulatory capital implications of a planned business combination and be prepared to comply with the applicable requirements. Therefore, a qualifying complex credit union that would not meet the qualifying criteria as a result of a business combination must fully comply with the 2015 Final Rule for the regulatory reporting period during which the transaction is completed.

> Question 14: What are the advantages and disadvantages of the proposed grace period? What other alternatives should NCUA consider with respect to a complex credit union that no longer meets the definition of a qualifying complex credit union and why? Should NCUA consider requiring complex credit unions that no longer meet the qualifying criteria to begin to immediately calculate their assets according to the RBC ratio? Is notification that a credit union will not meet the qualifying criteria necessary? Should NCUA consider a grace period for previously qualified credit unions that have opted into the CCULR framework if after a business combination the credit union no longer qualified as of the next reporting period? Should NCUA consider alternative notification requirements or consider not requiring any notification at all?

## (8) Treatment of a Qualifying Complex Credit Union That Falls Below the CCULR Requirement

Under the proposed rule, a minimum CCULR (10% after the transition period) is one of the qualifying criteria. Therefore, if a qualifying complex credit union has a CCULR that falls below the minimum requirement, it would receive the same grace period of two calendar quarters, as applicable when a credit union ceases to meet the other qualifying criteria.

A credit union that becomes less than well capitalized during the two-quarter grace period would not be required to begin calculating its capital under the 2015 Final Rule immediately. Instead, the credit union would still be eligible for the full two-quarter grace period; however, it would be subject to any applicable PCA requirements for its capital category.

Under the other banking agencies' CBLR framework, an electing bank with a leverage ratio of 8% or less is not eligible for the grace period and must comply with the generally applicable rule, that is, for the quarter in which the bank reports a leverage ratio of 8% or less. NCUA believes that it would be unduly burdensome to require complex credit unions to immediately begin calculating their capital under the 2015 Final Rule.

As discussed previously, credit unions have not previously been subject to the 2015 Final Rule. NCUA believes it is reasonable to provide complex credit unions the full two-quarter grace period regardless of their CCULR as the 2015 Final Rule would be a new system of capital adequacy and would require an adjustment for the complex credit union. NCUA does not believe permitting two quarters to comply with the qualifying criteria or to begin calculating capital under the 2015 Final Rule presents unreasonable risk to the NCUSIF.

> Question 15: What are the advantages and disadvantages of permitting a two-quarter grace period? Should NCUA consider including the CCULR in the PCA framework similar to the other banking agencies' CBLR proposed rule? To what extent does the calibration of the CCULR relate to NCUA's choice between including the CCULR into the PCA framework versus relying on a grace period when a credit union's CCULR falls below 10%?

## (9) Transition Provision

NCUA is aware that the unprecedented balance sheet growth has resulted in declining net worth ratios for most complex credit unions. To help mitigate the impact of this unprecedented balance sheet growth, NCUA is proposing a two-year transition provision to delay the introduction of a 10% CCULR. This two-year phase-in would permit complex credit unions time to increase their net worth ratios.

Under the proposed rule, from January 1, 2022, to December 31, 2022, a complex credit union may opt into the CCULR framework if it has a net worth ratio of 9% or greater. Therefore, a qualifying complex credit union that opts into the CCULR framework and that maintains a 9% CCULR would be considered well capitalized. Beginning January 1, 2023, a complex credit union that has opted into the CCULR framework must have a CCULR of 9.5% or greater to meet the eligibility criteria. Finally, beginning January 1, 2024, a complex credit union must have a CCULR of 10% or greater to be eligible to determine its capital adequacy under the CCULR framework.

> Question 16: What are the advantages and disadvantages of the transition provision starting at 9% and permitting a transition period to a CCULR of 10%? Should NCUA consider a transition period longer or shorter than two years? If suggesting a longer transition period, such as four years, discuss the merits of a longer phase-in and why the additional time over two years would be needed.

## (10) Reservation of Authority

In general, a complex credit union that meets the eligibility criteria may opt into the CCULR framework. However, there may be limited instances in which the CCULR framework would be inappropriate and not require sufficient capital to adequately protect the NCUSIF. To address such situations, the proposed rule includes a reservation of authority. Under the reservation of authority, NCUA can require a complex credit union that has opted into the CCULR framework to use the RBC framework to calculate its capital adequacy if NCUA determines that the complex credit union's capital requirements are not commensurate with its credit or other risks.

NCUA expects to apply the reservation of authority only in limited circumstances. Under the reservation of authority, credit unions would be entitled to a two-quarter grace period before being required to comply with the RBC framework. The other banking agencies also have reserved the authority to disallow the use of the CBLR framework by a bank, based on its risk profile.

> Question 17: Should NCUA consider a reservation of authority that applies to the RBC rule? Should NCUA consider a general waiver provision or consider including a statement that assets can be provided a more conservative risk weight than provided in the proposed rule? Should NCUA consider adopting notice and response procedures to be used in determining whether the reservation of authority should be used?

## (11) Effect of the CCULR on Other Regulations

*Member Business Loan Cap:* NCUA proposes that for qualifying complex credit unions opting into the CCULR framework, such credit unions may calculate a different limitation on MBLs from what they do currently under the 7% net worth ratio. This is because the CCULR is considered a risk-based net worth requirement, and thus falls under section 216(c)(1)(A)(ii) as a measure of the minimum net worth required to be well capitalized. Accordingly, under the proposed rule, a qualifying complex credit union that opts into the CCULR would determine its MBL limitation by reference to the amount of net worth required to be well capitalized under the CCULR. Complex credit unions that do not qualify or do not opt into the CCULR would determine their MBL limitation by reference to the 10% risk-based capital ratio, as described in the 2016 MBL final rule. In either scenario, if a complex credit union has actual net worth below those measures, its actual net worth would determine its MBL limitation.

*Capital Adequacy:* Under the 2015 Final Rule, a complex credit union must have a process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive written strategy for maintaining an appropriate level of capital. While a qualifying complex credit union opting into the CCULR framework, is required to have a comprehensive written strategy for maintaining an appropriate level of capital, such strategy may be straightforward and minimally state how the credit union intends to comply with the CCULR framework, including minimum capital requirements and qualifying criteria. In contrast, complex credit unions that do not opt into the CCULR framework will be required to have a more detailed written strategy. The NCUA intends to review the written strategies during the supervisory process.

## (12) Amendments to the 2015 Final Rule

*Off-Balance Sheet Exposure Risk Weights:* The 2015 Final Rule states that the risk-weighted amounts for all off-balance sheet items are determined by multiplying the off-balance sheet exposure amount by the appropriate credit conversion factor and the assigned risk weight. However, the definition of off-balance sheet items is not aligned with the definition of off-balance sheet exposure. Under the 2015 Final Rule, only commitments, loans transferred with limited recourse, and loans transferred under the FHLB mortgage partnership finance program are provided explicit exposure amounts. The rule is silent on the appropriate treatment for the remaining items included in the definition of off-balance sheet items (contingent items, guarantees, certain repo-style transactions, financial standby letters of credit, and forward agreements). In addition, the 2015 Final Rule does not include a credit conversion factor or risk weight for the off-balance sheet items that are not provided a specific exposure amount in the definition of off-balance sheet exposure.

The proposed rule would make several changes to clarify the treatment of off-balance sheet items. First, as discussed previously, the proposed rule would amend the definition of off-balance sheet exposures. This definition is used as one of the CCULR eligibility criteria and is proposed to be amended to more closely align with the other banking agencies' CBLR framework. As a consequence of amending the definition of off-balance sheet exposure for the CCULR framework, the proposed off-balance sheet exposure definition would also more closely align with the existing definition of off-balance sheet items. Therefore, under the proposed rule, several items currently defined as an off-balance sheet item, but not included in the current definition of off-balance sheet exposure, would be provided an exposure amount. This change reduces ambiguity in the 2015 Final Rule. In addition, in the proposed rule, each item included in the definition of off-balance sheet exposure would be provided an explicit credit conversion factor and risk weight for purposes of the RBC rule.

*Asset Securitizations Issued by Complex Credit Unions:* The proposed rule would require credit unions that issue securitizations to use the other banking agencies' 2013 capital rules when determining whether assets transferred in connection with a securitization are excluded from RBC. NCUA has reviewed these standards and finds they would be appropriate as applied to credit union securitizations, with minor differences. Specifically, under the proposed rule, a credit union must follow the requirements of the applicable provisions of 12 CFR 324.41 when it transfers exposures in connection with a securitization. A credit union may only exclude the transferred exposures from the calculation of its risk-weighted assets if each condition in 12 CFR 324.41 is satisfied.

> Question 18: What are the advantages and disadvantages of relying on the other banking agencies' RBC rule for determining whether a credit union has transferred the credit risk associated with a securitization? Should credit union-issued securitizations be subject to the same capital treatment as bank-issued securitizations? Should there be an option for complex credit unions to use the gross-up approach for risk weighting non-security beneficial interest of a securitization?

*Mortgage Servicing Assets:* NCUA is proposing a deduction to the RBC numerator for MSAs that exceed 25% of the RBC numerator for two primary reasons. First, this change will make the NCUA's RBC calculation more consistent with the other banking agencies' revised RBC rules as the other banking agencies simplified their MSA calculation post-issuance of the 2015 Final Rule. Under the other banking agencies' revised RBC rule, banking organizations deduct MSAs that exceed 25% of the banking organization's common equity tier 1 capital. NCUA believes the simplification of the other banking agencies' approach easily allows the NCUA to be consistent with the other banking agencies' RBC rule. Also, NCUA believes it would be important to implement prudential conditions around MSAs if NCUA adopts the recent proposed rule to amend parts 703 and 721 to allow FCUs to purchase mortgage servicing rights from other FICUs. If adopted, this rule could increase MSA holdings for complex credit unions. But even if NCUA does not adopt the proposed rule on mortgage servicing rights, the other considerations in this section support the proposed amendment to the 2015 Final Rule.

NCUA believes that by including a deduction to the RBC numerator for MSAs in RBC, complex credit unions will be encouraged to avoid excessive exposures in MSAs relative the other risks on their balance sheets. As mentioned in the preamble of the 2015 Final Rule, NCUA believes the risks of MSAs contribute to a high level of uncertainty regarding the ability of credit unions to realize value from these assets. Therefore, NCUA believes it is appropriate to add the proposed risk-based numerator deduction to address the potential of complex credit unions purchasing MSAs from other FICUs.

> Question 19: What are the advantages and disadvantages of deducting MSAs from the RBC numerator? Should NCUA consider a higher or lower deduction threshold? Why or why not?

*Definitions of Consumer Loan and Current:* NCUA is proposing to amend the definitions for Consumer Loan and Current in section 702.2. The 2015 Final Rule does not include leases in the definition in Consumer Loan, despite the fact that the 2014 Risk-Based Capital Proposal stated "[c]onsumer loans (unsecured credit card loans, lines of credit, automobile loans, and leases) are generally highly desired credit union assets and a key element of providing basic financial services." NCUA is providing this proposed change for clarity. Without this proposed change the treatment of consumer leases is unclear and, therefore, may be risk weighted in the catchall category of 100%. The change makes clear that consumer leases receive a 75% risk weight. Due to the proposed change in the definition of a consumer loan, the definition of current will also be amended for consistency and would include the term leases.