May 9, 2017

Mr. Gerard Poliquin
Secretary to the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Re: NASCUS Comments on Advanced Notice of Proposed Rulemaking for Supplemental Capital

Dear Secretary Poliquin:

The National Association of State Credit Union Supervisors (“NASCUS”), the professional association of the state credit union regulatory agencies and the nation’s state credit union system, submits the following comments in response to the National Credit Union Administration's (“NCUA's”) Advance Notice of Proposed Rulemaking for Supplemental Capital (“the ANPR”).¹ The ANPR addresses issues concerning both low income credit union (LICU) issuance of secondary capital as well as the non-LICU natural person credit union potential use of supplemental capital to meet impending complex credit union risk-based capital requirements. NASCUS appreciates the opportunity to provide our perspective to NCUA on this important rulemaking and submit the following recommendations for the agency’s consideration.

As discussed in detail below, NASCUS supports allowing supplemental capital to contribute toward a portion of a credit union’s risk-based capital ratio.² As NCUA implements a more complex regulatory capital framework, the agency should also modernize credit union regulatory capital concepts to match. Including supplemental

² NASCUS also supports a statutory modernization of credit union capital definitions to permit the use of supplemental capital in net worth calculations for natural person credit unions. However, as the issue presented in The ANPR is limited to risk-based capital ratios so too will our comments be limited to risk-based capital.
capital in credit union risk-based capital ratio calculations is well within NCUA’s statutory authority. Furthermore, including supplemental capital in risk-based capital ratio calculations is consistent with the statutory purposes of both state and federal credit unions and is sound public policy. Expanding credit union access to supplemental capital will not impair credit union mutual ownership and governance, nor imperil the credit union tax exemptions.

We also believe that it is essential NCUA take a flexible approach to creating the risk-based supplemental capital framework. To the extent it is determined that credit union specific regulations are needed to safeguard investors, members, and the National Credit Union Share Insurance (NCUSIF), NCUA should look to existing regulation found in state, federal and international regulatory regimes for instruction. However, NCUA’s regulations must provide room for the marketplace to evolve and shape supplemental capital in ways that maximize its utility to credit unions as well as its attractiveness to investors. Essential to that flexible approach will be NCUA allowing state chartered credit unions to raise supplemental capital from both entities or individuals (member and non-member) as permitted by state law or regulation.

Risk-based supplemental capital should adhere to the credit union mutual ownership and governance principles, be available to cover losses, and be subject to prior regulatory approval.

While the statutory basis for low income credit union ("LICU") designated secondary capital and complex credit union supplemental capital are distinct, NCUA should consolidate rules regarding both. So doing would diminish the potential for confusion among credit unions and the public regarding capital sources beyond retained earnings.

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3 Some commenters responding to the ANPR have asserted that providing credit unions access to supplemental capital is inconsistent with “the credit union purpose to serve members of modest means.” These comments offer nothing in support of their assertion. Furthermore, they ignore the fact that some credit unions have as their statutory purpose to promote thrift among their members rather than singularly serving members of modest means. Finally, and perhaps most perplexing, they fail to reconcile their assertion with the fact that Congress expressly authorized secondary capital for low income designated credit unions.
In addition, LICUs could benefit from instruments, processes, procedures and disclosures developed by complex credit unions for risk-based supplemental capital.

**Background**

In 1996, NCUA issued a final rule authorizing federal credit unions (FCUs), and federally insured state chartered credit unions (FISCUs) to the extent permitted by state law, serving predominantly low income members to use secondary capital to meet regulatory capital requirements.\(^4\) For low income designated credit unions (LICUs) the ability to accept secondary capital investments was intended to both improve their capital holdings and finance services to members.\(^5\) LICUs secondary capital authority is currently governed by NCUA Rules and Regulations Part 701.34. LICU secondary capital must come from non-natural person non-members and be subordinate to all claims.\(^6\)

In addition to LICUs, corporate credit unions may also use supplemental/contributed capital toward a portion of their regulatory capital requirements.\(^7\)

In 1998, the Credit Union Membership Access Act (“CUMAA”) was signed into law, in part establishing Prompt Corrective Action (“PCA”) for credit unions.\(^8\) The CUMAA amended the Federal Credit Union Act (“FCUA”) to create a net worth ratio requirement for all federally insured credit unions and a risk-based net worth ratio requirement for federally insured credit unions the NCUA Board designates as complex.\(^9\) The net worth ratio is explicitly defined in the CUMAA as a ratio of a credit union’s net worth to total assets with net worth being defined as retained earnings, certain NCUA emergency capital

\(^6\) 12 C.F.R §701.34(b).
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assistance (Section 208 assistance), and for LICUs, secondary capital.¹⁰ However, the CUMAA did not define the risk-based net worth ratio, granting the NCUA Board discretion in developing a risk-based net worth framework.

In 2015, NCUA promulgated a final risk-based PCA rule that amended Part 702 to replace the risk-based net worth ratio with a two-tiered risk-based capital ratio.¹¹ As part of that rulemaking, NCUA solicited comments on whether non-LICU natural person credit unions should be allowed to count supplemental capital toward their risk-based capital ratio.

**Incorporating Supplemental Capital into Credit Union Regulatory Capital Rules is Good Public Policy**

As NCUA has acknowledged, expanding natural person credit union access to supplemental capital is a “worthwhile policy consideration.”¹² Studies of the issue have concluded “that U.S. credit union capital formation has lagged behind capital formation options for other institutions,” and NCUA itself has cited a 2007 Filene Research Institute study:

> Banks and thrifts in the United States and abroad enjoy much broader authority than U.S. credit unions to pursue alternative sources of capital. Similarly, non-U.S. credit unions and domestic and foreign financial cooperatives have many capital-raising options. Production, consumer, and other types of cooperatives throughout the developed world can access capital markets in a variety of ways.¹³

Enhancing credit union ability to access capital, in a manner consistent with their mutual organization and not-for-profit status, would do more than just bring them on

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¹⁰ 12 U.S.C. §1790d(o)(3); 12 CFR 702.2(g) and (k).
par with banks and credit unions worldwide. In addition to helping credit unions meet risk-based capital ratio requirements, supplemental capital can help credit unions meet the needs of their members. Supplemental capital can help credit unions manage growth, support the formation of new credit unions, promote investment innovation, assist in the funding of credit union infrastructure, and help consumers. Increasing access to supplemental capital may also strengthen the system’s cooperative foundation.

By creating another layer of loss absorption before the NCUSIF, supplemental capital adds a layer of protection to the overall credit union system. On an individual credit union level, supplemental capital provides redundancy in recovery from unexpected losses, economic downturns, or from countercyclical flights to safety. In the absence of supplemental capital, an otherwise healthy credit union’s tools to recover from a decline in regulatory capital ratios are counterproductive in the long term: shrinking assets, reducing dividends, raising loan rates and increasing fees, cutting services and other operating expenses, or merging away the credit union.

➤ The Market for Credit Union Supplemental Capital

There would be an active market for credit union issued supplemental capital. In addition to members supporting their credit unions through patronage capital, there would be a market for other credit union instruments among investors. As noted by CUNA Mutual Group:

According to CB Insights, a venture capital database, more than $23 billion of capital flowed into Fintech startups in 2016 alone. In addition, the FDIC quarterly banking profile currently shows more than $87 billion in subordinated

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16 Ibid. NCUA does note that supplemental capital is not as effective as retained earnings in covering losses. We agree. However, the question is not whether supplemental capital is better than retained earnings (it is not) but rather, would having supplemental capital in addition to retained earnings increase the buffer for losses. It would. Furthermore, with respect to NCUA’s concern regarding investor litigation, that risk may be mitigated with disclosures comparable to those mandated by other federal bank regulators or state securities laws.
debt currently resides on the books of U.S. banks. Imagine the value and growth for consumers and credit unions if just a portion of this capital could be deployed through credit unions!17

Of course, the fact that tens of millions of dollars has been invested in LICU secondary capital demonstrates a market among investors for credit union issuances, as does the fact that credit unions around the world have found investors for their supplemental capital offerings.

➢ Effect of Supplemental Capital on LICU Secondary Capital Utility

The ANPR questions whether the use of supplemental capital by non-LICUs will negatively impact LICUs.18 We do not think it would. To the extent that some investors in LICU secondary capital have been philanthropic, it is unlikely that non-LICU supplemental capital will dilute those opportunities for LICUs.19 Of course, not all LICU investors are philanthropic. However, we believe that rather than dilute opportunities for LICU issuances, expanding supplemental capital for complex credit unions will revitalize the market for LICU capital instruments. In particular, this could be the case should NCUA accept our recommendation and expand the LICU eligibility for natural person investors and harmonize LICU and non-LICU supplemental capital rules.

NCUA has the Authority to Issue a Risk-Based Supplemental Capital Rule

As discussed above, Congress instructed NCUA to implement a risk-based net worth rule for complex credit unions.20 Specifically, Section 301 of the CUMAA amended the FCUA to add new section 216 requiring the NCUA Board adopt by regulation a system of PCA that is “comparable to” section 38 of the Federal Deposit Insurance Act (“FDI

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18 The ANPR, at 9694
20 12 U.S.C § 1790d(o)(3); 12 CFR 702.2(g) and (k).
In establishing a system of PCA for credit unions, the amended FCUA clearly defined “net worth” and “net worth ratio” for the leverage ratio (base or Tier I capital) for credit unions while leaving it to NCUA’s discretion to develop a risk-based capital framework for complex credit unions:

(d) Risk-based net worth requirement for complex credit unions,

(1) In general.—The regulations required under subsection (b)(1) of this section shall include a risk-based net worth requirement for insured credit unions that are complex, as defined by the Board based on the portfolios of assets and liabilities of credit unions.

(2) Standard.—The Board shall design the risk-based net worth requirement to take account of any material risks against which the net worth ratio required for an insured credit union to be adequately capitalized may not provide adequate protection.22

Because the FCUA did not include a definition of “risk-based net worth” for complex credit unions, NCUA has discretion to include factors in addition to retained earnings for calculation of the complex credit union risk-based capital numerator requirements. Indeed, as has been pointed out by other commenters, NCUA’s final risk-based capital rule has already established a capital numerator that differs from the statutory net worth ratio numerator. Pursuant to the final risk-based capital rule, complex credit unions may include loan loss reserves in addition to retained earnings minus accounting for good will, the NCUSIF deposit, and other intangible assets.23

NCUA’s approach with respect to risk-based capital calculations is consistent both with the statutory language of the FCUA and that of federal bank regulators. Extending that discretion to include supplemental capital for risk-based capital ratio calculations is well

23 12 C.F.R. § 702.104(b)(1), (2).
within NCUA’s authority. In fact, failure to include supplemental capital in the complex credit union risk-based calculation could be construed as failing the requirement that NCUA’s regulation be comparable to that of the FDI Act.

- Credit Union Authority to Accept Secondary Capital and Issue Supplemental Capital

The authority for FISCUs to raise supplemental capital is a matter of state law. Currently, more than a quarter of the states that charter credit unions permit the issuance of supplemental capital instruments. In other states, FISCUs will have to seek regulatory changes to benefit from the enhanced NCUA regulation. It will be incumbent on the state credit union system to seek those changes. The fact that in some cases changes might be needed should not impede progress on moving forward with the promulgation of the supplemental capital framework now. From NCUA’s perspective, the analysis should be whether providing for additional capital accumulation in federally insured credit unions to absorb potential losses, or to fund services to members, enhances the NCUSIF. As discussed above, it does. As with the application of NCUA’s derivatives rule for FISCUs, the NCUSIF should allow for the exercise of the authority for those credit unions able to benefit.

NCUA notes that FCUs may need clarified borrowing authority in order to effectively issue subordinated debt. NASCUS offers no opinion on FCU authority to engage in supplemental capital transactions. If changes are needed in statute or regulation to clarify FCU authority, we encourage NCUA to pursue such changes. However, we reiterate, as with FISCUs needing changes at the state level, this rulemaking should advance regardless of whether additional changes to credit union powers must be sought in addition.

26 The ANPR, at 9695.
The Credit Union Tax Exemptions

NCUA notes in the ANPR that the FCU tax exempt status is derived from the FCUA, in part because FCUs “could not access capital markets to raise capital” while SCUs derive their federal income tax exemption from §501(c)(14)(A) of the Internal Revenue Code. The SCU federal income tax exemption is predicated upon the lack of “capital stock,” and credit unions’ not-for-profit mutual organization and purpose. NCUA expresses concern about the possible effect of credit union access to supplemental capital on the credit union tax exemption. The agency seeks to ensure that supplemental capital authority for non-LICU designated complex credit unions does not negatively impact the tax exemptions.

Concerns regarding the possible effect of supplemental capital on the credit union tax exemptions are legitimate, but hardly insurmountable.

As NCUA notes in its ANPR, the Internal Revenue Service (“IRS”) has not established an official definition of “capital stock.” A few courts addressing similar issues have suggested a lack of certain features tends to make an instrument less like “capital stock” and more like a debt instrument. One of the key features in such determinations is whether voting rights are conferred with the instrument. It will be essential that supplemental capital instruments issued by credit unions do not confer voting rights, and future regulations should so stipulate. Ultimately, it will be the IRS that determines if supplemental capital instruments are consistent with the credit union tax exemptions.

It is instructive that the IRS has opined twice on previous supplemental capital instruments issued by credit unions. In 1997, the IRS issued a private letter ruling to U.S. Central Corporate Credit Union that its Member Paid-in-Capital (“PIC”) did not constitute capital stock for purposes of determining whether or not the corporate credit

27 Id. at 9696.
28 Ibid.
union was exempt from federal income taxation under Section 501(c)(14)(A). The corporate credit union PIC in question in that case would be analogous to the concept of “patronage capital” in the natural person credit union setting. With respect to natural person credit unions, the IRS issued a private letter ruling to State Employees’ Credit Union of North Carolina regarding its issuance of Equity Shares concluding that the Equity Shares did not constitute “capital stock” within the meaning of section 501(c)(14)(A) of the Internal Revenue Code.

While IRS private letter rulings are fact specific, and are not generally applicable guidance, these two rulings none-the-less are informative regarding how the IRS might view future supplemental capital in the context of the credit union tax exemption. NCUA suggested in the ANPR that credit unions be required to obtain a ruling from the IRS regarding the effect of their supplemental capital instrument on their tax exemption.

We caution against that approach.

The potential delay in obtaining a private letter ruling from the IRS would render the supplemental capital impractical. A better approach would be to require credit unions obtain a legal opinion that their supplemental capital or secondary capital offering did not convey voting rights and was otherwise consistent with the credit union tax exemption. This legal opinion could then be submitted with credit union’s supplemental capital business plan during the pre-approval process (as discussed below in more detail). This approach mirrors NCUA’s existing regulation requiring credit unions obtain a legal opinion affirming the corporate separateness of the credit union and its credit union service organization (CUSO).

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31 Ibid.
32 The ANPR, at 9696.
33 12 C.F.R. §712.4.
Creating supplemental capital instruments that are attractive to investors without conferring control of the credit union will not be difficult, given that “cooperatives and credit unions around the world have figured out how to access alternative forms of capital without diluting the core ownership structure of their organization.”

**Framework for Complex Credit Union Supplemental Capital**

Prudential safety and soundness considerations should be addressed in a credit union supplemental capital rule to protect credit unions, their members, investors, and the NCUSIF from litigation and reputation risk from mismanaged offerings as well as fundamental issues such as concentration and earnings risk.

Initial supplemental capital rules should focus on fundamental principles while allowing enough flexibility for the marketplace to develop and innovate. We note that innovative changes are not limited to the marketplace: they also take place within the supervisory perspective. For example, in just the past three years, NCUA has determined its existing approach to a number of credit union powers has been too restrictive. NCUA has re-evaluated its supervisory approach to FCU holding of fixed assets and FCU full occupancy of acquired properties. It has replaced a prescriptive commercial lending rule with a principle based rule. It has undertaken a broadening of FCU field of membership and explicitly permitted the use of derivatives to hedge interest rate risk.

To allow future marketplace and supervisory adaptation to non-LICU supplemental capital, the initial rulemaking should focus on establishing characteristics consistent with the mutual nature of the credit union system, supervisory safeguards to mitigate risks to the safety and soundness of the participating institution, investor safeguards, and credit union policies and procedures.

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36 Member Business Loans; Commercial Lending, 81 Fed. Reg., 13530 (March 14, 2016).
Prior Supervisory Approval Should be Required

As the credit union system gains experience with supplemental capital, NASCUS supports a requirement for prior regulatory approval before issuance.

The business plan submission requirements could contain provisions mandating certification that the credit union’s plan is in compliance with any applicable securities laws, director liability, disclosures and tax laws. As discussed above, credit unions would also submit the legal opinions they obtain regarding the effect of the instrument on their tax exempt status. The business plan would also cover the amount of supplemental capital to be offered, the rates and maturities (if any), and the business reason for the offering.

Once the plan is submitted to NCUA or the state regulator, NCUA and the state should consult on the plan and application to issue the instruments. The regulation should provide that the credit union may deem its plan approved 90 days after its plan is submitted to regulators unless informed that the plan has been rejected. Once a plan is approved, or the 90 day period has run, the rule should give credit unions a set time frame within which to proceed with the issuance. These time frames will provide a degree of certainty to the process. From a credit union’s perspective, establishing a time frame for supervisory approval allows them to move forward or know their plan has been rejected. From a supervisory perspective, requiring the credit union to move forward within a set time after receiving approval helps ensure the credit union’s condition, and other circumstances, can be reasonably expected to be the same as when the supervisory evaluation of the business plan was made.

The supplemental capital rule should also provide for an expedited approval process for credit unions that have been previously approved for similar offerings and/or remain in sound condition.

38 The ANPR at 9697.
In addition to prior approval before issuance, NASCUS supports a requirement for prior approval before early redemption. While credit unions should have the option to reduce costs by redeeming excess supplemental capital ahead of its issued maturity date (if any), it would be prudent to have a pre-approval safeguard to prevent collusion/exodus of capital prior to its use for loss absorption.39

➢ Investor Suitability and Disclosures

NASCUS agrees that supplemental capital instruments should be subject to investor suitability safeguards and disclosures. There is no need to reimagine standards from scratch. As a starting point, NCUA may look to existing rules applicable to LICU secondary capital as well as standards for bank supplemental capital as promulgated by the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and state securities laws. NCUA should consider whether it needs to adopt a “credit union tailored” version of existing rules. An alternative approach could be for NCUA, rather than develop its own rules, to rely on the existing regulatory frameworks by requiring compliance with applicable disclosure rules.

As a starting point, both secondary capital and supplemental capital should be available to natural persons as well as non-natural person investors.40 The rules should also allow for both member and non-member investors. Such flexibility accomplishes several policy goals, such as increasing the market for secondary and supplemental capital, diversifying the investor pool, providing for investor discipline, and permitting members to contribute additional support for their credit union.

Both the OCC and the FDIC utilize tiered approaches to their disclosures.41 In these cases, streamlined disclosures are available for non-public offerings, and more detailed

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39 NCUA Whitepaper, p. 18.
40 The limitation on secondary capital sales to natural persons is a regulatory construct, not a statutory prohibition. See 12 CFR 701.34(b).
disclosures for public offerings. Either of these existing frameworks may be used to tailor appropriate disclosures for credit union supplemental capital offerings.

- **Additional Prudential Considerations**

Criteria for supplemental capital should be consistent with sound prudential standards, and should include the following characteristics:

- Uninsured and junior to other claims against the credit union
- Available to cover operating losses of the credit union in excess of retained earnings
- If it has a stated initial maturity, that maturity is no less than five years
- Its risk-based capital value discounts as it approaches maturity (if any)
- It is subject to concentration and aggregate limits
- Reciprocal holdings should be limited

Supplemental capital regulations should clearly establish the criteria for a credit union seeking approval to make an issuance. Qualifying credit unions should be well run, sufficiently capitalized, and free from material findings in their most recent Report of Examination (ROE). Credit unions classified as troubled, or reasonably at risk for conservatorship, should be ineligible.

Credit unions should be permitted to structure offerings with varying priorities with respect to loss absorption among the offerings themselves. In addition, the regulatory definition of operating losses should include the payment of dividends unless prohibited by order.

Many of these recommended prudential standards already exist within NCUA’s existing secondary capital rules or those of other bank regulators.42

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42 12 C.F.R §701.34 and 12 C.F.R. §3.22(c)(3).
Mergers and other Covenants

NCUA seeks comments on how supplemental capital should be treated for purposes of voluntary mergers. Under current secondary capital rules, LICUs are required to close and pay out secondary capital accounts to investors before a merger with another credit union. Credit unions should be given more flexibility to make a business decision as to the benefits of closing or retaining secondary and supplemental capital accounts during a voluntary merger. It should be the credit union’s choice whether to redeem or carry the alternative capital in the event of a merger.

We do agree that covenants mandating the early redemption of the supplemental capital in the event of a future merger should be prohibited. While as noted above we support the credit union having discretion in this regard, we do not think the decision should be included in a covenant of the issuance. Such a covenant bears similarities to an investor veto of a merger decision, albeit tangentially. Such a covenant obfuscates the issue of ownership and control.

NCUA should look to OCC regulations for guidance on these issues as well as several other covenants prohibited in the contracts for national bank securities issuances:

(2) Corporate authority. A subordinated debt note must not include any provision or covenant that unduly restricts or otherwise acts to unduly limit the authority of a national banker interferes with the OCC's supervision of the national bank. Specifically, this would include a provision or covenant that:

(i) Maintains a certain minimum amount in its capital accounts or other metric, such as minimum capital assets, liquidity, or loan ratios;
(ii) Unreasonably restricts a national bank's ability to raise additional capital through the issuance of additional subordinated debt or other regulatory capital instruments;

The ANPR, p. 9701.
12 C.F.R. §701.34(b)(9).
(iii) Provides for default and acceleration of the subordinated debt as the result of a change in control, if such change in control results from the OCC's exercise of its statutory authority to require a national bank to sell stock in that national bank, enter into a merger or consolidation, or be acquired by a bank holding company;

(iv) Requires the prior approval of a purchaser or holder of the subordinated debt note in the case of a voluntary merger by a national bank where the resulting institution:45

Consultation and Cooperation with State Regulatory Authorities

As NCUA begins to evaluate the responses to the ANPR and proceed to drafting of a proposed rule, the agency should work closely with state regulators as envisioned by Congress in the CUMAA.46 Consulting and cooperating with state regulators will be invaluable to NCUA given the experience many states have supervising varied securities and capital instruments in their state banks. As noted above, more than $80 billion in subordinated debt “resides on the books” of U.S. banks.47

NCUA should move expeditiously to form a working group with state regulators to draft a proposed supplemental capital rule.

Forms of Supplemental Capital

In 2010, NCUA’s Supplemental Capital working group identified three base forms of supplemental capital that might be made available to the credit unions system. Mandatory patronage would allow credit unions to convert the member share required to join the credit union into a form of supplemental capital. Voluntary patronage capital

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47 As just one example, state banks in Georgia report approximately $3.4 billion in Tier 2 capital on their books.
would be an instrument available only to members of the credit union, but remain distinct from their member share. The third instrument would be a subordinated debt instrument available to members and non-members both individual and institutional. We note these instruments to illustrate that supplemental capital rules should be flexible and allow for broad development of marketable instruments. We do not think these three options represent the exclusive universe of possibly beneficial supplemental capital instruments that could be developed for the credit union system.

We discourage NCUA from attempting to pre-determine the specific types of instruments that may be offered by credit unions. The rule should focus on the instrument’s attributes and qualifying criteria. In particular, we are intrigued by the possible development of “pooled” supplemental capital instruments that provide cost savings to the issuers and expands access to capital markets for credit unions seeking more limited offerings. CUNA Mutual Group has demonstrated proof of the pooling concept in 2006 when it helped 21 Australian credit unions raise nearly $100 million in subordinated debt and preferred equity in an innovative offering that was named the “Structured Finance Deal of the Year.” Not only would innovative pooled offerings provide efficiencies for the credit union system, it epitomizes the cooperative spirit that founded the movement more than 100 years ago.

**Conclusion**

Truly comprehensive capital reform for credit unions requires Congressional action. However, that this rulemaking would fall short of comprehensive reform in no way diminishes the important framework it would establish. As discussed throughout these comments, developing a supplemental capital rule for non-LICU natural person credit unions is sound policy.

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From a supervisory perspective, in particular a deposit insurer supervisory perspective, more capital, at risk and junior to the share insurance fund, is almost always better than less capital.

We anticipate there will be those voices that suggest moving forward with a supplemental capital rule is in some way an unnecessary exercise because, in their view, there has not been an overwhelming demand from credit unions for the authority. This view is misguided. It is incumbent on supervisory authorities to not just do the popular and the easy, but to also do what is right. As with NCUA’s derivatives rule, supplemental capital is the right thing to do. It is a potentially valuable “tool in the tool box” of credit unions’ and regulators’ risk management, provides a capital buffer, and serves as a counter cyclical means to maintain service to members. And, like derivatives authority, while supplemental capital is not going to be appropriate, or useful to all credit unions, for those complex credit unions with the expertise to manage it, supplemental capital can be a very important tool.50

Financial services and the financial services marketplace continue to evolve. A risk-based net worth supplemental capital rule should be flexible enough to accommodate innovations in the market place as well as accommodate possible future statutory capital modernization. Therefore, the rule should focus on establishing the framework for parameters necessary to maintain compatibility with credit union cooperative principles:

- Preservation of the Cooperative Model
- Robust Investor Safeguards
- Prudential Safety and Soundness Requirements

In closing, we commend NCUA for its hard work on this important issue. Our comments and recommendation contained herein result from extensive discussions with our

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50 Much in the same way that an increased member business lending cap is not universally beneficial to all credit unions, nor is an expanded community field of memberships for federal credit unions beneficial to all FCUs.
members. We would be pleased to discuss these comments in detail at NCUA’s convenience.

Sincerely,

- signature redacted for electronic publication -

Lucy Ito
President and CEO