The National Voice of the State Credit Union System

July 8, 2020
Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Re: NASCUS - Comments on Proposed Rule: Subordinated Debt (RIN 3133-AF08)

Dear Mr. Poliquin:

The National Association of State Credit Union Supervisors (NASCUS)[1] submits the following comments in response to the National Credit Union Administration's (NCUA's) publication of RIN 3133-AF08, Proposed Rule: Subordinated Debt.[2] NASCUS appreciates the scale and complexity of NCUA's undertaking related to this rulemaking. We commend NCUA for proposing a rule that would allow low-income designated credit unions (LICUs), complex credit unions, and newly chartered credit unions to issue Subordinated Debt for regulatory capital treatment.

NASCUS appreciates the opportunity to provide NCUA our perspective on this important rulemaking and submit the following recommendations for the agency's consideration. We support the inclusion of Subordinated Debt in the calculation of a credit union's regulatory capital and modernization of the regulatory capital framework. It is apparent from NCUA's proposal that agency staff gave thoughtful consideration to NASCUS' comments submitted in response to the Advance Notice of Proposed Rulemaking for Supplemental Capital (ANPR) issued in 2017.[3]

General Comments

Although NASCUS advocated for a broader, more flexible rule, we recognize that a Subordinated Debt rule is a logical starting point for NCUA rulemaking. The more precise nomenclature clearly communicates what the proposed rule is incorporating into credit union capital treatment. Organizing the proposed rule around Subordinated Debt instruments and borrowing minimizes issues related to the federal and state credit union tax exemptions and credit union mutuality. However, as noted throughout our comments, we urge NCUA to avoid promulgating a rule that inadvertently forecloses the potential for future market innovation.

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[1] NASCUS is the professional association of the nation's 45 state credit union regulatory agencies that charter and supervise over 2,000 state credit unions. NASCUS membership includes state regulatory agencies, state chartered and federally chartered credit unions, and other important stakeholders in the state system. State chartered credit unions hold nearly half the $1.6 trillion assets in the credit union system and are proud to represent nearly half of the 122 million credit union members.
[2] NCUA Proposed Rule: Subordinated Debt, 85 Fed. Reg. 47, at 13982 (March 10, 2020).
[3] 82 Fed. Reg. 9291 (Feb. 8, 2017).

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An inclination to control risk through a prescriptive standard is not only understandable; it also makes sense in the narrow context of product-based risk analysis. But in the case of Subordinated Capital in general, and Subordinated Debt in particular, an overly prescriptive approach is counterproductive and unnecessary. The approach is counterproductive because it would unduly restrict the ability of credit unions and the marketplace to develop and evolve models of Subordinated Debt or Subordinated Capital that benefit the credit union system, present an attractive return to third-parties, and cohere to the unique features of credit unions. An overly restrictive initial rule could thwart the very innovation needed for the development of a robust Subordinated Debt marketplace. A prescriptive approach also runs counter to NCUA's efforts to "modernize" its rules by favouring a principles-based approach to rulemaking over a prescriptive approach.[4] In addition, numerous supervisory safeguards mitigate the risk of materially unsafe and unsound offerings, further rendering a prescriptive approach unnecessary. For example, proposed § 702.409, by requiring pre-approval of the original issuance of securities, ensures that federal and state regulators will have the opportunity to identify imprudent offerings. Many state regulators have extensive experience with securities regulation and subordinated capital by virtue of their roles as banking and securities regulators and are therefore well positioned to evaluate innovative offerings.

A final rule should also be flexible enough to be scaled for more modestly sized credit unions to participate in the Subordinated Debt marketplace. Where possible and appropriate, regulatory burden should be balanced against safety and soundness considerations. NCUA should consider including automatic approval provisions for certain reissuances or for credit unions seeking an extension of the approval period.

We also believe the ability of credit unions to "pool" offerings to reduce costs and leverage the cooperative nature of the credit union system will be essential.

Allowing the proceeds of the debt issuances to cover operating losses in excess of retained earnings will provide credit unions needed flexibility to manage their risk and operations, particularly in times of macroeconomic stress. Mandating a minimum maturity of five years provides an adequate time for repayment and discounting the "regulatory value" of the issuance as it matures is sound policy. NCUA could improve the flexibility of credit union offerings by permitting maturities greater than 20 years, and we recommend NCUA consider allowing thirty-year maturities.

While NASCUS agrees that treating Subordinated Debt offerings as securities makes sense from a prudential standpoint, we believe that due consideration should be given to the successful history of LICU issuances of Secondary Capital as well as the unique nature of the credit union system. In addition, NCUA should take care to avoid classifying credit union debt agreements as "securities" where comparable contracts executed by other depository

[4] NCUA Final Rule: Commercial Lending, 83 Fed. Reg. 108, 25881 (June 5, 2018). We recognize "principle-based" rulemaking is not without its flaws: it can lead to uncertainty and lead to prescription through guidance and interpretation (both of which lack the safeguard of notice and comment). However, in this case we believe principle-based rulemaking is a better approach as it provides the flexibility needed for the marketplace to adapt.

institutions might not be so classified. NASCUS does not support special registration requirements or special supervisory fees because both would disproportionately burden smaller credit unions.[5] We also have concerns that proposed limitations on negative covenants may dampen the potential market for credit union issuances. We do support the inclusion of interest payment and repudiation safe harbors.

The proposed rule prescribes various protections for investors and issuing credit unions including requirements for reporting and disclosures, director and officer liability, broker dealer registration requirements, and suitability standards for investors. In general, NASCUS supports these provisions as proportionate and balanced. We do have concerns that Proposed 702.406 limitations on re-sale of credit union Subordinate Debt might hinder the marketability of the issuances. In particular, the distinction between entity and individual investor suitability combined with the pass-through restrictions on the secondary market is too prescriptive to be workable in the marketplace.

We find limitations on the dollar amount of the offering to be overly prescriptive and recommend those limitations be reconsidered.

With respect to concentration limits, NASCUS supports a baseline 25% limit, but recommend NCUA include a waiver provision allowing qualifying credit unions to request an increase up to 40%.

Below, we explore many of these issues in more detail and provide specific recommendations for NCUA's consideration.

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.[6] For LICUs, the ability to accept Secondary Capital investments was intended to both improve their capital holdings and finance services to members.[7] LICU 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.[8]

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[5] As we noted in 2013 in response to an NCUA request for comments on charging fees for credit union derivative authority, we believe such fees divide the credit union system and ultimately act as an impediment for modest-sized credit unions to enjoy the same powers and authorities exercised by their larger asset-sized peers.
[6] 61 Fed. Reg. 50696 (Sept. 27, 1996).
[7] Williams, Marva. Woodstock Institute. *Critical Capital: How Secondary Capital Investments Help Low-Income Credit Unions Hit Their Stride,* (May, 2002), p. 6. Available at http://www.woodstockinst.org/sites/default/files/attachments/criticalcapital_0.pdf (viewed March 2017).
[8] 12 C.F.R §701.34(b).

In 1998, the Credit Union Membership Access Act ("CUMAA") was enacted establishing Prompt Corrective Action ("PCA") for credit unions.[9] 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.[10] 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 assistance (Section 208 assistance), and for LICUs, Secondary Capital.[11] 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.[12] In conjunction with that rulemaking NCUA acknowledged the utility of providing credit unions designated as complex access to Subordinated Capital to utilize in regulatory capital calculations. In 2017, NCUA issued the ANPR which served as the foundation for the proposed rule we address with this letter.

NCUA's Legal Authority to Authorize Subordinated Debt be Included in Capital Treatment

As NCUA notes in the Supplemental Material, The FCUA grants NCUA broad discretion to design RBC standards.[13] NASCUS wrote at length in support of NCUA's authority to issue rules related to Subordinated Capital as well as the credit union ability to issues various Subordinated Capital instruments consistent with their mutual organization and federal tax exemption.[14] We do not believe any credible question remains as to NCUA's authority to promulgate these rules.

The Importance of Preserving an Option for Credit Unions to Pool Offerings

As we have previously noted in past comments and discussions with NCUA, we believe that the ability of credit unions to "pool" offerings is critical to the success of a Subordinated Debt rule. By pooling their offerings (including by selling to a single entity that issues instruments representing ownership interest in a pool of assets consisting of Subordinated Debt Notes offered by credit unions), credit unions may work together and leverage the mutuality of the credit union system to offer investors a more attractive, and diversified, debt offering. In this way, credit unions can reduce their individual costs and often improve the offering documents. Credit unions that might not be able to issue an individually marketable offering can work together to scale up offerings that might draw investor interest.

[9] The Credit Union Membership Access Act of 1998, HR 1151, Public Law 105–219, 112 Stat. 913 (1998),
[10] PCA is implemented by 12 C.F.R. §702.
[11] 12 U.S.C. §1790d(o)(3); 12 CFR 702.2(g) and (k).
[12] 80 Fed. Reg. 66626 (October 29, 2015).
[13] 85 Fed. Reg. 47, at 13986 (March 10, 2020).
[14] NASCUS Comments on Advanced Notice of Proposed Rulemaking for Supplemental Capital (May 9, 2017). Available at https://www.ncua.gov/files/comment-letters/2017/cl-altcap-20170515LIto.pdf.

We again note that this pooled offering model has been used by both banks and credit union systems in other countries.[15] In view of the potential merits of this model, we recommend NCUA include a specific provision providing for pooling by groups of credit unions and work with stakeholders to address the feasibility and application process for such a pooled offering.

NCUA's Specific Request for Comments

Throughout the Supplemental Material, NCUA seeks specific comments on elements of its proposal. NASCUS' general responses to those questions follow:

NCUA Specific Questions	NASCUS Position
1. NCUA asks whether 15%, 25%, or 40% is an appropriate investment limit for Subordinated Debt.	NASCUS supports 25% as a baseline limit, but we recommend NCUA allow qualifying credit unions to seek a waiver up to 40%.
2. Should NCUA limit FISCUs to only the Subordinated Debt instruments being allowed for FCUs per new § 701.25?	NASCUS opposes limiting FISCUs to the Subordinated Debt instruments being allowed for FCUs. The state system has a long history of leading the way in innovative credit union products and services. Homogenizing borrowing and other related authorities weakens dual chartering and stifles innovation. State Regulators, many of whom supervise banks and securities, are more than capable of supervising FISCU innovation as it develops.
3. NCUA seeks feedback on whether a final rule should prohibit default covenants.	NASCUS opposes a blanket prohibition on default covenants. Such covenants are standard in bank debt obligations to allow parties to restructure deals in the event of material changes to the condition of the issuer.
4. NCUA asks whether the rule should establish minimum dollar amounts issuances.	NASCUS opposes establishing minimum limits because they may impede LICU access to Secondary Capital.
5. NCUA proposes limiting purchase of Subordinated Debt to U.S. persons and entities.	NASCUS supports this limitation. Limiting purchase to U.S. persons and entities is a reasonable initial limitation as NCUA and credit unions gain experience with this new rule.
6. NCUA asks for comment on whether the proposal should only allow sales of Subordinated Debt to accredited investors.	NASCUS supports limiting sales of subordinated debt to accredited investors. Investor suitability is an important prudential standard.

[15] As cited in NASCUS 2017 ANPR comments, see Hoel, Alternative Capital for U.S. Credit Unions? A Review and Extension of Evidence Regarding Public Policy Reform, (Filene Institute, 2007) p. 48. Also see "CUNA Mutual Capital Project Named One Of Australia's Best," *Credit Union Times*, (October 18, 2006). Available at http://www.cutimes.com/2006/10/18/cuna-mutual-capital-project-named-one-of-australias-best.

7. NCUA asks for comments on whether the rule should distinguish between "Entity" and "Individual" accredited investors.	NASCUS has concerns that limiting the re-sale of Subordinate Debt to the same class of investor may hinder the marketplace.
8. Should NCUA prohibit credit union insiders and their family members from holding Subordinated Debt of a credit union?	NASCUS supports preventing insiders from acquiring the Subordinated Debt of a credit union.
9. NCUA seeks comment on extending the time horizon of the pro forma financial statements to 5 years compared to the Current Secondary Capital Rule of two years to match the minimum maturity requirement of 5 years.	NASCUS supports the increase to 5 years of pro forma financials.
10. NCUA seeks comment on the proposed 1-year expiration on supervisory approval of an issuance to ensure a credit union does not offer Subordinated Debt after a material change in condition.	NASCUS requests further clarity on this issue. It is unclear if NCUA intends to allow a credit union to request authority to issue debt over a 12-36 month after approval or if the entire issuance needs to be completed in 12 months. A better approach would be to allow NCUA to withdraw authorization after 12 months if the credit union's condition has materially changed.
11. NCUA requests feedback on whether the agency should impose filing fees on credit unions seeking approval to offer Subordinated Debt instruments.	NASCUS opposes the imposition of filing fees on credit unions related to Subordinated Debt.
12. NCUA proposes a safe harbor for interest payments on Subordinated Debt for credit unions other than "Critically Undercapitalized."	NASCUS supports the Safe Harbor provision for interest payments as necessary for instrument marketability.
13. NCUA seeks feedback on a repudiation safe harbor.	NASCUS supports the repudiation safe harbor.
14. NCUA seeks comment on an appropriate date for grandfathering LICU Secondary Capital issuance.	NASCUS recommends that the grandfather protection for previously issued Secondary Capital be aligned with the final rule's time frame for expiration of Subordinated Debt approval.

15. NCUA requests comment on whether their estimate of the record keeping/regulatory burden of the proposed rule is accurate.	NASCUS believes NCUA underestimates the hours required to prepare offering documents and regulatory approval submissions as well as comply with reporting and record keeping requirements.

NASCUS Section-by-Section Analysis of the Proposed Rule and Specific Recommendations for Improvement

Part 702.207 and Related Changes for New Credit Unions

NCUA proposes a new section of the PCA rules that would provide an exception from PCA for a New Credit Union with outstanding Subordinated Debt. Under the proposal a New Credit Union meeting certain criteria could use its Subordinated Debt for regulatory capital treatment.[16] We support this provision. By providing a path forward for newly chartered credit unions to use Subordinated Capital to meet PCA thresholds, NCUA has facilitated the ability for individuals to charter new credit unions without materially increasing risk to the share insurance fund.

Proposed § 702.207(c)(3) would require NCUA to consult and cooperate with State Regulators before taking discretionary PCA action on a newly chartered credit union under this provision. We agree this is the appropriate approach as envisioned by Congress for all implementation of PCA. We commend NCUA for the specific inclusion here and recommend an "umbrella reference" to NCUA PCA related consultation and cooperation. Specifically, we recommend new sub-provision § 741.3(h) to read "in administering any of the above provisions, NCUA will seek to consult and cooperate with the state regulator."

Part 702.403 Eligibility

NCUA proposes including any credit union that has a reasonable likelihood of meeting the eligibility requirements within 24 months. The rule would prohibit eligible credit unions from both issuing and investing in Subordinated Debt. NCUA includes in the proposal a limited exception that would allow a credit union issuer of Subordinated Debt to hold investments in Subordinated Debt it acquired by way of a merger or consolidation, but it could not invest in any new holdings while it has issuances outstanding.

NASCUS supports the 24-month eligibility window. This allows credit unions anticipating eligibility to begin the process with a modicum of certainty for business planning purposes.

We are less certain with respect to the prohibition on the simultaneous holding of and investing in Subordinated Debt. There is a difference between an individual credit union both issuing and holding Subordinated Debt in separate arms-length transactions and two or more

[16] 85 Fed. Reg. 47, at 139996 (March 10, 2020).

credit unions engaging in a mutually agreed-upon reciprocal transaction(s). From a supervisory standpoint, there is also a question of whether "transparency" or "prescription" is the properly calibrated approach. However, as an initial matter for a new rule, we concede that while perhaps too prescriptive, limiting eligible credit unions to either issuing or investing is a workable approach. Should NCUA determine to retain the prohibition without alteration at this time, we would recommend the Supplemental Material include a discussion of an intent to revisit the prohibition after the system's experience with Subordinated Debt has matured.

§ 702.404 Requirements of the Subordinated Debt Notes

Under proposed § 702.404, NCUA proposes limiting FISCUs to issuing only debt instruments, expanding the regulatory requirements for LICU Secondary Capital issuances, mandating maturities of no less than five years and no more than twenty years, be offered only to accredited individual or entity investors, and prohibiting any default covenants that would accelerate repayment.

While many of the proposed requirements for the Subordinated Debt note make sense from a risk mitigation approach, we recommend NCUA consider some nuanced changes from a practical perspective.

We understand that independent of a Subordinated Debt rule, some could argue that LICU Secondary Capital rules are in need of review and updating. Accepting that to be the case and supporting regulatory and supervisory parameters that help ensure safe, sound, and compliant transactions, we remain concerned that the extensive nature of the Subordinated Debt proposal and its application to LICUs may prove overly burdensome. While we have advocated for a streamlined set of Subordinated Capital rules for LICUs, new credit unions, and complex credit unions, we continue to believe that simplified offerings by LICUs should qualify for an approach that recognizes their needs and successful history with Secondary Capital. We encourage NCUA to work with stakeholders to identify changes to achieve that goal.

While we support the minimum 5-year maturity to ensure stability for capital treatment, we are unsure of the need to cap maturity at 20 years. We encourage NCUA to consider whether the marketplace entertains offerings with greater-than 20-year maturities for some offerings and to adjust the rule accordingly. We understand that 30-year maturities are not uncommon.

NASCUS supports the limitation on offerings of Subordinated Debt to accredited investors. However, as discussed below, we recommend that NCUA consider whether a single standard of suitability for investors in Subordinated Debt would be more manageable. In particular we have concerns that the proposed restrictions on re-sale of Subordinated Date and the "pass-through" of the dual standard for suitability will dampen the market's interest in credit union offerings.[17]

[17] We also note that is easy enough for an individual investor to be coached around an individual standard by simple incorporation of an entity for a purported purpose other than to circumvent the suitability standard.

The proposed restriction on covenants is also of concern. In our comments filed for the 2017 ANPR, we did support limitations on covenants that would have **prevented** credit union mergers. However, after considering the proposed limitations we are concerned they are too restrictive and may hinder successful offerings. It is our understanding in commercial debt transactions that default covenants are commonly negotiated and often expected. While we support limiting the ability of covenants to accelerate repayment, we want to ensure the rule provides for the inclusion of covenants that are commonly accepted in the marketplace. Furthermore, inclusion of traditional elements of debt transactions supports the characterization of these issuances as Debt.

In addition, as noted throughout our comments, we oppose an overly preemptive approach to state authority. We support NCUA requiring FISCUs comply with these provisions to have Subordinated Debt receive capital treatment. However, blanket requirements that FISCUs only issue Debt pursuant to this rule go beyond capital treatment and are unnecessary at this time.

Finally, proposed § 702.404(e) would establish minimum issuances of $100,000.00 for individual investors. We oppose setting minimum dollar thresholds for issuances. While we support NCUA expanding LICU eligible investors to individuals, and support suitability standards, we caution against provisions that are overly restrictive. Credit unions should be given the flexibility to make issuances in whatever denominations suit their needs and their business strategy. Bearing in mind that individual investors must be accredited to qualify under 17 CFR 230.501(a)(5) or (6), there should be no question about the adequacy of investor acumen.[18] Given the costs associated with Subordinated Debt, it is likely that offerings available to individuals will be in excess of the proposed thresholds to make the exercise a cost-effective way to raise capital.

NCUA's Proposed 702.406 and 702.407 Must be Scalable

NCUA has proposed a comprehensive Disclosure and Offering document process that we fear may be too burdensome for many credit unions. From a Supervisory perspective, NCUA's treatment of the Subordinated Debt process as a securities offering with all the hallmarks of said offerings makes sense. However, NASCUS believes more refinement is needed to properly calibrate the rule with the risk and the burden. In many respects, NCUA's proposal is more onerous than the submissions, disclosures, and other requirements for banks. As such, it is likely many credit unions would find entry into this market, and the value it can provide, inaccessible.

We encourage NCUA to work with state regulators and stakeholders to better tailor these provisions to reflect the credit union system and the likely marketplace while preserving

[18] NASCUS is also sensitive to the fine line between investor suitability and exclusivity. There are numerous credit union members with the sophistication to understand the offering but not the means to acquire $100,000 chunks. Given the origins of the credit union movement are founded on inclusiveness, we caution against overly exclusive thresholds that would arbitrarily exclude members.

accessibility for all eligible credit unions and allowing for innovative disclosure and offering documents.

Proposed § 702.408 Pre-Approval Requirements Would Benefit from Automatic Approvals

Under proposed § 702.408(k), approval to issue Subordinated Debt would expire one year after the later of NCUA's written approval of (A) the initial application, or (B) if the offering is made to any natural person, the Offering Document. This 1-year window is too prescriptive. In addition, NCUA should consider including automatic approvals to reduce burden on issuing credit unions and align the process more with that for banks.

Rather than a 1-year expiration of authority, NASCUS recommends the NCUA create a 36-month window within which credit unions act on approved issuances. The extended time period would allow some credit unions to follow a strategy of staggered issuances as part of a strategic offering built out over time. It is our understanding that it is neither unreasonable, nor uncommon, for an issuer to draw down on an issuance over time. If the 1-year expiration is intended to protect the investor, we suggest that is a role for the investor's underwriting. If the 1-year delay is to preserve the integrity of NCUA's assessment of its initial approval, then that may be accomplished by expressly reserving the authority to terminate approval upon a change in material condition with a 36-month window.

We also encourage NCUA to consider streamlining the approval process by providing for presumption of approval at the end of the 60-day review period rather than requiring written approval for each submission and developing a process for automatic approvals of identical resubmissions of previously approved submissions or other low-risk offerings.

Minor Adjustments are Needed for Proposed Pre-Approval of FISCUs

Proposed § 702.409 contains pre-approval requirements unique to FISCUs. NASCUS agrees that both state regulators and NCUA should pre-approve credit unions before they issue Subordinated Debt (for capital treatment in NCUA's case). In order to prevent unnecessary delays in the approval process for a FISCU, NCUA's Supplemental Material and the proposed rule text should make clear that NCUA and state reviews may be conducted in parallel to ensure timeliness.

We must similarly qualify any support for NCUA's requirement that FISCUs obtain a tax opinion regarding federal income tax. First, it is not clear that there is a need for this provision if NCUA persists in preempting State authority to allow other kinds of Subordinated Capital issuances or if NCUA otherwise limits FISCUs to the narrow parameters of this rule. Second, in view of the extra cost of obtaining such opinions, we seek some limitation on the requirement for such an opinion as a matter of course rather than as an exception. For example, under certain circumstances the NCUA should at least consider a request for waiver of this requirement.

NCUA Should Reconsider New Parts 741.226 and 741.227

NCUA proposes creating two new provisions to the FISCU rules of § 741. Proposed § 741.226 instructs FISCUs to comply with § 702 before issuing subordinated debt.[19] Proposed § 741.227 would extend the FCU rule in § 701.25 related to borrowings to FISCUs.[20] We believe a final Subordinated Debt rule would be better without these proposed revisions.

At a macro level, the final Subordinated Debt rule should not foreclose the authority of FISCUs to offer other instruments in the future. Although we understand NCUA's desire for consistency between FCUs and FISCUs, it is important to remember that diversity in the system is a feature, not a bug. As the United States Treasury Department recognized years ago: "Diversity increases the chances that innovative approaches to policy problems will emerge..."[21] The strength of the dual chartering system is that states serve as micro laboratories of innovation that encourage the evolution of the credit union system while containing systemic risk.

NCUA specifically seeks recommendations on other instruments that FISCUs may offer if not limited by this rulemaking. That we cannot answer this with certainty is the point. As of this writing there is no mature market for instruments issued by non-LICU credit unions. We are confident that as complex credit unions explore issuance of instruments a market will develop and begin to evolve. NCUA's final rulemaking should not foreclose that evolution.

The best approach in a final rule would be to leave existing state authority in place to provide for ***potential*** innovation in credit union offerings. There is minimal risk in allowing the possibility for future innovation because any future offering would need NCUA approval before being given capital treatment. Similarly, there is no reason for this rule to foreclose the existing authority of FISCUs to offer supplemental capital instruments that would not count toward regulatory capital. There have been few instances of FISCUs exercising that authority in the past, and there will be even less incentive now with a subordinated capital rule in place.

With respect to proposed § 741.226 referencing proposed Sub-part D of § 702, we further note that FISCUs are already "directed" to comply with all of Part 702 by reference in § 741.3(a)(1). Accordingly, the parallel reference to Part 702 is redundant and unnecessary. In the unlikely event the NCUA and state regulators believe further restrictions are warranted in the future, the rule can be revised.

Conclusion

NASCUS appreciates NCUA's continued efforts to develop a comprehensive rule regarding Subordinated Capital in natural person credit unions. The development of a Subordinated Debt rule is an essential complement to the implementation of the RBC rule with potential

[19] 85 Fed. Reg. 47, at 14033 (March 10, 2020).
[20] Id.
[21] U.S. Department of the Treasury, Modernizing the Financial System, February 1991, page XIX.

benefits for the credit union system that have been well documented.[22] Including Subordinated Debt in risk-based capital ratio calculations is consistent with the statutory purposes of both state and federal credit unions and is sound public policy. This rule will help credit unions and their members, protect the share insurance fund, and help place natural person credit unions in the United States on par with credit unions and other depository institutions worldwide. We would be happy to discuss our comments in detail or provide additional information at NCUA's convenience.

Sincerely,

- signature redacted for electronic publication -

Lucy Ito
President and CEO

[22] *See* NCUA Supplemental Capital White Paper (April 12, 2010); NASCUS, Alternative Capital for Credit Unions: Why Not? (2005); James A. Wilcox, Reforming Credit Union Capital Requirements (Mar 3, 2011); Robert Hoel, Alternative Capital for U.S. Credit Unions? A Review and Extension of Evidence Regarding Public Policy Reform (2007).