July 8, 2020

Gerard Poliquin, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314–3428

RE: NCUA Proposed Rule – Subordinated Debt RIN 3133–AF08

Dear Mr. Poliquin:

The Indiana Credit Union League (ICUL) appreciates the opportunity to submit comments on the National Credit Union Administration's Proposed Rulemaking for Subordinated Debt. The ICUL member credit unions represent 99% of assets and members of Indiana's credit unions, with those memberships totaling more than 2.6 million consumers.

The NCUA Board issued a proposal to permit low income designated credit unions (LICUs), complex credit unions (>$500 million in assets), and new credit unions (<10 years in operation and $10 million or less in assets) to issue subordinated debt for purposes of regulatory capital treatment under NCUA's risk-based capital rule (RBC). The proposal does not impact LICUs' ability to include such instruments in its net worth. The proposal also contains requirements related to applying for authority to issue subordinated debt, credit union eligibility to issue subordinated debt, prepayments, disclosures, securities law, the terms of a subordinated debt, limits on terms to other credit unions, grandfathering of any secondary capital issue before the effective date of any adopted changes, and how subordinated debt will be treated by mergers and involuntary liquidations.

We are supportive of NCUA's efforts to develop a methodology for credit unions to grow capital in ways other than generating net income. However, we believe the proposed regulation for subordinated debt is too complex for the vast majority of small- and medium-sized credit unions. Rather than expanding the number of credit unions that could add a form of secondary capital, we believe the regulation as proposed will ultimately severely limit the option to only the largest credit unions due to its complexity and likely expenses associated with issuing subordinated debt instruments.

Given the significantly higher level of complexity to issuing subordinated debt, we encourage NCUA to consider allowing small- and medium-sized LICUs, new credit unions, and potentially non-LICUs the option of issuing secondary capital under the current regulation. We are very concerned that the requirements of the proposed rule will result in the issuing subordinated debt instruments being too expensive and not feasible for these smaller credit unions to participate. The effective result of the proposed rule, we fear, will result in only the largest credit unions being able to take advantage of issuing subordinated debt. Small- and medium-sized credit unions will likely see the proposed rule effectively eliminating this option for them to grow capital in this manner.

Since 2015 when the RBC rule was proposed, NCUA has been seeking comments on subordinated debt. We believe subordinated debt is particularly important because credit unions are at a disadvantage in the financial marketplace because most lack access to additional capital outside of retained earnings. Allowing complex and new credit unions to issue subordinated debt as a tool to manage RBC requirements is welcomed; however, all credit unions should be allowed to issue subordinated debt and the vast array of proposed requirements may diminish the use of such a strategy. We understand that NCUA needs to have appropriate checks and balances for

allowing subordinated debt; however, we question whether complexity as outlined in the proposal will limit credit unions' participation and add unnecessary expense to the process.

While the NCUA anticipates issuing credit unions will be exempt from the Section 5(a) registration requirements, the proposal includes requirements for the offer, issuance, and sale of subordinated debt notes. These requirements are independent of any available exemptions from the registration requirements of Section 5(a). For example, the NCUA is proposing that every planned issuance would require an issuing credit union to prepare and deliver an offering document to potential investors even though there are no SEC-mandated disclosure requirements for offerings of securities pursuant to the Section 3(a)(5) exemption, and there generally are no SEC-mandated disclosure requirements for offerings of securities pursuant to the Rule 506 private placement exemption as long as all purchasers in the offering are "accredited investors." Unlike the OCC prospectus delivery rule, which is subject to a variety of exemptions, the NCUA's proposed rule does not appear to provide any exemptions from the offering document delivery requirement. We ask the NCUA to consider whether it would be appropriate to allow exemptions from the proposed offering rules in limited circumstances, such as for small offerings under a certain dollar threshold or to a very limited number of institutional accredited investors.

The general application of a securities issuance across all acquisitions of subordinated debt by credit unions will create substantial effort and cost. Although it is welcomed that new credit unions and LICUs can raise secondary capital, it is doubtful that such a credit union will have the resources, both expertise and financial, to take advantage. With the proposal's complexity, credit unions will most likely seek third party expertise which will result in added costs. Additional flexibility, resources and assistance should be considered to assist such credit unions in their infancy. While secondary capital is particularly important as the events of the past few months illuminate, NCUA should reconsider the proposal's complexity so credit unions can respond to members' needs and economic trends.

Additional clarity and standardization of the preapproval application process is valuable; however, a standardized application reflects the use of a single structure for all subordinated debt requests. In many cases, especially for smaller credit unions and smaller loans, the proposed requirements outlined are both unnecessary and overly burdensome. ICUL recommends that the NCUA focus on the continuance of its current secondary capital requirements and limit changes to supplemental enhancements, not a wholesale restructuring of the application.

Under the proposed rule, an issuing credit union's authority to issue subordinated debt would expire in one year. Such a timeframe appears arbitrary, as there is no supporting evidence to show that a material change would be expected to occur within one year.

NCUA's review time of the initial application and prepayment requests need to be shortened. A 60-day, and 45-day subsequently, review time with the potential to extend the deadline for incomplete or missing information is too long and may lead to missed opportunities for the credit union. Also, the removal of automatic approval could be detrimental for both credit unions and lenders.

Adequately capitalized credit unions should have the same ability to prepay, without regulatory approval, the portion of subordinated debt not included in net worth. NCUA should conform with the standards delineated in the National Supervision Policy Manual. A regulatory approval process for repayment of amortized portions of subordinated debt no longer included in net worth is, in most cases, unnecessary and not beneficial for any party.

In purchasing subordinated debt from credit unions, investors face certain regulatory uncertainties. For example, the FCU Act and the NCUA's regulations provide authority to prohibit dividend or interest payments in specified scenarios. This makes it difficult for investors to gauge risks related to subordinated debt purchases, resulting in more extensive disclosure requirements and higher costs for issuing credit unions. NCUA should continue to allow specific discretionary authority for "critically undercapitalized" credit unions to pay interest. This will allow

flexibility in certain situations for those credit unions to find investors. The safe harbor for credit unions in a net worth category more favorable than “critically undercapitalized” is welcomed and could make subordinated debt issued a more viable product at a lower cost.

We ask the NCUA to reexamine its conclusion regarding an increase of risk to the NCUSIF when multiple issuing credit unions both issue and invest in subordinated debt. The investment of one credit union in the subordinated debt of another could benefit the credit union system overall since it is likely, or at least possible, that credit unions with higher net worth ratios will invest in those with lower net worth ratios. To address a scenario where the net worth of the system appears to increase while the actual loss-absorbing capacity remains unchanged, the NCUA could add a line item to the Call Report to exclude all amounts invested in the subordinated debt of other credit unions. Therefore, we ask the NCUA to reconsider its proposed blanket prohibition on a credit union both issuing and investing in subordinated debt.

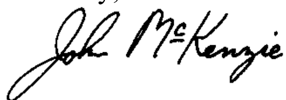
In a merger situation, any credit union, regardless of whether the surviving credit unions is a LICU, complex or new credit union, should be able to treat acquired subordinated debt as regulatory capital. First, all credit unions should be given the ability to issue subordinated debt; the surviving credit union is assuming all liability and no benefit; and NCUA may be limiting the potential suitors for the merger.

NCUA’s estimated implementation cost of $1 million a year to hire senior staff with securities law experience and to augment legal staff needs more evaluation. This is a sizeable cost where more explanation and justification is warranted. If NCUA believes that a vast majority of debt will be exempt from SEC laws, this leads us to question the added cost. Also, what is NCUA’s anticipated credit union debt/requests and does the complexity of the proposed rule lead to unnecessary steps and timing to these costs?

While we appreciate NCUA consideration of how credit unions can be positioned to grow capital as needed in ways other than generating net income, we are concerned that this proposed rule is too complex and restrictive. We again ask NCUA to look at whether a combination of the current secondary capital rule and a subordinated debt rule could be constructed in a way to make this alternative to grow capital a viable option for all credit unions regardless of size.

We appreciate the opportunity to comment on the proposed rule. We agree that having the process for credit union combinations with non-credit unions spelled out in the regulations is important to ensure credit unions understand what is required. We ask NCUA to consider the recommended changes we discussed above. If you have any questions about our letter, please do not hesitate to give me a call at (317) 594-5320.

Sincerely,



John McKenzie
President, Indiana Credit Union League