



NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 702 and 741

[NCUA 2021-0127]

RIN 3133-AF38

Subordinated Debt

AGENCY: National Credit Union Administration (NCUA).

ACTION: Proposed rule.

SUMMARY: The NCUA Board (Board) is proposing to amend the Subordinated Debt rule, which the Board finalized in December 2020 with an effective date of January 1, 2022. The Board proposes to amend the definition of “Grandfathered Secondary Capital” to include any secondary capital issued to the United States Government or one of its subdivisions (U.S. Government), under an application approved before January 1, 2022, irrespective of the date of issuance. The proposed change would benefit eligible low-income credit unions (LICUs) that are either participating in the U.S. Department of the Treasury’s (Treasury) Emergency Capital Investment Program (ECIP) or other programs administered by the U.S. Government that can be used to fund secondary capital, if they do not receive the funds for such programs by December 31, 2021. The Board also proposes to extend the expiration of regulatory capital treatment for these issuances to the later of 20 years from the date of issuance or January 1, 2042.

DATES: Comments must be received on or before [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit written comments, identified by RIN 3133-AF38, by any of the following methods (**Please send comments by one method only**):

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments on Docket NCUA 2021-0127.

- Fax: (703) 518-6319. Include “[Your Name]—Comments on Proposed Rule: Subordinated Debt 2021” in the transmittal.
- Mail: Address to Melane Conyers-Ausbrooks, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.
- Hand Delivery/Courier: Same as mail address.

Public Inspection: You may view all public comments on the Federal eRulemaking Portal at <http://www.regulations.gov>, as submitted, except for those we cannot post for technical reasons. The NCUA will not edit or remove any identifying or contact information from the public comments submitted. Due to social distancing measures in effect, the usual opportunity to inspect paper copies of comments in the NCUA’s law library is not currently available. After social distancing measures are relaxed, visitors may make an appointment to review paper copies by calling (703) 518-6540 or e-mailing OGCMail@ncua.gov.

FOR FURTHER INFORMATION CONTACT: Justin M. Anderson, Senior Staff Attorney, Office of General Counsel, 1775 Duke Street, Alexandria, VA 22314-3428. Justin Anderson also can be reached at (703) 518-6540.

SUPPLEMENTARY INFORMATION:

I. Background

A. Subordinated Debt Rule

At its December 2020 meeting, the Board issued a final Subordinated Debt rule (the final rule) permitting LICUs, Complex Credit Unions, and New Credit Unions to issue Subordinated Debt for purposes of Regulatory Capital treatment.¹ Relevant to this proposal, the final rule grandfathered secondary capital issued before January 1, 2022, and allowed such secondary capital to receive regulatory capital treatment until January 1, 2042 (20 years from the effective

¹ 86 FR 11060 (Feb. 23, 2021).

date of the final rule).² The grandfathering provision of the final rule allowed LICUs with grandfathered secondary capital to continue to be subject to the requirements of § 701.34(b), (c), and (d) (recodified in the final rule as § 702.414), rather than the requirements of the final rule.³ The final rule also includes a provision stating that any issuances of secondary capital not completed by January 1, 2022, are, as of January 1, 2022, subject to the requirements applicable to Subordinated Debt in the final rule.⁴ This provision would nullify any approved secondary capital application if the associated issuance was not completed before January 1, 2022. Any LICU in this situation would be required to reapply under the final rule if such LICU sought to proceed with its planned secondary capital issuance.

B. Emergency Capital Investment Program

Subsequent to the issuance of the final rule, Congress passed the Consolidated Appropriations Act, 2021.⁵ The CAA, among other things, created the ECIP. Under ECIP, Congress appropriated funds and directed Treasury to make investments in “eligible institutions” to support their efforts to “provide loans, grants, and forbearance for small businesses, minority-owned businesses, and consumers, especially in low-income and underserved communities.”⁶ The definition of “eligible institutions” includes federally insured credit unions that are minority depository institutions or community development financial institutions, provided such credit unions are not in troubled condition or subject to any formal enforcement actions related to unsafe or unsound lending practices.⁷

Under the terms developed by Treasury, investments in eligible credit unions will be in the form of subordinated debt. Treasury also aligned its investments in LICUs with the Federal

² *Id.* at 11074.

³ *Id.* at 11074.

⁴ *Id.* at 11083.

⁵ Consolidated Appropriations Act, 2021, Pub. L. 116–260 (H.R. 133), Dec. 27, 2020.

⁶ *Id.* codified at 12 USC § 4703a *et seq.*

⁷ 12 USC § 4703a(a)(2).

Credit Union Act and the NCUA's regulations to allow eligible LICUs to apply to the NCUA for secondary capital treatment for these investments.

Treasury opened the ECIP application process on March 4, 2021, with an application deadline of May 7, 2021. Treasury has subsequently extended this deadline multiple times, with the most recent deadline, as of the date of this proposal, being September 1, 2021. As of September 17, 2021, 44 LICUs have received approval from the NCUA to issue secondary capital under the ECIP for an aggregate amount of approximately \$1.9 billion.

II. Proposed Rule

The changes proposed in this rule are narrowly tailored to address a specific situation with funding of approved secondary capital applications. Therefore, the Board notes that it is not considering any other changes to the final Subordinated Debt rule. Comments outside the scope of the changes discussed herein will be treated as such for the purposes of any final rule the Board may issue. In light of this targeted scope and the prior public comment period on the Subordinated Debt rule, the Board finds that a 30-day comment period will provide an adequate opportunity for public input.⁸

In the event approved LICU ECIP investments, or investments from any other programs administered by the U.S. government that can fund secondary capital, are not funded by the end of 2021, those approved LICUs would be required to reapply for regulatory capital treatment under the Subordinated Debt rule. As this scenario would impose an unnecessary burden on these LICUs, the Board is proposing to amend the Subordinated Debt rule to permit funding of secondary capital approved under the current rule, beyond 2021, without the need to reapply under the Subordinated Debt rule. Regardless of the issuance date of the secondary capital, such secondary capital would, for the purposes of the Subordinated Debt rule be considered Grandfathered Secondary Capital, and remain subject to § 701.34(b), (c) and (d) of the NCUA's

⁸ See NCUA Interpretive Ruling and Policy Statement (IRPS) 87-2, as amended by IRPS 03-2 and IRPS 15-1. 80 FR 57512 (Sept. 24, 2015), available at <https://www.ncua.gov/files/publications/irps/IRPS1987-2.pdf>.

regulations, (recodified in the final rule as § 702.414). The Board notes that the proposed changes in this rule are narrowly tailored to provide an exception to the issuance cutoff date, if the secondary capital issuance is:

1. To the U.S. Government; and
2. Being conducted under a secondary capital application that was approved before January 1, 2022, under either § 701.34 of the NCUA's regulations, for federal credit unions, or § 741.203 of the NCUA's regulations, for federally insured, state-chartered credit unions.⁹

Consistent with the final Subordinated Debt rule, any LICU not meeting the above criteria will remain subject to the requirement to complete any issuance by the end of 2021 or such issuance will be subject to the requirements of the final Subordinated Debt rule.

The Board believes it is appropriate to narrowly tailor this rule, using the above criteria, for the following reasons. First, the issuances targeted by this rule were applied for and approved under the requirements of the current secondary capital rule. The Board included the issuance cutoff date in the Subordinated Debt rule to ensure future issuances were done in accordance with the more robust requirements in that rule, particularly in the area of disclosures and investor protections. As the issuances that are the subject of this rule are to the U.S. Government, the Board believes that the sharing of non-public, confidential supervisory information between the NCUA and the U.S. Government investor is sufficient to warrant a limited exception. The sharing of non-public, confidential supervisory information also separates the issuances subject to this proposed rule and issuances to non-U.S. Government investors. As such, the Board is not proposing to apply the exception in this proposed rule to secondary capital issuances to entities or persons other than the U.S. Government. Further, the Board notes that, as of September 7, 2021, there were four approved secondary capital applications not related to U.S. Government programs that have not been funded.

⁹ 12 CFR 701.34 and 741.203

While the Board is permitting this limited exception for issuances to the U.S. Government, the Board continues to believe that the requirements of the Subordinated Debt rule, including the issuance of an Offering Document, should apply to all future issuances, regardless of the identity of the investor. The Board notes that information sharing between government agencies is not a substitute for executing an offering document. However, given the non-recurring nature of the transition from the current secondary capital requirements to the new Subordinated Debt requirements, the Board is willing to rely on information sharing in this instance.

The Board is proposing the above criteria to limit the scope to address potential funding timelines under U.S. Government programs that extend beyond the end of 2021. As such, if funding is completed by the end of 2021 for these limited number of applications, there may be no need to finalize this proposed rule. However, out of an abundance of caution, the Board believes it is prudent to be prepared to act should funding delays continue beyond the end of 2021.

The Board reiterates that any LICU that would qualify for the exception granted by this proposed rule must be operating under a secondary capital plan approved before January 1, 2022 under either §§ 701.34 or 741.204 of the NCUA's regulations. Operating under an approved secondary capital plan means that a LICU may only conduct secondary capital issuances in accordance with the terms and conditions included in the LICU's approved secondary capital plan. Further, any LICU that receives an investment from the U.S. Government that is less than the amount approved under its secondary capital application with the NCUA would be limited to only that lesser investment and would not be permitted to use the proposed exception to conduct subsequent issuances. For example, if a LICU was approved to issue \$100 million of secondary capital by the NCUA, but under the U.S. Government program was only granted a \$60 million investment, the LICU would not be permitted to issue the remaining \$40 million of approved secondary capital to another investor or under another U.S. Government program. Further, if a

LICU receives a lesser investment amount, the NCUA reserves the right to revisit the LICU's approved plan to verify that the LICU continues to operate in accordance with that plan.

Finally, the Board is proposing to amend the starting point for Grandfathered Secondary Capital to retain its status as Regulatory Capital. Currently, the Subordinated Debt rule states that all Grandfathered Secondary Capital will be treated as regulatory capital until January 1, 2042 (20 years from the effective date of the final rule). As this proposal would allow limited issuances of Grandfathered Secondary Capital beyond January 1, 2022, the Board is proposing to allow such secondary capital to count as regulatory capital for up to 20 years from the date of issuance. The Board notes that this proposed amendment would provide equitable treatment for all issuances of Grandfathered Secondary Capital. Finally, the Board notes that this proposed change does not change the Board's rationale, as articulated in the proposed and final Subordinated Debt rules, for imposing a 20-year cutoff for regulatory capital treatment.

This change also would not permit LICUs to issue secondary capital with terms longer than 20 years. The Board was clear in both the proposed and final Subordinated Debt rules that the maximum 20-year maturity was necessary to help ensure Subordinated Debt was not considered equity, which is an impermissible issuance for federal credit unions.¹⁰ To permit longer term issuances of secondary capital would be counter to the Board's concerns and reasons articulated in the aforementioned rules.

III. Regulatory Procedures

A. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*) requires that the Office of Management and Budget approve all collections of information by a Federal agency from the public before they can be implemented. Respondents are not required to respond to any collection of information unless it displays a valid Office of Management and Budget control

¹⁰ See 86 FR 11071 (Feb. 23, 2021) and 85 FR 13986, 14000 (Mar. 10, 2020).

number. This proposed rule extends the time for certain issuances of secondary capital and the corresponding Regulatory Capital treatment of such issuances. As such, this rule would not require any information collection as defined by the Paperwork Reduction Act of 1995.

B. Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. The NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the Executive Order to adhere to fundamental federalism principles.

This proposed rule does not have substantial direct effects on the states, on the relationship between the National Government and the states, or on the distribution of power and responsibilities among the various levels of Government. The NCUA has therefore determined that this proposed rule does not constitute a policy that has federalism implications for purposes of the Executive Order.

C. Assessment Of Federal Regulations And Policies On Families

The NCUA has determined that this rule will not affect family well-being within the meaning of § 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

D. Regulatory Flexibility Act

The Regulatory Flexibility Act¹¹ requires the NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small entities (primarily those under \$100 million in assets).¹² This proposed rule would affect a small number of LICUs with approved secondary capital applications for issuances to the U.S. Government or its subdivisions. This rule extends the deadline for such credit unions to complete their issuance

¹¹ 5 U.S.C. 601 *et seq.*

¹² *Id.* at 603(a).

of secondary capital. Accordingly, the NCUA certifies that this proposed rule would not have a significant economic impact on a substantial number of small credit unions.

List of Subjects

12 CFR Part 702

Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 741

Bank deposit insurance, Credit unions, Reporting and recordkeeping requirements.

By the NCUA Board on September 23, 2021.

Melane Conyers-Ausbrooks,
Secretary of the Board.

For the reasons discussed in the preamble, NCUA proposes to amend 12 CFR parts 702 and 741, as amended by 86 FR 11060 (Feb. 23, 2021) and scheduled to become effective on January 1, 2022, as follows:

PART 702—CAPITAL ADEQUACY

1. The authority citation for part 702 continues to read as follows:

Authority: 12 U.S.C. 1766(a), 1790d.

2. In § 702.2 revise the definitions for “Grandfathered Secondary Capital” and “Regulatory Capital” to read as follows:

§ 702.2 Definitions.

* * * * *

Grandfathered Secondary Capital means any secondary capital issued under § 701.34 of this chapter, before January 1, 2022 or, in the case of a federally insured, state-chartered credit union, with § 741.204(c) of this chapter, before January 1, 2022. (12 CFR 701.34 was recodified as § 702.414 as of January 1, 2022). This term also includes issuances of secondary capital to the U.S. Government or any of its subdivisions, under applications approved before January 1, 2022, pursuant to §§ 701.34 or 741.204(c) of this chapter, irrespective of the date of issuance.

* * * * *

Regulatory Capital means:

(1) With respect to an Issuing Credit Union that is a LICU and not a complex credit union, the aggregate outstanding principal amount of Subordinated Debt and, until the later of 20 years from the date of issuance or January 1, 2042, Grandfathered Secondary Capital that is included in the credit union's net worth ratio;

(2) With respect to an Issuing Credit Union that is a complex credit union and not a LICU, the aggregate outstanding principal amount of Subordinated Debt that is included in the credit union's RBC Ratio;

(3) With respect to an Issuing Credit Union that is both a LICU and a Complex Credit Union, the aggregate outstanding principal amount of Subordinated Debt and, until the later of 20 years from the date of issuance or January 1, 2042, Grandfathered Secondary Capital that is included in its net worth ratio and in its RBC Ratio; and

(4) With respect to a new credit union, the aggregate outstanding principal amount of Subordinated Debt and, until the later of 20 years from the date of issuance or January 1, 2042, Grandfathered Secondary Capital that is considered pursuant to § 702.207.

* * * * *

3. Revise § 702.401 to read as follows:

§ 702.401 Purpose and scope.

(a) *Subordinated Debt.* This subpart sets forth the requirements applicable to all Subordinated Debt issued by a federally insured, natural person credit union, including the NCUA's review and approval of that credit union's application to issue or prepay Subordinated Debt. This subpart shall apply to a federally insured, state-chartered credit union only to the extent that such federally insured, state-chartered credit union is permitted by applicable state law to issue debt instruments of the type described in this subpart. To the extent that such state law is more restrictive than this subpart with respect to the issuance of such debt instruments,

that state law shall apply. Except as provided in the next sentence, any secondary capital, as that term is used in the Federal Credit Union Act, issued after January 1, 2022, is Subordinated Debt and subject to the requirements of this subpart. Issuances of secondary capital, as that term is used in the Federal Credit Union Act, to the U.S. Government or any of its subdivisions, under applications approved before January 1, 2022, pursuant to §§ 701.34 or 741.204(c) of this chapter, are not subject to the requirements applicable to Subordinated Debt, discussed elsewhere in this subpart, irrespective of the date of issuance.

(b) *Grandfathered Secondary Capital*. Any secondary capital defined as “Grandfathered Secondary Capital,” under § 702.402 of this part,, is governed by § 702.414 of this part. Grandfathered Secondary Capital will no longer be treated as Regulatory Capital as of the later of 20 years from the date of issuance or January 1, 2042.

4. In § 702.402 revise the definition for “Grandfathered Secondary Capital” to read as follows:

§ 702.402 Definitions.

* * * * *

Grandfathered Secondary Capital means any secondary capital issued under § 701.34 of this chapter before January 1, 2022, or, in the case of a federally insured, state-chartered credit union, with § 741.204(c) of this chapter, before January 1, 2022. (12 CFR 701.34 was recodified as § 702.414 as of January 1, 2022). This term also includes issuances of secondary capital to the U.S. Government or any of its subdivisions, under applications approved before January 1, 2022, pursuant to §§ 701.34 or 741.204(c) of this chapter, irrespective of the date of issuance.

* * * * *

5. In § 702.414 revise the introductory text and paragraph (a)(2) to read as follows:

§ 702.414 Regulations governing Grandfathered Secondary Capital.

This section recodifies the requirements from 12 CFR 701.34(b), (c), and (d) that were in effect as of December 31, 2021, with minor modifications. The terminology used in this section

is specific to this section. Except as provided in the next sentence, all secondary capital issued under § 701.34 of this chapter before January 1, 2022, or, in the case of a federally insured, state-chartered credit union, § 741.204(c) of this chapter, that is referred to elsewhere in this subpart as “Grandfathered Secondary Capital,” is subject to the requirements set forth in this section.

Issuances of secondary capital to the U.S. Government or any of its subdivisions, under applications approved before January 1, 2022, pursuant to §§ 701.34 or 741.204(c) of this chapter, are also considered “Grandfathered Secondary Capital” irrespective of the date of issuance.

(a) * * *

(2) *Issuances not completed before January 1, 2022.* Except as provided in the next sentence, any issuances of secondary capital not completed by January 1, 2022, are, as of January 1, 2022, subject to the requirements applicable to Subordinated Debt discussed elsewhere in this subpart. Issuances of secondary capital to the U.S. Government or any of its subdivisions, under applications approved before January 1, 2022, pursuant to § 701.34 or 741.204(c) of this chapter, are not subject to the requirements applicable to Subordinated Debt, discussed elsewhere in this subpart, irrespective of the date of issuance.

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PART 741—REQUIREMENTS FOR INSURANCE

6. The authority citation for part 741 continues to read as follows:

Authority: 12 U.S.C. 1757, 1766(a), 1781-1790, and 1790d; 31 U.S.C. 3717.

7. Amend § 741.204 by revising paragraph (c) to read as follows:

§ 741.204 Maximum public unit and nonmember accounts, and low-income designation.

* * * * *

(c) Follow the requirements of § 702.414 of this chapter for any Grandfathered Secondary Capital (as defined in part 702 of this chapter).