



August 16, 2022

Office of the General Counsel
National Credit Union Administration
17775 Duke Street
Alexandria, VA 22314

Via e-mail to ogcmail@ncua.gov

Re: Regulatory Review (2022)

Dear Office of the General Counsel,

Inclusiv appreciates the opportunity to provide comments on the National Credit Union Administration's (NCUA) request for comments on the 2022 Regulatory Review covering NCUA Rules and Regulations Parts 700 – 710. Our comments focus on Part 702 and we urge the NCUA to revise its subordinated debt regulations to remove significant barriers for low-income designated credit unions seeking secondary capital.

Inclusiv is the national network of community development credit unions committed to promoting financial inclusion and equity through credit unions. The Inclusiv network represents more than 470 credit unions serving 18 million people in predominantly low-income urban, rural, and reservation-based communities across 47 states, DC and Puerto Rico. More than 46% of our members are governed by and predominantly serving people of color; and near 60% are also CDFI certified. Inclusiv channels capital and builds capacity of these institutions dedicated to serving low-income and underserved consumers with fair and responsible financial products and services and the supports to help consumers succeed with those services. We design, implement, and track numerous initiatives aimed enabling members to use their credit unions to build wealth and assets.

Inclusiv has been making secondary capital loans since 1998, deploying more than \$120 million directly into community development credit unions. Moreover, Inclusiv has led educational and advocacy efforts to grow investment from the public and private sectors to enable credit unions serving low-income and communities of color to grow and serve their communities. In the aftermath of the financial recession, Inclusiv led the effort to ensure that credit unions were included in the CDCI program under ARRA. Our analysis of that program showed that capital deployed in CDCUs during the five-year period was leveraged and deployed 60 times over in new lending among CDCU recipients. All secondary capital investments are made as loans with clear terms, interest rates and maturity dates explicitly stated in loan agreements and closing documents. At no point has there been any indication or interpretation in our own loan agreements or those we have reviewed by the many social impact investors whom Inclusiv has advised that the secondary capital investment provides an equity stake in the institution.

Background on Secondary Capital

In 1996, the NCUA Board finalized § 701.34 of the NCUA's regulations to permit low-income credit unions to borrow secondary capital to build regulatory capital to: (1) support greater lending and financial services in the low-income communities; and (2) absorb losses to prevent the low-income designated credit unions from failing.

In 1998, as part of the Credit Union Membership Access Act, Congress amended the definition of "net worth" in the Federal Credit Union Act (the FCU Act) to include secondary capital issued by a LICU, provided the secondary capital was uninsured and subordinate to all claims against the LICU, including the claims of creditors, shareholders, and the National Credit Union Share Insurance Fund (Share Insurance Fund). While this legislation could set a limit on the maximum term or maturities for this secondary capital, Congress did not do so.

In 2006, the NCUA Board further amended § 701.34 to require regulatory approval of a low-income credit union's secondary capital plan before the credit union could accept the secondary capital. This tightening of the review and approval process did not restrict the length or term of secondary capital loans.

In December 2020, NCUA passed a new subordinated debt rule enabling large, complex credit unions to raise subordinated debt to count toward new risk-based capital standards. The Agency swept secondary capital into that rule despite substantial differences in the nature and intent of these two instruments. This new rule was hastily considered and approved over many concerns raised in comments from industry leaders, including Inclusiv, on the ANPR. These concerns include the NCUA's treatment of secondary capital, a debt instrument, as equity; the rule treating simple, bilateral credit agreements the same way as complex subordinated debt packaging from multiple investors; and limiting the term of subordinated debt to 20 years, which prevents credit unions from matching long-term assets and liabilities and limits secondary capital's effectiveness in supporting affordable mortgage lending.

Changes Needed to Part 702

The NCUA should simplify the rule for small and mid-size credit unions (with assets of less than \$500 million) seeking a loan from a single lender. At a bare minimum, the NCUA should simplify the rule for small credit unions.

The Rule Has Deterred Small, Low-Income Credit Unions from Borrowing Secondary Capital

The new rule has so many requirements for closing that we have seen a sharp drop in demand among small credit unions for our simple bilateral secondary capital loans. In the past 25 years Inclusiv has made critical small loans to support growing CDFI and MDI credit unions and ensure they have sufficient capital to keep up with growing membership and savings. Without secondary capital, credit unions have actually turned away new members seeking to move their money to credit unions that align with their values. But, in moments of growth and without outside capital, some of the highest impact credit unions have had to turn away new members and new deposits because they simply could not grow their capital to keep up with the growth in their market. Inclusiv has made loans as small as \$50,000 to help a

small MDI credit union be able to boost capital and fuel their growth. With the new subordinated debt rule, small institutions seeking a single loan from a single investor are forced to jump through the same hoops as multi-billion dollar credit unions seeking millions of dollars of subordinated debt from multiple investors (seeking financial gain). It makes no sense to consider these activities of equal risk to the system or as subject to similar securities review.

Allow Standardized Subordinated Debt Policies

The NCUA's rule needs to be clarified and should be amended to allow low-income designated credit unions seeking to borrow secondary capital to use standardized policies developed with experienced attorneys. The current policy requirements are extremely challenging for small credit unions that often have the deepest reach into their communities. Indeed, many low-income credit unions, especially those in markets without a significant concentration of securities lawyers, struggle to find and afford appropriate representation to meet the NCUA's current requirements, limiting their opportunities to access secondary capital and grow. We recommend the NCUA permit credit unions to use standardized policies when borrowing secondary capital. At a minimum, there should never be a requirement for opinions of counsel for individual transactions. Requiring review by counsel on a deal-by-deal or credit union-by-credit union basis will have a bias against small institutions and a strong regional bias against areas of the country without sufficient legal resources.

Increase the Allowed Term of Subordinated Debt to 30 Years

The NCUA limited the term of subordinated debt to 20 years, significantly reducing secondary capital's utility in supporting affordable mortgage lending. This problem was highlighted when Treasury launched the Emergency Capital Investment Program, with loan terms of 30-year terms. Although NCUA has been working on addressing this conflict for that program, it has not addressed the underlying issue of small credit unions to be able to match long-term assets with long-term liabilities. If we want to address the racial wealth divide, we need small, MDI credit unions to be able to provide fixed-rate home loans to their members. Small credit unions should be able to use secondary capital for the highest impact lending possible, and a 30-year term is necessary to reach this goal.

Simplify the Application Process

The NCUA's current rule treats all credit union efforts to raise subordinated debt in the same way and creates significant barriers for small, low-income designated credit unions that seek to issue a small amount to a single investor. The requirement for small, mission-focused credit unions to comply with the same extensive rules as large broadly marketed issuances is wrong-headed and undermines Congress' original intent for subordinated debt issued by low-income designated credit unions. For these credit unions, the NCUA should reduce the application and approval requirements. This approach would be consistent with the NCUA's practice of adjusting its supervision and oversight based on risk. NCUA should allow low-income designated credit unions offering these smaller, single investor issuances to rely on the standard exceptions afforded to them under 3a5 of the Securities Act of 1933.

Improve the Prepayment and Pre-approval Process

The NCUA's subordinated debt rule retained the provision that a credit union must receive prior approval, with a 45-day timeframe for the NCUA to approve the application. Although the 45-day

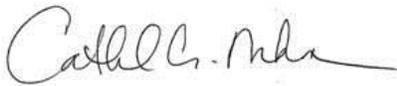
approval timeframe is similar to the previous secondary capital rule, the Board eliminated the provision for automatic approval if a credit union is not notified of a decision by the Appropriate Supervision Office within 45 days. This leaves credit unions in limbo should their decision take longer than 45 days.

Subordinated debt investors require certainty and consistency in the application of prepayment approval. NCUA must provide written guidance to its regional offices concerning the objective criteria upon which credit unions will be evaluated for prepayment approval. The absence of such written criteria is a material barrier to subordinated debt investments.

Compounding the problem, NCUA has removed the criteria for “streamlined” prepayment approval that was previously incorporated in the National Supervisory Policy Manual. We urge NCUA to incorporate simple, reasonable, and objective prepayment approval criteria. Investors cannot make large, long-term investments without such information.

Thank you for the opportunity to comment. We urge the NCUA to reconsider its approach to regulating secondary capital issuance to support rather than impede the growth of mission-driven low-income designated credit unions. Even if our recommendations cannot be applied across the system, it is critical to address these issues for small and mid-sized credit unions. Please contact Eben Sheaffer, CFO (esheaffer@inclusiv.org), with any questions about these comments.

Sincerely,

A handwritten signature in black ink, appearing to read "Cathie Mahon". The signature is fluid and cursive, with a long horizontal stroke at the end.

Cathie Mahon
President/CEO