August 21, 2024

Melane Conyers-Ausbrooks
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

RE: 2024 Regulatory Publication and Voluntary Review (Docket NCUA-2024-0014)

Dear Board Members:

Thank you for the opportunity to respond to the National Credit Union Administration's (NCUA's) request for comment on the 2024 Regulatory Review concerning "Applications and Reporting" and "Powers and Activities." Our comments focus on subordinated debt regulations and implementation, credit union field of membership and chartering, and opportunities to address barriers to community development credit unions (CDCUs) seeking to deepen impact in their communities through small business and green lending.

About Inclusiv
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 500 credit unions serving more than 20 million people in predominantly low-income urban, rural, and reservation-based communities across the United States, including Puerto Rico, Guam, and the U.S. Virgin Islands. Inclusiv channels capital to and builds the capacity of these institutions that are dedicated to serving low-income people and redlined and disinvested communities that mainstream financial institutions fail to serve.

Subordinated Debt (12 CFR 701.25, 12 CFR 702)

Inclusiv thanks the NCUA Board for the opportunity to partner in ensuring that credit unions dedicated to advancing financial inclusion in underinvested communities continue to have access to issue subordinated debt. Subordinated debt plays a critical role in helping these credit unions grow their lending and development services and strengthen the financial health and well-being of all communities. Following the March 16, 2023 NCUA Board meeting, Inclusiv has continued to work with the NCUA, as well as CDFI, MDI, and other community development credit unions, on the subordinated debt process. Between the NCUA Board Meeting and the end of the second quarter of 2024, Inclusiv successfully worked with six community development credit unions in issuing and funding $12.25 million in subordinated debt. However, as Inclusiv has outlined in previous comment letters to the NCUA on subordinated debt, there remain a few key issues with the updated regulations and their implementation that need to be resolved

for community development credit unions to be able to use subordinated debt to grow and deepen their impact. Smaller CDFI and MDI credit unions have reported being less likely to apply for subordinated debt products because the process requirements can be unduly burdensome for the amount of risk and complexity of the transaction they are pursuing.

Between January 2022 and the end of the first quarter of 2024, only five (19%) of the credit unions issuing subordinated debt held less than $500 million in assets. Additionally, no credit unions with less than $100 million in assets issued subordinated debt (excluding ECIP investments) and the average size of issuing credit unions has nearly doubled (from $658 million to $1.29 billion in assets). These changes in which credit unions are able to access subordinated debt shine a light on the barriers small credit unions, especially MDIs, now face when trying to access subordinated debt. These barriers are keeping small credit unions from expanding financial inclusion and impact initiatives in underinvested communities, despite the credit union movement and secondary capital having been founded expressly for this purpose. We encourage the NCUA to offer a bifurcated process, making subordinated debt available to complex credit unions seeking to raise risk-based capital and restoring secondary capital for low-income designated (LID) credit unions seeking to enter into simple, bilateral loan agreements. In the meantime, the following regulatory and guidance changes would support small and MDI credit unions in accessing this vital capital tool.

Allow Exceptions in Disclosure Requirements Commensurate with the Risk and Complexity of the Transaction

§702.408 states that the issuance of subordinated debt must comply with all applicable Federal and state securities laws and regulations. The NCUA's decision to treat credit union subordinated debt as non-exempt securities is unduly burdensome to credit unions entering into simple, bilateral loan agreements. The current rule applies disclosure requirements to credit union issuances of subordinated debt that mimic the requirements of the federal securities laws, even if the credit unions' issuances to accredited investors would not be subject to such requirements under the securities laws themselves. There already exists a U.S. securities law framework which applies to such exempt issuances, and that framework stipulates that registration and disclosure requirements are not necessary in these cases. The NCUA should allow exceptions in the disclosure requirements commensurate with the risk and complexity of transactions. It is unnecessary, improper, and unduly burdensome for NCUA to impose such requirements on exempt credit union issuers when U.S. securities law does not impose these requirements. NCUA should allow low-income designated credit unions offering smaller, single investor issuances to rely on the standard exceptions afforded to them by Congress under 3(a)(5) of the Securities Act of 1933, consistent with the Office of the Comptroller of the Currency's practice of allowing banks to rely on the 3(a)(5) exemption. In addition to being unnecessary and out of step with other federal prudential regulators, the NCUA's securities disclosures requirement increases the cost of subordinated debt markedly. Comparing the closing fees Inclusiv charged credit unions for secondary capital before the rule change and the fees credit unions are being quoted by investment banks now shows that the cost of securing this capital has,

for some credit unions, increased more than 25-fold.

Offer Simple, Reasonable, and Objective Prepayment Approval Criteria
Effective utilization of subordinated debt and capital mobilization requires clear, reasonable, and objective criteria for repayment. Such standards were integral to Inclusiv's ability to mobilize over $85 million in secondary capital from social impact investors. These investments increased the sustainable growth and provision of financial inclusion, asset building, and wealth creation opportunities to more than 1 million people in under-resourced communities through our secondary capital and subordinated debt investments. The NCUA has removed the criteria for "streamlined" prepayment approval that was previously incorporated in the National Supervision Policy Manual. Without written, publicly available, simple, reasonable, and objective prepayment approval criteria, investors cannot make large, long-term investments. The NCUA's subordinated debt rule retains the provision that a credit union must receive prior approval and creates 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 has 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. However, subordinated debt investors require certainty and consistency in the application of prepayment approval. To remedy this issue, the NCUA should provide written guidance to its regional offices concerning the objective criteria upon which credit unions will be evaluated for prepayment.

Discounting of Amount Treated as Regulatory Capital: Use Initial Aggregate Principal Amount, Not Outstanding Amount
The updated rule's approach to calculating Regulatory Capital during the last 5 years of a subordinated debt loan term now mirrors the approach of the bank subordinated debt market, which is not an improvement compared to the prior secondary capital rule, and effectively shortens the term of loans as credit unions will be strongly incentivized to fully repay or refinance the loan with 5 years left in the term. This new approach harms credit unions, their lenders, and the NCUA by increasing net worth volatility and transaction costs to credit unions. The previous secondary capital rule reduced Regulatory Capital by 20% of the original loan balance each year, which let credit unions step down from 100% Regulatory Capital to 0% over the last 5 years of the loan, avoiding any shocks to the capital ratio of the borrower at maturity. Now, the rule reduces Regulatory Capital by 20% of the outstanding loan balance each year, accelerating the reduction of Regulatory Capital when credit unions prepay the balance of their loan that is no longer considered Regulatory Capital. This penalizes prepayment and incentivizes credit unions to refinance the loan or repay it in full when there are 5 years left in the loan term. In the bank market, lenders structure subordinated debt around these incentives and notes typically carry fixed-to-floating rate terms, with the floating rate in effect in the last five years of the loan term. This further incentivizes refinancing, costing credit unions more in transaction fees and increasing net worth volatility for credit unions that do not refinance or repay early. The NCUA should update the rule to reduce Regulatory Capital based on the original loan balance and not the current loan balance.

Provide Additional Guidance and Legal Templates in the National Supervision Policy Manual to Ensure Consistency in Application Review

Inclusiv thanks the NCUA for updating the National Supervision Policy Manual (NSPM). We appreciate NCUA's partnership over the years to strengthen the effectiveness of secondary capital and other resources to advance credit unions' ability to reach unbanked and underbanked populations. Building on past work, the following additional guidance would address barriers to entry for smaller credit unions, CDFIs, and MDIs in their decision to apply for and access subordinated debt:

1. Guidance on Qualified Legal Counsel and Required Opinions: Pursuant to 12 CFR 702.408(b)(10), credit unions are required to submit, inter alia, "a draft written policy governing the offer, and issuance, and sale of the Subordinated Debt, developed in consultation with Qualified Counsel." Based on interviews with CDFI and MDI credit unions, there has been a lack of clarity on what is required in these policies and the evaluation parameters for determining the sufficiency of their policies. Additionally, the lack of clear guidance and requirements can be a deterrent to those interested in issuing subordinated debt. This lack of clarity has lengthened the application timeline and often results in legal fees that are cost prohibitive for many smaller institutions.

2. Legal Templates in the National Supervision Policy Manual: The closing documents and policy development can be made more accessible to credit unions of all sizes by sharing sample legal templates for the subordinated debt note, note purchase agreement, and accredited investor certification in NCUA's Supervision Policy Manual. NCUA, of course, would make it clear in the Manual that these templates are for guidance only and are not binding or exhaustive. This addition would align with standard practice from other federal regulators, such as the OCC, which like the NCUA, oversees federally chartered institutions. Templates would provide clarity and transparency around NCUA's expectations for these materials, providing the standardization necessary to increase the efficiency and effectiveness of subordinated debt processes and streamline the administrative burden and review by the NCUA. We would also suggest offering New York (NY) as the default choice of law jurisdiction in these templates. Other federal agencies have done so in similar circumstances—for example, the U.S. Treasury used NY as the default choice of law jurisdiction in the Emergency Capital Investment Program (ECIP) securities purchase agreements. Furthermore, NY has a trusted body of precedent around general securities law and contracts. Finally, offering a specific choice of law jurisdiction in the templates would help further standardize and create uniformity for credit unions entering into subordinated debt agreements across the country.

   Adding clear guidance and templates to the NSPM would also reduce transaction costs associated with applying for and issuing subordinated debt, since hiring consultant support to complete these documents has been cost prohibitive for smaller credit unions. Reported legal costs have totaled as much as $30,000 when exploring a subordinated debt issuance.

Loans to Members and Lines of Credit to Members (12 CFR 701.21)

Clarify that Residential Clean Energy Upgrades are Eligible Under §701.21(4) Exceptions, Allowing 20-Year Loan Term

The manual text currently states that member loan terms may not exceed 15 years but allows an extension to 20-year terms for loans "to finance repair, alteration, or improvement of a residential dwelling which is the residence of the member-borrower." We recommend amending this section to specifically call out green loans for deep energy saving and clean energy projects, such as installation of solar energy systems, that may require a lower monthly repayment amount (with a longer term) to be affordable for the borrower, as eligible exceptions. Codifying this exception is critical to ensure that credit unions are aware that they can take advantage of longer loan terms to reach low-income and disadvantaged communities (LIDACs) under the Greenhouse Gas Reduction Fund (GGRF). This amendment would additionally assure that examiners evaluating credit unions' green lending understand and have documentation of the exception. Establishing this clarity would help boost LIDACs' access to clean energy technology, since they may not be able to afford to take advantage of these opportunities without longer repayment terms.

Equitable Implementation of NCUA Regulations

The NCUA Board and staff are clearly committed to financial inclusion and the critical role credit unions play in serving people and communities excluded from the financial mainstream. During the examination process, however, some well-run, high-impact credit unions have reported fielding examiner questions and concerns that suggest not all NCUA staff members are familiar with the community development credit union (CDCU) business model and its success and impact. We suggest NCUA introduce a training update for examiners, educating them on how to evaluate green loans, micro and small business loans, and loans to borrowers with low credit scores and/or ITINs, and providing context on the role of CDFIs, MDIs, and LIDs.

Although NCUA regulations do not contain language penalizing credit unions for ITIN lending or lending to borrowers with lower credit scores, some of our member credit unions have reported being advised to cut back on these loans even though their loans to ITIN holders or to people with lower credit scores are performing well. In the absence of robust, standardized training on how to evaluate ITIN loans and loans to borrowers with lower credit scores, examiners may be more likely to make assumptions based on misunderstanding the risk these loans carry. However, these types of loans are critical both to CDCUs' mission to serve historically excluded communities and to their financial sustainability. Research shows that CDFI credit unions outperform their mainstream peers, and, in Inclusiv's mortgage portfolio, we also have found that ITIN loans consistently perform very well, outperforming SSN loans.

Green loans to low-income households are expected to scale dramatically under the Greenhouse Gas

Reduction Fund's Clean Communities Investment Accelerator (CCIA) program. Because 100% of CCIA funds are required to go to projects in low-income and disadvantaged communities (LIDACs), many target borrowers are likely to have imperfect credit histories and we are concerned about CCIA subgrantees facing the exam challenges mentioned above. As a CCIA awardee, Inclusiv plans to make subgrants to an estimated 400 credit unions over the next four years to help start new green lending programs or expand existing ones. We hope to work closely with NCUA to issue clear guidance to credit unions on how to book CCIA grants and familiarize examiners with green lending and the CCIA grant structure, so that they can evaluate these credit unions appropriately. Green loans already show strong performance—a 2022 report by Lawrence Berkeley National Laboratory analyzed 52,511 energy efficiency loans across four states and found that annualized loss rates are low compared with unsecured consumer loans and are comparable to the rates for prime auto loans. CCIA capitalization funding will only further derisk green lending for subgrantee credit unions. With proactive and thorough training, we can ensure that credit unions are able to deploy these funds effectively and expeditiously, enabling low-income households across the country to reap the benefits of greater energy efficiency, resilience, and financial security.

Member Business Loans (12 CFR 723)

Clarify Qualifications Sought in Staff Experience Requirements

In §723.3 "Board of directors and management responsibilities," NCUA requires that prior to engaging in commercial lending, a federally insured credit union must employ qualified staff with experience in (i) underwriting and processing for the relevant type(s) of commercial lending, (ii) overseeing and evaluating commercial loan portfolio and performance, and (iii) conducting collection and loss mitigation. We ask that NCUA clarify the extent of "experience" sought here and make considerations for credit unions of different sizes in their evaluation, being cognizant of the community needs for commercial credit, opportunities for credit union growth that business lending provides, and the risks of small business lending that credit unions must manage carefully. Hiring the number of staff members that would be needed to cover all of the required areas of experience can be impossibly costly for a small credit union, and often the head of lending is the only one with experience across all of these areas. For smaller credit unions, we believe it would be appropriate to accept lending staff who may not have expertise in all three areas but who will be closely supervised by the head of lending, who has the required experience. Smaller credit unions may be able to successfully engage in commercial lending even with less experienced staff, because they focus on smaller, less complex loans or work with a CUSO to help bridge any staffing gaps. We also recommend allowing an alternative way for small credit unions to qualify staff for the requisite skills via trainings like Inclusiv's Small Business Capital Initiative Learning Center, even if they do not have a professional background specialized in the activities specified in §723.3.

Federal Credit Union Chartering and Field of Membership (12 CFR 701.1, Appendix B to Part 701)

<u>Chartering Process</u>

Increase Transparency in Business Plan Evaluation in the Charter Application

Many charter applications are returned based on inadequate business plans. Since *de novo* credit unions are new to working with the NCUA and are developing their first business plan, they require more support and resources to understand the specific expectations of the NCUA. Confusion around how to tailor the business plan results in unnecessary back-and-forth between NCUA and credit unions applying to charter, expending considerable time and resources. As a result, some credit unions that could be effectively reaching underserved communities take years to charter, even when they otherwise have a strong application.

The Chartering and Field of Membership Manual contains a bulleted list of items to include in a charter application's business plan, many of which do not provide enough detail to guide applicants to develop a successful business plan (e.g. "plans for operating independently" and "written policies"). Providing clear and detailed standards on how to develop and present the business plan coupled with further application assistance would establish greater understanding of the information credit unions need to share in this critical part of a successful charter application. A more detailed FAQ document could also provide much needed specificity around what types of targets credit unions should be striving to meet.

Providing specific guidance on requirements, benchmarks, and minimums would also promote consistency in application evaluation across regions. Chartering can be unnecessarily difficult for credit unions if reviewers in different regions hold different interpretations of what meets NCUA standards for the business plan. Transparently stating NCUA's expectations and evaluation criteria upfront would help credit unions achieve their charters expeditiously and start serving communities that need better financial access.

Reframe Vague and Subjective Requirements

Two of the three central requirements for a charter are that "subscribers are of **good character** and fit to represent the proposed credit union," and "establishment of the credit union is **economically advisable**." Both requirements require interpretation that can differ from staff member to staff member, opening the door to bias or inconsistency in the review process. The Manual would benefit from further detail about how subscribers' character will be evaluated, including specific criteria and disqualifying characteristics. Subscribers organizing a credit union in an underserved community are already likely to face barriers to financial inclusion. Given credit unions' critical role in serving historically marginalized and redlined communities, NCUA should maintain a high standard of equity-guided practice and be cautious of language and measures that could potentially be used to exclude high-need communities that stand to benefit from access to fair and affordable credit union financial services.

We also suggest that the term “economically viable” may be more apt than “economically advisable,” as “advisable” appears to prioritize profitability over meeting community needs sustainably, which is what most *de novo* credit unions are working to achieve. The manual provides further detail on how economic advisability is determined, but some of the criteria are equally vague and difficult to observe, such as “character and fitness of management.” NCUA should clarify how the agency determines that officials and employees have demonstrated their “ability to effectively handle financial matters” and “requisite skills and commitment to make the proposed credit union a success.” Greater clarity on how to qualify for these standards would aid credit unions in preparing for investigation of their charter application and strengthen credit union success, helping more credit unions charter and expand services in underserved communities.

Field of Membership

The NCUA’s request for comment on changes to the Chartering and Field of Membership Manual in Spring of 2023 included several helpful proposals that we encourage the NCUA to implement as it finalizes the proposed rule. One key recommendation from Inclusiv’s May 30, 2023 comments we would like to highlight again here is the importance of helping credit unions complete the Concentration of Facilities Test when they apply to expand their fields of membership to include underserved areas.

The Concentration of Facilities Test has proven challenging for some credit unions seeking to serve underserved areas. The three test options outlined in the statute should, in theory, provide sufficient flexibility for credit unions to demonstrate that underserved areas they wish to serve are not well-served by other depository institutions. In practice, however, the test often requires significant data analysis outside of the scope of most credit unions’ expertise that requires credit unions to hire consultants when they could otherwise develop a successful application on their own. To address this issue, the NCUA should provide interactive data analysis tools and train interested credit union staff on how to use them so that credit unions can easily determine if an underserved area passes the Concentration of Facilities Test. The tool should allow credit unions to select custom geographies down to the Census tract level.

Thank you for the opportunity to comment. Inclusiv looks forward to engaging with the NCUA to improve credit union regulatory efficacy and amplify CDCU impact. For any questions regarding these comments, please contact Alexis Iwanisziw, SVP Policy & Communications, Inclusiv (aiwanisziw@inclusiv.org).

Sincerely,

Cathleen A. Mahon
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