/ inclusiv /

October 1, 2021

Chairman Todd Harper
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Subordinated Debt and Secondary Capital

Dear Chairman Harper,

Inclusiv and our members are deeply concerned about the impending subordinated debt rule and its impact on Low-Income Designated and Minority Designated applicants for Treasury's Emergency Capital Investment Program and other impact mission-driven secondary capital investments. Specifically, NCUA's placement of a 20-year maximum term on secondary capital loan is both unnecessary and damaging to low-income credit unions and their members, MDIs, and even the share insurance fund.

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 sector 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 clearly stated in loan agreements and closing documents. At no point, has there been any indication or interpretation in our own loan agreements that the secondary capital investment an equity stake in the institution nor has it ever been considered as such by the many social impact investors for whom Inclusiv has managed or advised on secondary capital lending.

Emergency Capital Investment Plan: The imperative to maximize impact on low-income and communities of color

In December 2020, Congress passed the Consolidated Appropriations Act of 2021 included $9 billion in the Emergency Capital Investment Plan (ECIP) which provided the capital facility for the US Treasury to invest long-term capital in MDI and CDFI depository institutions. For credit unions, this capital is in the form of long-term secondary capital. The US Treasury established terms of 15 year and 30 year secondary capital loans.

The impending subordinated debt rule scheduled to take effect on January 1, 2022 was threatening to raise unnecessary obstacles and confusion in the closing of ECIP loans. At last week's Board meeting, the NCUA took an important step forward by agreeing to grandfather in ECIP applications in which the secondary capital plans have been approved before the rule takes effect.

However, the Board left open this question about the term of the capital and specifically the ability of the term to exceed 20 years. This insistence on loans not to exceed 20 years is purportedly based on securities case law which has not been presented or publicly documented by the Agency. As with 30-year government bonds, and with NCUA explicitly stating in advance that secondary capital cannot be considered "equity", 30-year secondary capital simply cannot reasonably be considered "equity" by any court or regulatory entity.

This lack of clarity has opened a Pandora's box where we are learning about regulators informing credit unions that secondary capital plans for 30-year Treasury funds will not be approved even if the credit union agrees to only count it as capital for the first 20 years and then subsequently treat it as a liability. Going back to our analysis of community impact of secondary capital being able to be deployed 60 times over in just 5 years. Consider the harm that this ruling is doing when it is essentially reducing the ability for this capital to leverage and deploy in communities in need of credit union products and services.

Background on Secondary Capital and where we are now

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 the ability 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. In fact, it was passed despite your own concerns raised during that meeting.

We urge the Agency to reconsider its position or at the very least make public the case law upon which it is basing this very harmful decision and rule.

Thank you for your time and the opportunity to share our thoughts.

Sincerely

Cathleen A. Mahon
President & CEO