



May 9, 2017

**Filed electronically**

J. Mark McWatters  
Acting Chairman  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314

Re: Comments on Advance Notice of Proposed Rulemaking for Supplemental Capital

Dear Chairman McWatters:

World Council of Credit Unions (World Council) appreciates the opportunity to comment on the National Credit Union Administration's advance notice of proposed rulemaking on credit union supplemental capital.<sup>1</sup> World Council is the leading trade association and development organization for the international credit union movement. Worldwide, there are over 60,000 credit unions in 109 countries with \$1.8 trillion in total assets serving 223 million natural person members.<sup>2</sup>

**1. The NCUA Board Has Broad Authority to Authorize FCUs to Issue Perpetual Equity Capital Shares Under Section 107(6) of the Act**

The NCUA Board can authorize all natural-person federal credit unions (FCUs) to issue perpetual capital shares similar to corporate credit union Perpetual Contributed Capital<sup>3</sup> under existing statutory authority in the Federal Credit Union Act. Providing all FCUs with expanded authority to build capital would promote a safe and sound, well capitalized credit union system. We urge the Board to use its Section 107(6) authority to authorize all FCUs to issue perpetual capital shares, in addition to issuing subordinated debt under FCUs' Section 107(9) borrowing authority.

Section 107(6) of the Act expressly authorizes FCUs to issue "shares" which are defined as "representing equity."<sup>4</sup> The federal government of Canada has also recently authorized natural-person Canadian federal credit unions to issue perpetual capital shares that qualify as Basel III "Common Equity Tier 1" capital—the same Basel III capital category as retained earnings—pursuant to the Canadian Office of the

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<sup>1</sup> Alternative Capital, 82 Fed. Reg. 9691 (Feb. 8, 2017), *available at* <https://www.federalregister.gov/documents/2017/02/08/2017-01713/alternative-capital>.

<sup>2</sup> World Council of Credit Unions, *2015 Statistical Report* (2016), *available at* <http://www.woccu.org/publications/statreport>.

<sup>3</sup> See 12 C.F.R. § 704.3 ("Corporate credit union capital").

<sup>4</sup> 12 U.S.C. § 1757(6).



Superintendent of Financial Institution's Capital Adequacy Requirement (CAR) regulation.<sup>5</sup>

Section 107(6) gives the NCUA Board broad authority to authorize all FCUs to issue perpetual capital shares similar to corporate credit union Perpetual Contributed Capital and capital shares authorized for Canadian federal credit unions.

Like corporate credit union Perpetual Contributed Capital, the "Common Equity Tier 1" federal credit union perpetual capital shares authorized by Canada's Office of the Superintendent of Financial Institutions in 2016 have the following key characteristics:<sup>6</sup>

- Perpetual duration;
- Absorbs losses that exceed retained earnings;
- Takes losses prior to lower-tiered capital items like subordinated debt;
- Non-withdrawable;
- Uninsured;
- Does not have a pre-set dividend rate and dividends are issued (or not) based on the credit union's profitability, but dividends can be subject to a contractual cap;
- Has no mandatory redemption features, but can be bought back by the FCU with prior supervisory approval: "A federal credit union may, with the prior consent of the Superintendent, purchase or redeem membership shares provided there are no reasonable grounds to believe that the payment would cause the institution to be in contravention of capital adequacy or liquidity requirements."

The NCUA Board can authorize all American FCUs to issue capital instruments with these limitations that result in high quality capital pursuant to Section 107(6) of the Act. Congress intended for the NCUA Board to have broad discretion with respect to the regulation of FCU shares by stating expressly in Section 107(6) that FCU shares be subject to "limitations prescribed by the [NCUA] Board," meaning that an NCUA regulation on FCU supplemental capital issued pursuant to Section 107(6) would be "filling a gap" in the statute under the *Chevron* Doctrine.

Under Step Two of the *Chevron* Doctrine, if Congress has explicitly left a gap for the agency to fill, the agency's interpretive rules are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute.<sup>7</sup> Similarly, Section 207(k)(1)(C) of the Act gives the NCUA Board broad discretion to exempt a class of

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<sup>5</sup> See Office of the Superintendent of Financial Institutions (OSFI) of Canada, Capital Adequacy Requirements (CAR) Chapter 2, § 2.1.1.1 (Dec. 2016), available at [http://www.osfi-bsif.gc.ca/Eng/fi-if/rq-ro/gdn-ort/gl-ld/Pages/CAR17\\_chpt2.aspx](http://www.osfi-bsif.gc.ca/Eng/fi-if/rq-ro/gdn-ort/gl-ld/Pages/CAR17_chpt2.aspx)

<sup>6</sup> See *id.*

<sup>7</sup> See *Chevron U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 842-44 (1984).



FCU capital shares from share insurance coverage (since capital shares would not be at-risk capital if they are insured).<sup>8</sup>

Section 117 of the Act provides statutory authority for FCUs' boards of directors to issue dividends based on the credit union's economic results as a bonus dividend on the capital shares without setting a pre-set dividend rate.

The full text of Section 107(6) reads as follows:<sup>9</sup>

A Federal credit union shall have succession in its corporate name during its existence and shall have power—

...

(6) to receive from its members, from other credit unions, from an officer, employee, or agent of those nonmember units of Federal, Indian tribal, State, or local governments and political subdivisions thereof enumerated in section 1787 of this title and in the manner so prescribed, from the Central Liquidity Facility, and from nonmembers in the case of credit unions serving predominately low-income members (as defined by the Board) payments, representing equity, on—

- (A) shares which may be issued at varying dividend rates;
- (B) share certificates which may be issued at varying dividend rates and maturities; and
- (C) share draft accounts authorized under section 1785(f) of this title;

subject to such terms, rates, and conditions as may be established by the board of directors, within limitations prescribed by the Board;

For any FCU, capital shares issued pursuant to Section 107(6) could be invested in by the FCU's members—including FCUs' sponsoring organizations, such as Universities, that would like to help their credit union grow—by other credit unions, or by governmental entities. Capital shares issued by low-income designated credit unions could also be invested in by non-members under Section 107(6).

Authorizing all FCUs to issue perpetual capital shares would also provide significant safety and soundness benefits. These shares would absorb losses that exceed retained earnings and would provide high-quality, loss-absorbing capital as a factual matter that would protect the National Credit Union Share Insurance Fund from loss. These perpetual capital shares would be included in the numerator of the risk-based capital ratio since they would meet the Basel III definition of "Common Equity Tier 1" capital—the same class of capital as retained earnings—whether or not this item is included in the numerator of the Section 216 Net Worth Ratio.

Members and sponsoring organizations that wanted to increase the capital of their FCU so that it can grow, or to help recapitalize the credit union after losses, would

<sup>8</sup> 12 U.S.C. § 1787(k)(1)(C) ("The Board may define, with such classifications and exceptions as it may prescribe, the extent of the share insurance coverage provided for member accounts . . .").

<sup>9</sup> 12 U.S.C. § 1757(6) (emphases added).



be able to do so by investing in perpetual capital shares. Philanthropic organizations that seek to support Low-Income Designated Credit Unions would also have another type of capital investment option, in addition to subordinated debt.

We urge the Board to use its Section 107(6) authority to authorize all FCUs to issue perpetual capital shares, in addition to issuing subordinated debt under FCUs' Section 107(9) borrowing authority.

## **2. The Basel Committee's Current Expected Credit Losses (CECL) Capital Add-Back Should be Included in NCUA's Supplemental Capital Rule**

NCUA's federal credit union supplemental capital rule should include the Basel Committee on Banking Supervision's transitional capital add-back to the numerator of the risk-based capital ratio for the new loan loss reserves required by US GAAP's Current Expected Credit Losses (CECL) accounting rules.

The Basel Committee on Banking Supervision has recently authorized supervisory agencies to include the additional loan loss reserves resulting from the phase-in of CECL in the numerator of credit unions' and banks' regulatory capital ratios. This standard, *Regulatory treatment of accounting provisions – interim approach and transitional arrangements*,<sup>10</sup> provides that new loan loss provisions created by CECL should be added-back to the institution's Basel III "Common Equity Tier 1" capital and amortized over a period of up to five years like a subordinated debt item's capital treatment under NCUA's rules for Low-Income Designated Credit Union secondary capital.<sup>11</sup>

We urge the NCUA Board to include the new loan loss reserves required by CECL as a form of supplemental capital in the numerator of the risk-based capital ratio for up to for up to five years as authorized by the Basel Committee's *Regulatory treatment of accounting provisions – interim approach and transitional arrangements* standard.

## **3. All Credit Union Shares Were At-Risk Equity Prior to Share Insurance and Are Consistent with Credit Unions' Tax-Exemption and Mutual Structure**

Authorizing credit unions to issue capital shares is fully consistent with congressional intent, credit union history, and credit unions' tax-exempt purpose and mutual structure. Federal credit union shares were at-risk equity when Congress first adopted the Federal Credit Union Act in 1934 and are referred to as

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<sup>10</sup> See Basel Committee on Banking Supervision, *Regulatory treatment of accounting provisions – interim approach and transitional arrangements* (Mar. 2017), available at <http://www.bis.org/bcbs/publ/d401.htm>.

<sup>11</sup> See 12 C.F.R. § 701.34(b).



“representing equity” in Section 107(6) and as “paid-in capital” Subsections (5), (7) and (9) of Section 107.<sup>12</sup>

FCUs issuing equity capital shares would be consistent with FCUs’ mutual structure and tax-exemption under Section 122 of the Act<sup>13</sup> because credit unions traditionally issued at-risk equity shares prior to share insurance systems like the National Credit Union Share Insurance Fund established in 1971. Traditional credit union shares as they existed when Congress first adopted the Federal Credit Union Act in 1934 were uninsured investments with an original issue price which was the same as the shares’ par value and were accounted for as equity.<sup>14</sup> A traditional credit union share issuance therefore created paid-in capital, which is a fundamental element of equity accounting, and Section 107 of the Act expressly references this tradition of “paid-in capital” shares.

State-credit unions acts, either expressly or pursuant to “wildcard” parity provisions, may authorize state-chartered credit unions to issue supplemental capital if NCUA authorizes supplemental capital for FCUs. State-chartered credit unions issuing capital shares would be consistent with state chartered credit unions’ I.R.C. § 501(c)(14) tax-exemption and mutual structure under the U.S. Supreme Court’s “Gross Misuse of Name Test” because state-chartered credit unions also traditionally issued at-risk equity shares beginning with St. Mary’s Credit Union in 1908, long before the establishment of share insurance.<sup>15</sup>

Until the 20<sup>th</sup> Century, joint-stock companies issued shares that were similar to perpetual credit union shares: They had an original issue price that was the same as the share’s par value—which is where the concept of par value originated—and investors were required to pay in these shares to par. In addition, these joint-stock company shares typically traded at par value and rarely fluctuated in value unless the company’s capital level became impaired by losses that exceeded retained earnings. Investors’ main return on these joint-stock company shares came in the form of dividends, much like bonds.<sup>16</sup>

<sup>12</sup> 12 U.S.C. §§ 1757(5), (6), (7), (9).

<sup>13</sup> 12 U.S.C. § 1768.

<sup>14</sup> See *Credit Union Nat’l Assn. v. AICPA*, 832 F.2d 104 (7th Cir. 1987).

<sup>15</sup> See *United States v. Cambridge Loan and Bldg. Co.* 278 U.S. 55, 59-60 (1928) (“The statutes speak of ‘domestic’ associations, that is, associations sanctioned by the several States. They must be taken to accept, with the qualifications expressly stated, what the States are content to recognize, unless there is a gross misuse of the name.”); *La Caisse Populaire Sainte Marie v. United States*, 563 F.2d 505 (1st Cir. 1977); *Bellco Credit Union v. United States*, 2009 U.S. Dist. LEXIS 106087, at \*2-\*3; 104 A.F.T.R.2d (RIA) 7337 (D. Colo. 2009).

<sup>16</sup> See, e.g., Jason Zweig, *At Long Last, Could the Dividend Revolution Be Here?*, WALL STREET JOURNAL, Dec. 29, 2012, available at

<http://www.wsj.com/articles/SB10001424127887323291704578199632820722650> (“In pursuing this approach, companies like Diamond hark back to another age: the 19th century, when U.S. corporations sought to pay out high dividends, often ranging from 6% to 10% of their ‘par value,’ or original issue price. As profits waxed and waned, the companies varied their dividends accordingly. As a result, ‘the stock price stayed relatively steady,’ says economic historian Peter Rousseau of Vanderbilt University.



The Rochdale Society of Equitable Pioneers, which formed the first cooperative in 1844, modeled cooperative shares on the terms and conditions of contemporary joint-stock company shares but with a “one-member-one-vote” voting rule (i.e. additional shareholdings beyond the member’s initial membership share do not confer additional voting rights).<sup>17</sup> FCUs’ shares are modeled on the cooperative shares first created in 1844 as a more cooperative version of contemporary joint-stock company shares.

FCU shares continue to be considered equity as a legal matter, and were accounted for as equity until the 1980s even if the shares were withdrawable.<sup>18</sup> After US Generally Accepted Accounting Principles shifted the accounting treatment of withdrawable shares to a liability, Congress amended Section 107(6) of the Act to clarify that FCU shares were “representing equity” as part of the Competitive Equality Banking Act of 1987.<sup>19</sup>

Authorizing credit unions to issue capital shares is fully consistent with congressional intent, credit union history, credit unions’ tax-exempt purpose, and credit unions’ mutual structure.

World Council thanks the NCUA Board for considering our comments in response to its advanced notice of proposed rulemaking on FCU supplemental capital. If you have questions about our comments, please feel free to contact me at [medwards@woccu.org](mailto:medwards@woccu.org) or +1-202-508-6755.

Sincerely,

Michael S. Edwards  
VP and General Counsel  
World Council of Credit Unions, Inc.

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Nearly all the returns on U.S. stocks in the 19th century came from dividend income—much the way, over time, the yield on bonds tends to account for nearly all their investment performance. ‘Equities in the 19th century functioned much like bonds do today,’ Prof. Rousseau says, ‘except that the dividends fluctuated much more.’”)

<sup>17</sup> J. Carroll Moody & Gilbert C. Fite, *The Credit Union Movement: Origins and Development, 1850-1970* at 2 (1971) (“The group of workers who organized the Rochdale Society of Equitable Pioneers subscribed to shares, payable in small amounts weekly, in order to raise capital to buy goods at less than retail costs and sell them to their members at a savings. Members were paid 5 percent interest on their shares and were entitled to a proportionate division of the society’s savings or profits at the end of the year.”)

<sup>18</sup> See *Credit Union Nat’l Assn. v. AICPA*, 832 F.2d 104 (7th Cir. 1987).

<sup>19</sup> Pub. L. No. 100-86, Title VII, § 703, 101 Stat. 652 (Aug. 10, 1987).