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Insights

NCUA Issues Proposed Rule Allowing Some Credit Unions to Issue Subordinated Debt

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On January 23, 2020 the National Credit Union Administration (the "NCUA") board issued its proposed rule (the "Proposed Rule" or the "Rule") to modernize existing secondary capital regulations applicable to low income credit unions ("LICUs"),[1] and to expand access to additional capital for non LICUs by permitting the issuance of subordinated debt for new credit unions and complex credit unions ("CCUs"). The Proposed Rule, if adopted in its current form, will provide many credit unions with access to alternate sources of capital for the first time, and provide a valuable method of satisfying the higher standards required by the previously released, but still delayed, risk-based capital rule (the "RBC Rule")[2] anticipated to become effective on January 1, 2021. This Client Alert provides a brief general summary of the key provisions of the Proposed Rule.

Key Provisions of the Proposed Rule

The Proposed Rule contains a significant number of substantive, and non-substantive technical changes impacting the ability of qualifying credit unions' to raise supplemental capital for the first time and proposes the restructuring of regulations applicable to LICUs currently offering secondary capital. In general terms, the Rule proposes the following changes:

- Expands who is eligible to issue subordinated debt to now include:
  - Non-LICU Complex Credit Unions;[3]
  - Non-LICU New Credit Unions;[4]
  - Credit Unions that anticipate being classified as LICU or Complex within 24 months; and
  - LICUs.
- Expands who can be an eligible investor in subordinated debt to now include institutional investors;
- Provides credit unions who wish to engage in multiple debt issuances within a one-year period with added regulatory flexibility by eliminating the need to reapply for approval to do so;
- Provides added regulatory flexibility for determining the repayment amount of subordinated debt by allowing prepayments beyond the portion of subordinated debt that is no longer counted towards capital; and
- Provides for new safe harbors for repudiation and interest payments on subordinated debt that will make subordinated debt instruments issued by credit unions much more attractive to the investment community.

In addition to these changes, many of the existing restrictions applicable to secondary capital offerings are carried over to the new subordinated debt provisions of the regulation, including but not limited to the

requirement that any subordinated debt treated as regulatory capital must decline by 20% for every year within 5 years of its maturity date.

The Proposed Rule also adds several new requirements, many of which are a codification of existing agency interpretations applicable to secondary capital issuances by LICUs, that will apply to all subordinated debt instruments, including:

- Establishing a maximum maturity for subordinated debt instruments of 20 years;
- Prohibiting a credit union from being both an issuer and an investor in subordinated debt;
- Expansive new requirements for disclosures and offering documents associated with subordinated debt;
- Restrictions on loans to other credit unions, including investments in subordinated debt; and
- Prohibition against an undercapitalized credit union from making interest payments on subordinated debt.

The ability of qualifying federally insured state charted credit unions to avail themselves of these changes will be dependent on their state law, and interpretation of those laws by the state supervisory authority.

The Proposed Rule is open for comment from interested parties for a 120 day period commencing on the date it is published in the Federal Register.[5] While the exact timing of adoption and effectiveness of the Rule is difficult to predict, given the NCUA' s acknowledgement of the significance of access to secondary capital for purposes of satisfying the new risk based capital requirements applicable to CCUs and the accompanying delayed effective rate of that rulemaking, we anticipate an effective date of any final rule to be no later than January 1, 2021.

Krieg DeVault Financial Institutions attorneys are actively monitoring the Proposed Rule's progress through the rulemaking process, and able to assist with any questions you may have with respect to the impact of the Rule on your credit union.

1 The Proposed Rule updates and relocates certain provisions of the existing NCUA Secondary Capital Rule currently found at 12 C.F.R. § 701.34 and renames this secondary capital as "subordinated debt."
2 80 FR 66625 (Oct. 29, 2015).
3 A credit union will be defined as "complex" pursuant to an amendment published in 83 FR 55478 (effective Janaury 1, 2022) if its quarter-end total assets exceed five hundred million dollars ($500,000,000), and its risk-based net worth requirement as calculated under §702.106 exceeds six percent (6%).
4 A New Credit Union is a federally insured credit union which both has been in operation for less than ten (10) years and has $10,000,000 or less in total assets.
5 As of the date of this Client Alert, the Proposed Rule was yet to be published in the Federal Register; however, it is anticipated publication will occur within the coming days.