

National Credit Union Administration
SUPPORTING STATEMENT

Risk-Based Capital, 12 CFR 702.101(b)
OMB Control Number 3133-0191

Summary of Action:

A final rule was published on October 29, 2015, at 80 FR 66626, amending 12 CFR 702 regarding prompt corrective action (PCA) to require credit unions taking certain risks hold capital commensurate with those risks. The risk-based capital provisions of this final rule apply only to federally insured, natural-person credit unions (credit unions) with assets greater than \$100 million. This final rule restructures the NCUA's PCA regulations and makes various revisions, including amending the agency's current risk-based net worth requirement by replacing it with a new risk-based capital requirement for complex credit unions.

This rule is scheduled to become effective January 1, 2019. This 3-year delayed effective date allows time for credit unions and the NCUA to adjust to these new requirements.

New information collection requirements associated with this final rulemaking are prescribed by §702.101(b)(2), as amended. Complex credit unions must have a process for assessing the overall capital adequacy in relation to its risk profile and a comprehensive written strategy for maintaining an approximate level of capital. The information collection requirements of Part 702 (subparts A-D) fall under OMB number 3133-0154. The 3133-0191 number will be consolidated into the current Part 702 requirements (3133-0154) upon effective date of this rule.

PLEASE NOTE: As of August 2, 2018, NCUA plans to publish a proposed rule that will increase the asset size of credit unions subject to the risk-based capital rule from \$100 million to \$500 million and delay the effective date to January 1, 2020. The amendatory language of this October 2015 rule will remain relatively unchanged.

A. JUSTIFICATION

1. Circumstances that make the collection of information necessary

A final rule was published on October 29, 2015, at 80 FR 66626, amending 12 CFR 702 regarding prompt corrective action (PCA) to require that credit unions taking certain risks hold capital commensurate with those risks. This final rule restructures the NCUA's PCA regulations and makes various revisions, including amending the agency's current risk-based net worth requirement by replacing it with a new risk-based capital requirement for complex credit unions. The risk-based capital provisions of this final rule apply only to federally insured, natural-person credit unions (credit unions) with assets greater than \$100 million.

This final rule replaces the method currently used by complex credit unions to apply risk weights to their assets with a new risk-based capital requirement that is generally comparable to that applied to other depository institutions. Section 216(d) of the Act (12

U.S.C. 1790d (d)) addresses the risk-based net worth requirement for complex credit unions. Accordingly, §702.103 defines “complex” and the risk-based capital requirement is applicable only if the credit union’s quarter-end total assets are greater than \$100 million, as reflected in its most recent Call Report. In addition, §702.101(b) specifically requires that a credit union defined as complex has a process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive written strategy for maintaining an appropriate level of capital.

PLEASE NOTE: As of August 2, 2018, NCUA plans to publish a proposed rule that will increase the asset size of credit unions subject to the risk-based capital rule from \$100 million to \$500 million and delay the effective date to January 1, 2020. The amendatory language of this October 2015 rule will remain relatively unchanged.

2. Purpose and use of the information collection

This information collection requirement applies to complex credit unions. The new recordkeeping burden associated with this rule involves the one-time burden associated with establishing a process for assessing their overall capital adequacy in relation to their risk profile and a comprehensive written strategy for maintaining an appropriate level of capital prescribed by §702.101(b)(2). The burden associated with credit union’s maintenance of this written strategy will be incorporated into the overall recordkeeping requirements of Part 702 cleared under OMB control number 3133-0154 when implemented.

The NCUA has determined the amendments to Part 702 would have additional information collection requirements associated with updating data collection and reporting systems for preparing Call Reports. The NCUA estimates all federally insured credit unions (FICUs) will amend their procedures and systems for preparing Call Reports. Accordingly, the NCUA will address the burden and provide a separate notice of these changes under OMB control number 3133-0004.

The NCUA will use the information collected to ensure a credit union’s capital is sufficient given its risk profile. Examiners will review risk-based capital plans as part of the routine examination and supervision process.

3. Use of information technology

Credit unions may maintain the requested information in any written form. Policies are maintained at the credit union and are not required to be submitted to the NCUA directly.

4. Duplication of information

There is no duplication of information requested.

5. Efforts to reduce burden on small entities.

The rule minimizes the policy requirements for credit unions not defined as complex. Only credit unions with assets greater than \$100 million fall under this information collection requirement.

6. Consequences of not conducting collection.

If policy information is not collected, examiners will not be able to determine if the credit union has a plan to establish adequate capital commensurate with its risk profile.

7. Inconsistencies with guidelines in 5 CFR 1320.5(d)(2)

This collection is consistent with the guidelines in 5 CFR 1320.5(d)(2).

8. Efforts to consult with persons outside the agency

On January 27, 2015, a proposed rule to amend the NCUA's PCA regulations, 12 CFR 702, was published at 80 FR 4339. The proposal addressed the competitive disadvantage concerns raised by commenters in the original rule (79 FR 1118: February 27, 2014) and made the proposal more comparable to the Federal Deposit Insurance Corporation (FDIC), Board of Governors of the Federal Reserve System, and Office of the Comptroller of Currency (Other Banking Agencies) risk-based capital requirements. The Board received over 2,100 comments. The information collections concerns were summarized and addressed in the preamble of the final rule and are included below:

a. Subpart A – Prompt Corrective Action

The title of proposed §702.101 would have been changed to “Capital Measures, capital adequacy, effective date of classification, and notice to NCUA” to better reflect the three major topics that would have been covered in the section. In addition, proposed §702.101 would have amended current §702.101 to include a new capital adequacy provision that was based on a similar provision in FDIC's capital regulations. The new capital adequacy provision was added as proposed §702.101(b). Paragraphs (b) and (c) of current § 702.101 would have been renumbered as paragraphs (d) and (e). The new capital adequacy provision would not have affected credit unions' PCA capital category, but could have supported the assessment of capital adequacy in the supervisory process (assigning CAMEL and risk ratings).

Public Comments on Proposal

A substantial number of commenters objected to the proposed addition of capital adequacy provisions to §702.101. Many commenters stated they were concerned about the subjective nature of the capital adequacy provision. Commenters contended that if a credit union meets the net worth and risk-based capital requirements, the NCUA should not have the ability to require the credit union to hold additional capital. Other commenters argued the proposed capital adequacy provisions could be problematic

because they would grant examiners considerable latitude to determine whether a credit union needs more capital even if it is well capitalized according to standard net worth and risk-based capital ratio requirements. Commenters argued credit unions and the NCUSIF have functioned well without these provisions and the NCUA has not provided sufficient justification to support their imposition now. Still other commenters noted credit unions already provide for capital adequacy through budgeting, ALM planning, liquidity, interest rate risk, and risk management, and speculated the proposed capital adequacy provision would subject credit unions' capital plans to be judged in an arbitrary and subjective manner by hundreds of different NCUA examiners. The commenters argued that such an approach would provide examiners with too much authority to change the "playing field," especially when there is no independent entity to which a credit union can appeal.

At least one commenter suggested the Board already has this authority, so adding to the existing authority would be unnecessary and redundant.

One commenter, however, acknowledged that codifying the additional capital adequacy requirements in §702.101(b) was reasonable. But the commenter suggested the standards surrounding the provision's use should be made clear because the NCUA already examines credit unions to determine whether they have sufficient net worth relative to risk, and whether credit unions have adequate policies, practices, and procedures regarding net worth and capital accounts. The commenter noted further, the proposed rule indicates that it "may provide specific metrics for necessary reductions in risk levels, increases in capital levels beyond those otherwise required under Part 702, and some combination of risk reduction and increased capital." The commenter recommended that the Board clarify how it envisions §702.101(b) augmenting the NCUA's current supervisory process and any enforcement authority the agency holds in conjunction with that process.

Another commenter suggested credit unions with lower risk profiles and/or higher capital levels should be subjected to less rigorous examinations of risk management. The commenter also suggested that credit unions with higher risk levels against a given set of reasonable thresholds, or those with lower capital levels, should have their examination of risk elevated to the risk management specialists within the NCUA.

The commenter suggested removing field examiners with little specific knowledge from the examination findings and recommendation process would provide a more consistent exam, and recommended the NCUA produce a set of known, published and reasonable filters to define outlier credit unions, including a cross-risk look at risks due to concentration, low capital or earnings levels, interest rate exposure, credit quality, etc. At least one commenter questioned the Board's legal authority to adopt a provision that would require individual credit unions to hold capital above that required under the other provisions of the regulation. The commenter acknowledged the FCUA establishes a risk-based net worth requirement for complex credit unions, but suggested it does not grant the NCUA the authority to impose individualized capital requirements on a credit union-by-credit union basis.

Another commenter suggested if Congress had intended the capital thresholds required under PCA to be minimum requirements, it would have described the classification as minimally capitalized. The commenter maintained that each credit union's long-term desired capital ratio will depend on the credit union's own assessment of the risks it faces, and its tolerance for risk. The commenter recommended the Board delete the capital adequacy provisions, because credit unions' capital plans should not be the subject of examination and supervision, and the goals a credit union establishes for its own capital sufficiency should not become targets or standards for review in an examination.

One commenter requested clarification on how the NCUA would coordinate the requirements of this new provision with state regulators for capital planning purposes.

Discussion

The Board has carefully considered the comments above, and disagrees with commenters who suggested the capital adequacy provisions are unnecessary. As stated in the preamble to the proposal, capital helps to ensure individual credit unions can continue to serve as credit intermediaries even during times of stress, thereby promoting the safety and soundness of the overall U.S. financial system. As a prudential matter, the NCUA has a long-established policy that federally insured credit unions should hold capital commensurate with the level and nature of the risks to which they are exposed. In some cases, this may entail holding capital above the minimum requirements, depending on the nature of the credit union's activities and risk profile.

Proposed §702.101(b) was based on a similar provision in the Other Banking Agencies' rules and is within the Board's legal authority under the FCUA. The FCUA grants the NCUA broad authority to take action to ensure the safety and soundness of credit unions and the NCUSIF and to carry out the powers granted to the Board. Requiring credit unions to maintain capital adequacy is part of ensuring safety and soundness, and is not a new concept. The NCUA's practice has been to monitor and enforce capital adequacy through the supervisory process.

Section 206 of the FCUA provides the Board with broad authority to intervene and require credit unions to take actions to correct unsafe or unsound practices, including requiring individual credit unions to hold capital above that required under the NCUA's PCA regulation. And Section 209 of the FCUA specifically authorizes the Board to prescribe such rules and regulations as it may deem necessary or appropriate to carry out the provisions of subchapter II of the FCUA, which includes section 206. Accordingly, the NCUA has the legal authority to include proposed §702.101(b) in this final rule. Accordingly, the Board has decided to retain the proposed capital adequacy provisions in this final rule without change.

b. Subpart A – 101(b) Capital Adequacy

For the reasons discussed above, the new capital adequacy provisions are added as §702.101(b) of this final rule, and paragraphs (b) and (c) of current §702.101 are designated as paragraphs (d) and (e) of §702.101 of this final rule.

§702.101(b)(1)

The proposal would have revised §702.101(b)(1) to provide: Notwithstanding the minimum requirements in this part, a credit union defined as complex must maintain capital commensurate with the level and nature of all risks to which the institution is exposed.

For the reasons discussed above, the Board has decided to retain the proposed capital adequacy provision in proposed § 702.101(b)(1) in this final rule without change.

§702.101(b)(2)

Proposed §702.101(b)(2) provided: A credit union defined as “complex” must have a process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive written strategy for maintaining an appropriate level of capital.

Public Comments on the Second Proposal

A significant number of commenters specifically objected to the proposed new provision added as §702.101(b)(2) that would require complex credit unions to have a comprehensive written strategy for maintaining an appropriate level of capital. One commenter pointed out that, while the Board has taken steps to closely align this proposal with Other Banking Agency requirements in other areas, it has chosen to deviate from that standard to add a written reporting requirement for credit unions under this provision. The commenter suggested that given the specific requirements of the proposed capital adequacy plan are not delineated in this proposed rule, but will be subsequently outlined in supervisory guidance, commenters are unable to determine the extent of the burden this requirement might entail. The commenter noted that all credit unions with assets of \$50 million or more are already required to have a written policy on interest rate risk management and a program to implement it effectively, as well as a written liquidity policy and contingency funding plan. In addition, the commenter noted that the largest credit unions are already required by regulation to maintain a written capital policy and capital plan that is approved annually by the NCUA. The commenter recommended the Board explain why it felt compelled to add a written requirement to this provision for credit unions, and make every effort to streamline it and other similar requirements to minimize the associated regulatory burden.

One commenter recommended that if the Board adopts a written capital strategy requirement for all complex credit unions, it utilize that written strategy to ensure that credit unions are addressing any heightened risks from loan concentrations. The commenter suggested such an approach should obviate the need for elevated risk weights in connection with real estate and commercial loans by allowing the NCUA to address

concentration risk in a more targeted way. The commenter suggested further that such an approach would satisfy recommendations from the NCUA's Office of Inspector General (OIG) and GAO that the NCUA consider concentration risk as it pertains to capital adequacy, without creating a competitive disadvantage for all complex credit unions in relation to their banking counterparts. The commenter also recommended that the Board incorporate any written capital strategy required within the credit union's strategic plan, or another existing report in order to minimize duplication of effort across various reporting requirements. In addition, the commenter suggested an exemption from the requirement be provided to institutions that are already subject to capital planning and stress testing requirements, as the analysis contemplated by this part, would already be addressed by those existing requirements. Other commenters contended the written capital plan requirement is not necessary for the vast majority of complex credit unions based on their management, risk profiles, and current levels of capital. And if the NCUA examiners have concerns regarding the credit unions they supervise, those commenters argued, those situations should be addressed on an individual basis and not through rulemaking that would apply universal requirements to all complex credit unions, regardless of how well managed they may be.

At least one commenter stated that while the NCUA should be able to access the adequacy of a credit union's capital adequacy plan, safeguards should be put in place to prevent over-zealous examiners from implementing individualized minimum capital requirements during the exam process. Another commenter suggested that the concept of a written strategy was not bad, but that the final rule should provide additional clarity about what exactly would be required under the provision. Yet another commenter asked: What are the components of the "comprehensive written strategy" contemplated under this provision? What are the possible consequences of an examiner determining that a credit union's comprehensive written strategy does not meet the requirements? The commenter requested the Board provide more description in this area and elaborate on its expectations of credit unions.

Discussion

The Board disagrees with commenters who suggested the requirement that complex credit unions maintain a written capital strategy be removed from the final rule. The supervisory evaluation of a complex credit union's capital adequacy, including the requirement to maintain a written capital strategy, is focused on the credit union's own process and strategy for assessing and maintaining its overall capital adequacy in relation to its risk profile. The supervisory evaluation may include various factors—such as whether the credit union is engaged in merger activity, entering into new activities, introducing new products, operating in a challenging economic environment, engaged in nontraditional activities, or exposed to other risks like interest rate risk or operational risks. The assessment evaluates the comprehensiveness and effectiveness of the capital planning in light of its activities. An effective capital planning process involves an assessment of the risk to which a credit union is exposed and its process for managing and mitigating those risks, an evaluation of capital relative to those risks, and consideration of the potential impact on earnings and capital from current and prospective

economic conditions. Under the proposal, the evaluation of an individual credit union's risk management strategy and process will be commensurate with the credit union's size, sophistication, and risk profile—which is similar to the current supervisory process for credit unions.

For credit unions subject to Capital Planning and Stress Testing under subpart E of Part 702 of the NCUA's regulations, compliance with §702.504 will result in compliance with §702.101(b). Thus, those credit unions subject to the stress testing regulation will not be expected to write redundant capital plans to fulfill the requirements of this final rule.

For other complex credit unions that will be expected to write capital plans, supervisory guidance will be issued to help those credit unions evaluate their compliance with §702.101(b). The supervisory guidance will also be designed to provide consistency in the examination process.

Accordingly, the Board has decided to retain the proposed capital adequacy provision in proposed §702.101(b)(1) in this final rule without change.

c. Section 702.103 Applicability of the Risk-Based Capital Ratio Measure

The proposal would have changed the title of current §702.103 from “Applicability of risk-based net worth requirement” to “Applicability of risk-based capital ratio measure.” Proposed §702.103 would have provided that, for purposes of §702.102, a credit union is defined as “complex” and the risk-based capital ratio measure is applicable only if the credit union's quarter-end total assets exceed \$100 million, as reflected in its most recent Call Report.

Public Comments on the Proposal

The Board received a large number of comments on proposed §702.103. Several commenters argued the FCUA requires the Board to define “complex” credit unions based on the “portfolios of assets and liabilities of credit unions,” and that the proposed use of an asset size threshold to define “complex” credit unions would not comply with the statutory requirement.

A substantial number of commenters also stated they opposed the proposed definition of “complex” credit union because they believed asset size should not be a primary qualifier of a credit union's complexity.

At least one trade association commenter, however, acknowledged that an asset threshold proxy, while less precise than individual balance sheet analysis, would allow for a streamlined application of the rule and would minimize opportunities for arbitrage. The commenter suggested that if the definition of “complex” were tied to specific activities, credit unions could be incentivized, on the margin, to simply avoid those activities in order to avoid the risk-based capital requirements. And such conduct could have unintended consequences and create new unanticipated risks to capital adequacy.

Similarly, at least one credit union commenter stated that using an asset size threshold to define complex credit unions would give credit unions a bright line test and eliminate the difficulty of having to anticipate what products and services should be classified as complex. Another credit union commenter suggested that a rule that identified specific types of lending activity that made an institution complex might mask undue concentration risk.

A substantial number of commenters suggested that asset size, if used in the final rule, should be raised to some amount above \$100 million. Specific threshold amounts suggested by commenters ranged from \$250 million to \$10 billion. Several commenters speculated that refining the complexity analysis and raising the asset size threshold would not considerably increase the risk to the Share Insurance Fund because by the time the final rule is implemented in 2019, an even greater percentage of system assets would be covered. Other commenters maintained the final rule should only apply to credit unions that meet the same asset size threshold used by the Other Banking Agencies to define small banks. One commenter suggested that the Board should align the definitions of “complex” credit union across all of the NCUA’s regulations so they are the same, and, at a minimum, the Board should increase the threshold to \$250 million to be consistent with the definition in the derivatives regulation.

Some commenters contended the proposed list of assets and liabilities identified as complex were much too broad. One commenter suggested that Congress limited the application of risk-based capital to complex credit unions and directed the NCUA to design the risk-based capital standard to protect against material risks that may not be adequately captured by the net worth ratio requirement because Congress intended that credit unions be designated as “complex” based on only their involvement in high-risk activities that the net worth ratio requirement may not account for. The commenter noted further that the list of complex assets and liabilities used by the Board to set the asset size threshold at \$100 million included several standard activities that are already contemplated by the statutory net worth ratio requirement. The commenter believed, for example, that real estate loans, investments with maturities greater than five years, and internet banking are staple activities of financial services institutions in today’s marketplace and should not be considered complex; and that other activities only become complex when undertaken in significant volumes—for example, a credit union that lends a member \$60,000 to purchase new equipment for his bakery is engaged in member business lending, but that credit union should not be designated as complex by virtue of that single loan. The commenter contended that the size of the portfolio and its significance to the credit union’s overall business strategy drives complexity; so the commenter concluded that member business, indirect, interest-only, and participation loans should only indicate complexity where the activity exceeds a certain percentage of total assets, and borrowings should only denote complexity where they constitute a significant element of the credit union’s funding strategy. Other commenters suggested that a credit union be defined as “complex” only if it engages in three or more of the following assets or liabilities: member business loans, participation loans, interest-only loans, indirect loans, non-federally guaranteed student loans, borrowings, and derivatives. Still other commenters suggested that the definition of “complex” be based on the

following activities: participation loans, interest only loans, indirect loans, real estate loans, non-agency mortgage backed securities, non-mortgage related securities with embedded options, collateralized mortgage obligations/real estate mortgage investment conduits, commercial mortgage-related securities, and derivatives.

In addition, commenters argued that because they do not adequately represent complexity, the Board should not use the following assets or liabilities: real estate loans, obligations fully guaranteed by the U.S. Government, investments with maturities of greater than five years, non-agency mortgage-backed securities, non-mortgage-related securities with embedded options, collateralized mortgage obligations/real estate mortgage investment conduits, commercial mortgage-related securities, and internet banking. In addition, one commenter argued that internet banking, a service that credit unions provide, is neither an asset nor a liability so the FCUA bars the NCUA from considering internet banking when considering complexity.

One commenter recommended that the asset size threshold should be set where all or most credit unions are engaged in four or more of the activities the Board identifies as complex. The commenter claimed that the FCUA, which requires the NCUA to specify which credit unions are “complex” based on the portfolios of assets and liabilities of credit unions, prohibits a credit union from being classified based on a single complex activity.

Another commenter suggested using an asset size threshold alone to define complexity was appropriate and that the presence of more complex lending products should not necessarily define a complex credit union because financial institutions in general become more complex with size and by moving into more complex/sophisticated financial transactions such as mortgage-backed securities, derivatives, loan sales or purchases, mortgage pipelines and servicing assets. The commenter suggested that these types of financial transactions are not ordinary in smaller asset size institutions because they generally require more scale and overhead of a larger institution to manage and understand.

Other commenters recommended the Board define complexity using a credit union’s product offerings, in a manner similar to that used in the current rule. The commenters suggested that the most analogous approach would be a ratio of risk-weighted assets to total assets greater than 67 percent as measure by the proposal’s risk weights. At least one of those commenters, however, acknowledged the 67 percent threshold might not be a meaningful measure of risk, but that using different thresholds yielded similar results.

At least one commenter suggested all federally insured credit unions with assets of \$500 million or less should be excluded from the definition of “complex,” and that only those credit unions with \$500 million or more in assets and that have an NCUA Complexity Index (discussed in the Supplementary Information to the Original Proposal) value of 17 or higher should be required to meet the NCUA’s risk based capital requirement. Similarly, another commenter suggested that all federally insured credit unions with assets of \$500 million or less should be excluded from the definition of “complex,” and

that only those credit unions with \$500 million or more in assets and that have an NCUA Complexity Index value of 20 or higher should be required to meet the NCUA's risk based capital requirement. Yet another commenter suggested that all federally insured credit unions with assets of \$1 billion or less should be excluded from the definition of "complex," and that only those credit unions with assets above \$1 billion and that have an NCUA Complexity Index value of 20 or higher should be required to meet the NCUA's risk-based capital requirement.

Additional suggestions provided by commenters for defining credit unions as "complex" included:

- Defining "complex" with attributes such as deposit account features, member services, loan and investment products, and portfolio makeup.
- Defining "complex" based on whether a credit union engages in a combination of activities including, participation loans, non-agency mortgage-backed securities, repurchase transactions, and derivatives.
- Defining "complex" as credit unions with over \$100 million or more in assets and that provide member business loans and invest in derivatives.
- Defining "complex" as credit unions with \$500 million or more in assets and/or that are engaged in over 50 percent of all of the categories, especially the investment section, noted in the preamble to the proposal.
- Defining "complex" as credit unions with \$500 million or more in assets, and that invest in non-agency mortgage-backed securities and nonmortgage related securities with embedded options.

As an alternative, one trade organization commenter suggested that with credit unions exiting an extreme financial crisis where many of these institutions failed due to lack of high quality capital and elevated risk profiles, the Board should be focusing its attention on raising the minimum regulatory capital levels for all credit unions.

Other credit union commenters argued the risk-based capital requirements should apply to all credit unions because recent data on credit union failures contradict claims that there is less risk in credit unions with less than \$100 million in assets.

Granted, the commenters suggested, in rural areas and in a few other special circumstances, small credit unions play a crucial role, and in such cases the NCUA should offer waivers. A small credit union commenter suggested that many credit unions with \$100 million or less in assets have the same, and often times more, risk on their balance sheets and in their operations than credit unions with over \$100 million in assets. The commenter believed that smaller credit unions engage in complex activities for the following reasons: (1) if they do not offer products and services that the bigger credit unions do, their members will leave and the credit unions will (eventually) be forced to merge (not an outcome they wanted); (2) they need products that increase their income and capital (*e.g.*, business loans, participation loans, and indirect lending); and (3) they recognize they do not have the expertise they should have but it is expensive and hard to attract expertise based on their compensation structure. Another credit union commenter claimed that smaller credit unions have failed at a higher rate and have had a higher

incidence of catastrophic failure due to a lack of comprehensive internal management and process controls that can lead to fraud. The commenter maintained that a credit union charter is a privilege and not a right and that all credit unions should be subject to the same risk-based capital requirements and examination standards.

One commenter suggested it is very likely that a small credit union could pose a much larger risk to the NCUSIF than a larger credit union, and that using asset size as a threshold for complexity suggests that capital is not as critical for smaller institutions. The commenter suggested further that “complexity” should be defined based on the quality of the management of the risks undertaken by the institution, which is ideally measured by the “M” in the CAMEL rating. The commenter recommended that identifying the credit unions to which the risk-based capital requirement applies is best done through the supervision process so that those credit unions posing a higher risk to the NCUSIF have higher standards and expectations by which to abide. The commenter suggested that this solution would reduce the “broad-brush” effect of the current proposal, applying more stringent standards to those institutions that may benefit from regulatory risk management and thus provide greater protection to the NCUSIF.

A significant number of commenters requested that the asset size threshold, if used, be indexed so that it does not apply to smaller and smaller credit unions through time due to inflation. And at least one commenter suggested that any credit union that is identified as “complex” by the NCUA should be able to present evidence to the agency as to why it is not complex and thus, should not be subject to risk-based capital requirements. The commenter suggested further that the process for contesting an agency designation of “complex” should be detailed in the final rule.

Discussion

The proposed use of an asset size threshold to define “complex” does comply with section 216 of the FCUA. As discussed in the Legal Authority part of this preamble, section 216(d)(1) directs NCUA, in determining which credit unions will be subject to the risk-based net worth requirement, to base its definition of complex “on the portfolios of assets and liabilities of credit unions.” The statute does not require, as some commenters have argued, that the Board adopt a definition of “complex” that takes into account the portfolio of assets and liabilities of each credit union on an individualized basis. Rather, section 216(d)(1) authorizes the Board to develop a single definition of “complex” that takes into account the portfolios of assets and liabilities of all credit unions. Consistent with section 216(d)(1), the proposed definition of a “complex” credit union included an asset size threshold that, as explained in more detail below, was designed by taking into account the portfolios of assets and liabilities of all credit unions.

Under the current rule, credit unions are “complex” and subject to the risk-based net worth requirement only if they have quarter-end total assets over \$50 million and they have a risk-based net worth ratio over 6 percent. In effect, this means that all credit unions with over \$50 million in assets compute the risk-based net worth requirement to determine if they meet the complex definition.

For reasons described more fully below, the Board maintains that defining the term “complex” credit union using a single asset size threshold of \$100 million as a proxy for a credit union’s complexity is accurate, reduces the complexity of the rule, provides regulatory relief for smaller institutions, and eliminates the potential unintended consequences of having a checklist of activities that would determine whether or not a credit union is subject to the risk-based capital requirement.

Under the Second Proposal, the term “complex” was defined only for purposes of the risk-based capital ratio measure. For the purpose of defining a complex credit union, assets include tangible and intangible items that are economic resources (products and services) that are expected to produce economic benefit (income), and liabilities are obligations (expenses) the credit union has to outside parties. The Board recognizes there are products and services—which under GAAP are reflected as the credit unions’ portfolio of assets and liabilities—in which credit unions are engaged that are inherently complex based on the nature of their risk and the expertise and operational demands necessary to manage and administer such activities effectively. Thus, credit unions offering such products and services have complex portfolios of assets and liabilities for purposes of NCUA’s risk-based net worth requirement.

Consistent with the proposal, the following products and services, if engaged in by a credit union, are accurate indicators of complexity:

- Member Business Loans
- Participation Loans
- Interest-Only Loans
- Indirect Loans
- Real Estate Loans
- Non-Federally Guaranteed Student Loans
- Investments with Maturities of Greater than Five Years (where the investments are greater than one percent of total assets)
- Non-Agency Mortgage-Backed Securities
- Non-Mortgage-Related Securities With Embedded Options
- Collateralized Mortgage Obligations/Real Estate Mortgage Investment Conduits
- Commercial Mortgage-Related Securities
- Borrowings
- Repurchase Transactions
- Derivatives
- Internet Banking

NCUA’s review of Call Report data as of June 30, 2014, and March 31, 2015, showed that all credit unions with more than \$100 million in assets were engaged in offering at least one of the products and services listed above; 99 percent engaged in two or more complex activities, and 87 percent engaged in four or more. On the other hand, less than two-thirds of credit unions below \$100 million in assets were involved in even a single complex activity, and only 15 percent had four or more. Moreover, credit unions with

total assets of less than \$100 million are only a small share (approximately 10 percent) of the overall assets in the credit union system—which limits the exposure of the Share Insurance Fund to these institutions. Accordingly, a \$100 million asset size threshold is a clear demarcation above which complex activities are always present, and where credit unions are almost always engaged in multiple complex activities. Additionally, the percentage of credit unions engaged in multiple activities using asset size thresholds above \$100 million does not produce a significant demarcation between credit unions when compared to the differences observed at the \$100 million threshold.

Conversely, using a credit union’s percentage of risk assets to total assets as the factor for determining whether the credit union is complex would require all credit unions to understand, monitor, and apply a complex measure their risk asset to asset ratio each quarter. This would be an additional and unnecessary burden for credit unions below the \$100 million asset size threshold.

As discussed earlier, \$100 million in assets is an accurate proxy for complexity based on credit unions’ portfolios of assets and liabilities. It is logical, clear, and easy to administer. Based on December 31, 2014 Call Report data, this approach exempts approximately 76 percent of credit unions from the regulatory burden associated with complying with the risk-based net worth requirement and capital adequacy plan, while still covering 90 percent of the assets in the credit union system. It is also consistent with the fact that the majority of losses (68 percent as measured as a proportion of the total dollar cost) to the NCUSIF spanning the last 12 years have come from credit unions with assets greater than \$100 million.

Accordingly, consistent with requirements of § 216(d)(1) of the FCUA, the final rule eliminates current § 702.103(b) and defines all credit unions with over \$100 million in assets as “complex.”

d. Effective Date: How much time would credit unions have to implement these new requirements?

In the preamble to the Second Proposal, the Board proposed an effective date of January 1, 2019 to provide credit unions and the NCUA a lengthy implementation period to make the necessary adjustments, such as systems, processes, and procedures, and to reduce the burden on affected credit unions in meeting the new requirements.

Public Comments on the Second Proposal

The Board received many comments regarding the proposed effective date of the final rule. Several commenters suggested that given the significant operational implications for both credit unions and the NCUA, a 2019 effective date is appropriate. Those commenters suggested the proposed effective date would allow credit unions to adjust their balance sheets and strategic plans to achieve a well-capitalized standard under the rule without disrupting member products and services. Commenters also noted that the proposed effective date aligns with the implementation timeframe of the Other Banking

Agencies and, thus, would avoid creating a competitive disadvantage across competing financial services entities.

A substantial number of other commenters, however, requested that the effective date be delayed until 2021 to coincide with refunds the commenters expect to receive from the Corporate Stabilization Fund. The commenters suggested the refunds will be important to those credit unions that will need to increase capital levels in order to comply with the new regulation.

Other commenters argued the proposed timeframe was insufficient given the significance of the impact of the proposed requirements and the length of time it would take credit unions to adjust their business strategies, portfolios and capital to best position themselves relative to the rule. Commenters argued the task would be burdensome for credit unions given their limited options for raising capital when compared to banks, which were afforded seven years to fully implement BASEL III. Accordingly, those commenters recommended various extended implementation periods ranging from five years to seven years, or phase-in periods over a similar timeframe.

One commenter speculated extending the implementation until 2019 would create a dual standard for credit unions near threshold levels. The commenter asked: What measure should be the plan for the coming 2–3 years? The commenter acknowledged that for some credit unions, the change will result in better risk-based capital levels than under the current rule. But the commenter argued that fixing the current capital levels under rules being phased out could cause real harm to memberships and credit union health.

Several commenters noted that the Financial Accounting Standards Board (FASB) plans to replace the current credit impairment model with a current expected credit loss model. Commenters suggested further that any final rule issued by FASB will require NCUA and FASB harmonization with respect to forecasting models utilized by credit unions to reduce conflicts between examination guidance. Accordingly, commenters recommended that the NCUA Board delay implementation of any final risk-based capital rule until the final FASB rule has been fully implemented by credit unions.

One commenter recommended that if interest rate risk, access to additional supplemental forms of capital, and risk-based share insurance premium changes are likely in the near future, the Board should delay finalization and implementation of the proposed rule until a comprehensive analysis can be conducted to ensure an integrated, aligned approach to risk-based capital. The commenter contended that addressing interest rate risk, supplemental capital, risk-based share insurance premiums and risk-based capital in silos will not create the most efficient and effective solution.

Discussion

The proposed January 1, 2019 effective date provides credit unions with more than three years to ramp up implementation, which should be more than sufficient time to make the necessary adjustments to systems and operations before the effective date of this final

rule. In addition, as noted above, the effective date generally coincides with the full phase-in of FDIC's capital regulations. In response to commenters who asked the Board to phase in the implementation, the Board found that phasing in the new capital rules for credit unions would add additional complexity with minimal benefit.

Further, it would be inappropriate to delay implementation due to potential changes in accounting that may be forthcoming, and the elimination of the cap on the amount of the ALLL will reduce the impact of the announced change in maintaining the ALLL.

Accordingly, this final rule will become effective on January 1, 2019.

e. Impact of This Final Rule

Public Comments on the Second Proposal

The Board received a substantial number of comments regarding the NCUA's estimates of the impacts of the proposal. Most commenters who mentioned the impacts of the proposal suggested the rule would have negative impacts on the credit union industry. Numerous commenters speculated the proposal would unjustifiably slow credit union growth in the future, and that the funds used to meet the newly proposed requirements could otherwise be used to make loans to consumers or small businesses, or be used in other productive ways. Commenters also speculated the requirements in the proposal would restrict credit union lending to consumers by forcing credit unions to maintain capital on their books rather than lending to their members. At least one commenter recommended that the Board more thoughtfully consider the actual market effect on the credit union industry and produce more reasonably calibrated risk weights based on the cooperative nature of credit unions. The commenter recommended the Board also reconsider the value of concentration escalators and provide empirical data that reflect what actual additional risk is created based on concentration of certain asset categories. Other commenters claimed the higher capital levels that would be required under the proposal would reduce the amount of support, both monetary and operational, that larger credit unions have historically provided to their smaller counterparts, which would put additional strain on the finances and operations of many smaller credit unions.

One credit union trade association commenter speculated that under the proposal, the number of credit unions downgraded would more than double during a downturn in the business cycle. Under the commenter's analysis, 45 credit unions would have been downgraded during the most 2007–2009 financial crisis if this proposal had been in place in 2009. According to the commenter, of those 45 credit unions, 41 would be well capitalized today. The commenter suggested that to have avoided a downgrade, those credit unions would have had to increase their capital by \$145 million, or an average of \$3.2 million per credit union. The commenter stated that almost all of the credit unions that would have been downgraded (95 percent) are well capitalized or adequately capitalized today. The commenter claimed this empirically proves the proposal is unnecessary and unduly burdensome, as it would further strain the credit union system during a financial downturn. The commenter estimated that, in order to satisfy the

proposal's well capitalized threshold, credit unions would need to hold at least an additional \$729 million. The commenter estimated further that, to satisfy the proposal's adequately capitalized threshold, credit unions would need to hold at least an additional \$260 million.

Another commenter argued the Board's cost estimates failed to include the one-time costs that would be incurred by the entire credit union industry in system changes, additional reports, potential additional segregation and segmentation of the balance sheet, etc. in order to fill out the new Call Report forms. The commenter speculated that such costs will far outweigh the costs that the Board has identified in the proposal.

Yet another commenter maintained that, according to the proposal, most complex credit unions are currently well capitalized under both the net worth ratio and the proposed risk-based capital ratio. The commenter calculated that as of September 30, 2014, complex credit unions had an average net worth ratio of 10.7 percent and a risk-based capital ratio of 19.3 percent, both well in excess of guidelines identifying well capitalized status. The commenter suggested that only 19 complex credit unions would fall from well capitalized status under the proposal. Thus, the commenter concluded that the costs associated with the proposal seemed excessive given how extremely well capitalized the credit union industry is today under current guidelines.

One credit union commenter suggested that for the risk-based capital requirement to be effective, it would have to be more complex. The commenter explained that this would mean requiring more information on the Call Report and adding new categories of loans in the final rule. Another credit union commenter supported making the risk-based capital framework as complicated as it needs to be to more accurately reflect the unique needs and structure of the credit union industry.

Several commenters noted that in March 2015, FASB announced expectations to finalize the standard for timely financial reporting of credit losses in the third quarter of 2015. Commenters recommended the Board consider the possible effects of the FASB proposal in relation to the NCUA's risk-based capital regulations and remove any duplicative regulatory burdens that may be created.

A significant number of commenters requested the Board minimize the burden on credit unions of expanding the Call Report. Several commenters suggested the Board consider an approach where credit unions would have the option of providing the additional, detailed information required under the proposal. One commenter suggested such an approach could be accomplished by including additional optional data fields within the Call Report, similar to the approach used by FDIC. The commenter suggested further that any changes required of a credit union require the expenditure of resources, and in a time when many credit unions are struggling to comply with existing rules from the NCUA and other regulators, the Board should consider any alternatives that will reduce the burden of this rule on credit unions. Another commenter contended that NCUA's current estimate of the public burden of collecting information for the Call Report grossly understates the actual amount of time required. The commenter suggested that the

variety of data needed to generate a quarterly Call Report takes employees from some credit unions 66 hours (10 times the NCUA's current 6.6 hour estimate). The commenter recommended the Board consider the time and resources dedicated to producing the additional Call Report data required by the proposal and focus on minimizing that burden and impact to credit unions. At least one commenter recommended that any Call Report updates required by this rulemaking be made available to credit unions at least six months before the effective date of the final rule.

Discussion

The Board has considered the comments received and recognizes that unduly high minimum regulatory capital requirements and unnecessary burdens could lead to less-than-optimal outcomes. Thus, as discussed throughout this preamble and in the Paperwork Reduction Act section, the Board has made appropriate efforts to target the impacts and reduce the burdens of this final rule. This final rule only targets outlier credit unions with insufficient capital relative to their risk. The final rule meets Congress' express purpose of prompt corrective action ". . . to resolve the problems of insured credit unions at the least possible long-term cost to the Fund," by establishing a risk-based capital requirement which will reduce the likelihood that a credit union will become undercapitalized and eventually fail at a cost to the Fund.

The Board's elimination of the 1.25 percent of risk-assets cap on the amount of ALLL in the risk-based capital ratio numerator will reduce the impact of the risk-based capital ratio during economic downturns when credit unions are more likely to be funding higher levels of loan losses. Removal of the ALLL cap will also mitigate concerns with FASB's proposed related changes to GAAP. A reduction in capital ratios during economic downturns is a normal result for both the risk-based capital ratio and the net worth ratio. The capital adequacy requirement will enhance a credit union's ability to measure and plan for economic downturns.

Sound capital levels are vital to the long-term health of all financial institutions. Credit unions are already expected to incorporate into their business models and strategic plans provisions for maintaining prudent levels of capital. This final rule ensures minimum regulatory capital levels for complex credit unions will be more accurately correlated to risk. The final rule achieves a reasonable balance between requiring credit unions posing an elevated risk to hold more capital, while not overburdening lower-risk credit unions.

Using another more conservative measure developed based on suggestions received from commenters, the NCUA identified 308 credit unions, or 20 percent of all complex credit unions, that are likely to have a higher minimum capital requirement under the risk-based capital ratio requirement being adopted under this final rule. While up to 20 percent of credit unions are likely to have the risk-based capital ratio as the binding constraint, only 20 of those credit unions have an estimated risk-based capital ratio below 10 percent.

The NCUA's latest analysis concludes it is reasonable for the risk-based capital ratio requirement to be the primary determiner of the capital requirement for about 20 percent

of complex credit unions because these 308 credit unions have an average risk-weighted assets to total assets ratio of 72 percent—which is significantly higher than the 59 percent average ratio for all complex credit unions.

Many commenters’ requests for further stratification of risk weights were determined to create a data burden in excess of the benefits. All revisions to the Call Report will be subject to the publication and opportunity for comment process in accordance with the requirements of the Paperwork Reduction Act of 1994, to obtain a valid control number from the U.S. Office of Management and Budget (OMB).

An entire listing of comments received on the proposed rule is available at <https://www.ncua.gov/regulation-supervision/Pages/rules/comment-letters/2015/risk-based-capital.aspx>.

9. Payment or gifts to respondents

The NCUA does not provide payment or gifts to the respondent.

10. Assurance of confidentiality

Credit union examination reports and any documents related thereto are exempt from the Freedom of Information Act disclosure, pursuant to exemption 8, 5 U.S.C. 552(b)(8).

11. Questions of a sensitive nature

No questions of a sensitive nature are asked. The information collection does not collect any Personally Identifiable Information (PII).

12. Burden of information collection

Burden associated with this information collection request is a recordkeeping requirement to establish the initial strategic plan. This one-time burden applies to 1,489 credit union that have been identified as complex. This information will be reviewed as part of the routine examination and supervision process and retained according to guidelines provide by Appendix A to Part 749. Any burden associated with credit union’s maintenance of this written strategy will be incorporated into the overall recordkeeping requirements of Part 702 cleared under OMB control number 3133-0154 when implemented.

12 CFR	No. Respondents	No. Responses per Respondent (Frequency)	No. of Responses	Hours per response	Total Annual Burden
702.101(b)(2)	1,489	1	1,489	40	59,560

Based on the labor rate of \$35 per hour, the total cost to the respondent is \$2,084,600.

13. Capital Start-up or on-going operation and maintenance costs

There are no capital start-up or maintenance costs.

14. Annualized Costs to Federal Government

This is a recordkeeping requirement. There are no annualized cost to the Federal government.

15. Changes in Burden

This is a new collection. There has been a slight increase to the number of respondents from what was reported at the time of the proposal. An increase of 34 credit unions is due to the increase of their assets size, which are now identified as complex. The proposal also included burden assigned to non-complex credit unions. This burden has been removed because this information collection requirement only applies to complex credit unions. No burden is imposed on non-complex credit unions. A reduction of 101,980 burden hours is attributed to this adjustment.

16. Information collection planned for statistical purposes

The information collection is not planned for publication.

17. Request non-display the expiration date of the OMB control number

The OMB control number and expiration date associated with this PRA submission will be displayed on the Federal Government's electronic PRA docket at www.reginfo.gov.

18. Exceptions to Certification for Paperwork Reduction Act Submissions

There are no exceptions to the certification statement.

B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS

This collection does not involve statistical methods.