American Bankers Association
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Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314–3428

re: National Credit Union Administration; Net Worth and Equity Ratio; 12 C.F.R. Parts 700, 701, 702, and 741; 76 Federal Register 16345, March 23, 2011

Dear Ms. Rupp:

The National Credit Union Administration (NCUA) Board (the Board) issued a proposed rule to amend the definition of net worth by permitting section 208 assistance to count as net worth for the purpose of meeting prompt corrective action requirements. The proposal also amends the definition of the equity ratio for the National Credit Union Share Insurance Fund (NCUSIF).

The American Bankers Association (ABA)[1] has several concerns about the proposed rule. ABA believes that the Board should clearly articulate that the section 208 assistance will ***only*** be used to facilitate a merger between a healthy credit union and a failing credit union. In addition, ABA requests that NCUA modify its 5300 Call Report by adding a line to its PCA Net Worth Calculation Worksheet that measures section 208 assistance. Furthermore, ABA recommends that the NCUSIF financial statement include information on section 208 assistance and that the assistance be divided between assistance that is for liquidity purposes and assistance that counts as capital.

Background

On January 4, 2011, President Obama signed Senate Bill 4036 into law, which, among other things, amended the statutory definitions of net worth and equity ratio in the Federal Credit Union Act.[2] The proposed rule makes conforming amendments to the definitions of net worth and equity ratio as it appears in NCUA's regulations.

Section 216(o)(2) of the Federal Credit Union Act (12 U.S.C. 1790d(o)(2)) was amended by adding "with respect to any insured credit union, includes, at the Board's discretion and subject to rules and regulations established by the Board, assistance provided under section 208 **to facilitate a least-cost resolution** consistent with the best interests of the credit union system" to the definition of net worth [emphasis added].

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees. The majority of ABA's members are banks with less than $165 million in assets. ABA's extensive resources enhance the success of the nation's banks and strengthen America's economy and communities.
[2] Pub. L. No. 111-382.

The Board is proposing to limit section 208 assistance that counts as net worth to those types of assistance containing minimum elements of equity. Specifically, accounts that qualify as regulatory capital will be limited to accounts that:

i. have a remaining maturity of five years or more;
ii. are not insured by the NCUSIF;
iii. may not be pledged as security on a loan to, or other obligation of, any party;
iv. have non-cumulative dividends;
v. are transferrable;
vi. are subordinate to the NCUSIF, shareholders, and creditors; and
vii. are available to cover operating losses realized by the insured credit union that exceed its available retained earnings.

Additionally, the equity ratio for the NCUSIF is amended so that the equity ratio will be calculated "using the financial statements of the Fund alone, without any consolidation or combination with the financial statements of any other fund or entity."

ABA's Position

ABA does not object to the proposed rule. However, ABA does seek clarification that the section 208 net worth capital assistance only be used to facilitate a merger between a healthy credit union and a ***failed credit union***. This is what Congress intended by using the phrase "to facilitate a least cost resolution", and NCUA should clearly articulate this intent in allowing such assistance to count as capital. ABA also believes that NCUA's 5300 Call Report should be amended to reflect such capital assistance. Additionally, ABA recommends that the NCUSIF financial statement include information on section 208 assistance and that this assistance should be divided between assistance that is for liquidity purposes and assistance that counts as capital.

NCUA can use section 208 assistance under two circumstances. The first circumstance is the provision of liquidity, which does not count as capital, and the other is when there is a capital shortfall and the assistance meets the minimum requirements of being equity.

ABA understands that this modification to the definition of net worth was for the purpose of facilitating ***the acquisition of a failing credit union*** by another credit union. Without this statutory change, NCUA assistance to a healthy credit union to acquire a failing credit union could not count as net worth. As a result, the healthy credit union would experience a dilution of its net worth ratio if a merger took place. This discouraged healthier credit unions from acquiring financially distressed credit unions and thus increased the cost of resolving credit union failures.

NCUA Chairman Debbie Matz acknowledged this. Testifying before the Senate Committee on Banking, Housing and Urban Affairs on December 9, 2010, NCUA Chairman Matz said:

> NCUA's ability to resolve problem credit unions at the least cost to the NCUSIF has been limited by the Financial Accounting Standard Board's changes in accounting standards, in combination with the existing statutory definition of net worth. Since NCUA does not have the ability to adjust the definition of net worth similar to the Federal Deposit Insurance Corporation's authority, this results in the dilution of a credit union's net worth when it

acquires another credit union, regardless of whether or not NCUSIF assistance is provided to facilitate the acquisition. This increases costs to resolve failed institutions and necessitates more outright liquidations instead of mergers. Liquidations immediately cut members off from credit union services.

However, ABA is concerned that as currently crafted the proposed rule could allow NCUA to provide capital assistance to failing credit unions in order to keep them open instead of requiring a merger with a healthy credit union. Congress has expressed deep reservations about the practice of open-bank assistance and prohibited the practice by enacting the Leach Amendment to the RTC Completion Act. ABA requests that when the Board issues its final rule it clearly articulate that section 208 assistance, which counts as capital, will only be used for the purpose of facilitating a merger between a healthy credit union and a failed credit union and that this assistance will not be used to prop up a failing credit union.

Additionally, since the proposed rule will now count section 208 assistance as net worth, ABA recommends that NCUA amend its 5300 Call Report by adding a line to its PCA Net Worth Calculation Worksheet to reflect this section 208 assistance. Such disclosure on the 5300 Call Report should improve transparency and accountability. While NCUA has expressed concerns in the past about disclosing information about credit unions receiving section 208 assistance,[3] this should not be a problem in this instance as the assistance is to facilitate a merger of a failed credit union with a healthy credit union.

Moreover, ABA recommends that NCUA should include section 208 assistance as part of the financial statement for the NCUSIF. In addition, NCUA should differentiate section 208 assistance for liquidity purposes from that assistance which counts as capital, since this assistance can bear a loss.

If you have any questions, please feel free to contact the undersigned.

Sincerely,

Keith Leggett

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[3] In an April 14, 1997, letter to Mr. Kunal V. Randery, NCUA wrote, "members may perceive provision of 208 assistance to indicate a weak and unstable credit union…Information on operating credit unions that have received 208 assistance can and will be withheld pursuant to exemption 8 since its release could affect the financial security of the operating credit unions…Hence, we will not disclose the requested 208 information, with or without names and charter numbers."