

NCUA Finalizes Amendments to Subordinated Debt Issuance Regulations

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On January 1, a new rule regarding credit unions' eligibility to issue subordinated debt became effective. At its December 17, 2020 open meeting, the board of the National Credit Union Administration (NCUA) approved a final rule that amended NCUA regulations to permit low-income designated credit unions (LICUs), complex credit unions (credit unions with total assets of at least \$500 million), and new credit unions to issue subordinated debt for purposes of regulatory capital treatment. The final rule largely mirrored the proposed rule issued by the NCUA at its January 2020 meeting.

Under the prior regulations, only LICUs were permitted to issue subordinated debt, which is a capital management tool that can be used to increase certain capital ratios, support growth, meet regulatory capital requirements, and expand products and services offerings. The final rule expanded subordinated debt eligibility by granting certain non-LICUs the authority to issue instruments in the form of subordinated debt and allowing those instruments to be counted in their respective risk-based capital calculations. In its 2020 proposed rule, the NCUA estimated that an additional 285 non-LICUs, with total assets of \$730 billion, would be eligible to issue subordinated debt.

The final rule amended NCUA's regulations in various ways, including by:

- Adding a new section to the regulations addressing limits on loans to other credit unions;
- Clarifying application requirements to issue subordinated debt;
- Expanding requirements for note disclosures and offering documents;
- Updating the borrowing rule to clarify that federal credit unions can borrow from any source; and
- Adding new safe harbors for repudiation and interest payments.

Out of 171 comment letters in response to the proposed rule, the NCUA received at least 125 letters opposing the proposed rule, including a [strongly worded letter](#) from the American Bankers Association "condemning" the proposal. Opposing commenters questioned whether the proposal undercuts the basis for credit unions' tax-exempt status and put forth three general arguments:

- Allowing credit unions to issue subordinated debt for regulatory capital purposes "undermines the foundation of

credit unions' tax-exempt status;"

- The proposed rule “usurps Congressional authority by approving the use of investor-raised funds to satisfy regulatory capital requirements, an area Congress clearly restricted to retained earnings in the Federal Credit Union Act;” and
- The proposed rule would pose significant risk to the National Credit Union Share Insurance Fund.

The NCUA disagreed with the opposing commenters on all three assertions, and the final rule passed unanimously.

The NCUA further amended the subordinated debt rule at its open meeting on December 16, 2021, by amending the starting point for grandfathered secondary capital to retain its status as regulatory capital. The final rule, which also became effective January 1, 2022, extended the expiration of regulatory capital treatment for secondary capital issuances to the later of 20 years from the date of issuance or January 1, 2042. In its final rule, the NCUA noted that such amendment would provide equitable treatment for all issuances of grandfathered secondary capital.

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