Credit Union Risk-Based Capital Update

- NCUA's risk-based capital provisions are scheduled to go into effect January 1, 2022
- RBC Rule applies to federally insured credit unions with assets greater than $500 million
- Institutions with assets less than $500 million are exempt from the 2015 Final RBC Rule

After having been delayed multiple times, the NCUA's risk-based capital provisions finalized in 2015 (2015 Final RBC Rule) are currently scheduled to go into effect January 1, 2022. The 2015 Final RBC Rule only applies to federally insured credit unions with assets greater than $500 million. Institutions with less than $500 million in assets are exempt from the 2015 Final RBC Rule. Complex credit unions (assets exceeding $50 million) remain subject to the current Risk-Based Net Worth (RBNW) requirement. All credit unions remain under the control of the minimum net worth ratio thresholds established under the NCUA's Prompt Corrective Action guidelines.

There have been two proposals issued by the NCUA that would provide regulatory relief to certain credit unions:

1. In February 2021 the NCUA issued ***Risk-Based Net Worth – COVID-19 Regulatory Relief**.* The proposed rule would raise the asset threshold for defining a credit union as "complex" for purposes of being subject to any RBNW requirement in the NCUA's regulations. Currently a complex credit union is defined as a credit union with assets exceeding $50 million with a RBNW requirement exceeding 6%. The proposed rule would raise the asset threshold to $500 million to match the prospective 2015 Final RBC Rule while retaining the requirement that a credit union's RBNW requirement also exceeds 6%. The proposal is in the final rule stage and, if passed, would allow many credit unions to simply manage their capital levels to meet the 7% net worth requirement to be well capitalized.

2. In July 2021 the NCUA's Board approved a notice of proposed rulemaking to provide a simplified measure of capital adequacy for credit unions with assets greater than $500 million. The new Complex Credit Union Leverage Ratio (CCULR) provides complex credit unions that maintain a minimum net worth level and meet other qualifying criteria a "streamlined framework" to manage capital. A complex credit union that opts into the CCULR framework would not be required to calculate a risk-based capital ratio under the 2015 Final RBC Rule and would be considered well capitalized if it maintains the required minimum net worth ratio.

   Under this proposal, the minimum net worth level under the CCULR framework would initially be 9% on January 1, 2022, and this level would gradually increase to 10% by January 1, 2024. The NCUA estimates that nearly 75% of complex credit unions would be able to meet the CCULR's initial net worth requirement of 9%. Other qualifying criteria for the proposed framework include: off-balance-sheet exposures must be 25% or less of total assets; trading assets and trading liabilities are 5% or less of total assets; and goodwill and other intangible assets are 2% or less of total assets.

   The main benefit of electing to use the CCULR framework is the time savings that would be gained by eliminating the need to calculate risk-based capital and complete the potentially complex NCUA Call Report schedules. The downside from opting into the framework is that the CCULR will likely require a credit union to maintain a higher level of capital than would be required under the existing well-capitalized thresholds of maintaining a 7% net worth ratio and 10% risk-based capital ratio.

   The proposed Complex Credit Union Leverage Ratio for federally insured credit unions is comparable to the Community Bank Leverage Ratio (CBLR) framework. The framework became effective on January 1, 2020 and allows qualifying banks the ability to opt in to the simplified CBLR. Qualifying banking organizations that elect to use the CBLR framework and that maintain a leverage ratio of greater than 9% are considered to have satisfied the risk-based and leverage capital requirements in the agencies' generally applicable capital rule. Approximately 1,845, or 41% of eligible community banks have opted into the CBLR framework.

Unlike community banks, which can opt in and out of the CBLR framework at any time, the same optionality with credit unions isn't as straightforward. Under the proposal, after a qualifying credit union has adopted the CCULR framework, it may voluntarily opt out of the framework by providing written notice to the NCUA. The notice must be provided at least 30 days before the end of the calendar quarter that the credit union will begin reporting its risk-based capital ratio. Following notification, the NCUA may monitor whether the credit union has acquired the necessary systems and processes to be capable of calculating and reporting its risk-based capital ratio accurately.

We will keep you apprised of any new developments or updates on the capital-related proposals. In preparation for the 2015 Final RBC Rule's effective date of January 1, 2022, credit unions with assets exceeding $500 million should consider doing the following:

1. Use the Risk-Based Capital Estimator tool found on the NCUA's website to review your risk-based-capital ratio. The spreadsheet-based model can be populated with your credit union's financial data to determine a pro forma risk-based capital ratio. If you have done this in the past, it might be prudent to do so again considering the reduction in net worth ratios across the industry during the past year due to historically high deposit and share growth.

2. Review and identify any capital deficiency based on current financial data and/or growth projections.

3. Develop a plan to address any capital deficiency prior to the effective date of the 2015 Final RBC Rule. Exchanging assets with a higher risk-weighting requirement (Vehicle Loans, Taxable Municipals) for assets with a lower-risk weighting requirement (1-4 Family First Mortgages, Agency MBS, Treasuries) could be an option, but might impact ongoing profitability. Our team can help by presenting strategies to address your needs with detailed analytics of how these strategies will impact capital, balance sheet, earnings, and other performance metrics.

Current risk-weightings for investment securities under the RBNW requirement range from 3% to 20% depending on the weighted-average life. The following table highlights the risk-weightings for investments under the 2015 RBC Final Rule, which range from 0% to 50%, depending on the underlying investment type.

Typical Investments (in order of ascending risk weight)	Risk Weight
Direct unconditional claims on the U.S. government	0%
Debt instruments issued by NCUA and FDIC	0%
Federal Reserve Bank and Central Liquidity Facility stock	0%
Agency obligations	20%
General obligation bonds issued by state or political subdivisions	20%
Federal Home Loan Bank stock	20%
Funds containing only 703 compliant investments subject to a 0% - 20% risk weight	20%
Agency and GSE residential MBS or ABS structured securities [3, 4]	20%
Revenue bonds issued by state or political subdivisions [3]	50%
Non-agency residential MBS structured securities [3, 4]	50%

[3] Non-subordinated

[4] Exclude interest-only, mortgage-backed security strips

As always, if you have any questions, comments, or would like to discuss further, please don't hesitate to reach out to your account representative or directly to me.

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