7535-01-U

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 702

RIN 3133-AF43

Subordinated Debt

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The NCUA Board (Board) is amending the Subordinated Debt rule (current rule), which it finalized in December 2020 with an effective date of January 1, 2022. This final rule makes two changes related to the maturity of Subordinated Debt Notes and Grandfathered Secondary Capital. Specifically, this final rule replaces the maximum permissible maturity of Subordinated Debt Notes with a requirement that any credit union seeking to issue Subordinated Debt Notes with maturities longer than 20 years demonstrate how such instruments would continue to be considered "debt." This final rule also extends the Regulatory Capital treatment of Grandfathered Secondary Capital to the later of 30 years from the date of issuance or January 1, 2052. This extension will align the Regulatory Capital treatment of Grandfathered Secondary Capital with the maximum permissible maturity for any secondary capital issued by

low-income credit unions (LICUs) under the 2022 U.S. Department of the Treasury's (Treasury) Emergency Capital Investment Program (ECIP) or other programs administered by the U.S. Government. In addition, the Board is making four minor modifications to other sections of the current rule to make it more user-friendly and flexible.

DATES: The final rule is effective [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT: *Policy:* Tom Fay, Director of Capital Markets, Office of Examination and Insurance. *Legal:* Justin M. Anderson, Senior Staff Attorney, Office of General Counsel, 1775 Duke Street, Alexandria, VA 22314-3428. Tom Fay can be reached at (703) 518-1179, and Justin Anderson can be reached at (703) 518-6540.

Supplementary Information:

I. Background

A. The current rule history

At its December 2020 meeting, the Board issued a final Subordinated Debt rule (the 2020 final rule).[1] The 2020 final rule permitted LICUs, complex credit unions, and new credit unions to issue Subordinated Debt for purposes of being included in Regulatory Capital.[2] Relevant to this final rule, the 2020 final rule provided that any secondary capital issued by LICUs under

[1] Throughout this document the Board uses the term "2020 final rule" to refer to the final Subordinated Debt rule issued in December 2020 and published in the *Federal Register* on February 23, 2021. The Board uses the term "the current rule" to refer to the current Subordinated Debt rule, as published in the Code of Federal Regulations, which includes the "2020 final rule" and subsequent amendments.

[2] 86 FR 11060 (Feb. 23, 2021). Unless otherwise noted, capitalized terms in this preamble are defined in the current rule.

previously effective 12 CFR 701.34(b), outstanding as of the effective date of the 2020 final rule, would be considered Grandfathered Secondary Capital. The grandfathering provision of the 2020 final rule allowed LICUs with Grandfathered Secondary Capital to continue to be subject to the requirements of § 701.34(b), (c), and (d) (recodified in the current rule as § 702.414), rather than the requirements of the current rule. The 2020 final rule also provided that any issuances of secondary capital not completed by January 1, 2022, are, as of January 1, 2022, subject to the requirements of the current rule. Finally, the grandfathering provision in the 2020 final rule stated that Grandfathered Secondary Capital would continue to be included in Regulatory Capital for up to 20 years from the effective date of the 2020 final rule.[3] The 2020 final rule also contained a provision requiring Subordinated Debt Notes to have a minimum maturity of five years and a maximum maturity of 20 years.

After the NCUA issued the 2020 final rule, Congress passed the Consolidated Appropriations Act, 2021.[4] The Consolidated Appropriations Act, 2021, among other things, created the ECIP. Under the ECIP, Congress appropriated funds and directed Treasury to make investments in "eligible institutions" to support the institutions' efforts to "provide loans, grants, and forbearance for small businesses, minority-owned businesses, and consumers, especially in low-income and underserved communities."[5] The definition of "eligible institutions" includes federally insured credit unions that are minority depository institutions or community development financial institutions, provided such credit unions are not in troubled condition or subject to any formal enforcement actions related to unsafe or unsound lending practices.[6]

[3] Id.
[4] Consolidated Appropriations Act, 2021, Pub. L. 116–260 (H.R. 133), Dec. 27, 2020.
[5] Id. codified at 12 U.S.C. 4703a *et seq.*
[6] 12 U.S.C. 4703a(a)(2). Throughout this document, the Board only refers to LICUs, as those are the only eligible institutions that could receive secondary capital treatment for the ECIP investments.

Under the terms developed by Treasury, investments in eligible credit unions are in the form of subordinated debt.[7] Treasury also aligned its investments in LICUs with the Federal Credit Union Act (the Act) and the NCUA's regulations, which allowed eligible LICUs to apply to the NCUA for secondary capital treatment for these investments. Relevant to this final rule, Treasury offered either 15- or 30-year maturity options for the investments. Treasury opened the ECIP application process on March 4, 2021, with an application deadline of May 7, 2021. Treasury extended this deadline to September 1, 2021.

In October 2021, the NCUA issued a Letter to Credit Unions permitting LICUs participating in the ECIP to issue 30-year subordinated debt instruments.[8] In December 2021, the Board issued a final amendment to the current rule permitting secondary capital to be considered Grandfathered Secondary Capital regardless of the actual issuance date, provided the secondary capital issuance met the following conditions:

1. It was issued to the U.S. Government; and
2. It was conducted under a secondary capital application that was approved before January 1, 2022, under either § 701.34 of the NCUA's regulations for federal credit unions, or § 741.203 of the NCUA's regulations for federally insured, state-chartered credit unions.[9]

[7] Throughout this document the term "Subordinated Debt" (initial caps) refers to issuances conducted under the current rule. Conversely, the term "subordinated debt" (lower-case) refers to debt issuances conducted outside of the current rule, such as those under the ECIP.
[8] Letter to Credit Unions 21-CU-11, Emergency Capital Investment Program Participation and enclosed Supervisory Letter No. 21-02 (Oct. 20, 2021), *available at* https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/emergency-capital-investment-program-participation.
[9] 12 CFR 701.34 and 741.203; 86 FR 72807 (Dec. 23, 2021).

The final amendment and Letter to Credit Unions provided LICUs with additional flexibility to participate in the ECIP without being subject to the terms of the current rule.

B. Maturity and treatment as Regulatory Capital for Grandfathered Secondary Capital

The current rule restricts the maturity of Subordinated Debt Notes to a minimum of five years and a maximum of 20 years. In alignment with this maximum maturity, the current rule also terminates Grandfathered Secondary Capital's inclusion in Regulatory Capital after a maximum of 20 years beginning on the later of the date of issuance or January 1, 2022 (the effective date of the current rule).

As previously noted, under the ECIP, Treasury allowed 30-year subordinated debt instruments. The Supervisory Letter accompanying the Letter to Credit Unions discussed in the previous section of this document stated:

> [F]ederally insured, state-chartered LICUs typically issue secondary capital under similar borrowing authority. As such, the agency has taken certain precautions to ensure that issuances under the ECIP that receive secondary capital treatment are considered debt. Such precautions have included the agency prohibiting LICUs from receiving secondary capital treatment for issuances under the ECIP's 30-year option.[10]

[10] Letter to Credit Unions 21-CU-11, Emergency Capital Investment Program Participation and enclosed Supervisory Letter No. 21-02 (Oct. 20, 2021).

The Supervisory Letter, however, went on to state that after further consideration, the agency was recalibrating its position and permitting LICUs to issue 30-year subordinated debt under the ECIP. In relevant portion, the Supervisory Letter stated the following:

> The agency has always recognized that no one term or factor of an ECIP instrument is dispositive in characterizing the nature of the instrument. As such, the agency is satisfied that the close collaboration between the NCUA and Treasury, the unique status of the ECIP, and the terms of the instrument have resulted in an instrument that complies with the Federal Credit Union Act, even with a 30-year term.[11]

While this change facilitated LICU participation in the ECIP, the agency recognized that there is a distinct mismatch between a 30-year ECIP subordinated debt instrument and the 20-year maximum for inclusion in Regulatory Capital of the same. To address this discrepancy, the NCUA conducted additional research into these issues.

Both the maximum Regulatory Capital treatment for Grandfathered Secondary Capital and the maximum maturity for Subordinated Debt Notes are based on the statutory authority under which an FCU issues both instruments. Specifically, an FCU may only issue these instruments under its authority to borrow from any source. Therefore, the agency took precautions in the current rule to ensure that all issuances are in the form of debt. As noted in the January 2020 proposed Subordinated Debt rule, such precautions included imposing a maximum maturity of 20 years on Subordinated Debt Notes. The Board stated it was proposing such

[11] Id.

requirement "to help ensure the Subordinated Debt is properly characterized as debt rather than equity. Generally, by its nature, debt has a stated maturity, whereas equity does not."[12]

With respect to Grandfathered Secondary Capital, the January 2020 proposed Subordinated Debt rule stated that "the Board believes 20 years would provide a LICU sufficient time to replace Grandfathered Secondary Capital with Subordinated Debt if such LICU seeks continued Regulatory Capital benefits of Subordinated Debt." The Board also stated that it believed "it is important to strike a balance between transitioning issuers of Grandfathered Secondary Capital to this proposed rule and ensuring that instruments do not indefinitely remain as Grandfathered Secondary Capital."[13]

As the Board received feedback from the credit union industry on the mismatch between ECIP investment maturities allowed and the Regulatory Capital treatment of the same, the NCUA conducted additional research into whether a 20-year maturity was necessary to ensure an FCU was operating squarely within its statutory authority. While the Board continues to believe that a 20-year maturity is an appropriate demarcation point to ensure an FCU is issuing Subordinated Debt under its statutory authority, the agency's additional research has provided grounds to offer additional flexibility in this area. Based on this additional research, the Board proposed the amendments discussed in the next section of this document.

C. Summary of the proposed rule

At its September 2022 meeting, the Board issued a notice of proposed rulemaking to amend the current rule in a variety of ways.[14] First, the Board proposed revisions to § 702.401(b)

[12] 85 FR 13892 (Mar. 10, 2020).
[13] Id.
[14] 87 FR 60326 (Oct. 5, 2022).

to permit Grandfathered Secondary Capital to be included in Regulatory Capital for up to 30 years from the later of the date of issuance or January 1, 2022. Second, the Board proposed to remove the maximum maturity limit of 20 years from § 702.404(a)(2). In its place, the Board proposed a requirement that a credit union must provide certain information in its application for preapproval under § 702.408 when applying to issue Subordinated Debt Notes with maturities longer than 20 years. To demonstrate the issuance is debt, the proposal included a new paragraph in § 702.408(b) that requires a credit union applying to issue Subordinated Debt Notes with maturities longer than 20 years to submit, at the discretion of the Appropriate Supervision Office, one or more of the following:

- A written legal opinion from a Qualified Counsel.
- A written opinion from a licensed CPA.
- An analysis conducted by the credit union or independent third party.

In addition to these substantive changes related to the maturity and Regulatory Capital treatment of issuances, the Board also proposed several minor changes to make the current rule clearer, more user-friendly, and aligned with current agency practices. First, the Board proposed to amend the definition of "Qualified Counsel" to clarify where such person(s) must be licensed to practice law by removing the phrase "in the relevant jurisdiction(s)" from the definition of "Qualified Counsel." Second, the Board proposed to amend §§ 702.408(b)(7) and 702.409(b)(2) to remove the statement of cash flow from the Pro Forma Financial Statements requirement and replace it with a requirement for "cash flow projections." Third, the Board proposed to amend the section of the current rule addressing the filing of documents and inspection of documents by

removing the phrase “inspection of documents” from the titling of this section and replacing the current requirement that a credit union submit all applicable documents via the NCUA’s website with a requirement that a credit union make all submissions directly to the Appropriate Supervision Office. Finally, the Board proposed to revise § 702.414(c) by removing “(“discounted secondary capital” re-categorized as Subordinated Debt)” from the description of Grandfathered Secondary Capital that may be redeemed by a credit union. This revision is consistent with recent changes to the NCUA Call Report.

For the reasons stated in the proposed rule and in consideration of the public comments received on the same, as discussed in the next section of this document, the Board is finalizing the proposed changes without further amendment.

II. Summary of comments

A. The public comments, generally

The NCUA received 21 comments following publication of the proposed rule. Two of the commenters supported the rule as written and two commenters opposed the rule in its entirety. The remaining 17 commenters supported the proposed changes but recommended additional changes that are outside the scope of this rulemaking.

B. Comments that opposed the proposal in its entirety.

Two commenters expressly opposed the proposed changes and, more generally, the current rule in its entirety. Specific to the proposed rule, both commenters opposed the change that would permit credit unions to issue Subordinated Debt Notes with maturities greater than 20 years. Specifically, one commenter stated that “by extending their maximum maturity, these

instruments become more like ‘equity-like.’ [sic] Even by the NCUA’s own admission, the fixed stated maturity is a factor in determining whether an instrument may be considered debt or equity with a general rule being that the shorter the maturity date, the more the instrument resembles debt.” The other commenter further stated the following:

> The 20-year limitation was created after the NCUA concluded that such a limitation would ensure that courts consider credit union subordinated debt to be debt rather than equity. This prevents credit unions from exceeding their statutorily permitted powers. There is no evidence that the risk of long duration subordinated notes being classified as equity has decreased, and therefore no justification for the NCUA Board to reverse its previous decision.

This commenter went on to recommend that the Board should require credit unions to submit a written legal opinion from Qualified Counsel and a written opinion from a licensed CPA to the Appropriate Supervision Office before issuing Subordinated Debt. Conversely, this commenter suggested that the Board should only allow maturities over 20 years for issuances to the U.S. Government. This commenter supported its argument by stating that “[d]etermining whether an instrument constitutes debt or equity is not a simple matter, particularly when evaluating notes with long maturities.” This commenter went on to state:

> Under the NCUA’s proposed rule, there is nothing that would preclude a newly formed LICU from issuing notes with 50 year maturities, 99 year maturities, or even 150 year maturities. All that would be required to satisfy the letter of the

> proposed regulation is an analysis conducted by the credit union itself stating that the note should be considered debt and not equity and the approval of the Appropriate Supervision Office. This is not sufficient to prevent credit unions from issuing securities that are nominally debt but are, in substance, an impermissible equity interest.

Finally, this commenter cited the following case to support its position that credit union Subordinated Debt is already equity-like under the current rule:

> For example, in United States v. Snyder Brothers Company, the Fifth Circuit concluded that 20-year debentures that were subordinated to all other indebtedness of the issuer and where there was no limitation as to payment of dividends or provision for any sinking fund or reserve did not constitute "indebtedness," despite the intention of the issuer. The Snyder Brothers court held that while subordination alone or a long term alone would not preclude classification as debt, those factors together, as well as the lack of any sinking fund or reserve, tended more "towards eliminating any difference between the holders of these debentures and preferred stockholders than any case that has been called to our attention." (Footnote omitted).

In response to the assertions made by these commenters, the Board notes that under established case law an agency may change its position, provided it acknowledges the change

and supports the change with a reasonable basis.[15] As discussed in the proposed and final rules, the NCUA is committed to ensuring FCUs offering Subordinated Debt Notes are doing so within their express statutory authority.[16] While the Board selected 20 years as a comfortable demarcation line in determining the length of maturity of a Subordinated Debt Note for purposes of ensuring it remained a borrowing, the Board never stated that any other maturity would automatically make Subordinated Debt Notes equity and not debt. Rather, in the proposed rule, the Board stated that during the formulation of the current rule, the agency engaged the services of an outside law firm that specializes in, among other things, taxation and securities law. Based on the research conducted by that firm and NCUA staff, the Board determined that 20 years was a comfortable demarcation point. NCUA staff and the Board are aware that courts have never set a strict limit on the length of a fixed stated maturity for purposes of a debt versus equity analysis. The agency recognizes that courts have, in some cases, found an instrument to be debt despite a maturity in excess of 50 years.[17] As discussed by legal scholars, as a general rule, the shorter the time between issuance of the debt instrument and the maturity or redemption date, the more the instrument appears to be debt.[18] Therefore, the Board continues to believe that 20 years is a comfortable demarcation point to balance flexibility with a rule firmly rooted in statutory authority.

The Board, however, recognizes that a fixed stated maturity date is but one factor in a debt versus equity analysis and, as noted by the U.S. Supreme Court, "[t]here is no one

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[15] See. F.C.C. v. Fox Television Stations, Inc., 556 U.S. 502, 129 S. Ct. 1800, 173 L. Ed. 2d 738 (2009).
[16] See. 85 FR 13892 (Mar. 10, 2020) and 86 FR 11060 (Feb. 23, 2021).
[17] "Although 50 years might under some circumstances be considered as a long time for the principal of a debt to be outstanding, we must take into consideration the substantial nature of the * * * [taxpayer's] business, and the fact that it had been in corporate existence since [*62] 1897, or 61 years prior to the issuance of the debentures. Therefore, we think that a 50-year term in the present case is not unreasonable. * * * [Monon R.R. v. Comm'r, 55 T.C. at 359]. PepsiCo Puerto Rico, Inc. v. Comm'r, 104 T.C.M. (CCH) 322 (T.C. 2012)."
[18] "Federal Income Taxation of Debt Instruments," David C. Garlock, Matthew S. Blum, Kyle H. Klein, Richard G. Larkins & Alan B. Munro (2011).

characteristic . . . which can be said to be decisive in the determination of whether obligations are risk investments in the corporations or debt."[19] Considering the factors mentioned above, the Board proposed to provide Issuing Credit Unions with additional flexibility on this requirement and remove the fixed maximum maturity limit.

In its place, the Board proposed a requirement that a credit union must provide certain information in its application for preapproval under § 702.408 when applying to issue Subordinated Debt Notes with maturities longer than 20 years. To demonstrate the issuance is debt, the proposal included a new paragraph in § 702.408(b) that requires a credit union applying to issue Subordinated Debt Notes with maturities longer than 20 years to submit, at the discretion of the Appropriate Supervision Office, one or more of the following:

- A written legal opinion from Qualified Counsel.
- A written opinion from a licensed CPA.
- An analysis conducted by the credit union or independent third party.

In the proposal the Board articulated that the amount and type of information required to satisfy this requirement would be at the discretion of the Appropriate Supervision Office, but this determination would be based on the overall structure of the issuance, including the fixed stated maturity and any other information requested by the Appropriate Supervision Office.[20] The Board reiterates that the overall structure of the issuance *and* the proposed maturity of the Subordinated Debt Notes will dictate what information is sufficient to demonstrate that the proposed issuance would be considered debt and not equity. Therefore, in many cases an analysis

[19] John Kelley Co. v. Comm'r, 326 U.S. 521, 530 (1946).
[20] 87 FR 60326, 60329 (Oct. 5, 2022).

by the credit union may not be sufficient to satisfy the requirements of the rule. As such, the proposal and this final rule are designed to guard against the assertions made by the commenters.

Further, in response to these two comments, the Board reiterates that FCUs only have the statutory authority to issue debt. As such, the current rule contains, in addition to the maturity restriction, several provisions designed to ensure issuances are debt and not equity. For example, the current rule requires that a Subordinated Debt Note must:

- Be in the form of a written, unconditional promise to pay on a specified date a sum certain in money in return for adequate consideration in money.
- Be properly characterized as debt in accordance with U.S. GAAP.
- Not provide the holder thereof with any management or voting rights in the Issuing Credit Union.[21]

In addition, each application to issue Subordinated Debt must go through a thorough vetting process by the Appropriate Supervision Office, and, if warranted, the Office of General Counsel.

Finally, the Board notes that the cases cited by the commenters present different circumstances than are created under the current rule. For example, one commenter cited United States v. Snyder Brothers Company for the proposition that "20-year debentures that were subordinated to all other indebtedness of the issuer and where there was no limitation as to payment of dividends or provision for any sinking fund or reserve did not constitute

[21] 12 CFR §§702.404(a)(1), (4), and (b)(4).

'indebtedness,' despite the intention of the issuer." The Board points out, however, that unlike the notes in the Snyder Brothers case, credit unions are required to repay the note at maturity and interest payments when due, unless the credit union is subject to certain restrictions under the NCUA's Prompt Corrective rules.[22] This is in stark contrast to the following discussion in the Snyder Brothers case:

> Recognizing, as we must, that there is nothing to guarantee to the debenture holders that they can collect the face amount of the debentures, or even collect a past-due payment, without forcing the company into liquidation in the sense that it will be required to raise sufficient cash to pay off all its existing creditors including the debenture holders, and recognizing the well-known economic fact stated so succinctly by appellee's counsel in their brief that even all ordinary creditors, who have a right to share pari passu, rarely get the face amount of their claims, we think it is plain that upon the admitted facts of this record the documents denominated "subordinated debentures" do not create the kind of "indebtedness" which Congress had in contemplation in enacting Section 163.[23]

Further, it should be noted that, in the Snyder Brothers case the holders of the debentures were the sole shareholders of the corporation who received the debentures when they transferred the assets of the partnership to that corporation, which they had created. While the Board appreciates the discussion in the Snyder Brothers case, the debentures and circumstances of that case are quite different from the Subordinated Debt Notes issued by credit unions and the

[22] 12 CFR part 702, Subparts A and B.
[23] *United States v. Snyder Brothers Company*, 367 F.2d 980, 985 (5th Cir. 1966).

circumstances under which they are offered.

For the reasons set out above, the Board disagrees with the commenters' assertions that the proposed change would allow FCUs to operate outside of their statutory authority.

C. Comments outside the scope of the proposed rule

As noted earlier in this document, 17 commenters supported the proposed changes but offered comments on other aspects of the rule. As these comments are outside the scope of this rulemaking, the Board is not addressing them here. Rather, the Board will retain these comments for use in any future proposals to amend the current rule.

III. Final rule

For the reasons articulated in this document and in the proposed rule, the Board is finalizing the proposed amendments without change.

IV. Regulatory procedures

A. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) applies to rulemakings in which an agency creates new or amends existing information collection requirements.[24] For purposes of the PRA, an information collection requirement may take the form of a reporting, recordkeeping, or a third-party disclosure requirement. The NCUA may not conduct or sponsor, and the respondent is not required to respond to an information collection, unless it displays a valid Office of

[24] 44 U.S.C. 3507(d); 5 CFR part 1320.

Management and Budget (OMB) control number. The current information collection requirements for Subordinated Debt are approved under OMB control number 3133–0207.

This rule removes the maximum maturity of Subordinated Debt Notes of 20 years and replaces it with a requirement that a credit union seeking to issue Subordinated Debt Notes with maturities longer than 20 years provide additional information as part of its application prescribed under new § 702.408(b)(15). This reporting requirement is estimated to impact two credit unions applying to issue Subordinated Debt for an additional 20 hours per response, an increase of 40 burden hours annually. The following shows the total PRA estimate for the entire Subordinated Debt rule, inclusive of the additions referenced in the preceding sentence:

OMB Control Number: 3133–0207.

Title of information collection: Subordinated Debt, 12 CFR Part 702, Subpart D.

Estimated number respondents: 3,300.

Estimated number of responses per respondent: 1.12.

Estimated total annual responses: 3,705.

Estimated total annual burden hours per response: 1.54.

Estimated total annual burden hours: 5,702.

The NCUA did not receive any comments on the proposed PRA burden estimate. In accordance with the PRA, the information collection requirements included in this final rule have been submitted to OMB for approval under control number 3133-0207.

B. Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. The NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the Executive Order to adhere to fundamental federalism principles.

This final rule will not have a substantial, direct effects on the states, on the relationship between the National Government and the states, or on the distribution of power and responsibilities among the various levels of government. The final rule affects only a small number of state-chartered LICUs with approved secondary capital applications for issuances to the U.S. Government or its subdivisions. This final rule extends the Regulatory Capital treatment for Grandfathered Secondary Capital, eliminates the maximum maturity for Subordinated Debt, and makes two minor clarifying changes. The final rule does not impose any new significant burden on credit unions and may ease some existing requirements. The NCUA has therefore determined that this final rule does not constitute a policy that has federalism implications for purposes of the Executive Order.

C. Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this final rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

D. Regulatory Flexibility Act

The Regulatory Flexibility Act[25] requires the NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small entities (defined as credit unions with under $100 million in assets).[26] This final rule extends the Regulatory Capital treatment for Grandfathered Secondary Capital eliminates the maximum maturity for Subordinated Debt, and makes several minor clarifying changes. As such, this final rule would not impose any new significant burden on credit unions and may ease some existing requirements. In addition, based on the NCUA's PRA estimates (shown elsewhere in this document), the NCUA estimates that any additional burden will only effect two credit unions per year. Accordingly, the NCUA certifies that this final rule would not have a significant impact on a substantial number of small credit unions.

E. Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104-121) (SBREFA) generally provides for congressional review of agency rules.[27] A reporting requirement is triggered in instances where the NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act (APA).[28] The NCUA does not believe this rule is a "major rule" within the meaning of the relevant sections of SBREFA. As required by SBREFA, the NCUA will submit this final rule to the Office of Management and Budget for it to determine if the final rule is a "major rule" for purposes of SBREFA. The NCUA also will file all appropriate Congressional reports.

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[25] 5 U.S.C. 601 *et seq.*
[26] Id. at 603(a); NCUA Interpretive Ruling and Policy Statement 15-2.
[27] Id. 801–804.
[28] Id. 551.

List of Subjects

12 CFR Part 702

Credit unions, reporting and recordkeeping requirements.

By the NCUA Board on March 16, 2023.

Melane Conyers-Ausbrooks
Secretary of the Board.

For the reasons discussed in the preamble, the NCUA Board is amending 12 CFR part 702, as follows:

PART 702—CAPITAL ADEQUACY

1. The authority citation for part 702 continues to read as follows:

Authority: 12 U.S.C. 1757(9), 1766(a), 1784(a), 1786(e), 1790d.

2. Revise § 702.401(b) to read as follows:

§ 702.401 Purpose and scope.

(a) * * *

(b) *Grandfathered Secondary Capital*. Any secondary capital defined as "Grandfathered Secondary Capital" under § 702.402 of this part, is governed by § 702.414 of this part. Grandfathered Secondary Capital will no longer be treated as Regulatory Capital as of the later of 30 years from the date of issuance or January 1, 2052.

3. In § 702.402, revise the definitions for "Qualified Counsel" and "Regulatory Capital" to read as follows:

§ 702.402 Definitions.

* * * * *

Qualified Counsel means an attorney licensed to practice law who has expertise in the areas of Federal and state securities laws and debt transactions similar to those described in this subpart.

Regulatory Capital means:

(1) With respect to an Issuing Credit Union that is a LICU and not a complex credit union, the aggregate outstanding principal amount of Subordinated Debt and, until the later of 30 years from the date of issuance or January 1, 2052, Grandfathered Secondary Capital that is included in the credit union's net worth ratio;

(2) With respect to an Issuing Credit Union that is a complex credit union and not a LICU, the aggregate outstanding principal amount of Subordinated Debt that is included in the credit union's RBC Ratio, if applicable;

(3) With respect to an Issuing Credit Union that is both a LICU and a complex credit union, the aggregate outstanding principal amount of Subordinated Debt and, until the later of 30 years from the date of issuance or January 1, 2052, Grandfathered Secondary Capital that is included in its net worth ratio and in its RBC Ratio, if applicable; and

(4) With respect to a new credit union, the aggregate outstanding principal amount of Subordinated Debt and, until the later of 30 years from the date of issuance or January 1, 2052, Grandfathered Secondary Capital that is considered pursuant to § 702.207.

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4. In § 702.404, revise the section heading and paragraph (a)(2) to read as follows:

§ 702.404 Requirements of the Subordinated Debt Note.

(a) * * *

(1) * * *

(2) Have, at the time of issuance, a fixed stated maturity of at least five years. The stated maturity of the Subordinated Debt Note may not reset and may not contain an option to extend the maturity. A credit union seeking to issue Subordinated Debt Notes with maturities longer than 20 years from the date of issuance must provide the information required in § 702.408(b)(14) as part of its application for preapproval to issue Subordinated Debt;

* * * * *

5. In § 702.408:

a. Revise paragraph (b)(7);

b. Redesignate paragraphs (b)(14) and (15) as paragraphs (b)(15) and (16);

c. Add new paragraph (b)(14); and

d. Revise paragraph (l)(1).

The revisions and addition read as follows:

§ 702.408 Preapproval to Issue Subordinated Debt.

(b) * * *

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(7) Pro Forma Financial Statements (balance sheet and income statement) and cash flow projections, including any off-balance sheet items, covering at least two years. Analytical support for key assumptions and key assumption changes must be included in the application. Key assumptions include, but are not limited to, interest rate, liquidity, and credit loss scenarios;

* * * * *

(14) In the case of a credit union applying to issue Subordinated Debt Notes with maturities longer than 20 years, an analysis demonstrating that the proposed Subordinated Debt Notes would be properly characterized as debt in accordance with U.S. GAAP. The Appropriate Supervision Office may require that such analysis include one or more of the following:

(i) A written legal opinion from a Qualified Counsel;

(ii) A written opinion from a licensed CPA; and

(iii) An analysis conducted by the credit union or independent third party;

* * * * *

(l) ***Filing requirements.***

(1) Except as otherwise provided in this section, all initial applications, Offering Documents, amendments, notices, or other documents must be filed electronically with the Appropriate Supervision Office. Documents may be signed electronically using the signature provision in 17 CFR 230.402 (Rule 402 under the Securities Act of 1933, as amended).

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6. In § 702.409, revise paragraph (b)(2) to read as follows:

* * * * *

(b) * * *

(2) Pro Forma Financial Statements (balance sheet and income statement) and cash flow projections, including any off-balance sheet items, covering at least two years. Analytical support for key assumptions and key assumption changes must be included in the application. Key assumptions include, but are not limited to, interest rate, liquidity, and credit loss scenarios.

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§ 702.414 [Amended]

7. In § 702.414(c) introductory text, remove the phrase "("discounted secondary capital" re-categorized as Subordinated Debt)".