Federal Issue Brief

2014

Supplemental Capital

Effect

Credit unions stand out as the only depository institutions in the U.S. without the ability to issue some form of capital instrument to augment retained earnings to build capital. All other U.S. depository institutions and most credit unions in other countries are permitted various forms of supplemental capital. Given the recent declines in capital ratios and net income, the case to amend the Federal Credit Union Act to provide access to additional capital for credit unions has never been more pressing. Legislation could provide the NCUA with the same authority and flexibility to adjust capital requirements in response to changes in economic conditions as Congress has provided to federal banking regulators.

Under appropriate rules and guidelines that preserve the cooperative ownership and governance of credit unions, access to supplemental capital would be good for credit unions, their members, and the economy. Given the importance of adequate capital to the nation's federal deposit insurance systems, extending authority to credit union regulators to permit access to supplemental capital would also provide additional protection to the U.S. taxpayer.

Background

The recent financial crisis led to a substantial drop in the average credit union capital ratio – from 11.4% at the end of 2007 to 10.1% as of the end of 2010. . At the beginning of the downturn, 90% of credit unions had net worth ratios of 9% or greater. At the end of 2010, only about 75% of credit unions had this level of capital.

While the credit union movement as a whole remains very well capitalized, a number of credit unions are close to or past the prompt corrective action (PCA) triggers as a result of the financial crisis. These credit unions will need to raise capital at a time when the outlook for credit union net income – the source of retained earnings – is not particularly strong.

A credit union's only source of capital is the retention of earnings, and maintaining a given capital ratio can only be accompanied by asset growth if there is sufficient net income, and increasing a net worth ratio requires even higher levels of net income or slower growth rates. This would not be the case if retained earnings could be augmented to some degree by supplemental capital, which would increase a credit union's capital ratio as soon as it is issued.

Status

While there are a variety of alternative capital options in the marketplace, not all of the forms available to other depository institutions will be appropriate because of credit unions' unique cooperative structure. The MCUL and CUNA believe supplemental capital would need to be created so that it in no way harms the unique credit union structure.

Legislation (H.R. 719, the Capital Access for Small Businesses and Jobs Act) was introduced this session by Representative Peter King (D-NY) to allow credit unions access to supplemental forms of capital. The legislation would do the following:

- Rectify a flaw in a 1998 law that is discouraging manageable asset growth by financially healthy credit unions.
- Ensure credit unions can continue to accept new deposit shares--even during tough economic times when demand for loans and other income-generating services are low.
- Allow credits unions to help keep private sector credit flowing at affordable rates even in recessionary times.

The NCUA would be authorized to set maturity limits and other conditions and parameters on this capital. From Michigan, Representatives Candice Miller, Kerry Bentivolio, and Dan Benishek are currently co-sponsoring the legislation. The legislation was introduced in the House in February of 2013.