Credit Union Issuance of Subordinated Debt for the Purpose of Enhancing Regulatory Capital per IC 28-7-1-19 Policy

Statute - Indiana Code 28-7-1-19 states that if a federal credit union is authorized by the federal regulatory authority with jurisdiction or by federal law to use one (1) or more forms of secondary capital, the department may by rule, order, or declaratory ruling allow a credit union to use one (1) or more forms of secondary capital. The rule, order, or declaratory ruling must include disclosure requirements concerning the conditions for return of the secondary capital and the liquidation priority of the secondary capital.

DFI Members Resolution 0211-2021 adopted this Credit Union Issuance of Subordinated Debt for the Purpose of Enhancing Regulatory Capital per IC 28-7-1-19 Policy (“Policy”), which grants, as detailed herein, credit unions the ability to petition the Indiana Department of Financial Institutions (“Department”) to issue subordinated debt to serve as secondary capital (“Subordinated Debt”), if federal regulatory authority, or federal law, provides the credit union the authority to issue Subordinated Debt, as outlined in 12 CFR 702 and the December 17, 2020 NCUA Subordinated Debt Rule. Credit Unions may submit a petition to the Department to request approval to issue Subordinated Debt as detailed herein.

Staff Considerations
Upon receiving the credit union’s petition for issuance of Subordinated Debt (“Petition”), Department staff shall assess the unique circumstances attributable to each credit union and each Subordinated Debt request. In determining whether to recommend approval to the Members Board, Department staff shall consider the following:

- compliance with all pertinent NCUA rules and regulations related to subordinated debt, including 12 CFR 701, 702, 709, and 741 and the 2020 Subordinated Debt Rule;
- purpose of the proposed subordinated debt issuance and the relevance to the mission of the credit union; including conformance with the credit union’s strategic plan, business plan, and budget;
- determination that the credit union is not issuing debt to facilitate the purchase of financial assets or fixed premises and recognition that secondary capital from Subordinated Debt will not be considered in determining capital adequacy for any subsequent purchase of financial assets or fixed premises during the term of the Subordinated Debt;
- the credit union’s formal capital plan, as required by NCUA 741.204;
- terms of the Subordinated Debt and the ability of the Subordinated Debt to be included as loss absorbing regulatory capital;
- credit union management’s strategy to deploy the proposed Subordinated Debt;
- the credit union’s risk management system and management capabilities to effectively administer and manage the proposed strategic initiatives;
- financial impact on the credit union and the repayment ability of the credit union from issuing debt;
• cost/benefit analysis focusing on the impact to credit union membership because of issuing Subordinated Debt; and,
• any pertinent safety and soundness issues that may arise from the Subordinated Debt issuance/plan and any pertinent supervisory concerns with the credit union at the time of petition.

Documentation Required
In order for Department staff and the Members to appropriately consider the factors above, the credit union shall submit with its Petition all of the items it provides to the NCUA to satisfy the requirements outlined in NCUA rules and regulations. Additionally, if not included with the NCUA submission, the credit union shall submit to the Department the below requested items with the Petition, recognizing that in some cases these requests go above and beyond NCUA requirements for review. The credit union shall submit the following:

• a five-year strategic plan, that must be updated annually, with a specific focus on the purpose of the Subordinated Debt, how the proceeds will be deployed over the plan period, and how the debt will be repaid. If a credit union is predicting to expand products, markets, or services over the plan period these activities shall be highlighted in the plan;
• pro-forma financial statements covering the five-year strategic plan, with pro-forma scenarios including Subordinated Debt inclusion and a pro-forma considering no Subordinated Debt is obtained. Pro-forma financials shall include a variety of different economic scenarios and contingency plans for debt repayment;
• a detailed contingency repayment plan. The contingency repayment plan should focus on the ability to satisfy debt requirements in a period of institution financial stress, including additional net worth and liquidity sources. Plans should include triggers for when growth may need to be curtailed or assets reduced to alleviate capital stress;
• if the low-income status of the credit union is the vehicle used to allow Subordinated Debt issuance by the federal insurer, the credit union shall submit to the Department a description of how the use of Subordinated Debt will substantially benefit the low-income membership in which the credit union serves;
• the formal terms of the proposed Subordinated Debt, including a cost-benefit analysis of the required debt payments in relation to member economic benefit;
• any vendor relationships resulting from the Subordinated Debt issuance, including vendor contracts, vendor due diligence, any financial or conflicts of interest inherent in the vendor relationship, and any future obligations of the credit union to conduct business with the vendor as a result of the subordinated debt issuance;
• a formal capital policy and formal capital plan, including capital stress scenarios;
• formal liquidity and funds management policies, including parameters to hold sufficient liquidity to support debt repayment. This policy shall be accompanied by base case and stress scenarios of the liquidity position during proposed Subordinated Debt repayment periods;
• a formal plan, and monitoring process, to remain below the maximum borrowing authority outlined in 12 CFR 741.2;
• a description of how the credit union satisfies the requirements outlined in NCUA regulation 701.34 and 741.204 for issuing Subordinated Debt;
• evidence of its compliance with State security laws as a factor of issuing the proposed Subordinated Debt;
• a proposed disclosure statement to be issued to membership regarding the issuance of Subordinated Debt, which includes language that acknowledges in the event of liquidation of the credit union, the debt is subordinate to all other claims against the credit union, including shareholders, creditors, and the NCUSIF; and
• any other documentation the Department believes necessary to analyze the request and help renders its decision.

Acknowledgements & Parameters

All Subordinated Debt approved by the Members shall be subject to the following provisions:

• Subordinated Debt shall not be issued for the purpose of purchasing financial assets or fixed premises;
• secondary capital from Subordinated Debt will not be considered in determining capital adequacy for any subsequent purchase of financial assets or fixed premises during the term of the Subordinated Debt;
• the amount of Subordinated Debt included in allowable regulatory capital shall decline by 20% each year during the last 5 years of the debt term, regardless of the repayment structure of the debt;
• a requirement that the 5-year strategic plan receives annual updates over the course of the subordinated debt term;
• the Department may restrict the repayment of the Subordinated Debt if the repayment would cause the credit union to fall below Well-Capitalized status, as defined in 702.102 and/or would jeopardize the safety and soundness of the institution as determined by the Department at the scheduled date of repayment. Additionally, the Department will restrict the repayment of the Subordinated Debt if the repayment would cause, or the credit union is already considered, undercapitalized as defined in 702.102; and,
• the credit union must request Director approval for repayment at least 90 days in advance of each payment due date.

Members Board Review

After review of all pertinent information, Department staff will provide the detail of its findings and recommendation to the Members. If the Members determine that the requirements of this Policy have been satisfied and approving the Petition will not reasonably negatively affect the safety and soundness of the credit union, they may approve the Petition.
Post Approval

If the Members approve the Petition, the credit union shall then (1) disclose to the Director the final terms of the proposed debt issuance and the repayment plan at least 60 days prior to issuance; and, (2) notify the Director within 30 days of issuing the Subordinated Debt and provide the Department with financial statements displaying the debt recognized on the balance sheet.

Approval to issue Subordinated Debt expires one-year after approval is granted.

The Members of the Indiana Department of Financial Institutions formally adopted this policy at its public meeting on February 11, 2021. This policy is effective as of February 11, 2021.

On behalf of the Members of the Indiana Department of Financial Institutions

[Signature]
Richard J. Rice, Chairman

Attest:

Nicole Buskill
Nicole R. Buskill, Secretary