CREDIT UNION ASSOCIATION OF THE DAKOTAS

November 20, 2017

Gerald Poliquin,
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314–3428

RE: NCUA Regulatory Reform Agenda

Dear Mr. Poliquin,

The Credit Union Association of the Dakotas (CUAD) represents 66 state and federally chartered credit unions in the states of North Dakota and South Dakota, whose assets total over $6 billion and who have more than 450,000 members. CUAD appreciates the opportunity to provide comment to the National Credit Union Administration (NCUA) regarding the Regulatory Reform Agenda.

First, CUAD wants to sincerely thank the NCUA for establishing a Regulatory Reform Task Force (Task Force) earlier this year and charging them with the daunting review of the NCUA's rules and regulations to identify areas where regulatory burden could be alleviated. While the NCUA was not subject to President Trump's Executive Order 13777, we appreciate the NCUA's willingness to voluntarily take steps to comply with the spirit of the Order. CUAD supports the Task Force's four-year agenda for reviewing and revising NCUA's regulations and its recommendations that, "propose greater and more significant regulatory relief amendments than have been embraced in the past." *82 FR 39703* CUAD also supports the temporary suspension until the year 2020 of the annual one-third review of NCUA's regulations as the Task Force is reviewing all NCUA regulations with this project.

In general, CUAD supports the direction and recommendations the Task Force makes for each area and looks forward to future opportunities to provide additional feedback as specific proposed rule amendments are issued for comment. However, as this review period is aimed at reducing regulatory burden, CUAD is concerned the direction that a "comprehensive third-party due diligence regulation" *82 FR 39708* could take. CUAD urges the Task Force and NCUA to focus on clarifying and condensing existing third-party due diligence requirements rather than adding overly burdensome requirements, as that is sometimes the result during regulatory rulemaking when a proposed outcome is "comprehensive."

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Associated Borrower.

With regard to specific areas of the Regulatory Reform Agenda, CUAD supports the proposed agenda item to bring clarification to single borrower and group of associated borrower limits, specifically as it relates to commercial and member business lending. While the tone of the agenda items seem to be combining the definitions into one provision, additional guidance and/or clarification as to the application of "associated borrower" for the context of commercial lending is needed.

Appraisals.

Agenda item 13, under Tier 1, would address appraisals, and more specifically raising the appraisal thresholds. Our credit unions need parity with the appraisal thresholds that banks operate under to stay competitive. As noted by the Regulatory Reform Agenda, "an interagency task force is now drafting a proposed rule to relieve certain appraisal burdens. In particular, the proposal would increase the appraisal threshold from $250,000 to $400,000 for 'commercial real estate loans' where repayment is dependent primarily on the sale of real estate or rental income derived from the real estate." *82 FR 39706*

One of the top issues of our credit unions is the inconsistency for appraisal requirements for business loans. This issue has been repeatedly brought to the attention of the NCUA in prior comment letters and meetings, and this inconsistency has existed for many years without resolution.

In 2010, the Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Office of Thrift Supervision, Treasury; and NCUA, issued their "final Interagency Appraisal and Evaluation Guidelines (2010 Guidelines) to provide further clarification of the Agencies' appraisal regulations and supervisory guidance to institutions and examiners about prudent appraisal and evaluation programs." *75 FR 77450* Section XI. Transactions that Require Evaluations, provides in relevant part, "The Agencies' appraisal regulations permit an institution to obtain an appropriate evaluation of real property collateral in lieu of an appraisal for transactions that qualify for certain exemptions. These exemptions include a transaction that…Is a business loan with a transaction value equal to or less than the business loan threshold of $1 million, and is not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment." *75 FR 77460* However, Footnote 42 provides, "NCUA regulations do not contain an exemption from the appraisal requirements specific to member business loans." *75 FR 77460*

NCUA rules and regulations currently provide under 12 CFR 722.3(a)(9), "Appraisals required. An appraisal performed by a State certified or licensed appraiser is required for all real estate-related financial transactions except those in which: (9) The regional director has granted a waiver from the appraisal requirement for a category of loans meeting the definition of a member business loan." Whereas, the Federal Deposit Insurance Corporation's regulation on the subject at 12 CFR §323.3(a)(5) provides, "(a) Appraisals required. An appraisal performed by a State certified or licensed appraiser is required for all real estate-related financial transactions except those in which:

(5) The transaction is a business loan that: (i) Has a transaction value of $1 million or less; and (ii) Is not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment."

In 1997, the NCUA issued a notice of proposed rulemaking which involved proposed amendments to Member Business Loans and Appraisals. In the discussion of the 1997 proposed rulemaking, the NCUA noted that, "[a] number of credit unions have suggested that a credit union should be able to obtain a waiver from the appraisal requirement for member business loans. They argue that, since the appraisal requirement for business loans is significantly lower for credit unions (threshold is $50,000) than for banks (threshold is $250,000) that credit unions are at a severe competitive disadvantage in making business loans to people of modest means. Furthermore, they suggest that in some instances an appraisal is practically meaningless. One example they have provided is the requirement for an appraisal on a business loan to construct a church. Another example where an appraisal may be unnecessary is where the loan-to-value ratio is extremely low due to property ownership interests such as borrowing a small amount to improve property that is already completely owned by the member. The NCUA Board continues to believe that, for credit unions engaging in business lending that involves real estate, their greatest single risk protection is a licensed or certified appraisal to support the loan-to-value ratio. However, the Board is willing to provide for a waiver from the appraisal requirement because there may be a small number of loans that credit unions may grant where the appraisal requirement is an unnecessary burden. The church loan scenario is a good example of where an appraisal may not be necessary." *62 FR 41316*

In 1998 the NCUA issued an interim final rule which amended 12 CFR 722.3(a) and added subsection (9) referenced above which is the provision credit unions currently operate under. The brief discussion concerning this amendment provided, "Certain loans as specified in Section 722.3(a) do not require an appraisal. In addition, the NCUA Board proposes a waiver process from the appraisal requirement where the appraisal requirement is an unnecessary burden. Eight commenters supported the waiver appraisal provision, although there was some confusion on whether it applied to a loan program or individual loans. The intent of the proposal was to apply to a loan program. The final rule reflects that the waiver applies to a loan program. Three commenters objected to having a waiver process. The NCUA Board does not believe that a waiver process will have a negative effect on the safety and soundness of credit unions." *63 FR 51798*

In 2003, the NCUA issued Letter to Credit Unions 03-CU-17 which included as an enclosure the October 27, 1994, Interagency Appraisal and Evaluation Guidelines (1994 Guidelines). The 1994 Guidelines only included the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Reserve Board, and Office of Thrift Supervision. The NCUA was not part of this interagency guidance. However, in the Letter to Credit Unions 03-CU-17, NCUA Chairman Dennis Dollar discusses the Joint Statement – Independent Appraisal and Evaluation Functions which also enclosed with Letter 03-CU-17. In his letter, Chairman Dollar noted, "The statement references the Interagency Appraisal and Evaluation Guidelines (Guidelines) which were implemented several years ago by the other agencies. Although NCUA was not a party to those Guidelines at that time, most of the content provides pertinent and valuable guidance for credit unions 1." Footnote 1 provides, "The interagency Guidelines indicate, under the section "Transactions That Require Evaluations," that a business loan of $1,000,000 or less could have an appropriate evaluation rather than appraisal. In contrast, §722.4(b)(2) of the NCUA Rules and

Regulations requires nonresidential transactions of more than $250,000 to have an appraisal prepared by a state-certified appraiser."

Based on the 1994 Guidelines, it is clear that the provision for business loans of $1 million or less to obtain an evaluation in place of an appraisal existed at the time NCUA was contemplating its 1997 proposed rulemaking and its 1998 interim final rule. Unfortunately, CUAD was unable to find discussion surrounding the NCUA rulemaking that explained why a waiver process was requested and adopted as opposed to the exemption threshold in the 1994 Guidelines that was being allowed for by other regulatory agencies.

NCUA's Commercial Lending/Member Business Loans final rule went into effective January 1, of this year. Among other changes, this final rule eliminated the current Member Business Loan waiver process which the NCUA found was unnecessary under the principles-based rule that was adopted. *81 FR 13530* In its discussion of the final rule, the NCUA referenced its proposal and noted, "The proposal also would eliminate the current MBL waiver process, which in some cases had hampered credit unions' ability to meet the commercial credit needs of their members. The current waiver process requires significant time and resources from both credit unions and NCUA, and has at times prevented credit unions from timely acting on borrowers' applications." *81 FR 13531*

NCUA must remove the clunky waiver process under 12 CFR 722.3(a)(9) and in its place include an exemption for commercial and business loans that provides parity with others in the financial industry, where exemptions have been in place for a significant period of time. If the NCUA can provide flexibility and parity on appraisals in a shorter period of time than joining the interagency process, then CUAD would support that pursuant provided credit unions will be given at least the same level of flexibility and reduced regulatory burden as others in the financial industry on this issue.

Payday Alternative Loan (PAL) program.

CUAD notes that the Regulatory Reform Agenda does not appear the arbitrary waiting period for new members to obtain a PAL pursuant to 12 CFR 701.21(c)(7)(iii) (previously referred to as "short-term, small amount loans" (STS loans)). To be a viable option for consumers in our communities and to remain competitive with other financial institutions, the PAL program needs be improved to remove the regulatory barriers that exist. Specifically, the requirement that an individual be a member for at least one month prior to being able to obtain a PAL. Consumers that are in need of a quick liquidity loan may not be able to obtain a PAL from a credit union unless they were an existing member, however, this is not the case for other financial institutions. Depending on the circumstances of the consumer's needs, waiting a month may not be an option, therefore, the consumer may have to turn to a predatory payday or title loan product.

In 2010, the NCUA finalized amendments to its lending rules under section 12 CFR 701.21, to "enable Federal credit unions (FCUs) to offer short-term, small amount loans (STS loans) as a viable alternative to predatory payday loans." *75 FR 58285*. The STS loan program allows a Federal credit union (FCU) to charge an interest rate of 1000 basis points above the maximum interest rate as established by the NCUA provided the loan meets certain conditions. One of these

required conditions includes that, "(6) The Federal credit union sets a minimum length of membership requirement of at least one month." *12 CFR 701.21(c)(7)(iii)(A)(6).*

In its discussion of the 2010 final rule, the NCUA discussed its reasoning to requiring a minimum length of membership. "The Board wants to provide FCUs with as much flexibility as possible in developing an STS loan program, but it must consider the riskier nature of this type of loan and the safety and soundness of the FCUs offering them. The Board believes a minimum membership requirement of one month will build a meaningful relationship between the borrower and the FCU and help reduce the chance of a borrower defaulting on an STS loan. While the final rule imposes a minimum requirement of one month, individual FCUs should evaluate their risk tolerance and set a membership requirement accordingly." *75 FR 58288*

In 2014, the NCUA issued a final rule to amend the name of the STS loan program to "payday alternative loans" (PAL) as it is known now. Per the NCUA, "the Board believes that replacing that terminology with ''payday alternative loans'' or ''PAL loans'' more accurately reflects the nature and purpose of this loan product." *79 FR 59627* [Emphasis added.] If the intent of this product is to be an alternative to payday loans, then the minimum length of membership requirement needs to be removed as it is unnecessary and limits a credit union's opportunity to be a viable option for quick liquidity loans.

As noted in its 2010 final rule, the NCUA established the minimum length of membership requirement as a safety and soundness item, however, the credit union should be provided the flexibility in setting its own minimum membership requirement if the credit union deems it necessary. The PAL program requires a FCU to meet further criteria, in addition to the minimum length of membership, which are aimed at reducing risk to the credit union. The additional restrictions and requirements under the PAL program, beyond the minimum membership requirement, should be more than sufficient to reduce the risk.

The NCUA issued an Advance Notice of Proposed Rulemaking (ANPR) in 2012 at 77 FR 59346. The APPR was issued during the NCUA's review of its PAL program. Per the NCUA, "the Board intends to improve the regulation to encourage more federal credit unions (FCUs) to offer PAL loans and believes it may be necessary to amend the regulation." *77 FR 59364* The NCUA went on to write, "as part of the solution, the Board is determined to provide a regulatory framework for FCUs to make PAL loans a viable alternative to predatory payday loans. The Board intends the PAL loan rule to provide short term and long term benefits for current payday borrowers. In the short term, the rule provides borrowers with a responsible alternative to high-cost payday loans. In the long term, the rule permits FCUs to offer borrowers a way to break the cycle of reliance on payday loans by building creditworthiness and transitioning to traditional, mainstream financial products." *77 FR 59347, September 27, 2012.*

CUAD would argue that having a minimum membership requirement is not allowing credit unions to provide the above noted "short term benefit" for payday borrowers. Again, the NCUA wrote, "In the short term, the rule provides borrowers with a responsible alternative to high-cost payday loans." *Id.* Unless the borrower is an existing credit union member, since emergencies typically won't wait a month, the borrower may have to turn to other financing that may not be as beneficial to them as a credit union loan.

CUAD acknowledges that the Consumer Financial Protection Bureau (CFPB) recently issued their final rule regarding Payday, Vehicle Title and Certain High-Cost Installment Loans, to be found under 12 CFR 1041. New 12 CFR 1041(e) defines "alternative loans" that are conditionally exempt from section 1041.

Section 1041(e) provides, "Alternative loan means a covered loan that satisfies the following conditions and requirements:

> (1) *Loan term conditions.* An alternative loan must satisfy the following conditions: (i) The loan is not structured as open-end credit, as defined in § 1041.2(a)(16); (ii) The loan has a term of not less than one month and not more than six months; (iii) The principal of the loan is not less than $200 and not more than $1,000; (iv) The loan is repayable in two or more payments, all of which payments are substantially equal in amount and fall due in substantially equal intervals, and the loan amortizes completely during the term of the loan; and (v) The lender does not impose any charges other than the rate and application fees permissible for Federal credit unions under regulations issued by the National Credit Union Administration at 12 CFR 701.21(c)(7)(iii).
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> (2) *Borrowing history condition*. Prior to making an alternative loan under § 1041.3(e), the lender must determine from its records that the loan would not result in the consumer being indebted on more than three outstanding loans made under this section from the lender within a period of 180 days. The lender must also make no more than one alternative loan under
> § 1041.3(e) at a time to a consumer.
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> (3) *Income documentation condition*. In making an alternative loan under § 1041.3(e), the lender must maintain and comply with policies and procedures for documenting proof of recurring income.
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> (4) *Safe harbor.* Loans made by Federal credit unions in compliance with the conditions set forth by the National Credit Union Administration at 12 CFR 701.21(c)(7)(iii) for a Payday Alternative Loan are deemed to be in compliance with the requirements and conditions of paragraphs (e)(1), (e)(2), and (e)(3) of this section."

CUAD would note that minimum length of membership, or being a customer, is not included in the above conditional exemption for alternative loans under the CFPB's recent payday final rule. CUAD requests the NCUA consider this minor amendment to its rules.

Pre-sold construction loans.

CUAD requests the NCUA provide clarification, or if necessary, parity regarding financing for pre-sold homes as it relates to requirements for construction and development loans under 12 CFR 723.6.

A home/unit is pre-sold, meaning that a buyer has entered into a binding contract to purchase the home/unit and has made a substantial and nonrefundable earnest money deposit. The credit union would obtain sufficient documentation that the buyer has entered into a legally binding sales contract and has obtained a written pre-qualification or commitment for permanent financing. The disparity between credit union and bank is that under current interpretation of section 12 CFR 723.6(c)(3), the credit union member would be required to obtain a loan for the full amount to

complete the project, whereas, a bank customer may only be required to obtain a loan for a portion of cost to fully complete the project, knowing that – and having proof that - the home is guaranteed to be sold and the resulting sale to the home buyer will satisfy amounts due to certain suppliers, contractors, etc.

Section 723.6(c)(3) requires "a federally insured credit union that elects to make a construction and development loan must also assure its commercial loan policy meets the following conditions: (3) Release or disbursement of loan funds occurs only after on-site inspections, documented in a written report by qualified personnel representing the interests of the federally insured credit union, certifying that the work requisitioned for payment has been satisfactorily completed, and the remaining funds available to be disbursed from the construction and development loan is sufficient to complete the project." This issue occurs with the language, "remaining funds available to be disbursed from the construction and development loan is sufficient to complete the project."

12 CFR 324.2 of the FDIC rules and regulations, while relating to capital adequacy requirements, includes the FDIC definition for "pre-sold construction loans." Specifically, "*Pre-sold construction loan* means any one-to-four family residential construction loan to a builder that meets the requirements of section 618(a)(1) or (2) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 (Pub. L. 102-233, 105 Stat. 1761) and the following criteria: (1) The loan is made in accordance with prudent underwriting standards, meaning that the FDIC-supervised institution has obtained sufficient documentation that the buyer of the home has a legally binding written sales contract and has a firm written commitment for permanent financing of the home upon completion; (2) The purchaser is an individual(s) that intends to occupy the residence and is not a partnership, joint venture, trust, corporation, or any other entity (including an entity acting as a sole proprietorship) that is purchasing one or more of the residences for speculative purposes; (3) The purchaser has entered into a legally binding written sales contract for the residence; (4) The purchaser has not terminated the contract; (5) The purchaser has made a substantial earnest money deposit of no less than 3 percent of the sales price, which is subject to forfeiture if the purchaser terminates the sales contract; provided that, the earnest money deposit shall not be subject to forfeiture by reason of breach or termination of the sales contract on the part of the builder; (6) The earnest money deposit must be held in escrow by the FDIC-supervised institution or an independent party in a fiduciary capacity, and the escrow agreement must provide that in an event of default arising from the cancellation of the sales contract by the purchaser of the residence, the escrow funds shall be used to defray any cost incurred by the FDIC-supervised institution; (7) The builder must incur at least the first 10 percent of the direct costs of construction of the residence (that is, actual costs of the land, labor, and material) before any drawdown is made under the loan; (8) The loan may not exceed 80 percent of the sales price of the presold residence; and (9) The loan is not more than 90 days past due, or on nonaccrual."

CUAD requests that the NCUA include a provision to address these lower-risk construction loans for pre-sold homes so as to allow credit unions to be more competitive with banks in this market.

LTV definition.

12 CFR 723.3 defines Loan-to-Value (LTV) as, "with respect to any item of collateral, the aggregate amount of all sums borrowed and secured by that collateral, including outstanding balances plus any unfunded commitment or line of credit from another lender that is senior to the federally insured credit union's lien position, divided by the current collateral value. The current collateral value must be established by prudent and accepted commercial lending practices and comply with all regulatory requirements. For a construction and development loan, the collateral value is the lesser of cost to complete or prospective market value, as determined in accordance with §723.6 of this part."

CUAD requests that the NCUA establish that certain standby letters of credit are excluded from this definition. Specifically providing, "standby letters of credit secured by the property that are issued to governmental authorities to ensure the completion of certain improvements, the cost of which are to be funded by the loan, need not be included in the loan amount for the purpose of calculating the SLTV. When the cost of the improvements is to be funded from other sources, however, the standby letter of credit should be included." This definition comes from the Office of the Comptroller's Handbook - Commercial Real Estate Lending Version 1.1, January 27, 2017, page 11.

While the LTV ratio noted in the NCUA Examiner's Guide are guidelines, establishing that Standby Letters of Credit that meet the provisions above are not to be included in the LTV would allow credit unions to operate within the recommended guidelines while being competitive with other financial institutions.

Restoration to Accrual Status on Member Business Loan Workouts.

Appendix C to Part 741 discusses the interpretive ruling and policy statement on loan workouts, nonaccrual policy and regulatory reporting of troubled debt restructured loans. CUAD requests that the Task Force revisit the requirements for restoration to accrual status on Member Business Loan Workouts, specifically addressing the six consecutive payments. CUAD recommends that this instead be six consecutive months.

In relevant part, Appendix C to Part 741 provides, "A formally restructured member business loan workout need not be maintained in nonaccrual status, provided the restructuring and any charge-off taken on the loan are supported by a current, well documented credit evaluation of the borrower's financial condition and prospects for repayment under the revised terms. Otherwise, the restructured loan must remain in nonaccrual status. The evaluation must include consideration of the borrower's sustained historical repayment performance for a reasonable period prior to the date on which the loan is returned to accrual status. A sustained period of repayment performance would be a *minimum of six consecutive payments* and would involve timely payments under the restructured loan's terms of principal and interest in cash or cash equivalents. In returning the member business workout loan to accrual status, sustained historical repayment performance for a reasonable time prior to the restructuring may be taken into account. Such a restructuring must improve the collectability of the loan in accordance with a reasonable repayment schedule and

does not relieve the credit union from the responsibility to promptly charge off all identified losses." [Emphasis added.]

The October 24, 2013, Interagency Supervisory Guidance Addressing Certain Issues Related to Troubled Debt Restructuring, discusses the borrower's sustained historical repayment performance, specifically noting on page 3 of 8, "A sustained period of repayment performance generally would be a minimum of six months and would involve payments in the form of cash or cash equivalents." [Emphasis added.] Footnote 10 provides, "for federally insured credit unions, a demonstrated period of repayment performance is defined as six consecutive payments and is limited to Member Business Loan restructurings. For further information, see Appendix C to 12 CFR Part 741." CUAD fully supports limiting a specified period of repayment to Member Business Loan (MBL) restructuring and not expanding past that category of loan, however, the six consecutive payments versus six consecutive months creates issues for MBLs with repayment schedules that are not monthly, such as semi-annually or annually which can be found in agricultural purpose MBLs. CUAD recommends Appendix C to Part 741 be amended to "six consecutive months" for MBLs.

Requirements for Insurance.

As noted above, CUAD represents both federally chartered credit unions and state chartered credit unions. As the Task Force reviews and clarifies areas of the NCUA's regulations, CUAD asks that the Task Force and NCUA take the opportunity to reorganize its regulations to clearly categorize those regulations that relate to credit union chartering, and apply only to federally chartered credit unions, versus those that relate to requirements for insurance, and apply to federally insured credit unions, and apply to both federally and state chartered credit unions.

Conclusion.

Again, CUAD thanks the NCUA for establishing a Regulatory Reform Task Force and its willingness to voluntarily take steps to comply with the spirit of President Trump's Executive Order aimed at reducing regulatory burden.

Thank you for this opportunity to share our comments and concerns.

Respectfully,

Jeffrey Olson
CEO/President

Amy Kleinschmit
VP of Compliance