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Mary Rupp, Esquire
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Proposed Amendments to 12 CFR Parts 701 and 741 Pertaining to Loan Participations

Dear Ms. Rupp:

This is a comment letter to the proposed changes in the loan participation regulation. Loan participations are very important to credit unions as they generate liquidity, assist in the management of loan concentration issues, provide favorable returns for credit unions that do not have a significant lending demand, diversify lending risk by asset class and geographic concentration, and are a tool to manage the aggregate business lending cap. Credit unions understand loans. For credit unions seeking yield, there is a much higher likelihood that credit unions will understand the risks in buying loan participations more so than investment products. Loan participations move capital from cash rich credit unions to loan rich credit unions to enable the system to put credit union capital to work for members. Loan participation interests purchased by banks add liquidity from outside of the credit union system.

I have always viewed the loan participation rule as critical to the success of credit unions. The previous loan participation rule only permitted credit unions to enter into loan participations prior to the funding of a loan. In 1995 I lobbied Chairman D'Amours to change the loan participation rule to give credit unions the same power as banks and permit credit unions to buy loan participation interests in closed loans as well. The rule was changed in 1996 and loan participations have delivered on the benefits cited above.

I welcome the review of the loan participation regulation as it is in need of revision. When considering the benefits and risks of loan participations, I ask the Agency to focus on the larger picture and do not cripple the benefits of loan participations to the vast majority of credit unions to address the failures of a few.

1. ***Part 701.22 now applies to state chartered federally insured credit unions ("FISCUs") in addition to federally chartered credit unions ("FCUs"), collectively "FICUs".*** I do not have a comment on the proposition that would apply uniform rules to all FICUs. As a practical matter, all credit unions tend to follow Part 701.22 in order to have the widest possible number of potential loan participation buyers. There are state chartered credit unions that have investment authority to invest in loans and loan participations. For example, Georgia chartered credit unions may invest in loan participations on loans issued by a financial institution regardless of the percentage retained by the financial institution and regardless of whether the borrower is a credit union member. I ask that NCUA clarify that it is not attempting to pre-empt or otherwise curtail state credit union investment powers in loans through this proposed regulation.

2. ***The underwriting standards in purchasing a loan participation interest may not be less stringent than the underwriting standards in originating the same loan.*** I support this requirement.

3. ***The originating credit union must retain at least a ten percent interest in the loan throughout the life of the loan.*** The proposal requires the originator to hold on to 10% of the face value of the loan for the life of the loan; to have "skin in the game". I understand and do not quarrel with this requirement as a general principal. I understand that NCUA wants the originator to have an economic interest in the performance of the loan so that the originator is incented to originate performing loans. Some credit unions use the sale of loan participations to manage their aggregate business lending cap. If the retention requirement was (a) 5%, or (b) 10% for at least a five year period without a default, or (c) at least 1% with a contractual duty to share in 10% of any losses, credit unions would have more ability to manage the aggregate business lending cap. Even at 5% of the loan balance there is an economic incentive to underwrite good loans. Any flexibility on this retention requirement would be very helpful to credit unions and flexibility can be achieved without adversely affecting the underlying principal of enlightened self-interest.

4. ***A credit union may not buy loan participation interests from a single originator that in the aggregate exceeds 25% of the purchasing credit union's net worth. There is no ability to seek a waiver from this restriction.*** The proposal appears to be intended to act as a firebreak keeping the ills of one originator's loans from spreading to a small group of credit union participants. While this rule addresses one type of risk, the unintended adverse consequences created by this rule greatly exceed the benefit of the rule.

The undeniable fact is that good loan participations are built on good due diligence. It is equally undeniable that good due diligence starts with a foundation of a good relationship between the originating lender and the participants. Currently there are many participation relationships where credit unions regularly sell and buy from each other. In most of these relationships, the credit unions have done extensive due diligence on each other, know each other well, and have a high confidence level in the quality of the loan products they buy from each other. That is why many credit unions limit their loan participation partners. Some of these relationships are centered around a commonly owned CUSO where the CUSO provides uniform underwriting and servicing. For every story of a bad loan participation relationship, there are dozens upon dozens of good ones. The yield from good quality loans is shared among trusted partners and grows capital.

This proposal will disrupt those relationships. Credit unions will not stop searching for yield. Loan participation interests will always be a source of yield. Credit unions will search for other loan participation partners and they will be forced to deal with credit unions they do not know. If due diligence is done correctly this proposal will cause the cost of due diligence to rise significantly as new partners are vetted; and, if done incorrectly, shortcuts will be taken and lending risks will increase.

There are issues with the application of this rule to credit unions involved in lending CUSOs. There are mortgage and business lending CUSOs that close loans in the CUSO's name and sell the loans in whole or in part to credit unions. Their model is to aggregate the expertise to make the loans and then share loan yields among each other. The credit union owners have done extensive due diligence in setting up the CUSO lending model and the vast majority of these CUSOs have enabled credit unions to be effective and safe lenders. This proposal will cripple those operations. Many credit unions involved in lending CUSOs will be out of compliance on day one of the enactment of the proposal and for no good reason. It makes no sense that a CUSO could sell whole loans to a credit union as an eligible obligation without these concentration limitations but be limited on the number of loan participation interests the CUSO can sell to the same credit union. Other questions are raised as well. If a credit union buys loan participation interests both from a CUSO and a credit union owner, does that mean that the buying credit union has a 25% net worth limitation from the CUSO and another 25% net worth limitation from the credit union owner or is it combined?

The fact that a credit union buys loan participation interests from a small number of originators does not by itself pose a risk as long as the credit union has done proper due diligence on the quality of the loans and the originator's lending practices. A safe originator will be safe for all buyers and a poor originator will be risky for all buyers. Prior to implementing absolute restrictions on transactions, we recommend that NCUA issue guidance (not a regulation) that would require due diligence on the originators that includes an evaluation of the delinquency rates on the types of loans being offered for sale. If the delinquency rate exceeds industry averages, the buying credit union should not purchase more than a limit specified by NCUA for a particular credit union through the examination and supervision process.

If there is a limit on loan participation interest purchases, we recommend that additional latitude be given to buying credit unions that have demonstrated that the buying credit unions are well capitalized as defined by Prompt Corrective Action, Part 216 of the Federal Credit Union Act. Well capitalized credit unions have the capital to absorb risk and therefore the level of capital should be part of the risk evaluation prior to cutting off successful loan participation relationships.

I understand the concern of NCUA; however, I recommend a different approach to the problem - an approach that does not break-up loan participation relationships that have proven over time to be successful. The industry cannot mature and grow if our regulations do not respect credit unions that are well managed and opportunity is taken from them due to the sins of others. This regulatory approach forces credit unions to reconsider the value of the credit union charter and hinders the ability of credit unions to rebuild capital. There is no reason why any concentration provision is not subject to waiver for good cause shown.

5. ***A credit union may not buy loan participations interests in loans to a single borrower or group of associated borrowers where the aggregate amount exceeds 15% of the purchasing credit union's net worth. This provision can be waived.*** I do not object to this revision but note that commercial lenders analyze loans based on whether the cash flow for a particular loan is sufficient in amount and segregated from other cash flows of the borrower and associated borrowers. I hope that this would be a factor in a waiver application.

6. ***Clarification of comments regarding pools of loans.*** The proposed Section 701.22 states that the loan participations do "not include the purchase of an investment interest in a pool of loans." In the comments to Part 701.22(c), it states, "This provision clarifies the existing prohibition against an FCU purchasing a participation certificate in a pool of loans." As I understand it, loan participations are permitted if a group of loans is purchased as long as loan participation interests are conveyed for each loan and the loan participation interest is not a single interest in the aggregate group or pool. I recommend clarifying this as it will cause confusion.

7. ***Recommended new term: Regarding the ability of credit unions to sell loan participations in a loan purchased under the eligible obligation rule.*** I note that when a credit union buys an eligible obligation, the credit union can never sell a loan participation in that loan as the originator of the loan would not be a participant. There is liquidity risk in a credit union being locked into that position. I recommend that a credit that buys an eligible obligation be considered an originator for purposes of the 10% originator retention requirement. Clearly the selling credit union would have "skin in the game". I note that an originator does not retain "skin in the game" when it sells an eligible obligation to a credit union yet it is permissible for the credit union to buy the whole loan.

8. ***Recommended new term: Regarding the ability of a purchaser of a loan participation interest in buying a loan where the originator obtained a regulatory waiver.*** Another liquidity risk occurs when a credit union obtains a waiver, such as a waiver from the personal guarantee requirement. Currently, a credit union that buys a loan participation interest in such a loan must also obtain the same

waiver. That renders the loan participation interest unsalable from a practical standpoint. No buyer wants to go through the waiver process. I recommend that if the originator obtains a waiver for a loan, a credit union that buys a loan participation interest in that loan does not also have to obtain the same waiver.

9. ***Recommended new term: Regarding organizations eligible to buy a loan participation interest.*** Is there a safety and soundness reason to prohibit the sale of a participation interest to a non-financial institution such as an insurance company? If a credit union could sell to institutional investors, there would be an opportunity to bring in more liquidity from outside the credit union marketplace to serve members.

I thank you for the opportunity to comment on this important proposal.

Very truly yours,

Guy A. Messick