Evangelical Christian Credit Union
955 West Imperial Highway
P.O. Box 2400
Brea, CA 92822-2400
800.634.3228 714.671.5700
www.eccu.org

ECCU

February 2, 2012

Ms. Mary Rupp
Secretary to the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Re: Comments on NCUA Proposed Rulemaking for Parts 701 and 741
Loan Participations Proposal

Dear Ms. Rupp,

On behalf of the Evangelical Christian Credit Union (ECCU), we respectfully submit these comments to the proposed loan participation rules issued by the NCUA on December 22, 2011.

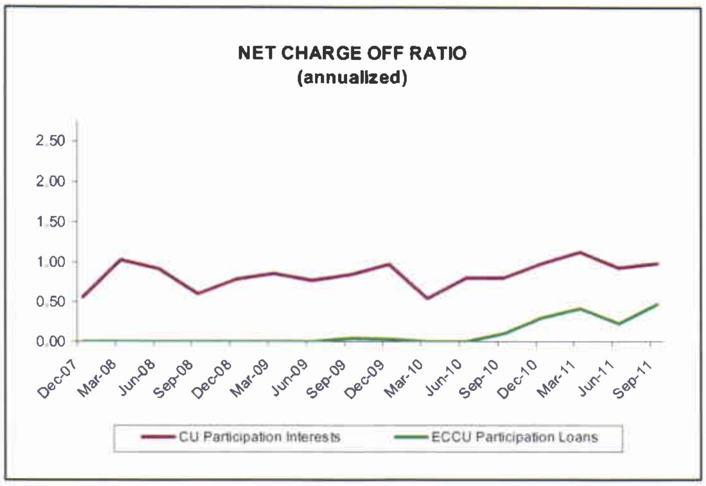
We believe that most of the proposal is appropriate in this economic climate. For example, the call to improve loan participation policies, agreements, underwriting, and monitoring is warranted. At the same time, we are concerned that certain aspects of the NCUA's proposal – such as the limit on loans purchased from a single originator – will have a devastating impact on ECCU, our members, and the credit union industry as a whole.

## ECCU'S LOAN PARTICIPATION PROGRAM

For the past 25 years, ECCU has been actively engaged in the credit union loan participation market by selling interests in member business loans made to churches, schools, and other non-profit organizations across the country. Today, we service $1.8 billion in loan participations originated by ECCU and sold to over 190 credit unions, credit union service organizations, banks, and other financial institutions.

ECCU's loan participation program has been a tremendous benefit to our members, allowing them to purchase property, build new facilities, renovate existing facilities, fund projects, and reduce interest costs. These activities have resulted in improved programs to serve over 600,000 church members, 30,000 students, and hundreds of local communities where these organizations are located.

Credit union purchasers have also benefited from our loan participation program through good yields and low losses. Of the 1,500 participation loans sold by ECCU over the past ten years, only 21 have resulted in charge offs. This success is reflected in net charge off ratios[1] for our loan participations portfolio that have been lower than the industry average:




Since 2008, we have seen positive changes in the participation industry overall. Just as ECCU has improved its underwriting standards, credit union participants have independently adopted stricter guidelines, requiring stronger credit qualifying ratios based on historically proven income. Almost all of our credit union participants have hired dedicated, in house resources to underwrite, review, and manage their participations portfolio. Our purchasers are also more actively involved in monitoring loan performance and our servicing activities, which has required ECCU to improve the delivery of information and recommendations to participants. In response to the realities of the current economy, credit union management and boards of directors have unilaterally improved risk management of loan participations without being compelled to do so by new regulation.

## STANDARDS FOR NEW REGULATION

Before providing our specific comments, we feel it is helpful to review the recently stated standards for issuance of new regulations. President Obama's Executive Orders 13563 (January 18, 2011) and 13579 (July 11, 2011) set a high bar for regulatory agencies issuing new regulations, including:

- Carefully analyzing the likely consequences of regulation, including consideration of its costs and benefits (both quantitative and qualitative);
- Promoting economic growth, innovation, competitiveness, and job creation;
- Using the best, most innovative, and least burdensome tools for achieving regulatory ends; and
- Seeking to improve the actual results of regulatory requirements.

[1] Net charge off figures for ECCU's sold loan participation interests are derived from charge offs taken by ECCU on the retained portion of participated loans.

The President summarized this directive succinctly in his State of the Union address on January 24, 2012: "I've ordered every federal agency to eliminate rules that don't make sense."

In the fall of 2011, NCUA Chairman Matz affirmed her support of these Executive Orders and launched the Regulatory Modernization Initiative which represents NCUA's "commitment to effective, not excessive, regulation."

We believe that certain aspects of the proposed loan participations regulation fail to achieve these standards. The regulation as proposed will suppress new loan originations and undermine the contribution of credit union members to economic growth and job creation, without effectively addressing the risks raised by the NCUA.

## PROPOSED RULE - BACKGROUND

***Benefits of Loan Participation***. The NCUA appropriately acknowledges that "involvement in loan participations strengthens the credit union industry." As stated in the background to the proposed rules, credit unions benefit from loan participations in a number of ways, including:

- Earnings. Increased earnings through ownership of quality earning assets, which help offset historically low loan-to-share ratios;
- Diversification. The ability to diversify across geographies, product types, and industries, which is especially important to smaller credit unions and those with a community or sponsor-specific charter;
- Low Cost Loan Origination. The ability to quickly acquire loans without the cost and burden of maintaining origination systems and channels;
- Liquidity. For originating credit unions, the ability to convert loan assets into liquid assets; and
- Serving Member Needs. Gaining an important tool which helps originating credit unions serve members with financing needs. Of the $12.8 billion in credit union participations, sixty-two percent (62%) funded small businesses and non-profit organizations which led to capital improvement projects, lower cost of borrowing, or other operational needs.

***Risks of Loan Participations***. Despite these benefits, the NCUA proposes new loan participation rules because of a concern about "systemic risk to the share insurance fund (NCUSIF) due to the resulting interconnection between participants." While the NCUA provides additional descriptive narrative for this risk, the NCUA does not provide any data to quantify this "systemic risk."

Seeking further clarification for this concern, we reviewed the November 7, 2011 letter from Chairman Matz to the Office of Management and Budget regarding the NCUA's implementation of Executive Order 13579, which states that the NCUA's Regulatory Modernization Initiative "will address a growing trend in the lending marketplace: Originators of risky loans are increasingly selling participation interests in those loans to a widespread group of credit unions."

The historical data available does not support the assertion that the loans originated and sold into the loan participations are "risky" nor that the sale of risky loans is "increasing."

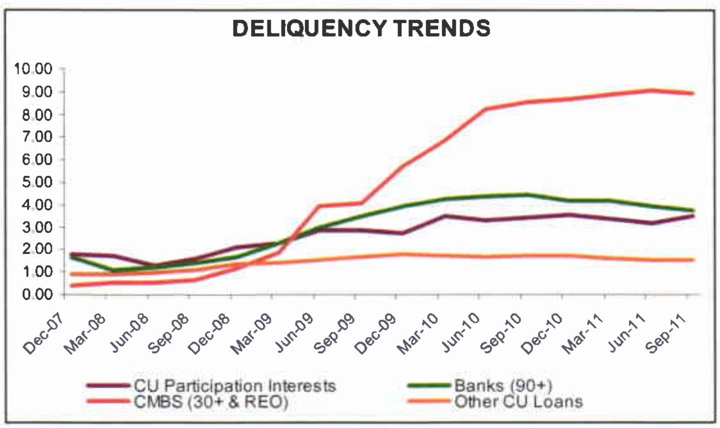
***Corrected Loan Participation Data.*** Before analyzing the data, it is important to note that there is material ambiguity in the 5300 Call Report instructions regarding loan participation delinquency and charge off data. The instructions state:

> ADDITIONAL DELINQUENCY INFORMATION
> 10b. Participation Loans. Report the total outstanding loan balance of all delinquent loan participations.
>
> ADDITIONAL LOAN LOSS INFORMATION
> 10. Participation Loans. Report the dollar amount of loans charged off year-to-date from loan participations on the left. Report the dollar amount of recoveries year-to-date from loan participations in the right column.

The instructions do not clarify whether these loan participations are those sold or purchased. In reviewing 5300 Call Report data, it appears that most credit unions report delinquency and charge off figures for loan participations purchased. However, at least five credit unions (including ECCU) report a higher loan participation delinquency than the total amount of loan participations purchased. ECCU has historically reported delinquency and charge offs for the on-book portion of loans which have been sold to others. We believe that the five credit unions referenced above have interpreted the 5300 Call Report instruction similarly, which would be natural given our context as a sellers of loan participations.

The result of this ambiguity in the 5300 Call Report instructions is that loan participation delinquency and charge offs are overstated. Correcting this issue for September 2011 lowers the industry-wide loan participation delinquency ratio by 13% and the net charge off ratio by 25%. The data and analysis referenced in the remainder of this letter reflect corrected industry-wide figures by removing loan participation delinquency and charge off data for the five credit unions referenced above.[2]

***Loan Participation Performance***. Historically, the delinquency ratio for all participation loan interests in the industry has been higher than other loans held by credit unions.[3] However, credit union loan participations have consistently performed as well or better than bank loans and CMBS.[4]

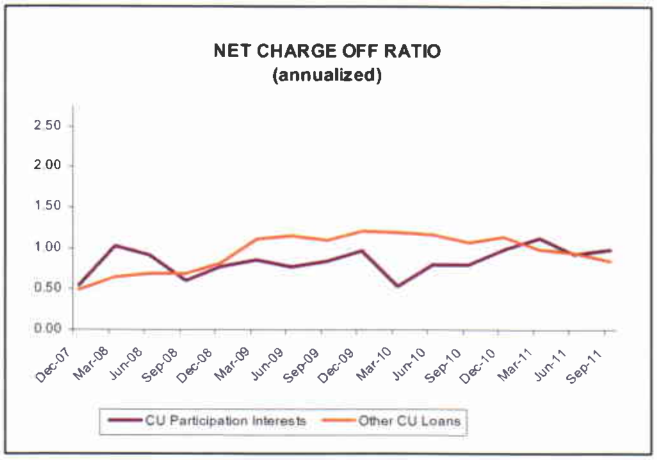



[2] The loans purchased by these five credit unions totaled $7,180,000 as of September 2011, or 0.056% of all participation interests in the industry. Any delinquency or charge offs related to these purchased participation interest would not have a material impact on the analysis presented in this letter.

[3] Credit Union data compiled from 5300 Call Report Aggregate Financial Performance Reports available from http://www.ncua.gov/DataApps/QCallRptData/Pages/FPRAggr.aspx and credit union data from Highline Financial. References to 2011 data are based on the September 2011.

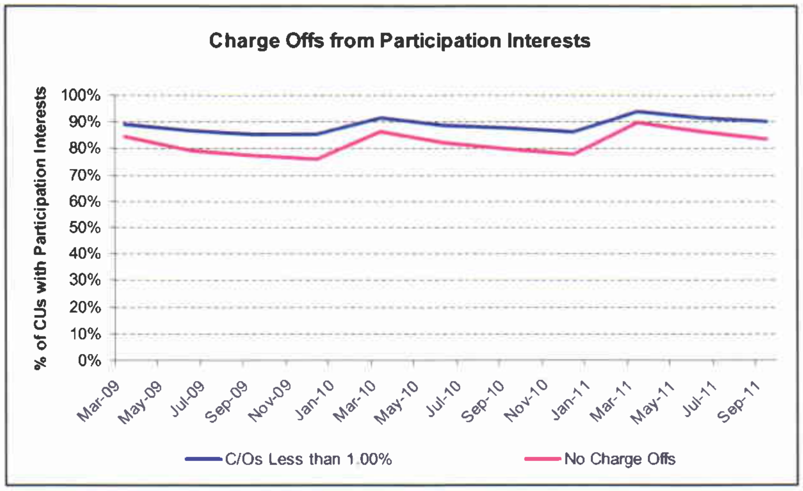
[4] Bank and CMBS delinquency data obtained from Mortgage Bankers Association, Commercial Real Estate / Multifamily Finance, Mortgage Delinquency Rates for Major Investor Groups, December 2011.

In addition, net charge offs for participation interests have generally been better than non-participation loans held by credit unions. The average annualized net charge off ratio since December 2007 is 0.84% for participation interests and 0.95% for other credit union loans. Several factors contribute to low charge off rates:




- In general, loan participations are individually and carefully underwritten by both the originating credit union and each participant purchaser, as opposed to desktop or automated underwriting with consumer mortgage, auto, and credit card financing.
- Most loan participations – whether consumer or commercial – are secured by real estate. Although real property values have fallen over the past few years, the recovery value of the collateral is still superior to auto loans and unsecured credit, such as student loans and credit cards.
- The majority of participation loans are real estate secured business loans to members who are owner-users. These borrowers have a stronger interest in retaining the property than an investor would.

A careful analysis of available credit union data affirms that the vast majority of credit unions are appropriately underwriting loan participations purchases. In 2011, 90% of all credit unions with loan participation portfolios experienced a charge off ratio of less than 1.00%. In addition, 84% experienced no charge offs at all. This has been consistently true even as financial institutions saw increased credit risk from 2009 to 2011 (see chart below).




The few credit unions which incurred charge offs in their loan participations portfolio had the earnings and capital necessary to absorb these losses. In 2011, the average amount of the annualized charge offs for these credit unions was 1.8% of their net worth or 0.097% of total assets. Only nine credit unions experienced participation related charge offs which exceeded

10% of net worth. This data supports the conclusion that the vast majority of credit unions are able to adequately underwrite participation loan purchases and have sufficient capital to absorb related losses if they occur.

There is no definitive support for the conclusion that participated loans are riskier than non-participated loans. In fact, our experience is that new participation loan interests are of higher quality today because the underwriting criteria and capabilities of credit union loan originators throughout the industry have strengthened during this period of economic weakness. In addition, purchasers of loan participations have become more selective, demanding only high quality assets.

In light of this, we ask that the NCUA reconsider its underlying assumption that loan participations represent a greater risk to the credit union industry than non-participated loans.

## COMMENTS TO THE PROPOSED RULE

***Proposed Rule - §701.22 – Introductory Text***
ECCU is generally supportive of the addition of the proposed introductory text to §701.22, except for the application to federally insured state chartered credit unions (see comments to proposed §741.225 below).

***Proposed Rule - §701.22(a) – Definitions***
ECCU has concerns about the proposed definitions of "loan participation" and "originating lender."

*Loan Participation.* We request the definition of "Loan Participation" be modified as follows:

> Loan participation means a loan where more than one eligible organization participates in ownership of the loan ~~one or more eligible organizations participate~~ pursuant to a written agreement with the originating lender~~, and the written agreement requires the originating lender's continuing participation throughout the life of the loan~~.

The requirement regarding the originating lender's continuing participation should not be placed in this definition, but rather in loan participation agreement requirements described in §701.22(c).

*Originating Lender.* We request the definition of "Originating Lender" be modified as follows:

> Originating lender means the lender ~~participant~~ with which the member ~~initially or originally~~ contracts for a loan or, in the event such lender is no longer an owner of the loan, ~~and~~ who, thereafter or concurrently with the funding of the loan, sells participations to other lenders.

The proposed definition, as applied, prevents the participation of loans in which the originating lender is not the seller of the loan. Examples of this situation include: loans purchased from the NCUA's Asset Management Assistance Center or loans to members purchased in their entirety by a credit union from another financial institution (such as through the loan trading market). If these loans are maintained and serviced by a competent credit union, and meet the underwriting standards of a purchasing credit union, they should be available for participation irrespective of the involvement of the originating lender.

***Proposed Rule - §701.22(b) – Conditions for Purchase of Loan Participations***

*Subsection (b) – Introductory Paragraph.* We request the introduction to this subsection be modified as follows:

> (b) A credit union may purchase a loan participation ~~from an eligible organization~~ only if ~~the loan is one the credit union is empowered to grant and~~ the following conditions are satisfied:

With regard to this subsection (b), limiting the purchase of loan participations to eligible organizations removes a credit union's ability to acquire loans from other legitimate sources. For example, in the church and non-profit industry, there are several REITs, denominational funds, church extension funds, and church bond companies which may have loans to our members worthy of participation. As noted later in the proposed regulation, the purchasing credit union must still underwrite the loan according to its own standards and perform the appropriate due diligence on the selling/servicing organization. The requirement that purchases must be from eligible organizations unduly restricts the ability of credit unions to pursue loan opportunities, even though other avenues exist to mitigate associated risk.

We proposed the language in the proposed regulation stating "the loan is one the credit union is empowered to grant and" be removed as it is duplicative of subsection 701.22(b)(5)(i).

On a separate note, the "Section-by-Section Analysis" for §701.22(b) states "Removing this provision [§701.22(c)(4)] prevents a FICU from purchasing a loan participation originated with less stringent underwriting standards than the FICU uses in making its own loans." The NCUA appears to have an underlying assumption that loan participations only occur at origination. In practice, participation interests in seasoned loans are often sold by the originating credit union or resold by a participant for liquidity, asset-liability management, or other purposes. The relevant period for underwriting analysis should be at the time of purchase, not at the time of origination. The final version of this regulation must be flexible enough to permit the sale or re-sale of participation interests in seasoned loans.

*Subsection (b)(1) – Compliance with Other Regulations (e.g. loan-to-one-borrower limitation).* ECCU has no objection to this proposed subsection.

*Subsection (b)(2) – Written Agreement Required.* ECCU has no objection to this proposed subsection.

*Subsection (b)(3) – 10% Interest Retained by Originating Lender.* ECCU requests this section be stricken as it is duplicative of subsection 701.22(c)(4)(ii).

*Subsection (b)(4) – Borrower a Member of a Participant.* ECCU requests this section be changed as follows:

> (4) The borrower is a member of a participating credit union ~~before the credit union purchases a loan participation~~

If the borrower is not already a member of the purchasing credit union, this membership requirement will not be satisfied before the purchase, but rather concurrently with the purchase.

*Subsection (b)(5) – Loan Participation Policy.* In general, ECCU is supportive of the requirement that purchasing credit unions establish a sound loan participation policy. It is appropriate for the NCUA to call out those areas which the policy must address, such as underwriting standards and concentration limits. However, the proposed language is problematic in two key areas.

*§701.22(b)(5)(i) – Underwriting Standards.* We propose the following revision to this subsection:

> i. Establish underwriting standards for loan participations which, at a minimum, meet the same underwriting standards in the credit union's loan policy ~~uses when it originates a loan~~;

This proposed rule would allow a credit union to only purchase those loan participations it has the ability to originate. One of the critical benefits of loan participations is diversification among loan product types, industries, and geographies. For this reason, a credit union will often purchase participations in loans it does not originate. For instance, a credit union whose core lending product is auto financing may pursue diversification by purchasing loan participation interests in real estate secured small business loans. However, it is unlikely this credit union would have an origination policy for real estate secured small business loans.

Without question, it is prudent to have a sound loan policy which sets forth guidance regarding underwriting standards independent of those used by the selling credit union. However, the applicable underwriting standards should not be tied to origination guidelines of the purchasing credit union.

*§701.22(b)(5)(ii) – Limit on Purchases from Single Originator.* We propose this section be revised as follows:

> (ii) Establish a limit on the aggregate amount of loan participations that may be purchased from any one originating lender~~, not to exceed 25 percent of the credit union's net worth~~;

We have a number of objections to the proposed limitation on participations from a single originating lender:

- *Nature of the Risk Being Mitigated.* It is unclear what risk is being mitigated by this restriction. This restriction does not mitigate credit risk, which is quantified and addressed through the application of underwriting standards set forth in the loan participation policy. The risk that this limitation appears to address is the potential failure of the servicer. If so, that risk is more appropriately mitigated through the appropriate due diligence by the purchasing credit union of the loan servicer. A one-size-fits-all cap is not the "least burdensome" approach to mitigating this perceived risk.

- *Impact on Small Credit Unions.* Small credit unions generally do not have the ability to maintain a robust, diversified loan origination platform. As of September 2011, there were 372 credit unions under $50 million in assets which held loan participation interests, totaling on average 48% of their net worth. Many of these credit unions are heavily reliant on loan participations to generate earnings. Small credit unions may not have the capacity or expertise to underwrite and monitor multiple originators. Instead, many would be better served by focusing on one or two reputable originators. The 25% of net worth limit would detrimentally impact the ability of these credit unions to acquire and maintain quality earning assets.

- *Servicing Experience.* By limiting originations from a single source, this rule will prevent credit unions from building the expertise and competence necessary to manage a large participation program. The result will be a more fragmented market, with smaller, less experienced originators managing more participation loans in the industry. As ECCU has experienced over the past few years, managing a participation portfolio – of any size – is a challenging and complex endeavor. Originators need to develop systems, processes, and controls to ensure communication with participants is complete and timely. Recommendations need to be fully analyzed and presented. Relationships with participants having differing credit philosophies need to be negotiated and resolved. Smaller, less experienced servicers may not have the capital or platform necessary to address these challenges.

- *Impact on Selling Credit Unions.* At a time when liquidity and asset-liability management is critical, this rule would severely limit the pool of available participant purchasers. For example, if unchanged this restriction would reduce ECCU's credit union participations capacity by 29% or more.

- *Restricting Good Originator Relationships.* Many purchasing credit unions have developed strong working relationships with a one or two originators which have delivered superior results. This relationship allows the purchasing credit union to focus its due diligence and go deeper in evaluating the competence and capability of the loan originator and servicer, as well as the loan products being sold. In addition, this focus allows process and systems integration to become much more efficient.

- *Form over Substance Solutions.* This restriction would encourage the creation of alternatives to work around its impact. For example, multiple CUSOs may be created by a group of credit unions solely for the purpose of originating loans for participation. The proposed rule would encourage these form-over-substance solutions introducing new costs and complexities to the industry which are unnecessary.

- *No Similar Regulation in Banking.* This regulation would be unique to federal banking regulators. None of the banking regulators have a restriction on how much can be purchased from a single originator.
- *Grandfathering Challenges.* This restriction will make it difficult to manage existing situations. For example, maturing loans with a balloon payment must be treated as grandfathered for every renewal through its scheduled amortization. However, if the participating credit union exceeds the proposed regulatory limit, it would not be able to make advances upon renewal that would otherwise be sound credit decisions. This inability to serve the members needs should not be driven by an arbitrarily set regulatory limit.
- *Fewer Loans Available.* Instead of mitigating risk, the proposed restriction will result in fewer loans available to small businesses and non-profit organizations, stifling economic growth and job creation. The new rule would significantly curtail the ability of several credit unions – including ECCU – to sell loan participations. This will result in fewer new loans granted to small business owners and non-profit organizations. This result contradicts the objectives of economic growth and job creation set forth in President Obama's Executive Orders.

Our suggested alternative requires the purchasing credit union's board of directors to adopt a loan participation policy with a limit on participations from a single originator, without prescribing what that limit should be. This is similar to the approach the NCUA utilized in the recently finalized Interest Rate Rule, to which Chairman Matz commented:

> *"Our standard for interest rate risk policies is not one-size-fits-all. We realize that exposed credit unions have different risk profiles. So while we are providing a template policy, we are also providing flexibility for credit union managers and board members to develop their own policy."*

Imposing an arbitrary 25% of net worth cap on loan participation purchases will have a negative impact on the loan participation market, reducing financing available to credit union members, without mitigating the associated risks. We ask that the NCUA give credit union managers and board members the flexibility and the responsibility to develop their own loan participation policies based on the credit union's risk profile.

*§701.22(b)(5)(iv) – Waiver Process.* As the NCUA suggests, it is challenging to inform a member that their loan transaction must be placed on hold until the credit union obtains from the NCUA's regional director. To make this process more effective, we suggest that waivers be made available to credit unions in advance by providing the regional director the underwriting and other guidelines under which an exception would be granted by the requesting credit union. If the regional director grants the exception guidelines, the credit union would have the ability to complete transactions in accordance with those guidelines. After completion of any transaction under the exception guidelines, the credit union would then inform the regional director in writing. Examiners could review compliance with the exception guidelines at the next scheduled examination. This proposed process would give the NCUA the opportunity to review guidelines in advance, and provide the credit union the ability to respond quickly to a member's needs.

## Proposed Rule - §701.22(c) – Loan Participation Agreements

In general, we find the proposed requirements for loan participation agreement reasonable and appropriate, except for the following comments:

*Subsection (c)(4)(ii) – 10% Retained Interest.* ECCU suggests the following modification to this subsection:

> (ii) The percent of the loan participation retained by the originating lender throughout the life of the loan, which must be at least 10 percent, unless otherwise agreed upon by the participants;

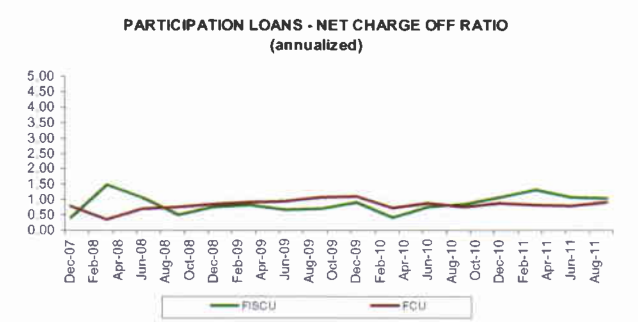
In some situations, such as a disagreement over a course of action, the participants may desire to re-purchase the originating lender's interest and remove it as servicer. The proposed regulation should allow for that action. In addition, the commentary to the proposed regulation should make it clear that it is up to the parties of the loan participation agreement to decide whether this and other decisions are made by majority, super-majority, or unanimous approval.

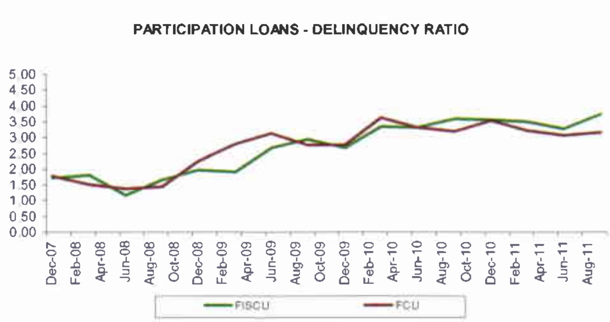
*Loan Renewals.* With regard to the application of the loan participation requirements, we request that the commentary to a final loan participation rule clarify that these new requirements do not apply to the modification of an existing loan participation agreement, such as when an underlying balloon loan is being extended for an additional term or when a loan modification is being granted.

## Proposed Rule - §741.225 – Regulations Applicable to State-Chartered Credit Unions

ECCU objects to the application of the proposed loan participation rules to federally insured state-charted credit unions, and feels that this usurps each state's right to regulate its own financial institutions. The delinquency and charge off statistics in the Section-by-Section Analysis fail to provide a complete picture of risks associated with loan participation interests held by state chartered credit unions.

After correcting for the ambiguity in the 5300 Call Report instructions described above, the delinquency and charge off performance of participation interests held by state chartered credit unions is almost identical to federally chartered credit unions.



This corrected data simply does not support a conclusion that there is additional risk in participation interests purchased by state chartered credit unions which sufficiently justifies the NCUA usurping the rights of the states to regulate their own financial institutions.

The proposed loan participation regulation will have a significant impact on ECCU, its membership, and the credit union industry. While we are supportive of the NCUA's effort to improve loan participation policies and agreements, the key changes described in this letter must be made to ensure that credit unions are able to effectively use loan participations to serve their members.

We appreciate your time and attention to our concerns. Please contact us if you have further questions.

Sincerely,

Mark G. Holbrook
President/CEO

James LePere
Chairman, Board of Directors

cc: Richard McCarthy, Chairman, ECCU Supervisory Committee
Commissioner William Haraf, California Department of Financial Institutions
Bill Cheney, President/CEO, Credit Union National Association
Diana Dykstra, President/CEO, California Credit Union League