



## KANSAS CREDIT UNION ASSOCIATION

February 15, 2012

Mary Rupp  
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:

KCUA represents 93 credit unions in the state of Kansas and this letter details our views regarding the NCUA's proposal to place additional restrictions on the use of loan participations. As a point of reference, Kansas has a total of 100 credit unions and 79 of those are state chartered, federally insured CU's. Since this proposal has the greatest impact on FISCUs, it obviously could affect the vast majority of our members. While we agree in concept with some of the intentions, we feel this proposal infringes on the dual-chartering system and we stand opposed to the rule as written.

**701.22(b)(5)(ii) Loan participations from one originating lender may not exceed 25% of the CU's net worth.**

This change will have the unintended consequence of a disparate impact towards smaller credit unions. A simple but real life example involves a \$5M Kansas credit union with \$750k in net worth. After extensive due diligence, this well-capitalized credit union purchased \$500k worth of auto loan participations from another well known, well capitalized, reputable credit union. In fact, this participation was recommended and encouraged by an examiner. Under the proposed rule, this transaction would not be allowed; not even with Regional Director approval.

Originators are not economically incented to sell small loan participations because it is difficult to recoup the administrative cost of packaging and accounting for a small pool. This will create fewer opportunities for smaller credit unions to buy participations because they will be relegated to only purchasing small pools. It could also reduce the loans made by originators because their list of potential participants has shrunk and they can't hold the entire loan on their balance sheet.

In the Regulatory Flexibility Act section of the proposal it states, "Generally, smaller credit unions are not actively involved in loan participation transactions". That statement is not true in our state. Through the third quarter of 2011, 11 Kansas credit unions had purchased loan participations; 8 of the 11 had assets under \$25M. Five of them had assets under \$10M. Smaller credit unions, arguably, receive the greatest benefit in loan participations; especially in this economic environment where it is difficult to grow loans internally.

We agree that credit unions should manage the risk in loan participations by establishing limits; however, these should be set as credit union policy and not by regulation. They also should reflect the types of loans being purchased, the source and the financial health of the credit union. This can't be a one size fits all approach.

**701.22(b)(5)(iv) Aggregate amount of loan participations with a single borrower or group of borrowers may not exceed 15% of the credit union's net worth.**

At first read this limit sounds very logical but after additional consideration, this rule could also adversely affect smaller credit unions. The most glaring example would be a single borrower who is on multiple commercial loans. Even though each loan cash flows, has different guarantors and collateral, the credit union may not be allowed to participate because of the single borrower limit. This artificial cap would be even more constrictive for small credit unions based on a pure dollar amount.

Another situation that is not addresses in the proposed rule is guaranteed loan participations such as USDA or SBA loans. If there is no credit risk, why should it be capped at 15% of net worth? This rule does allow for exception approval by the Regional Director; however, by your own admission, this process is not as efficient as it could be. The proposal would just increase the transactions in a process that is already broken.

Limits should be established which address the nuances that come with different participations but, again, they should be made as a part of credit union policy.

### **Membership Requirements**

There appears to be contradictory or, at the very least, confusing language in the proposed rule regarding membership requirements on participation loans. In the introductory paragraph of 701.22 it states, "This section applies only to a federally insured credit union's purchase of a loan participation where the borrower is not a member of that credit union". Section 702.11(b)(4) requires..."The borrower is a member of a participating credit union before the credit union purchases a loan participation" Section 741.225 states "Any credit union that is insured pursuant to Title II of the Act must adhere to the requirements stated in 701.22 of this chapter with the exception of 701.22(b)(4).

Credit unions insured pursuant to Title II include both Federal and State chartered CU's so, according to 741.225 neither FCUs or FISCUs would be required to make the borrower a member of one of the participating credit unions. Herein lays the confusion. It should be clarified in the proposal when membership is required, if it's required by the originator or the seller and how the rule applies individually to FCUs and FISCUs. Our recommendation is that membership not be required at all on participation loans. Doing so would severely limit the public's ability to obtain much needed financing for higher education and housing. It would also dampen the economic recovery by reducing funding for small business loans.

### **Indirect Auto Loan Programs**

We believe it was NCUA's intent to exclude indirect lending from this rule however; the introductory paragraph for 701.22 states, "Generally, a federally insured credit union's purchase of all or part of a loan made to one of its own members, where no continuing contractual obligation between the seller and purchaser is contemplated, is governed by section 701.23 of this chapter". There are two issues with this

statement. First, there are continuing contractual obligations in most indirect lending programs. For example, the seller (dealer) is bound by a dealer agreement to warranty the information presented to the purchaser (credit union), pay any charge-backs and refund insurance premiums.

The second issue relates to 701.23. This section specifically excludes indirect loans and leasing but, 701.23 only applies to Federal credit unions. This language would need to be amended or new language added to clearly exclude indirect loans from this rule for both FCUs and FISCUs.

## **Definitions**

The proposal, as written, limits the eligible originating organization to a credit union, CUSO, federally insured/federally chartered financial institution, or a state or federal government agency. We feel this would exclude other viable financial institutions that may not be federally chartered or insured. One example would be companies licensed to originate SBA loans. Language would need to be added to allow this or allow for State or NCUA examiner approval.

The current definition for originating lender is the participant lender with which the member initially or originally contracts for a loan. Since this section deals with borrowers who are not members, the word member should not be included. Also associated with this definition are indirect loan participations. In the classic indirect relationship, the dealer technically is the originating lender and they assign/sell the loan to the credit union. The proposed language would prevent credit unions from buying participations in these types of indirect loans because the originating lender (dealer) did not keep 10% of the loan. Language should be added to allow this either in the definitions or in separate sections dealing specifically with indirect loans.

## **Conclusion**

Credit unions are in the business evaluating risk associated with lending. It's the responsibility of credit union Boards and their management team to put in place policies and procedures that mitigate those risks while still allowing their members access to credit and creating an overall portfolio mix that addresses the strategic financial and operational goals for the credit union. Therefore, we urge NCUA to allow credit union policy to dictate parameters on loan participations instead of federal regulation.

Thank you for your consideration,



Bob Mayes

VP, Member & Strategic Services  
Kansas Credit Union Association