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February 16, 2012

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

RE: Proposed Rule on Loan Participations

Dear Secretary Rupp;

Thank you for providing Capital Communications Federal Credit Union ("CCFCU" or "Cap Com") with this opportunity to provide our comments regarding the proposed amendments to the NCUA loan participation regulation (§701.22 of NCUA's Rules and Regulations).

Cap Com is a $900 million credit union operating primarily in the Capital Region of New York with its headquarters in Albany, NY. CCFCU serves over 80,000 members by way of 10 full-service branches, a comprehensive online banking application, a full service call center, an extensive ATM network and our newly introduced mobile banking application.

As drafted, this proposal would:

1. Limit the aggregate amount of loan participations purchased from a singular originating lender to 25% of the purchasing credit union's net worth; and
2. Limit the aggregate amount of loan participation purchases involving one borrower, or a group of associated borrowers, to 15% of the purchasing credit union's net worth.

Loan participations are very important to credit unions as they: (1) generate liquidity, (2) assist in the management of balance sheet and loan concentration issues, (3) provide favorable returns for credit unions that do not have significant lending demand, (4) diversify lending risk by asset class and geographic concentration, and (5) provide a tool to manage the aggregate business lending cap.

Credit unions have a history of success in many different types of lending. For credit unions seeking yield, there is a much higher likelihood that credit unions will understand the risks in buying loan participations 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.

We applaud the NCUA for proposing changes to the existing loan participation regulation as it is in need of revision. However, when considering the benefits and risks of loan participations, we ask the NCUA 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. In regard to the Interest Rate Risk Rule, 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*" (italics added). It is our opinion that a similar approach be taken regarding the loan participation regulations as each credit union will have different risk profiles and thus would not be practical and/or prudent to require all credit unions to universally comply with a regulation that is definitely not "one size fits all".

§701.22(b) - 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". We understand and do not quarrel with this requirement as a general principle. We understand the NCUA's intent to ensure the originator have an economic interest in the performance of the loan so that the originating institution is incented to conduct prudent and pertinent due diligence when originating 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 greater ability to manage the aggregate business lending cap. Even at 5% of the loan balance, there exists an adequate economic incentive to conduct proper and prudent underwriting standards when originating loans. Any flexibility on this retention requirement would be very helpful to credit unions and flexibility can be achieved without adversely affecting the underlying principle of enlightened self-interest.

§701.22(b) Concentration Limits - Single Originator:

The Proposed Rule would limit loan participation purchases involving a single originator to a maximum of 25% of the credit union's net worth. Furthermore, there is no ability to seek a waiver from this restriction.

We strongly disagree with this aspect of the proposal. The 25% limitation is intended to act as a preventive measure against systematic failure, keeping the ills of one originator's loans from spreading to a small group of credit union participants. This is an easy rule to apply but there are many unintended adverse consequences.

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.

In addition to loan origination practices, significant due diligence is conducted relative to the loan servicing capabilities of the originating credit union. 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 origination, underwriting and servicing. The yield from good quality loans are shared among trusted partners.

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. A credit union is expected to perform and monitor due diligence on all loan participations. 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.

For example, the number of credit unions that are very effective in business lending is a small subset of all credit unions making business loans. Forcing credit unions to walk away from a known and trusted lending partner to find an equally effective partner is not easy in practice. This will likely bring more loan brokers into the marketplace attempting to fill the void. As credit unions need to turn away from trusted sellers and look for other sellers, loan brokers will see an opportunity to push loan participation interests in substandard loans on less experienced credit unions.

For larger credit unions the 25% rule will make it much harder to develop long term participation relationships with other credit unions. This means that we will be forced to establish additional relationships with many other credit unions that we do not know as well, and that do not know us, and go through the necessary and prudent, but lengthy and resource-intensive due diligence process with each of them. This will have a direct and negative impact on our ability to serve our members, meet their borrowing needs and improve net worth through proper risk mitigation strategies.

There are issues with the application of this rule to credit unions involved in lending CUSOs whereby the lending CUSO closes loans in the CUSO's name and sells the loans, in whole or in part, to credit unions. Although this isn't the current practice of our residential mortgage CUSO, CCFCU Funding, if approved, this regulation would seemingly obstruct our CUSO's ability to enter into loan participation arrangements as a viable future business strategy.

For those CUSOs that currently enter into loan participation arrangements, the CUSO and the credit union that owns the CUSO has certainly undertaken 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. If approved, this proposal will inhibit the business strategies of credit unions whose business models are set up in this manner. It makes no sense that the CUSO could sell whole loans to a credit union as eligible obligations 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?

We suggest an alternative approach to achieve the same end. Our recommendation is to require purchasing credit unions to adopt a loan participation policy with a limit on participations from a single originator, without NCUA establishing a "one size fits all" approach to what that limit should be. This would enable credit unions' boards and management to establish a prudent limit that is appropriate for that credit union's particular size and financial condition. Those credit unions that have greater net worth and a track record of prudent lending practices can afford to adopt a higher single originator limit than those that possess less attractive financial condition.

§701.22(b) Concentration Limits-One Borrower or Group of Associated Borrowers:

Under the Proposed Rule, a credit union may not buy loan participation 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.

The risk is not inherently related to the dollar amount of the participation loans in relation to one borrower as much as it is the actual risk of the particular borrower. If the borrower is financially sound and robust, the participation loan arrangement should be considered low risk regardless of the limitation in place. On the other hand, if the borrower is particularly weak and financially unsound there would be risk involved whether a net worth limitation is in place or not. This proposal does not look at the risk of a particular borrower but merely places arbitrary restrictions on a credit union entering into the participation loan arrangement. While it is highly unlikely that we would ever enter into a loan participation arrangement where the aggregate amount exceeds 15% of our net worth, we are of the opinion that the sensible due diligence efforts should determine the risk and that credit unions should not be subject to an arbitrary limitation.

§701.22(C) - 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 we 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 not a single loan participation interest in the aggregate group or pool. We recommend clarifying this as it will cause confusion.

Recommendation in regard to the ability of credit unions to sell loan participations in loan purchased under the eligible obligation rule:

It is noted 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. We 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" and the fact that the selling credit union did not originate the loan is not a reason to prohibit the sale of a loan that is seasoned. It was not a reason to prevent the purchasing of the whole loan by the credit union. The fact that the loan is seasoned gives a buyer the opportunity to see if the loan is performing.

Recommendation in regard to 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 a waiver. That renders the loan participation interest unsalable from a practical standpoint. No buyer wants to go through the waiver process. We 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 a waiver.

Recommendation in regard to organizations eligible to buy a loan participation interest:

We do not understand any 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 would like to thank you for providing us with this opportunity to submit comments in relation to the proposal regarding concentration limits on participation loans and we stand ready to further discuss the comments stated in the letter. Should you have any questions please feel free to contact me at (518) 458-2195 extension 3204 or by way of email at pstopera@capcomfcu.org.

Sincerely,

Paula A. Stopera

Paula A. Stopera,
President/CEO