February 21, 2012

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

Via e-mail: regcomments@ncua.gov

RE: NCUA Proposed Rulemaking for 12 CFR Parts 701 and 741; Loan Participations; Purchase, Sale and Pledge of Eligible Obligations; Purchase of Assets and Assumption of Liabilities

Dear Ms. Rupp:

The New Jersey Credit Union League (NJCUL) appreciates the opportunity to comment on the NCUA Board's proposal to amend the loan participation regulations. The proposal would impose new limitations on participations and add minimum requirements regarding loan participation policies and agreements to credit unions. In addition, the proposal expands loan participation requirements to federally-insured and state-chartered credit unions. By way of background, NJCUL is the trade association representing New Jersey's credit unions, with its primary role being advocacy. For NJCUL, advocacy comes in three forms: regulatory, legislative, and consumer awareness.

NJCUL's Position

NJCUL strongly opposes NCUA's proposed amendments to the loan participation rules and urges the agency to withdraw the proposal as written. Loan participations are extremely important to credit unions in their ability to generate liquidity, assist in the management of loan concentration issues, provides favorable returns for credit unions when faced with a sluggish lending demand. Loan participations also allows for diversification of lending risk by both asset class and geographic concentration. Additionally, loan participations also serve as an essential tool for managing aggregate business caps.

NJCUL applauds NCUA Chairman Debbie Matz's Regulatory Modernization Initiative to evaluate existing rules that need to be "streamlined, eliminated, or clarified", which follows the spirit of E.O. 13579, President Obama's Executive Order on Regulations and Independent Regulatory Agencies. Clearly, the loan participation proposal is a rule that is not warranted as the agency already has existing rules to effectively regulate loan participations. NJCUL urges NCUA to withdraw this rule and utilize its existing powers. Loan participations remain one of the prime examples of the cooperative nature of credit unions. To enact a regulation that would so dramatically limit this cooperative tool due to "headline" cases of participations gone bad is regulation overload. NJCUL urges NCUA not to further tie the hands of credit unions to grow their businesses and find new revenue streams in these difficult economic times. This proposed regulation further exacerbates the growing concern in the credit union community that NCUA continues to creep into "managing" credit unions, rather than regulating.

NCUA's Proposed Cap Rule

Loan participations move capital from cash rich credit unions to loan rich credit unions enabling the system to put credit union capital to work for members and could have deep ramifications across the credit union industry under the proposed regulation, in particular the following amendment from NCUA's proposal:

"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 is intended to act as a check and balance, keeping the problems of one originator's loans from crippling a participating credit union. Unfortunately this proposal does not address the underlying issue of concentration risk management and as written will have unintended consequences that do far more damage than the issue it is attempting to resolve.

Determining concentration limits are an important factor in a credit union's overall risk analysis and mitigation program, establishing an arbitrary, nationwide limit such as this without considering the credit union's individual risk management plan and asset mix does little to lower the credit union's risk profile. Concentration limits should be viewed within the context of the participating credit union's overall risk management program. Proper due diligence is essential for any credit union entering into any new lending program.

Whether it is a credit card program, home equity program or participation program of some type, the credit union must perform its due diligence and consider the impact that this loan type has on their balance sheet, strategic plan and ability to provide services to their membership. Similarly, the participant must perform effective due diligence on an originator when considering a loan participation program. Excessive concentrations by originator has very little to do with credit union failures. The originator typically, though not always, performs the function of servicer.

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Servicing has not historically proven to be a significant factor in credit union failures. Rather, it has been the quality of the underlying loan and concentrations in a loan type that are at issue. Poor underwriting, over reliance by the participant on the originator's analysis, poor due diligence by the participant and simple over concentration in the asset class by the participant (poor risk management) have played a far more significant role in losses and failures than the mere choice of an originator. Problems such as fraud and weak or non-existent internal controls will undermine the best of loan programs, but proper due diligence by the participant which includes understanding the originator and participation investment will go a long way towards managing and mitigating these risks.

Sound judgment and asset liability management analysis should dictate how an individual credit union manages its loan participations, not regulation. The proposed regulation is likely to drive up a buying credit union's costs as more time and effort must be spent on due diligence seeking out more credit unions to purchase participations from. The regulatory amendments could have unintended consequences, as credit unions now run the risk of 'reaching' to find more loans and credit union participants, thereby possibly exposing a credit union to even greater risk of dealing with new and untried partners. A number of credit unions have worked hard to build strong and profitable relationships; this regulation could prevent those relationships from moving forward should the credit union exceed the proposed 25% cap rule.

NJCUL asserts that NCUA's proposal "to impose a limit on loan participation purchases for federal and state chartered federally insured credit unions from a single originator to 25% of the purchasing credit unions net worth" is a poor gauge for any proposed caps. Capital is a cushion, yes for potential losses, but also a reservoir for investing in the credit union's business for the future. Tying loan participations to 'net worth' is a dangerous path to take a credit union's asset liability management down. If this amendment is finalized, what next? Home loans?

Systematic Risk

In the proposal, NCUA invokes the concern of systemic risk to the share insurance fund as justification for expanding it loan participation requirements to federally-insured, state-chartered credit unions, as well as imposing new limitations on participations as follows;

"The (NCUA) Board recognizes, however, that loan participations also create more systemic risk to the share insurance fund (NCUSIF) due to the resulting interconnection between participants. For example, large volumes of participated loans in the system tied to a single originator, borrower, or industry or serviced by a single entity have the potential to impact multiple credit unions if a problem arises. Additionally, as both federal credit unions (FCUs) and federally insured state-chartered credit unions (FISCUs) actively engage in loan participations, it is important to the safety and soundness of the

NCUSIF that all federally insured credit unions (FICUs) adhere to the same minimum standards for engaging in loan participations."

However, NCUA provides no data to support this assertion. According to Call Report data, 1,458 federally-insured credit unions reported almost $12.8 billion in outstanding loan participations as of September 2011. This is equal to 2.25 percent of the credit union loan balances. In addition, there are 117 federally-insured credit unions (approximately four percent of all federally-insured credit unions) that have outstanding loan participations in excess of their net worth. Outstanding loan participations at these credit unions equal $3.2 billion. Finally, there are only 20 credit unions with a risk exposure greater than 300 percent of their net worth, with approximately $764 million in outstanding balances. NJCUL believes it stretches the limits of responsible oversight to suggest that such amounts rise to the level of systemic risk.

Further, as we indicated in the previous section, 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. NCUA's proposal would only add to the regulatory burden of affected credit unions in a manner that is disproportionate to the risks associated with loan participations. In today's overly regulated environment NJCUL appreciates that NCUA is attempting to address concentration risks and other issues the agency has identified concerning loan participations, but NCUA should not do so at the expense of severely limiting, if not eliminating, sound participation programs that presently serve credit unions, their members, and other credit unions well. Further, the proposal may inadvertently undermine lending programs and even negatively impact earnings for some credit unions. The amendments to concentration risks and application of new underwriting criteria will minimize the ability of credit unions to mitigate risk through diversifying sources and types of loan participations.

Conclusion

NJCUL's position is that it is the responsibility of each individual credit union's management and board of directors to determine the level and types of participation lending, including concentration limits, based on that individual credit union's financial position; including capital position and expertise. While it is understood NCUA's directive is to regulate safety and soundness and the agency's efforts are to be commended as well intentioned in these challenging times, various aspects of this proposal will actually result in more, not less, safety and soundness concerns long-term as it will significantly limit the ability of credit unions to diversify their loan portfolios, improve earnings and share their risks through relationships with proven loan participation partners. Regulations, as proposed, will lead to a competitive disadvantage.

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Thank you for the opportunity to express the views of NJCUL regarding the NCUA Board's Loan Participation proposed rule changes. If you have any questions about our comments, please do not hesitate to contact me at 1-800-792-8861.

Sincerely,

Paul Gentile

Paul Gentile
President/CEO
New Jersey Credit Union League

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