OHIO CREDIT
UNION LEAGUE

February 21, 2012

Via email to: regcomments@ncua.gov

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

Dear Ms. Rupp:

On behalf of the Ohio Credit Union League (OCUL), this letter responds to the National Credit Union Administration's (NCUA) proposed rule changes to 12 CFR Parts 701 and 741, amending its Loan Participation rules. The OCUL is a credit union trade association representing the interests of Ohio's federal and state-chartered credit unions, serving its 2.7 million members.

The comments reflected in this letter represent the recommendations of the Ohio Credit Union League, and input from its Government Affairs Committee and member credit unions. We appreciate the opportunity to provide suggestions and feedback to NCUA prior to adoption of any rules as proposed.

Background and Summary

NCUA recognizes in its proposal that loan participations strengthen the credit union industry in numerous ways, including loan portfolio diversification, improved earnings, loan growth, balance sheet management, and increased availability of credit to small businesses and consumers. However, NCUA is concerned that loan participations are now creating increased systemic risk to the share insurance fund (NCUSIF), and is proposing to change the requirements for a federally-insured credit union (FICU) to purchase loan participations. The proposal prescribes certain concentration limits due to what NCUA believes are large volumes of participated loans in the system tied to a single originator, borrower, (industry or serviced by a single entity), and have the potential to impact multiple credit unions problems arise. NCUA also states in it proposal that it is important that all FICUs (proposal expands coverage of current rules from federally-chartered credit unions to FICUs) should adhere to the same minimum standards to ensure the NCUSIF consistently recognizes and accounts for the risk associated with loan participations.

Therefore, in order for FICUs to adhere to the minimum standards for loan participations, NCUA proposes to expand its current rules to include FICUs.

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NCUA proposes to change or modify its loan participation rules in several ways. Most significantly, the proposal would invoke the following:

- Limit loan participation purchases from a single originator to 25% of the purchasing credit union's net worth. No waivers would be permitted.
- Limit loan participation purchases involving one borrower or a group of associated borrowers to 15% of a FICU's net worth. The NCUA regional director could approve and grant a waiver.
- An originating lender must retain 10% of the participated loan throughout the life of the loan (FCUs must comply with this requirement now).
- Prohibit an FCU to purchase a loan participation that is originated with different underwriting standards than its own.
- Establish a list of minimum provisions that a loan participation agreement must address.

OCUL Urges Withdrawal of Proposal

OCUL strongly urges the NCUA to withdraw its loan participation proposal. While a critical on-going role of the NCUA is to control risk and losses to the NCUSIF, OCUL firmly believes that NCUA's justification that "loan participations…create more systemic risk to the NCUSIF due to the resulting interconnection between participants" is not substantiated with sound research or facts, ignores the reduction of actual risks loan participations currently create, and attempts to "easily resolve" risks by an overly burdensome, across-the-board, one-size-fits-all rule to control perceived concentration risk. The proposed rule would negatively impact credit union earnings, and severely limit, if not eliminate sound participation programs that serve credit unions, their members and other credit unions as well.

Below are specific concerns of OCUL with the loan participation proposed rule:

NCUA's Claim of "Systemic Risk" / Flawed Data

As much publicized by trade publications and comment letters already submitted, OCUL believes that NCUA's data used in its assertion that loan participations systemically are riskier than that of other credit union loan portfolios is flawed. This is evidenced by the unsound data NCUA has relied upon in its assertion of higher loan participation delinquencies and charge-offs, particularly in state-chartered credit unions. It appears that NCUA is using data from its Call Report instructions (specifically section 10 and 10b that do not separate purchased from sold loan participations) that has caused numerous credit unions to incorrectly and substantially overstate delinquency and charge-off data. Research completed by the California and Nevada Leagues, correcting for the overstated figures used by NCUA, resulted in net loan participation charge-off data that are generally better than nonparticipation loans held by credit unions. Further, current research by the Credit Union National Association indicates loan participation charge-off rates are lower than loss rates on many other credit union (and bank) loan products, including credit cards and home-equity loans.

NCUA has also ignored that much of the loan participation losses that have occurred in the credit union industry are as a result of isolated incidents that should be dealt with individually, or have been incurred due to fraud…completely outside the realm of the rule's proposed solutions to fix perceived safety and soundness risks.

Arbitrary Limit on Purchases Involving a Single Originator

OCUL further believes that NCUA has not provided any specific data or concrete rationale in many of its arbitrary limitations, as cited in the summary section above. Of greatest concern, is NCUA's proposed ceiling limitation of 25% of the purchasing credit union's net worth on loan participations from any one originator, with no possibility of a waiver.

OCUL believes that this artificial means to control concentration risks, by imposing an arbitrary cap, will have a deep and negative impact on the loan participation market for numerous reasons. It is unclear as to why this cap is needed and how it would control risk.

Effective loan participation programs are built around ongoing and trusted relationships over time, many times through a credit union service organization (CUSO) that provides uniform origination, underwriting, and servicing. The proposed cap will result in credit unions needing to search for other, less-known loan participation partners. This, along with decreased experience with each partner will only result in increased risk to purchasing credit unions. Many credit unions limit the number of entities that they purchase from in order to adequately monitor them on a regular basis. With the loss of familiarity and the forced increased number of partners, the impact will increase overall administrative costs and ultimately result in fewer loans available to small businesses.

The lack of a waiver process only further undermines the needed flexibility that would allow credit unions and CUSOs with a history of safe and sound loan participation operations and successes to further increase loans, spread risk, and increase revenue.

More importantly, smaller credit unions, in particular, would be impacted. First, small credit unions do not have the resources to initiate and conduct the monitoring of numerous loan originators. The new limitation will negatively and severely impact (if not terminate in some cases) one of small credit unions' best tools to increase loan volume and spread risk. Small credit unions have never struggled more to survive today, and this represents one more regulatory hurdle they simply do not need. Second, larger credit unions will be less willing to sell participations to smaller credit unions if the amount they can sell to each is limited to 25% of the purchasing credit union's net worth. All together, the resulting impacts above represent one more door shut to opportunity to get loans into the hands of qualified members…and real income, not investment income on to the books of small credit unions that need it most.

NCUA's proposed rules are not in sync with, and are not supportive of, the spirit of President Obama's Executive Order that requires new regulations, among other factors, to "promote economic growth, innovation, competitiveness, and job creation." The most pervasive impact of the arbitrary cap on purchases from one originator is increased costs and lower incentive to use loan participations as a means to spread risk and increase loan volume, as corrected loan participation data reveals.

Finally, NCUA should adopt a common sense approach to its regulations that would provide credit unions opportunities and flexibility for growth and service to their members and businesses that they serve. NCUA only appears to seek to ever-expanding rules that <u>all</u> credit unions must hurdle, regardless of past experience and safety and soundness controls in place. Regulations should be adopted to help credit unions operate efficiently and effectively, and should not be so egregious that credit union growth would be at risk.

Limitations on Purchases

OCUL does not support NCUA's provision that would limit a credit union's loan participation purchases to those involving loans that the purchasing credit union is authorized to originate. This provision would severely curtail loan participation programs by further limiting a purchasing credit union's abilities to diversify their lending portfolio, even if the purchasing credit union has the resources and expertise to monitor the performance of the loan. Small credit unions, in particular, would have great difficulty in monitoring multiple credit unions' services and underwriting standards. Overall, NCUA's proposed provisions would limit the pool of credit unions that originating credit unions could sell participation interests to. Its long-term impact would decrease diversification and negatively impact loan participation programs and interests.

Dual Chartering Implications

OCUL is increasingly concerned over NCUA's continual encroachment into the affairs of the state chartering system, providing critical, safe, and local balance and alternatives to credit unions in conducting their business affairs. While OCUL fully supports safety and soundness involving loan participations, NCUA's rules leave little to no leeway for state regulators to develop loan participation rules or guidelines that address local business programs or ventures that can be fully monitored and regulated by the respective state regulators, and that can further diversify and spread loan risk.

NCUA's unwarranted expansion of its loan participation rules is the latest example of how a "one-size-fits-all" approach further limits creativity and business opportunities – for credit unions, businesses, and their members. Requiring all federally-insured credit unions to conform to the same limitations and underwriting standards that apply to federal credit unions, denies state regulators the ability to develop even stronger and more flexible rules over time. Federal and state credit union systems are supposed to challenge each other, and have proven to dramatically improve the credit union system over time (i.e. share drafts, ATMs, field of membership diversity, etc.).

Conclusion

OCUL believes that NCUA's underlying loan participation research/data, arguments, conclusions and proposed regulations are generally flawed and counterproductive in addressing perceived concentration risks and safety and soundness concerns. OCUL does not find sufficient and valid arguments for why NCUA finds loan participations a systemic risk to the NCUSIF, therefore, we strongly urge the NCUA to withdraw its proposal.

Of gravest concern is NCUA's proposal to rein in loan participation programs by implementing standard, one-size-fits-all caps and standards, without waiver considerations in some cases, in order to reduce concentration and safety and soundness concerns. OCUL finds that NCUA's conclusions will have the opposite effect: curtail loan participation volume; decrease lending portfolio diversification; increase credit union costs to find and monitor more credit union loan participation partners; and, create more regulatory burdens and roadblocks.

The proposed regulations handcuff state regulatory agencies in developing flexible state regulations that meet local needs, impose restrictions to diversify loan portfolios to only those credit unions with like lending portfolios, and will make credit unions' efforts in serving the needs of their members all the more difficult and complicated.

OCUL believes there are alternatives to NCUA's arbitrary standards to improve loan participations within the credit union industry. One alternative would be to require that credit unions adopt a loan participation policy with a limit on loan participations purchased from a single originator, with the limit commensurate with the safety and soundness controls in place (similar to the approach the NCUA utilized in the recently finalized Interest Rate Risk Rule). Rather than flooding all credit unions with burdensome rules, NCUA should communicate detailed guidelines/best practices that recognize loan participations as one of the best lending and income producers today and how risks are best controlled. Individual credit unions not practicing safe and sound procedures should be dealt with appropriately through NCUA's examination process.

OCUL appreciates the opportunity to comment on NCUA's Loan Participation proposal. Thank you for your consideration of the comments presented. OCUL is available to provide additional comments or information on this proposal if so requested. If you have any questions, please contact me at (800) 486-2917 or jkozlowski@ohiocul.org.

Respectfully submitted,

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