Patelco

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January 24, 2012

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

Via Federal Express

To Whom It May Concern:

This is a comment letter to the proposed changes in the loan participation regulations 12 CFR Parts 701 and 741 (Loan Participations; Purchase Sale and Pledge of Eligible Obligations; Purchase of Assets and Assumptions of Liabilities). We will cite the proposed changes and provide comments as appropriate.

1. *Part 701.22 now applies to state chartered federally insured credit unions ("FISCUs") in addition to federally chartered credit unions ("FCUs"), collectively "FICUs".* We do not have any comment on the proposition that would apply uniform rules to all FICUs. As a practical matter, credit unions tend to follow Part 701.22 in order to have the widest possible number of potential loan participation buyers. However, see our comment number 10 below on the clarification that this proposal will not adversely affect a state credit union's investment powers in loans.

2. *The underwriting standards in purchasing a loan participation may not be less stringent than the underwriting standards in originating the same loan.* We do not have any opposition to this requirement.

3. *The originating credit union must 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 oppose this requirement as a general principal. We understand that NCUA wants the originator to have an economic interest in the performance of the loan so that the originator is incented to originate high quality and economically viable loans. Patelco actually has a provision in our policy that requires that the originating institution retain at least 10% of the loan. However, we feel that this decision should be left to the originating and purchasing institutions, as some credit unions use the sale of loan participations to manage their aggregate business lending cap. Placing additional restrictions on participation loans may slow credit union business lending in areas of the country where bank lending restrictions have already hindered the financing of small businesses.

4. *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.* We understand that the proposal is intended to act as a firebreak keeping the ills of one originator's loan portfolio from spreading to a concentrated group of participant credit unions. The idea is that these concentration limits will prevent loan failures from becoming systemic. This is an easy rule to apply and appears rational in its design, however, there are unintended adverse consequences that need to be considered and an alternative process that would better addresses these risks.

Solid loan participation programs are generally built on ongoing due diligence and time-tested performance. 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 based on years of performance. As such, we limit the total amount of entities that we will purchase loans from in order to adequately monitor these institutions on a regular basis. Some of these relationships are centered around a commonly owned CUSO, where the CUSO provides uniform origination, underwriting, and servicing. For every bad loan participation relationship, there are dozens upon dozens of good ones, where the yield from good quality loans is shared between trusted partners.

This proposal will disrupt those trusted relationships, and will result in credit unions searching for other, less known loan participation partners. This increase in the number of partners, and decrease in familiarity of each partner, will result in increased risk to purchasing institutions. 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 amount and cost of due diligence to rise significantly as new partners are vetted; and if done incorrectly lending risks will increase.

The number of credit unions that are very effective in sound business lending is a small subset of all credit unions making business loans today. 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 market place attempting to fill the void. As credit unions need to turn away from trusted sellers and look for other sellers, brokers will see an opportunity to push loan participation interests on some of the less experienced credit unions.

We understand the concern of NCUA, but we recommend a different approach to the problem; an approach that does not break-up loan participation relationships that have proven over time to be successful, but instead focuses examination resources on each institution's participation due diligence and underwriting practices. The industry cannot mature and grow if our regulations do not respect credit unions that are well managed and opportunity is taken from them due to the inadequate practices of others.

5. *A credit union may not buy loan participations 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. This provision can be waived.* We again understand the proposal's intent to limit a credit union's exposure to one borrower or group of borrowers. However, we feel that there may be unintended consequences to both members and active credit unions. For instance, a credit union may have a very long relationship with a strong and growing business. However, if the total loans outstanding to the business were to reach the 15% cap, a well cultivated customer may be forced to find additional financing elsewhere. This example shows how a cap in this area would restrict the credit union's ability to attract highly successful business members (with growth plans) and/or retain them once they reach a specific size.

Additionally, the proposed 15% limit does not appear to take into account business structures and/or cash flow sources that, in some cases, provide good diversification within a group of associated borrowers. For example, if one guarantor had five separate bankruptcy remote businesses, that owned five separate commercial properties, in five separate parts of the country, with five different leases, to five different lessors, this would provide significant diversification based on the fact that no one business is dependent on the other, and a resulting bankruptcy of any one borrower or the guarantor, would not materially impact the remaining businesses. The proposed limitation above does not appear to address this point, or any other material points related to business structure and/or cash flow sources. As such, we recommend that the provision include exceptions similar to those noted above.

6. *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." When a pool of loans is referred to, is this a reference to a securitized pool of loans and a collection of loans sold in a pool format that are not securitized? Further clarification is required.

7. *Recommended new term: Regarding the ability of credit unions to sell loan participations in loan purchased under the eligible obligation rule.* We note from this recommended change, that when a credit union buys an eligible obligation, the credit union could 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 union 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 reasonable justification for prohibiting the sale of a seasoned loan. The fact that the loan is seasoned gives a buyer the opportunity to see the performance of the loan prior to purchasing.

8. *Recommended new term: Regarding the ability of a purchaser of a loan participation interest in buying a loan where the originator obtained a regulatory waiver.* Another threat/restriction to a credit union's liquidity position 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 based on potential inconsistent application (from region to region) and time delay caused by the process. We recommend that if the originating institution obtains a waiver for a loan, any (eligible) credit union would be able to buy a loan participation interest in that loan, via the originating institution's waiver, and does not have to obtain an additional waiver.

9. *Recommended new term: Regarding organizations eligible to buy a loan participation interest.* There appears to be no supportable 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 could be an opportunity to bring in more liquidity from outside the credit union marketplace to better provide for members through higher servicing revenues and greater lending balances outstanding.

10. *Clarification of the investment powers of state chartered credit unions.* There are state chartered credit unions that have investment authority to invest in loans and loan participations. For example, Georgia chartered credit unions may invest in loan participations on loans issued by a financial institution regardless of the percentage retained by the financial institution and regardless of the membership issue. We ask that NCUA clarify that it is not attempting to pre-empt or otherwise curtail that power through this proposed regulation.

Respectfully,

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