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January 31, 2012

Mary Rupp
Secretary of the Board,
National Credit Union Administration
1776 Duke Street
Alexandria, Virginia 22314

RE: *Loan Participations; Purchase, Sale and Pledge of Eligible Obligations*

Sirs:

We are writing to comment on the NCUA's proposed regulation of loan participations. As an institution we have both acquired loan participations and sold loan participations. These participations have been based on underlying credits that are both consumer and commercial loans. As a general rule we are very supportive of the regulatory ability to perform both functions and we believe that the NCUA should be as well.

Let's look at the loan participation process from an institutional and from an industry perspective. From the perspective of a moderately sized federal credit union we find the opportunity to participate in and to participate out loans of great competitive advantage, particularly on the commercial side of the house. We all operate under single loan to one borrower limitations which are an inhibiting factor in building a credible commercial lending practice. Generally, these limitations pale in comparison to the size of loans that can be acquired by the very largest financial institutions in our region.

Commercial lending is good for our balance sheet and good for the industry as it diversifies the risk exposure of the institution by allowing investments other than consumer and mortgage loans. To the extent we can "participate-out" these loans; we are able to remain competitive in the market and to spread the diversification benefit to smaller credit unions that do not have sufficient staff to underwrite such credits. This is not an unusual practice on the commercial front and indeed we wonder what the benefit would be to limiting the investment in participations to a percentage of capital.

Generally speaking, these investments are made with well known, collaborative groups of local institutions to the good of everyone involved. Pushing investment-starved credit unions away from such local collaborations will expose them to unknown actors with unknown, but potentially dangerous, consequences. For those unable to secure healthy participation interests above the proposed threshold both earnings and diversification benefits will evaporate, exposing these institutions to dangerous concentrations in assets where reasonable returns can only be had by incurring greater risk.

One need only look to the most current economic outlook and note that there is a shortage of good assets in which to invest that promise any reasonable return, and the Federal Reserve has recently committed to keeping this yield structure in place until 2014. One wonders whether it would make more sense to require third party due diligence on participations for those institutions that do not have the in house expertise to evaluate the underlying credits in question.

The proposed investment limitations in requiring a limit of 25 percent of net worth from one originating lender and 15 percent limit for participations from a single or affiliated group of borrowers seems overly prohibitive and aimed at two different issues. The latter is consistent with traditional debt to single borrower limitations that have been around forever. On the other hand, the former seems to penalize good originators for the ills of a few selected originators and seemingly misses the point of looking to the underlying quality of the credit.

In this respect, we have worked for years with a CUSO that provides commercial lending and support services and conducts an analysis of commercial credits that are offered to participating institutions. Like the CDO crisis we are all recovering from nationally, the initial regulatory focus was on the structure of the deal when in fact the underlying weakness was in the collateral that was packaged into these structures.

On another level, we as an institution have been actively and profitably engaged in the indirect automobile lending business. And, over the past 18 months have been actively selling participations in pools of consumer indirect loans. Like commercial lending it is a business that suffers from selective attention to the market and when successful generates volumes that can support our institution and several others when these loans are carefully packaged, underwritten and sold to participating institutions.

Unlike large commercial credits that are participated, these investments are composed of hundreds of small credits diversified over dealers, geography and consumers and represent an extraordinary value, return and short durations. Earnings, default losses, recoveries and related expenses are shared on a loan by loan basis to ensure that the investments are not treated and equity interests in the pool. These are loans that are unattainable for the most part by smaller credit unions unless they venture into indirect lending, which we do not advocate for a multitude of reasons related to the complexity of the market.

Furthermore, our ten percent retention of the sold participations figures heavily in the choice by investors to acquire a participation interest from the credit union. Indeed, this retention feature is a part of almost every single proposal to reform the mortgage market and one we advocate as a means of ensuring quality underwriting. Why would the NCUA want to limit this activity on either side of the transaction?

It is probably axiomatic that flat, percentage based rules are simple to administer but they inadvertently incentivize alternative behavior that is even worse. Additionally, it is an action that will precipitate market entry into a "form of investment" that will require a broad, impersonal, national and possibly fee-driven agent to facilitate the acquisition of a badly needed investment.

We know it is not the form of the investment vehicle but the substance of the investment that matters; asset quality. This coupled with sufficient requirements for due diligence around the acquisition of a participation will better serve the industry than any percentage backstop that the NCUA can devise. A rather more direct approach of examining institutions and CUSO's that generate participations is

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preferred to a rule that blinkers an entire industry and fosters bad behavior, perverse market entry, and unknown incentives to institutions desperate for earning assets.

Sincerely,

Edward P. Shea

EVP, Chief Operating Officer
First Citizens' Federal Credit Union