PortAlliance
FEDERAL CREDIT UNION

February 7, 2012

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

RE: Comments on "Proposed Rule on Loan Participations"

Dear Ms. Rupp:

We appreciate the opportunity to respond to your office in reference to the proposed new rules on Loan Participation. The NCUA has provided credit unions with procedures, guidelines, evaluation documents and guidance as it applies to new regulations and proposed rules on existing regulation. We appreciate your office providing us the tools necessary to comply with new regulations or allowing us to provide comments in reference to changes to existing regulations.

PortAlliance Federal Credit Union buys and sells loan participations and we have been doing this for over six years. Our loan participation programs are built on a foundation of extensive due diligence. We manage these programs by having sound procedures in place to monitor and manage the associated risk with loan participations.

This letter will address the proposed changes to 12 CFR Parts 701 and 741, Loan Participations; Purchase, Sale and Pledge of Eligible Obligations; purchase of Assets and Assumption of liabilities.

PortAlliance Federal Credit Union analyzed the potential risk that these new rules would have on the credit union industry. We reviewed our Loan Participation Policy, Loan Participation Philosophy/Methodology, Concentration Risk Policy, and Strategic Plan for 2012 and used Enterprise Risk Management as the tool to help determine existing and potential risk that these new rules would have on credit unions. The results from our review concluded that adding these additional requirements and restrictions on loan participations would have an unintended negative impact on the credit union industry.

The following are our credit union's responses to each one of the rule changes along with a recommendation, a solution, a suggestion or a need for clarification.

Respectfully submitted,

William E. Owens III President & CEO	Robert McMichael Project Manager & Financial Analyst	Nathalie Williams Director of Marketing, Strategy & Project Administrator

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1. *Part 701.22 now applies to state chartered federally insured credit unions ("FISCUs") in addition to federally chartered credit unions ("FCUs") collectively "FICUs".* Response: We think that this is a good rule due to the fact this will provide uniform rules to all FICUs. We also understand that credit unions follow Part 701.22 due the fact this rule provides the widest possible number of potential loan participation buyers.

2. *The underwriting guidelines standards in purchasing a loan participation interest may not be less stringent than the underwriting standards in originating the same the loan* Response: Our credit union reviews the underwriting guidelines of the selling credit union. The selling credit union's underwriting standards may take into consideration the geographic area and the member demographics. Other considerations would be the unemployment rate in the area and the economy. We require the selling credit union to provide us reporting on how these loans are performing. Underwriting is not about the same size fits all, it's all about how the portfolio is performing or will perform. Underwriting is one of the most important components of loan participation and therefore extensive due diligence is required. Our recommendation is that the examiner obtain a good handle on underwriting and confirm that all the proper due diligence has been completed. Our goal is to make sure we understand their underwriting guidelines, and that they meet or exceed our expectations. This whole extensive due diligence process will reduce credit risk.

3. *The originating credit union must retain at least ten percent (10%) interest in the loan throughout the life of the loan.* Response: Our credit union understands the concept of the originator holding on to at least 10% of the face value of the loan and therefore having more economic interest in the loan. With the originator having more economic interest they may provide the buyer with more performing loans. We agree with the originating credit union having at least ten percent (10%) interest throughout the life of the loan. This concept also makes sense with the selling credit union servicing the loan due to the fact they now have more equity in the loan.

4. *Clarification of comments regarding pools of loans.* The proposed section 701.22 states- that loan participations do "not include the purchase of an investment interest in a loan pool." In the comments to Part 701.22 it states, "This provision clarifies the existing prohibition against a FCU purchasing a participation certificate in a pool of loans." Response: Purchasing investment interest in a loan pool may require an additional set of guidelines and may bring on additional risk and this is something we have no interest in at this time.

5. *Recommended new term: Regarding the ability of credit unions to sell loan participations in loan purchases under the eligible obligation rule:* Response: Our credit union would have no interest in buying an eligible obligation due to the fact we can never sell a loan participation in that loan as the originator of the loan would not be a participant. We understand that this type of loan has liquidity risk and our credit union would be locked into this position. We agree with this aspect of the proposed rule.

6. *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. Response: Our credit union understands the concept that if a credit union obtained a waiver, for example, a waiver from the personal guarantee requirement and if a credit union desires to purchase a loan participation interest in that loan they must also obtain waiver. Our recommendation is that the originator of the loan obtained the waiver and the purchaser of the loan should not have to obtain another waiver on this loan. This new term will discourage buying credit unions from purchasing loans if they have to obtain another waiver. The only condition is the buyer of the loan must review the existing loan and if the status of the loan is the same as when the loan was made the waiver shouldn't be required.

7. *Recommended new term: Regarding organizations eligible to buy a loan participation interest.* The question has come up on why the NCUA wants to prohibit the sale of participation interest to non-financial institutions, for example an insurance company. If this was approved we see this as a potential safety and soundness issue. PortAlliance Federal Credit Union would not recommend this due to the fact we are talking about potentially a whole new set of rules and regulations in dealing with non-

financial organization and potentially a new sub-set of risk. We agree with this aspect of the proposed rule.

8. *ii. Establish a limit on the aggregate amount of loan participations that may be purchased from any one originating lender, not to exceed 25 percent of the credit union's net worth;*
   We agree that more supervision may mitigate systemic risk; however, more regulation would increase overall risk as it limits diversification of loan portfolios, lessens earnings, and hinders loan growth. Credit unions, unlike banks, have limited means by which to manage the balance sheet (e.g., banks can sell stock or shares when they need additional capital, where credit unions cannot). Restricting loan participations in the manner proposed would hinder one of these avenues (e.g., a credit union could sell loans to increase capital versus borrowing from a line of credit or running a certificate special which might increase interest rate risk).

   There is no bigger risk than establishing, building and perfecting a relationship with another credit union. Under the present regulations, we can simply find one buyer or seller for loans we wish to sell or purchase loans with. Before that transaction takes place, we undergo a process of due diligence to ensure the relationship with the other credit union is safe and sound, and we continue ongoing due diligence with the purchasing or selling credit union periodically. With the proposed regulations, overall risk would increase and operational efficiency would decrease as we would likely have to seek out multiple credit unions to transact with, forcing us to perform ongoing due diligence on multiple relationships. One can mitigate risk without discouraging continued growth by increasing supervision, not regulation. By increasing regulation instead of supervision, this rule would cause unintended consequences and restrict the opportunities credit unions currently have to manage loan portfolios and, in turn, their balance sheets.

9. *A credit union mat not buy loan participations interest in loans to a single borrower or group of associated borrowers where aggregate amounts exceeds 15% of the purchasing credit union's net worth. This provision can be waived.* Response: Having the waiver option in place is a good thing; however, a credit union with a well- managed and profitable loan participation program should not have to request a waiver. Loans that are made by well managed credit unions with tested underwriting guidelines to one borrower or a group of associated borrowers is underwritten based on whether cash flow is sufficient enough to make the payment along with extensive due diligence. We are recommending that we provide a similar solution for the single buyer or group of associated buyers where aggregate amounts exceed 15% as we did for a credit union that may not buy loan participation interest from a single originator that in the aggregate exceeds 25% of the purchasing credit union's net worth.

The Solutions We Suggest to Reach the Same Goal: An Alternative Approach to Mitigating the Inherent Risks of Loan Participations

We offer the following suggestion for consideration to maintain and increase supervision without restricting loan participation opportunities:

Don't establish limits tied to net worth. Net worth is not the right measure for this job. Explaining these limits is confusing and complicated. Using established Loan-to-Assets limits that credit unions already have in place, then using a percentage of total loans is much easier to put into perspective and thus, easier for Management and Board of Directors to understand and use as a tool to manage a credit union.

Use multiple factors or ratios to establish limits, such as percentage of total loans, capital ratio, and even CAMEL rating. **With this multi-factor approach, concentration limits of 25% of net worth as the NCUA is proposing should be prescribed to institutions where either of the following is true:**

1. **The credit union has a CAMEL rating of 4 or 5, or**
2. **The credit union's capital ratio, i.e., Net Worth/Total Assets, is below 7.00%.**

The following page illustrates an example:

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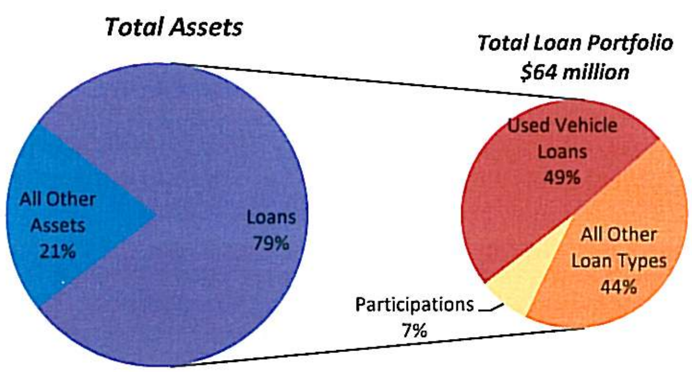
<table>
<tr><th>Using Loan-to-Assets Ratio and % of Total Loan Portfolio</th><th>Using Net Worth to Determine Limits</th></tr>
<tr><td>Assets = $81 million
Loans = $64 million</td><td>Assets = $81 million
Loans = $64 million</td></tr>
<tr><td>Total Loans = $64 million
Total Loans/Total Assets = 78.98%</td><td>Net Worth = $6.9 million
Net Worth/Total Assets = 8.43%
(well-capitalized by NCUA definition)</td></tr>
<tr><td colspan="2">We have: $31.3 million in used vehicle loans
$4.7 million in loan participations (purchased & interest retained)
$27.8 million in all other loan types</td></tr>
<tr><td>$31.3 million = 49% of Total Loans
$4.7 million = 7% of Total Loans
$27.8 million = 44% of Total Loans</td><td>$31.3 million = 454% of Net Worth
$4.7 million = 68% of Net Worth
$27.8 million = 403% of Net Worth</td></tr>
<tr><td>Credit union policies already prescribe limits on Total Loans/Total Assets.

This is much easier to understand and explain, because it talks about a 'piece of the same pie.' Credit Unions establish limits on loan participation concentrations WITHIN the total loan portfolio, and this is supervised by the NCUA examiner.</td><td>Comparing loan amount in relation to net worth makes no sense and is confusing to understand—no chart could explain this.

Monitoring Net Worth/Total Assets ALONG SIDE other ratios is more effective and easier to understand.</td></tr>
<tr><td>
</td><td></td></tr>
<tr><td colspan="2">EXAMPLE: We want to diversify the portfolio by selling $5 million in used vehicle loans and purchasing a $5 million pool of loans of another type in order to decrease our concentration in used vehicles.</td></tr>
<tr><td>Capital Ratio = 8.43% → evidence the CU is well-capitalized

CAMEL Rating ≠ 4 or 5 → evidence of sound practices in place</td><td>$5 million = 72% of Net Worth</td></tr>
<tr><td>Because we have sound policies and practices in place, and because we have performed due diligence according to our guidelines (all of which are reviewed by our examiner and in accordance with NCUA Guidelines), we would be able to diversify our loan portfolio by purchasing from one credit union without increasing overall risk and without decreasing efficiency.</td><td>With the proposed regulation, we would now have to seek out 3 different credit unions to purchase from instead of one. This increases overall risk and expenses to manage these multiple relationships, and decreases overall efficiency.</td></tr>
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Summary

PortAlliance Federal Credit Union made a decision prior to responding with our comments; that we would do a complete in depth review of the potential risk that this new regulation would have on the credit union industry. We used Enterprise Risk Management as the tool to help determine existing and potential risk that this new rule would have on credit unions. The results from our review concluded that adding these additional requirements and restrictions related to loan participation would have an unintended negative impact on the credit union industry and the share insurance fund. We responded to each proposed rule and then provided our recommendation, solution, suggestion or request for additional clarification.

Our research pointed to the fact that to have a well-managed loan participation program you must have a loan participation policy, participation philosophy, participation methodology, risk concentration policy supported by a concentration risk financial statement. You also must manage the participation program using Enterprise Risk Management as a tool to anticipate potential risk. We know the NCUA always has good intentions and we are suggesting that the NCUA train their examiners on loan participation. The theory is more supervision instead of more regulation.

In summary, we are not in favor of some of the proposed regulation that we believe would cause detriment to the credit union industry. Credit unions as a whole, under NCUA supervision, have managed loan participation programs well and should have the opportunity to continue to do so. We provide our alternative approach to mitigating the inherent risks of loan participations without unreasonably restricting those credit unions that have sound practices in place and pose no threat to the NCUSIF or the industry.