KINECTA
FEDERAL CREDIT UNION

February 11, 2012

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

Re: Comment on Proposed Rule on Loan Participations

Dear Ms. Rupp,

Please accept Kinecta Federal Credit Union's response and comment to the NCUA's proposed amendments to 12 CFR Parts 701 and 741 concerning loan participations.

Kinecta has been involved in loan participations as both the originating lender and the purchaser for several years. As a result of our experience in this business, we understand and appreciate the need for proper oversight of loan participations in the credit union industry.

Kinecta agrees with the Board's comment that, "...involvement in loan participations strengthens the credit union industry," and is pleased to provide this comment for our part in seeking to improve the management and oversight of the loan participation process. Kinecta's MBL platform focuses exclusively on commercial real estate term lending. Our comments herein will be directed towards that specific portion of the industry, and we hope that our comments will be helpful to the NCUA in its consideration of the proposed amendments.

Our concerns related to the amendments follow in their order of importance to Kinecta:

Guidelines versus Broad Regulation

Some prior responses to the proposed amendments include comments that the NCUA and credit unions would be better served by the establishment of guidelines via policy statements that outline prudent participation lending and due diligence standards versus overarching regulations. **We agree with this approach.**

Regulations should define principles and set bright line standards where appropriate; however, the means needed to address more complex issues and policies should be provided to credit union MBL lenders through policy statements that work to set "best practices" in the industry.

Single Originator / 25% Concentration Limit on Loan Participations

We **disagree** with this provision of the proposed amendments. We believe the proposal to limit loan participation purchases involving a single originator to a maximum of 25 percent of a federally insured credit union's net worth is misdirected and will produce adverse unintended consequences for a number of reasons.

First, when a purchasing credit union nears this cap, the limitation will force the credit union to seek relationships with other credit unions who may not have the same high quality underwriting standards as their existing relationships or, alternatively, would force the credit union to seek different types of loans that they are not historically experienced in.

Second, credit unions spend a significant amount of time establishing relationships and understanding the type of debt that they participate in. The proposed cap will add additional effort and expense when vetting new relationships and loan types. This in turn will drive member's borrowing costs higher and simultaneously put credit unions at a competitive pricing disadvantage with other lending institutions. Any new regulation should seek to encourage deeper relationships among credit unions who transact together, not force credit unions to venture to new, potentially riskier partners and products than commercial real estate secured lending.

Third, originating lenders may become capacity constrained by reaching their MBL cap and, without any other alternative to free up capacity to continue to lend, might be forced to suspend their MBL program.

This proposed amendment will also serve to increase the systemic risk in the industry by mechanically forcing credit unions to venture into new relationships and lending areas and will drive down profitability by increasing counterparty risk and loan due diligence costs. The proposed amendment and the 25 % level are not supported by empirical data and appear to be arbitrary in intention and anticipated effect.

Should the rule be adopted, we strongly encourage the Board to include a provision allowing for exceptions to the rule via waiver from the credit union's regional director. The waiver process will allow credit unions with well established relationships, a robust program with appropriate controls, minimal charge-offs and strong oversight to defend their program and document why their underwriting and processes actually limit risk even though they will exceed the new cap.

Underwriting standards: Section 701.22(b)(5)(i)

We **disagree** with the specific wording of this proposed amendment as well as the stated intent.

The proposed amendment may seem wise in the intent to have prudent underwriting standards, but it will serve to create a vast array of negative issues in the process. Specifically, the phrase "same underwriting standards" is ill-defined and nebulous.

In concept, taken alone, it appears thoughtful to compare one credits union's underwriting standards to another's and to have the originating standards aligned with the participating standards; however, it becomes problematic in practice. As an example, are the standards to be taken as a whole for the assessment of the credit risk or in very specific detail?

The Board comments that the removal of the current exception allowing a credit union to purchase a loan participation originated with different underwriting standards than it own "...prevents a FICU from purchasing a loan participation originated with less stringent underwriting standards than the FICU uses in making its own loans." (emphasis added) This comment is as troubling as the terms of the proposed amendment. The troubling aspect of this provision is that removal of the exception will force the industry to regress to a mean of ever more restrictive underwriting standards. Practically speaking how will underwriting standards be objectively compared to determine whether one credit union has "less stringent" standards?

To illustrate this point, when making a commercial real estate loan the originating credit union should mark the property's rents down to market, except in the case of a credit-rated long term tenant. But what happens when the purchasing credit union marks all rents down to market, irrespective of the tenant being credit-rated? Such a difference in underwriting standards could result in the buying credit union having to perhaps pass on the opportunity for a very conservative loan with a low loan-to-value ratio and a higher than usual debt service coverage ratio all for the sake of a conflict in one very specific underwriting standard.

We suggest revision of the regulation to either substitute "credit policies" for "underwriting standards", or keep the proposed verbiage and add "...and document the rational for the deviations from the underwriting standards".

Ten percent Originator Retention

We have **no objection** to the proposed regulation requiring the originating credit union to keep a portion of a loan it originates for the life of the loan.

While we do not opine as to the appropriateness of ten percent as the standard, it does appear to be reasonable. The adoption of a more flexible standard may be appropriate in the future; however, a clear common standard will avoid confusion.

Other concepts that we suggest be incorporated into participation agreements are "first loss" and "greater loss" provisions. In our experience, lead originators/servicers that control any legal action on a loan in the event of default do not bear a significant expense or loss burden compared to the cost borne by the participants who usually have a greater percentage ownership in the loan.

Extending Regulations on Participations to FISCUs

We have **no objection** to the proposed amendment expanding loan participation oversight to FISCUs.

We believe that this would foster standardization which would promote the loan participation market and increase the level of participation activity.

Single Borrower / 15% Concentration Limit on Loan Participations

We have **no objection** to this aspect of the proposed amendment and believe it adequately addresses safety and soundness concerns without impeding the development of credit union business.

Loan Participation Agreements: Section 701.22(c)

We have **no objection** with the provisions of section 701.22(c) dictating the content requirements of a loan participation agreement. We would encourage the development of principles that guide originators in developing a strong participation platform as well as principles that govern participant on-going servicer monitoring.

We appreciate the opportunity to comment on the proposed amendments and trust that the commentary will prove beneficial to the amendment review. We look forward to continued interaction with the NCUA in order to promote the safety and soundness of the industry and its financial health for the benefit of credit union members.

Please do not hesitate to contact us for any additional assistance you may seek.

Sincerely,

Paul Cleary

Paul Cleary
First Vice President
Member Business Services

Cc: Roger Ballard, CEO, Kinecta Federal Credit Union
Brian Robinett, CCO, Kinecta Federal Credit Union