The Cypress Group LLC

February 13, 2012

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

RE: Proposed Rule on Loan Participations (CFR Parts 701 and 741)

Dear Ms. Rupp,

I am the President of The Cypress Group, LLC, a credit union service organization (CUSO) located in Orlando, Florida. Our CUSO was formed in December 2003 to provide member business lending services for our seven credit union owners which include the following:

- Campus USA Credit Union (Gainesville, FL)
- CFE Federal Credit Union (Orlando, FL)
- Community First Credit Union of Florida (Jacksonville, FL)
- Grow Financial Federal Credit Union (Tampa, FL)
- Pen Air Federal Credit Union (Pensacola, FL)
- Space Coast Credit Union (Melbourne, FL)
- Tropical Financial Credit Union (Miramar, FL)

The purpose of creating an MBL CUSO was to allow our credit unions the opportunity to offer business loans to their membership while sharing a common set of underwriting and documentation standards. Over its existence, the CUSO and CU owners have been successful in developing a collective expertise which benefits each of the CUs in building solid, well-balanced and profitable MBL portfolios.

The operating model chosen by The Cypress Group limits the CUSO's services to its owners. We are not a CUSO which solicits new credit unions as either owners or subscribers. As such, we serve as the de facto credit and documentation department for our credit unions. This model allows us to work with the decision makers within the credit unions (senior lenders / business loan committees) to properly identify, assess and mitigate risk associated with business lending. Under this model we are also able to establish a stronger working relationship with the loan officers at each CU to better target lending efforts. The credit unions maintain their own portfolios and handle their own loan servicing.

The Cypress Group is supportive of the Board's continuing efforts to improve industry standards while ensuring credit unions are able to diversify their investments, generate acceptable returns, and offer members an array of competitive lending products. The proposed amendments on loan participations being considered by the NCUA Board are of great interest to us as they directly impact our MBL operations.

The vast majority of our combined $400MM MBL portfolio is comprised of "in-house" loans originated and closed by the loan officers. Approximately 20% to 25% represent loan participations from within the CUSO or from outside sources (e.g. other CUSOs or credit unions).

1200 Weber Street • Orlando • Florida 32803 • 407.228.7664 Office • 407.898.3026 Facsimile

As concerns the proposed changes being considered by the Board, we offer the following commentary:

1. *Part 701.22 to apply to state-chartered federally insured credit unions in addition to federally-chartered credit unions.*

   We are supportive of this proposition as it will allow for a more consistent approach to assessing and mitigating risk in purchasing loan participations.

2. *Require that underwriting standards in purchasing a loan participation interest not be less than the underwriting standards in originating the same loan.*

   We are also in support of this proposition.

3. *An originating credit union must retain at least a ten percent interest in the participation loan throughout the life of the loan.*

   The Cypress Group supports this requirement as it induces the originating credit union or CUSO to be more diligent in soliciting and financing acceptable loan opportunities. While we acknowledge the challenge this requirement presents to originating credit unions that may be reaching the 12.25% cap on member business lending, we feel it is more prudent to raise the 12.25% cap than lower the 10% participation interest requirement.

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.*

   It is our firm opinion that this proposition will unnecessarily have a negative impact on our CUSO operations. The concern raised by the NCUA Board in proposing to limit purchases from a single originator is tied to the "interconnection between participants" and its potential to create more systemic risk to the share insurance fund. The proposal states that "large volumes of participated loans in the system tied to a single originator, borrower, or industry or serviced by a single entity have the potential to impact multiple credit unions if a problem arises".

   It has been our observation that the negative impact being observed across the credit union industry of purchases from one originator is not wholly attributable to the single nature of the originating CUSO or CU but, instead, is more indicative of the lending strategy of those CUSOs or CUs which serve as originators as well as the inherent industry risks associated with the participations being sold. <u>We feel it is more prudent to focus on the diversification of risk in a participation portfolio instead of limiting purchases from a single originator.</u>

   In building an MBL portfolio, it is imperative that a credit union follow a lending strategy which takes into account the following risks:

   Market Risk – defined at risks related to the overall macro-economic situation which are generally not within the control of the borrower. Such risks may be national or local in scope and will also impact similar businesses or industries with the same intensity. These risks can be classified more specifically as macro-economic risk, industry risk and geographic risk.

Credit Risk – defined as risks directly related to the business which may reflect weaknesses in its business plan, a limited or speculative financial track record, a non-demonstrated or unproven operating model, inexperienced management or unknown project desirability. Credit risk has its most direct impact upon cash flow of the business.

Valuation Risk – defined as the risks associated with properly ascertaining the value of the collateral being perfected and determining its marketability in the event of foreclosure or repossession.

Construction Risk – the probability of loss associated with the physical construction phase of a construction project due to non-completion, insufficient construction monitoring, fraud or contractor mismanagement.

Legal Risk – the probability that a defect in loan documentation, insufficient closing due diligence, or a change in law will affect the ability of the lender to get repaid or perfect its claim on collateral.

Furthermore, when determining its target markets, credit unions need to focus on the type of businesses to which they are lending. To assist our credit union owners to better refine their focus, The Cypress Group has classified borrowers in the following categories:

Type 1 Businesses – "Mom & Pops", Retail Establishments, Small Service Companies

Sales Revenue – Usually under $1,000,000
Loan Exposure Range – Less than $250,000

Advantages:

- Spreads credit risk over a number of smaller deals instead of concentrating it in a limited number of larger loans.
- Solicitation and marketing can be easily integrated into the existing branch network.
- Loans can be easily underwritten by the credit union, CUSO or, in some instances, by the CU Consumer Area.
- Only requires basic loan products and deposit services.

Disadvantages:

- Large number of relationships to manage means more operational costs.
- Borrowers and owners tend to have limited financial strength.
- Minimal deposit balances to be gained.

Operational Infrastructure Required – Business Loan Officer(s), Experienced Underwriter(s), Trained Branch Managers, MSRs, Loan Approval Officer or Small Business Loan Committee.

Type 2 Businesses – Legal, Medical & Financial Professionals, Wholesalers, Small to Mid-Size Manufacturers, Specialty Contractors, Technology & Other Services, Small to Mid-Size Non-Profit Organizations, Local Small to Mid-Size Churches.

Sales Revenue – Between $500,000 and $5,000,000
Loan Exposure Range - $250,000 to $1,500,000

Advantages:

- Highly-prized relationships comprised of stable businesses with good financial track records.
- Businesses and owners usually provide significant deposits.
- Good referral sources to similar businesses.
- Most of the time only requires basic loan products and deposit services with some customization on certain deals.

Disadvantages:

- Relationships are hard to solicit and require much proactive marketing due to strong competition from banks.
- Borrowers expect quick approval turnaround with minimal effort.
- Borrowers expect preferential treatment from branches and loan officer.
- Regional and National Banks have significant competitive advantages with unsecured lending products for professionals in this group (doctors, lawyers, etc.) as they tend to base their risk analysis on the professional field more than the individual.

Operational Infrastructure Required – Experienced Business Loan Officer(s) or Business Banker(s), Strong Underwriting & Documentation Expertise, Business Loan Committee.

Type 3 Businesses – Large Manufacturers, Real Estate Developers & Contractors; Hotels & Motels, Home Builders, Large Contractors, & Real Estate Investment Properties (Apartments, Office and Retail), Large Non-Profits Organizations or Large Churches (Local & Non-Local)

Sales Revenue – Between $1,000,000 and $20,000,000
Loan Exposure Range - $1,500,000 to $25,000,000

Advantages:

- Large loans with only minimal CU operational costs (these type of borrowers are not heavy users of the branch network).
- Relationships comprised of experienced borrowers with many potential projects available for temporary or permanent financing.
- Businesses and owners usually provide good (but not significant) deposits.
- Relationship network provides numerous referrals with minimal proactive marketing required (loan brokers & participation networks available).

Disadvantages:

- Loan requests tend to be specialized projects or higher-risk requests that require customized underwriting and documentation.
- Difficult to get an accurate picture of true financial strength as borrowers & principals tend to "splinter" their financial assets and income-generating properties into numerous corporations and holding companies. Deals are evaluated on more of a "project-specific" basis and not a global basis.
- Projects tend to have a speculative or non-demonstrated component to the primary source of repayment requiring specialized knowledge by the decision makers on the loan committee.
- Borrowers or principals are usually hesitant to provide full financial disclosure.
- Borrowers are very interest rate and fee sensitive resulting in tighter net interest margins
- Limited loyalty to the CU as the borrowers & principals approach commercial lending relationships on a project-by-project basis.

Operational Infrastructure Required – Experienced Commercial Lender(s), Administrative Assistant for Commercial Lender(s), CU Underwriting and Documentation Expertise in Specialized Commercial Lending, and Experienced Loan Committee Members.

Each credit union must determine which types of business it seeks to target when building its MBL portfolio. Depending on its asset size and/or operational resources, a credit union may not be in a position to actively solicit loans from all three types of borrowers. They may be better served by only targeting Type I or Type II businesses and being cautious about financing Type III transactions.

The challenges being faced by credit unions which seek to purchase business loan participations is that there are very limited loan participations available which reflect Type I or Type II businesses. Because these types of businesses are more desirable there is less incentive for an originating credit union or CUSO to offer them as participations to other credit unions. They would prefer to keep such types of businesses for themselves as these loans provide a diversified and local foundation to a strong MBL portfolio.

Because of the abundance of Type III transactions being presented and sold as participations by loan brokers and originating credit unions/CUSOs, the loan participation market is skewed towards inherently higher-risk projects and loan structures. The effect of this imbalance is visible in the recent challenges experienced at some large credit unions or MBL CUSOs which built their operating model upon the origination, sale, and servicing of loan participations to small and medium-sized credit unions. There has been a mismatch in the ability of the purchasing credit unions to understand fully the risks of the participations as well as their ability to continuously monitor those risks on a periodic basis. Those CUs least capable of affording loan losses are purchasing inherently higher-risk MBL participations.

In stating our opinion and observations, The Cypress Group does not mean to infer that all loan participations are unacceptable. *It is our opinion that the NCUA proposal to limit purchases of loan participations from any one originator to 25% of net worth does not adequately address the issue of the types of participations being offered in the marketplace. The systemic risk to the share insurance fund comes from the types of projects and borrowers being sold as participations and not necessarily because it is a single originator.* This is especially evident when the originating credit union or CUSO limit their strategy to only one type of borrower or project (i.e. large churches, hotels, office complexes, etc.). There are many originating credit unions or CUSOs which follow a strategy of diversifying the risk of the participations they offer to purchasing CUs. They also seek to help those credit unions which may not have adequate resources or expertise to fully identify, assess and mitigate the risks associated with the participation being offered.

In the case of the Cypress Group model, we are pro-active in reviewing and "re-underwriting" any participations being considered for purchase by our seven credit union owners from an originator outside our CUSO. When the participation originates within the CUSO, it is underwritten to common underwriting standards and policies shared by all seven credit unions and is, therefore, within the expertise and scope of our existing MBL capabilities. *To impose this NCUA proposition and limit purchases from the credit unions within our CUSO to each other when the standards and policies correspond would be to unfairly impair our ability to continue building a well-balanced and diversified MBL portfolio across all types of borrowers. To limit purchases from any one originator for all CUs or CUSOs will also unfairly impact those which are prudent in their portfolio strategies. We would recommend that the focus be placed upon evaluating the diversity of the loan participation portfolio*

as well as ensuring the proper level of expertise within each credit union rather than limiting purchases from any one originator.

5. *A credit union may not buy loan participation 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.*

   This revision is prudent and, by allowing for a waiver, allows for consistency with NCUA regulation 723 for member business lending when a credit union originates the loan itself.

6. *Regarding the ability of a purchaser of a loan participation interest when buying a loan where the originator obtained a regulatory waiver.*

   The Cypress Group would strongly recommend that the process for obtaining regulatory waivers on loan participations be amended to allow for the originating credit union to seek any necessary waivers and that such waivers cover all the participants without the need for each participant to duplicate such requests.

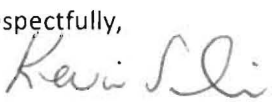
   The Cypress Group credit unions have submitted a number of waiver requests over the past two years related to renewals of MBLs and the higher loan-to-value ratios on commercial properties resulting from the economic downturn.

   The existing process of requiring each participant to seek a waiver from its own NCUA Regional Office has created an excessive burden for both the credit unions as well as the NCUA Regional Staff. It is necessary to prepare separate packages for each participant and to have many individuals spend time considering the same waiver request. When the waiver requests are limited to the same NCUA Region, each lead examiner for the participating credit unions needs to become fully acquainted with the request and, in the end, may decision the request differently than another examiner resulting in irreconcilable challenges (especially in the renewal of existing loan participations). The process can also become inconsistent when more than one NCUA regional office is involved.

   Overall, there is a lack of understanding how waiver requests are evaluated and the how the originating credit union or CUSO can easily respond to any concerns or issues which arise during the evaluation. It would be most helpful if each regional office had a similar process in place which could be is communicated to the credit unions and CUSOs. This would allow for direct contact, when necessary, between those evaluating the waiver requests and the originating CU staff.

We are most appreciative of the Board's continuing support and its emphasis on prudent lending practices. The challenges of the current lending environment require flexibility to ensure each credit union and CUSO can effectively manage portfolio risk while generating an acceptable investment return. We hope that our comments are helpful in providing a greater perspective of the variety of lending strategies and operating models within the credit union industry.

Respectfully,



Kevin S. Dion
President