Missouri Credit Union Association

February 21, 2011

Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street, Alexandria, Virginia 22314-3428
regcomments@ncua.org

RE: Michael V. Beall, Esq., - Comments on Proposed Rule on Loan Participations for Parts 701 and 741; 76 Fed. Reg. 79,548, proposed Dec. 22, 2011

Dear Ms. Rupp:

On behalf of the 1.3 million credit union members, the Missouri Credit Union Association (MCUA) would like to take this opportunity to express our views on the National Credit Union Administration Board's (NCUA's) proposed rulemaking regarding Loan Participations. We recommend that the Board withdraw these proposals, which would act to restrict the use of loan participations by credit unions.

Our response is informed by discussions and correspondence with member credit union officials who are directly involved with loan participation programs.

Loan participation programs are of high importance to credit unions, both those that originate and those that purchase them. Participations assist in managing the use of and need for liquidity. Participations aid in management of loan concentrations. Participations can improve returns for credit unions facing inadequate loan demand. Participations help to diversify lending risk by asset class and geographic concentration. Finally, participations sold to institutions outside the credit union system can add liquidity to the system.

The proposed rulemaking will make it more difficult for credit unions to originate and purchase loan participations by adding to the regulatory burden. This increased regulatory burden may, inadvertently, work to reduce access to credit for credit union members. Federally insured credit unions (FICUs) would be limited to a maximum of 25% of their net worth in participations purchased from one originator, and no waiver is available. Further, FICUs would be limited to 15% of their net worth in participations from one borrower or group of associated borrowers. State-chartered FICUs selling participations would be required to hold a 10% interest in the originated loan. Participation loans would have to meet the same underwriting standards the credit union uses when originating its own loan. Finally, FICUs would be limited to purchasing participations from eligible organizations. In combination, these restrictions will likely reduce the volume of loan participations sold because of the costs of monitoring and compliance on each side of the transaction thereby reducing the lending ability of selling institutions, and correspondingly limiting the ability of purchasing institutions to put excess liquidity to work in participated loans.

MCUA understands and supports the goal of reducing lending concentration risks with regard to loan participations. However, an arbitrary limit of 25% of net worth does not appear to appropriately mitigate that risk. We believe credit union boards should be allowed the latitude to determine the level of risk they can accept and manage. As a result of this limitation, smaller credit unions would likely be forced to establish relationships with a larger number of originators, increasing due diligence costs. Larger originators might be dissuaded from dealing with smaller purchasers as the smaller participation units would drive up administrative costs. Many credit unions have long-established and profitable relationships with a small number of partners, which result in deep understanding and mutual confidence. The 25% limitation may disrupt these successful relationships. A further unintended consequence may very well be that smaller participation-purchasing credit unions could abandon the idea of purchasing participations, and may be forced to search for higher yield elsewhere, in investments that are removed from a credit union's lending-based experience.

We believe that the loan participation proposals may in fact harm credit union lending, earnings and loan diversification, outcomes at odds with improving the safety and soundness of the industry. The requirement for originating credit unions to retain a 10% interest in the loans sold at first glance is an incentive for the originator to make good loans. However, the same result would be obtained from a smaller retention requirement, or a requirement to share in actual realized losses. By requiring a 10% interest retention, the selling credit union is effectively limited in the amount of new lending it can do. Further, if loan participation purchases are restricted to only those loans a purchasing credit union is authorized to originate, the result is another reduction in the volume of loan participation transactions, and the purchasing credit union would be unable to diversify its portfolio geographically and by loan type. Credit unions on both sides of a participation transaction benefit therefrom, the seller gaining liquidity to redeploy into additional lending and the purchaser putting excess liquidity to use. Credit unions are specialists at consumer lending. Loan participations help credit unions lend and serve their members' borrowing needs. Restrictions on loan participations unnecessarily reduces lending and reduces credit union earnings, and forces excessively liquid credit unions away from lending and toward alternative investments with risk profiles far different from their lending expertise.

Finally, the proposed restrictions will actually minimize risk mitigation from diversification. The 25% of net worth from one originator limitation will clearly result in fewer participations being purchased by smaller credit unions. Additionally, the limit of 15% of (purchaser's) net worth from one borrower or associated borrowers can be exceeded by waiver. Proper underwriting of all loans, including cash flow analysis, is of critical importance, but it is unclear why the 25% limit is a hard cap imposed on a participation consisting of possibly dozens or hundreds of borrowers and the 15% limit to a single borrower or group is flexible. Our instincts and experience indicate that participations representing more borrowers with more dispersed sources of income and perhaps more geographic distribution should be the preferred goal to limit overall loan portfolio risks. In conjunction with the limitation of participation purchases to loans the purchaser is authorized to originate, the proposal operates at cross purposes to the goal of diversifying loan portfolios to spread risk.

Missouri's credit unions work hard to serve their members' financial needs. The proposed restrictions on loan participations will only serve to make it more difficult for credit unions to respond to the credit needs of their memberships.

As always, we appreciate the opportunity to respond to the request for comments on NCUA's proposed rulemaking regarding Loan Participations. We will be happy to respond to any questions regarding these comments.

Sincerely,

Michael V. Beall, Esq.
President/CEO