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February 21, 2012

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

Re: Georgia Credit Union League's Comments on Proposed Rule on Loan Participations

Dear Ms. Rupp:

This comment letter represents the views of the Georgia Credit Union League (GCUL) regarding NCUA's proposal to amend its rule on loan participations. Our letter was developed with contributions from the GCUL Regulatory Response Committee, which has been appointed by the League Board to provide input into proposed regulations such as this.

As a matter of background, GCUL is the state trade association and one member of the network of state leagues that make up the Credit Union National Association (CUNA). GCUL serves approximately 149 credit unions that have nearly 1.9 million members. GCUL has concerns about the proposal as issued for comments, and we would respectfully ask that the Board withdraw it or revise it substantially.

The Georgia Credit Union League urges NCUA to reconsider the proposed rule on loan participations. We have had considerable discussion with a number of credit union officials who operate loan participation programs as well as a number of GCUL committees. Through these deliberations, it became obvious that <u>we could not support the proposal as drafted and would respectfully ask that NCUA withdraw the proposal.</u>

In today's over-regulated environment, this proposal would add to the regulatory burden of affected credit unions in a manner that is wholly disproportionate to the risks associated with loan participations. It would seem that this proposal is in conflict with President Obama's executive orders directing federal agencies to address and improve their regulatory processes and make sure that each agency makes sure that regulatory proposal benefits justify its costs; that each agency tailors its regulations to impose the least burden on society and considers alternatives that could accomplish the same compliance objective.

While the proposal seeks to address concentration risks and other issues the agency has identified concerning loan participations, it would do so at the price of severely limiting, if not eliminating, sound participation programs that serve credit unions, their members, and other credit unions well. The proposal would also seriously undermine lending programs and even earnings for some credit unions. Moreover, through the application of concentration and underwriting limitations, it would – contrary to the agency's goal of risk management – actually **minimize** the ability of credit unions to mitigate risk through diversifying sources and types of loan participations.

In addition, another concern is the one-size-fits-all approach. *All* credit unions would be subject to the same arbitrary caps, which is at odds with the agency's stated goal to tailor regulations to reflect real risk. It would seem instead of lumping all credit unions and all types of participations into one category, limits should be placed where real problems and risk exists.

In reviewing the proposal, the data NCUA shared in the proposal that is intended to support this regulatory action seemed to be unpersuasive, and the claim that loan participation activity creates more systemic risk to the share insurance fund to be unsupportable.

NCUA's Proposed Rule Weakens Dual Chartering

NCUA's proposal raises concerns with respect to the long-term viability of the dual chartering system. The League is concerned that the proposal would usurp a state's right to exercise authority in this area, and would serve to undermine dual chartering. Through the dual chartering, state governments were able to pioneer innovative new financial services. For example, the dual chartering system brought share drafts, ATMs, real estate mortgage lending, home equity loans, and field of membership diversity to credit unions. In fact, we should remember that it was on the state level that credit unions were first created in the United States.

Historically, state-chartered federally insured credit unions have looked to state law and regulation to govern their loan participation activities. With this proposal, NCUA is poised to do away with another distinction between state and federal charters. A strong, diverse dual chartering system allows the credit union network to work together on common challenges affecting the entire system. It ensures that federal and state credit unions regulatory structures challenge each other constantly to improve.

By requiring all federally insured credit unions to conform to the same limitations and underwriting standards that apply to loans originated by federal credit unions, and denying state regulators the opportunity to regulate these issues with their credit unions (especially involvement in waiver requests), the proposal would further erode the traditional and essential role that dual chartering plays. GCUA, on behalf of all credit unions, will continue to oppose efforts—such as this proposal—to preempt state authority without a clear and certain threat to the share insurance fund.

Comments on Specific Proposed Provisions

Associated Borrower

In the proposal, NCUA would define an "associated borrower" as "any borrower with a shared ownership, investment, or other pecuniary interest in a business or commercial endeavor with the borrower. This includes guarantors, co-signors, major stakeholders, owners, investors, affiliates and other parties who have influence on the management, control, or operations of the borrower." This definition seems quite broad and open-ended definitions leave too much discretion after the fact when trying to understand what went wrong.

No rationale has been given why the definition of associated borrower for purposes of loan participations is so much broader than the term's definition for member business loans. It would seem that the inconsistent definitions will cause "confusion" – which is one of the reasons given by NCUA for the need for this rule. This broad definition, coupled with a waiver process that NCUA considers possibly being unworkable and not viable by credit unions, will prove unnecessarily cumbersome.

We are not convinced that it is necessary to dictate a uniform associated borrower limit for all credit unions to protect the insurance fund. From the Fund's perspective, credit unions must demonstrate an awareness of the risks presented by associated borrowers and limits should be addressed in the credit union's policies. Because no evidence is presented that a 15% limit, sans consideration of any other mitigating factors, is anything other than an arbitrary restriction, the rule should allow state regulators to address regulatory requirements for state charters. At a minimum, the definition of associated borrower should be consistent between §723 and the proposed loan participation rule. For state-chartered credit unions, the authority to grant waivers should reside with the state regulator.

Definition of Credit Union Organizations is too Limiting

The proposed rule would define a credit union organization for purposes of loan participation regulation as "any credit union service organization meeting the requirements of part 712 of this chapter." Credit union organizations are among the entities that the proposed rule would allow federally insured credit unions to participate in loans. The other entities include any state or federal credit union, generally any bank, and government agencies. The definition as proposed would include all federal credit union service organizations (credit union service organizations or CUSOs) as eligible for participation in loans. However, the definition is not clear if it would include all state credit union CUSOs since at this time part 712 does not apply in full to state credit union CUSOs.

Limit on Purchases Involving a Single Originator

Proposed §701.22(b)(5)(ii) would limit credit unions from participating in loans, in the aggregate, in excess of 25% of their net worth from a single originator. There would be no waiver provision for the 25% limit. The 25% limit on originators in the aggregate seems to be of questionable regulatory value. It would seem that under-writing and servicing risks deserve more attention than originating lender risks. In fact, the 25% limitation might introduce more risk. Many credit unions that rely on purchasing loans have developed relationships with specific originators upon whom the purchasing credit union has performed due diligence.

Our credit unions are not convinced that the regulatory benefit of limiting exposure to a single originator outweighs the detrimental impact of disrupting established, effective relationships and forcing purchasing credit unions into the marketplace to contract with unknown entities. In addition, the lack of a waiver provision for this arbitrary provision conveys a lack of flexibility for a highly problematic limitation that we have yet to find a regulatory justification for.

The 25% limit would likely have a disproportionate impact on smaller sized credit unions. These credit unions do not have the resources to initiate and conduct ongoing monitoring of a number of loan originators. As a result, smaller credit unions often focus on purchasing loans from a single originator. In addition, larger credit unions that sell loans and loan participations to smaller credit unions will also be impacted. It is possible that larger credit unions may be reluctant to sell participations to smaller credit unions if the amount they can sell to each is limited to 25% of the purchasing credit union's net worth.

It is possible that this regulation, if adopted without material changes, could mean fewer loans would be originated if selling credit unions are concerned about having to find a number of additional credit unions to which they can sell their loan participations.

The 25% limit also fails to consider the differences in the types of loans being participated. Large pools of car loans, for example, represent many multiple streams of repayment, whereas an equal dollar amount of mortgage or commercial loans may rely on a far less diverse stream of repayment. Yet, the proposed rule makes no distinction.

<u>Purchase a loan participation only if the loan is one the credit union is empowered to grant</u>

Credit unions are concerned about the provision in the proposal that would limit their loan participation purchases to those involving loans that the purchasing credit union is authorized to originate. This provision could inhibit loan participation programs because it would prevent credit unions from investing in participations that involve loans that the credit union does not already make -- even if the credit union has the resources to monitor the performance of the loans. This would undermine the ability of purchasing credit unions to diversify their loan participations and limit the pool of credit unions to which originating credit unions could sell participation interests. This provision would be counterproductive.

<u>10% Originator Risk Retention Requirement</u>

NCUA's proposed requirement that credit unions only participate in loans where the originating entity retains 10% is problematic. While requiring retention of some part of the loan by the originator is a best practice, there is little justification for mandating that retention be 10% and there is no evidence that "skin in the game" lowers risk. While a10% retention may have been long required for federal credit unions, it is new for state charters and there is ample evidence that a retention level less than 10% might be appropriate. In Georgia, Credit Union Loan Source (CULS) presently keeps 1% of originations but owner credit unions keep a much larger portion than the 10%. And it should be noted that the Federal Deposit Insurance Corporation (FDIC) does not require a10% risk retention.

NCUA's 10% risk retention requirement should not be extended to state credit unions and absent NCUA identifying a compelling justification for a uniform 10% risk retention requirement, state law or regulation should control for state credit unions.

Waivers

The agency has asked for comments about its waiver process. We have heard reports that credit unions who have applied for waivers in the past have had problems that include the following: examiners discouraging credit unions from seeking a waiver; delayed responses from the agency regarding the waiver application; and a lack of adequate explanations for agency denials of the waiver request. With that as a background, we support the agency's efforts to review the wavier process and we urge NCUA to pursue comments from the credit unions about waivers separately to identify all material problems with the process and to ensure any changes will result in improvements to address problem areas.

But, in response to this proposal, if federally insured credit unions are subjected to a new rule on loan participations that contains concentration limits and the requirement that loan participations conform to underwriting standards, then we urge NCUA to allow credit unions to obtain waivers from these provisions. These waivers should allow credit unions to seek program waivers; not waivers for each individual purchase. In addition, credit unions whose programs demonstrate expertise should be allowed maximum flexibility to vary from various limits by policy or waiver.

At a minimum for state-chartered credit unions, the authority to grant waivers should reside with the state regulator. Any differences in assessments of credit unions seeking waivers should be able to be worked out between regulators.

Elements of the Proposal that Have Some Merit–

In our review of the proposal, we have found some elements of the proposal to have merit and wanted to share our thoughts about those elements.

- We believe that concentration risk is more tied to a borrower than to an originating lender, especially when a credit union-owned CUSO is performing underwriting, servicing and collections. So, we can understand some percentage of capital limitation is prudent and acceptable in practice, but we think that further study and analysis is needed before some arbitrary percentage is chosen.
- We support stronger due diligence ….purchasing credit unions should perform careful and competent analysis and monitoring throughout the life of the loan. Detailed contractual requirements for sourcing, underwriting and servicing/collections partners are essential.

And, contractual elements should address problem resolution at the partner and borrower level. Credit unions should address all major elements of risk in policies.

- In addition, servicers should be expected to provide routine loan performance updates to the purchasers and this type of due diligence should be included in contractual language.
- We would recommend to NCUA that regulators should provide credit unions with best practices advice for participation loan activities <u>outside</u> of regulation.

If NCUA Proceeds With a New Rule

While GCUA and Georgia credit unions oppose the proposal, if the agency does decide to go forward with a regulation in this area, we strongly urge NCUA to incorporate the following revisions and improvements.

- Proposed rulemaking should focus on underwriting and effective adoption and implementation of policies. Effective risk management of loan participations begins with effective management and due diligence.
- NCUA should rely on credit union boards to determine concentration limits that are appropriate for their credit union. The boards should address those limitations in their policies and the credit union should be able to implement them as approved by the board, subject to examiner scrutiny as part of routine examinations. This approach will achieve NCUA's objective that any risks associated with loan participations be identified and well managed but without imposing regulatory limits that may not fit the credit union's situation.
- If NCUA will not allow credit unions to determine these limitations, the agency should raise the 25% and 15% concentration limits substantially and allow these limits to be flexible. Credit unions that have higher levels of net worth could reasonably take on greater levels of risk without impairing an institution's safety and soundness.
- It is too simplistic to establish simple limitations on 'originating lender' since these risk management activities can be outsourced or co-sourced to multiple counter-parties. Risk management guidance should focus more on credit risk – for example, the industry, collateral type and geography – is it out of the credit union marketplace or well known to the credit union.
- Allow credit unions to obtain waivers from those limits on a program basis and not be required to seek a waiver for each purchase. Likewise, if NCUA pursues the requirement that loan participations must conform to underwriting standards, then waivers should be permitted from this provision as well.
- Recognize participations from a single originator could be a single loan, or a part of a pool of thousands of loans – a difference that translates to real differences in risk exposure. In addition, NCUA should acknowledge risk mitigation characteristics of CUSO structures for participation lending.
- There is concern that some of the definitions seem ambiguous and that has caused credit unions to be worried about the application of the definitions if the proposal is approved. We urge the agency to review and revise some of them if the rule moves forward without additional input from credit unions.
- Re-define 'Originating Lender' to include (Collectively) the Owners of a CU-Controlled CUSO. While it would be preferable to eliminate reference to Originating Lender, if the

term remains, it could be redefined so that credit unions could pool their efforts to enhance loan production and mitigate risk exposure through CUSO structures.

- Provisions should exist for a credit union to buy out the originating lender's share in the loan prior to maturity. The borrower and related risk exposure could matter more to the purchaser of the participation than the originating lender or servicer, especially when collections activities commence. This would call for removal of the 'life of the loan' language.
- Allow credit unions ample time to prepare for compliance.
- Reissue the revised proposal for further comments from the credit union system.

Conclusion

We respectfully ask the NCUA withdraw this proposal and carefully consider the positive benefits that loan participations provide credit unions, and to recognize the significant negative impact the imposition of such requirements would have on credit unions.

If NCUA determines that a new rule must be issued, we urge NCUA to acknowledge that different pools of loans carry different risks and as such the proposal should address those specific risks. It would seem that the proposal should address the problem where the real problems exist…speculative real estate development, subprime auto loans and high-risk commercial loans and those loans that should have more restrictive limits. We appreciate the opportunity to submit comments on this proposed rule. We would be pleased to discuss these comments at NCUA's convenience.

Sincerely,

Cindy Connelly

Cynthia Connelly
Senior Vice President Government Influence
Georgia Credit Union Affiliates