State of North Dakota
DEPARTMENT of FINANCIAL INSTITUTIONS

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

Re: Comments on Proposed Rule on Loan Participations

Dear Ms. Rupp:

Thank you for this opportunity to comment on the proposed changes to parts 701 and 741 of NCUA's Rules and Regulations. As the regulator of North Dakota State Chartered Credit Unions, I appreciate the efforts of the NCUA to promote safety and soundness. However, the rules as proposed create several concerns that need to be addressed.

The Dual Chartering System

The proposed rule further erodes the dual chartering system with no meaningful risk mitigation to the NCUSIF. The justification outlined for this expansion seems to focus primarily on the need for better loan documentation as well as the establishment of more appropriate concentration risk limits. In my opinion, existing regulations, including member business lending rules and existing safety and soundness regulations, already adequately address these concerns. Expanding these regulations adds little to the already existing risk mitigation tools.

The proposed rule outlines a number of documentation and structural requirements for participation credits. Existing State and Federal regulations require credit unions to operate in a safe and sound manner, and these principles currently dictate that credit union management properly underwrite every credit decision. This concept has been made very clear by NCUA Letters to Credit Unions and FFIEC guidance. While the proposed requirements may address part of the necessary due diligence for the purchase of a credit, it is not possible for a rule to be written that will capture all required due diligence elements for every credit. Because of this, the **existing** safety and soundness rules will continue to be the regulator's and insurers most effective means of enforcing due diligence standards. It is my opinion the expansion of this rule, while potentially limiting some of the risk to the NCUSIF, crosses into the active daily management of a credit union to a level that is inappropriate for a regulator.

The proposed rule also outlines new concentration limits, one of which establishes a limit of 25% of net worth from any one originating lender. This arbitrary limit seems to imply that all originating lenders are the same and all present undue risk if the concentration exceeds 25%. The risk profile of every originating lender will vary nearly as much as the risk profile of every individual loan. The responsibility of identifying appropriate concentration limits more appropriately resides with credit union management. The role of the regulator and insurer is to evaluate the reasonableness of management's decisions. This proposed limit seems to question the ability of credit union management as a whole and in my view is unnecessary if proper underwriting is in place on the front-end, which is of course required in this

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proposal. Here again, the **existing** safety and soundness rules are the most effective means of enforcing reasonable concentration limits.

The proposed rule establishes a 15% of net worth individual loan limit, regardless of the type of loan. The risk profile of loans varies significantly by type. Individual loan limits that posed lower risks to the NCUSIF have historically been established by the regulator. The proposed rule seems to be reversing this long standing precedent. Since the **existing** Member Business Loan Rule already establish limits on participation credits deemed to be of high risk, it is not clear how the expansion of this rule to state charters will further limit the risks to the NCUSIF.

I recognize that NCUA has a vested interest in the risk profile of credit unions, including asset concentrations; however, the proposed changes to regulation do not address the real safeguard available to the insurer; Capital. Concentrations by geography, loan types due to industry concentration in the field of membership, employer concentrations in credit unions with closed fields of membership are all factors which can result in an asset concentration that may be beyond the individual institution's control. While these concentration risks may be a function of the institution's environment, risk mitigation tools are available to the institution, most notably a capital level that is commensurate to the risk level. The current risk based net worth requirement formula outlined in Part 702, or more specifically, the formula for the alternative calculation of the risk based net worth requirement, does not adequately capture the risk associated with asset concentrations. Efforts to reform capital regulation would be more effective in limiting the risk to the NCUSIF, this would limit the regulatory burden on the industry and help retain the integrity of the dual chartering system.

Waiver Process

The commentary included with the proposed regulation solicited feedback on how to make the waiver process more practical. While I can appreciate the efforts to improve the waiver process, it appears the real issue is being missed. The proposed rule attempts to codify the parameters that constitute safety and soundness. The flaw in this approach is that it does not account for the differences in individual institution risk profiles or risk mitigation tools. It *should be* managements responsibility to establish appropriate concentration limits for their risk profile. The role of the regulator and insurer is to evaluate the reasonableness of management's limits. As mentioned previously, existing safety and soundness rules can be used if the examiner finds the limits to be unreasonable.

Great care needs to be taken to ensure that the role of the regulator and insurer remains focused on safety and soundness of the institution as a whole, and that regulations are not established which effectively usurp the role of credit union management.

Credits Originated by Banks

The prohibition of state chartered credit unions from buying participations in credits originated by banks has been a concern of this Department for several years. We are pleased with what appears to be an effort by NCUA to address this issue related to state chartered credit unions.

Blending of Chartering and Insuring Regulations

An issue that was not addressed as part of the revisions of these two regulations is the blending of chartering and insurance regulations. Generally, NCUA's rules lack clarity and create difficulty in distinguishing the class of credit unions for which the regulations are intended (state or federal). This comingling of regulations has created significant confusion for the industry, and has even created confusion among state and federal examiners. The Department strongly encourages the NCUA to take this opportunity to clearly separate chartering and insurance into completely separate regulations. This step will both reduce the regulatory burden on the industry, as well as to ensure the rules conform to the congressional intent of the dual chartering system.

Conclusion

While the proposed rules appear to be well intentioned, we encourage the NCUA Board to reconsider several elements as outlined within this letter. Thank you for this opportunity to comment, and we look forward to our continued working relationship with NCUA.

Sincerely,

Robert J. Entringer

Robert J. Entringer
Commissioner

RJE/cjk