



February 21, 2012

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

Re: Proposed Amendments to 12 CFR Parts 701 and 741 Pertaining to Loan Participations

Dear Ms. Rupp:

We are providing this letter to comment on proposed changes to the loan participation regulation. We welcome a review and improvement of the current regulations and agree certain parts are in need of revision. Investment in loan participations is an important strategy for Delta Community Credit Union (DCCU). However, DCCU believes several proposed changes are arbitrary, burdensome, and may increase risks within the credit union system.

Wise investment in loan participations allows DCCU to be more responsive to member needs, better manage liquidity, tune loan portfolio concentrations, and support earnings. At DCCU, we recognize the range of risks that can be present with loan participations. But we are confident that our model enables us to effectively and efficiently manage those risks. We urge the Agency to recognize and avoid the unintended consequences of a one-size-fits-all approach that sets arbitrary parameters on participation programs as the purpose of regulations should encourage the completeness and capability of each credit union's participation management practices.

The following comments communicate our understanding of the proposed changes, our view of the potential consequences, and some thoughts on alternative approaches.

- 1) Part 701.22 now applies to state chartered federally insured credit unions ("FISCUs") in addition to federally chartered credit unions (FCUs), collectively "FICUs".***

DCCU Comment: As a practical matter, DCCU tends to follow Part 701.22 in order to create the largest possible universe of potential loan participation counterparties. This is particularly true with MBL participation loans. The Georgia Department of Banking and Finance, however, permits state-chartered credit unions to purchase, in part or in whole, loans from any federally insured financial institution (banks, credit unions, thrifts, and other institutions).

DCCU Recommendation: The Agency should clarify that this proposed language is not intended to pre-empt or otherwise curtail state-chartered credit union investment powers.

2) *The underwriting standards in purchasing a loan participation interest may not be less stringent than the underwriting standards in originating the same loan.*

DCCU Comment: DCCU supports the logic of this recommendation. A loan that does not meet the credit risk parameters of a credit union should not be placed on its books, regardless whether it is originated or purchased. That does not mean that loan approval criteria for purchased loans must exactly match approval criteria for directly originated loans. There are many good reasons a credit union may establish unique credit criteria for participation loans. Furthermore, credit unions can easily circumvent the spirit of this proposed language by taking a lowest-common-denominator approach with internal credit policies.

DCCU Recommendation: The regulation should require a thoroughly documented due diligence process for each loan or loan pool purchased to confirm an understanding of the risks involved. The credit union's loan purchase policy should be required to address the process by which these risks are identified, communicated, accepted, monitored, and managed. Furthermore, credit unions should set specific credit policies and approval standards for all loans, purchased or originated.

3) *The originating credit union must retain at least a ten (10) percent interest in the loan throughout the life of the loan.*

DCCU Comment: DCCU supports the idea of having the originator maintain some level of ownership to ensure that originators are not simply originating for a quick profit on the sale of loans. Underwriting and due diligence at time of purchase is the best way to mitigate origination risks. However, the Agency's proposed language may have the unintended consequence of increasing counterparty risk overall. Assuming the "purchasing" credit union is confident in the credit quality of a particular loan, a 100% purchase would reduce the number of total counterparties and thereby decrease counterparty risk.

Servicer risk is often more important than originator risk over the long term. If a loan is purchased 100%, the servicing counterparty becomes a much more immediate risk than the originating counterparty. Again, these counterparty risks should be actively managed by each credit union in a way that goes beyond some arbitrary ownership holdback requirements.

DCCU Recommendation: The Agency should require a thoroughly documented due diligence process for each loan or loan pool purchased to confirm an understanding of the risks involved. A key component of this process should be counterparty (originator, servicer, dealer, broker, etc.) due diligence.

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.*

DCCU Comment: DCCU understands the importance of monitoring and managing concentration risks with any given counterparty. However, there is no logical basis for an arbitrary percentage that could likely increase risk overall and cause credit unions to expand the total number of partners with whom they do business.

A sound loan participation program or transaction is founded on thorough due diligence and an open, “trust-but-verify” relationship with the counterparties involved. **A larger number of counterparties may reduce concentration risk but it increases exposure to counterparty risk overall.** Said another way, the risk of concentration with a single counterparty must be reasonably balanced with the risks and costs of managing a wide range of counterparties with varied cultures and capabilities. DCCU has a number of counterparties, including originators, servicers, brokers, and third-party advisors. As our program has matured, we have refined our standards and now prefer to work with a select few partners who we know operate with the same high standards as DCCU. We are actively managing down the number of counterparties we work with. We choose partners who consistently demonstrate safe, sound, reliable, and transparent processes that align with DCCU’s goals and objectives.

DCCU Recommendation: Instead of establishing some arbitrary percentage, the Agency should require credit unions to address how counterparty concentrations will be identified, communicated, accepted, monitored, and managed. An example of this management is a scaled approach to the concentration; the more seasoned the counterparty relationship, the more exposure that may be reasonably justified. An arbitrary cap on exposure would simply force credit unions to leave their seasoned, trusted relationships in search of new ones with potentially higher risk.

- 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.***

DCCU Comment: DCCU agrees to this proposed revision.

DCCU Recommendation: None.

- 6) ***Recommended new term: Regarding the ability of credit unions to sell loan participations in a loan purchased under the eligible obligation rule.***

DCCU Comment: When a credit union buys an eligible obligation, the credit union can never sell a loan participation in that loan as the originator of the loan would not be a participant. Similar to our comment in 3) above, the originator of the loan becomes less important over time. **However, the servicer of the loan is always important.** Additionally, if the loan is purchased in whole, any “skin in the game” concept would be applicable to the new owner (seller) of that loan in the future.

DCCU Recommendation: Along with 3) above, the Agency should clarify an understanding of the roles played by purchasers, sellers, originators, and servicers as needed. Counterparty risk for each is different, and changes when a loan is sold. **Further, it is important to not create unintended liquidity risk by preventing the purchasing credit union from ever selling that loan in the future** (due to the originator not retaining an arbitrary percentage).

7) Recommended new term: Regarding organizations eligible to buy a loan participation interest.

DCCU Comment: **Safety and soundness of participation activity should be managed on the buying side of the transaction, rather than the selling side.** Restricting eligible purchasers creates additional liquidity risk to a credit union.

DCCU Recommendation: The Agency should clarify that credit unions may sell participations to any buying institution, provided the sale and/or participation agreements adequately protect the selling credit union from unwanted control by the purchaser.

We appreciate the opportunity to submit our comments above. We also welcome any invitation to dialogue with the Agency further on these topics.

DELTA COMMUNITY CREDIT UNION



Rick Foley
President & CEO

cc: Walter Brill, Chair, Delta Community Credit Union Supervisory Committee
Daisy Mitchell, Georgia Department of Banking and Finance