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VIA E-MAIL TRANSMISSION
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February 21, 2012

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

Re: Comments on Proposed Rule on Loan Participations
12 C.F.R. Parts 701 and 741, 76 FR 79548, December 22, 2011

Dear Ms. Rupp:

The Illinois Credit Union League represents over 375 federal credit unions (FCUs) and federally insured state chartered credit unions (FISCUs) in Illinois. We are pleased to comment on the proposed amendments by the National Credit Union Administration (NCUA) to its Loan Participations Rule.

The proposed rule would impose substantial additional restrictions on the purchase of loan participations and would, for the first time, extend the scope of the rule to federally insured state-chartered credit unions.

The restrictions imposed by the proposed rule would include:

- A ceiling of 25% of net worth on loan participations from one originator, with no possibility of a waiver;
- A limit of 15% of net worth on loan participations from one borrower;
- A requirement that state-chartered CUs that are selling loan participations (originating lenders) must retain a 10% interest in the loan originated (FCUs are currently subject to this requirement);
- A requirement that the loan is one the purchasing credit union is empowered to grant;

- A requirement that "[t]he borrower is a member of a participating credit union before the credit union purchases a loan participation" (which could be interpreted to mean that the borrower must be a member of each credit union participating in the loan); and
- A requirement that loan participations would have to conform to the same underwriting standards that a credit union employs when originating a loan;

The Proposal Should Be Withdrawn.

We will set forth our specific concerns with the restrictions contained in the proposed rule, but we are compelled to state that the Board should withdraw the proposal as currently drafted. The only reasons stated in the Supplementary Information on why the new rule is needed is a statement that loan participations create more systemic risk due to the interconnection between participants, and that examiners have encountered confusion regarding the entities and transactions subject to the rule.

The proposed restrictions (particularly the minuscule amount of participation loans that may be purchased from one originator) would severely limit if not end the current participation programs that substantially benefit credit union members and credit unions' bottom lines. In addition the concentration limits and underwriting restrictions would substantially reduce the ability to mitigate risk through diversifying types and sources of loan participations.

The NCUA has provided no statistics regarding losses incurred by credit unions purchasing participation loans but we understand that the percentage of participation loans charged off is less than the percentage of non-participation loans charged off. Given loan participation programs' relatively low risk, the proposed regulatory burden is extremely disproportionate and runs directly counter to President Obama's Executive Order 13563 of January 18, 2011, Improving Regulation and Regulatory Review (76 FR 3821, Jan. 21, 2011).

Section 1(a) of that Order states that our regulatory system "must identify and use the best, most innovative, and least burdensome tools for achieving regulatory ends." Section 1(b) of the Order affirms and restates the principles governing contemporary regulatory review established in President Clinton's Executive Order 12866 of September 30, 1993.

> …each agency must, among other things, (1) propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs (recognizing that some benefits and costs are difficult to quantify); (2) tailor its regulations to impose the least burden on society, consistent with obtaining regulatory objectives, taking into account, among other things, and to the extent practicable, the costs of cumulative regulations; (3) select, in choosing among alternative regulatory approaches, those approaches that

> maximize net benefits (including potential economic, environmental, public health and safety, and other advantages; distributive impacts; and equity); (4) to the extent feasible, specify performance objectives, rather than specifying the behavior or manner of compliance that regulated entities must adopt; and (5) identify and assess available alternatives to direct regulation, including providing economic incentives to encourage the desired behavior, such as user fees or marketable permits, or providing information upon which choices can be made by the public.
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> 76 FR 3821, Jan. 21, 2011 [Emphasis added.]

The proposed loan participation rule fails to comply with the Executive Order. There is no determination that the benefits outweigh the costs of the proposal; the NCUA has not tailored the proposed regulation to be the least costly alternative; there is no indication that the NCUA has considered alternatives and chosen the one that maximizes benefits; there appears to have been no attempt to provide performance objectives rather than mandating specific behavior or manner of compliance; and the agency has not indicated that it has considered any alternatives to direct regulation.

We urge the NCUA to comply with both the spirit and letter of Executive Order 13563 (and with the NCUA's "Regulatory Modernization Initiative" representing the commitment of Chairman Matz to "effective, not excessive, regulation") and withdraw the proposal. Some of the aspects of the proposal have merit but should be provided in a Supervisory Letter or other less intrusive method than a direct regulation. We support the recommendations regarding a less intrusive approach in CUNA's letter and have included them in our letter.

Regulatory Flexibility Act--Impact on Small Credit Unions.

In section IV of the Supplementary information, the NCUA states that it does not believe that the proposal would have a significant impact on small credit unions because "generally smaller credit unions are not actively involved in loan participation transactions." 76 FR 79551. While this may be true, it is also clear that the proposal would ensure that smaller credit unions will not be able to become involved in loan participations.

We have recently been contacted by a number of faith-based credit unions located in disadvantaged areas of Chicago regarding instituting a participation loan program. We have been forced to warn them that the proposed rule would cause such a program to fail. The draconian restriction of the loan participations from one originator to 25% of a purchasing credit union's net worth (a miniscule 1.25% of the assets of a "well capitalized" credit union with a net worth of 7%) would in itself render the purchase of loan participations by a small credit union unworkable.

One of the original reasons for amending the Federal Credit Union Act to allow credit unions to engage in participation loans was to enable smaller credit unions to be involved in loans to their members when the small credit union's size precluded holding the whole loan. The fact that a less than substantial number of smaller credit unions are involved in loan participations is not an adequate reason to deny their involvement.

Federally Insured State Chartered Credit Unions should not be subject to the rule.

The proposed rule would expand the loan participation requirements to FISCUs. The NCUA states its rationale for expanding the rule to FISCUs in part I of the Supplementary Information:

> …as both federal credit unions (FCUs) and federally insured state-chartered credit unions (FISCUs) actively engage in loan participations, it is important to the safety and soundness of the NCUSIF that all federally insured credit unions (FICUs) adhere to the same minimum standards for engaging in loan participations. The Board believes such standards are necessary to ensure the NCUSIF consistently recognizes and accounts for the risks associated with the purchase of loan participations.
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> 76 FR 79548

The "safety and soundness" issue is the so-called "systemic risk" for which the NCUA provides no data and, as discussed earlier in this letter, such risk seems to be very minimal. Regarding the argument that the safety and soundness of the NCUSIF requires both FCUs and FISCUs to adhere to the same standards, if this logic is applied generally, state regulation of every aspect of a FISCUs operations that involves any risk should be replaced by NCUA regulation.

The NCUA addresses its compliance with President Clinton's Executive Order 13132 of August 4, 1999, Federalism, which requires federal agencies to consider the impact of their actions on state and local interests, in section IV of the Supplementary Information. With respect to the current proposal, NCUA states:

> The proposed rule, if adopted, will also apply to federally insured, state-chartered credit unions. By law, these institutions are already subject to numerous provisions of NCUA's rules, based on the agency's role as the insurer of member share accounts and the significant interest NCUA has in the safety and soundness of their operations. The proposed rule may have an occasional direct effect on the states, the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. The proposed rule may supersede provisions of state law, regulation, or approvals. The proposed rule could lead to conflicts between the NCUA and state financial institution regulators on occasion….
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> 76 FR 79551

The NCUA has repeatedly stated its belief in the dual chartering system--which provides credit unions with a meaningful choice between following the policies and regulations of their state as a state-relegated institution versus the policies and regulations of the federal government as federal chartered entities and has been a longstanding hallmark and source of strength of the credit union system. However a number of recent NCUA actions provide troubling indications that the NCUA is attempting to substantially reduce the legal ability of state regulators to address safety and soundness issues in a manner that differs even slightly from that of the NCUA, and the future of a meaningful dual chartering system is in jeopardy. .

The NCUA has requested comments on ways to eliminate, or at least minimize, potential conflicts with state financial institution regulators regarding this proposal. While it is the duty of the NCUA to protect the safety and soundness of the NCUSIF, the lack of any substantive safety and soundness concerns regarding loan participations mandates that the rule should not be expanded include FISCUs.

Specific Concerns

1. Imposition of a ceiling of 25% of net worth on loan participations from one originator, with no possibility of a waiver (proposed §701.22(b)(5)(ii)).

   Virtually every comment letter on the proposal has argued that the extremely low ceiling on purchase of loan participations from one originator will increase risk rather than reduce risk. The proposal will disrupt long-time relationships of purchasers with trusted originators and will result in purchasing credit unions searching for other, less known originators. The increase in originators and decrease in familiarity with those originators will result in increased risk to purchasing institutions. The need to turn away from trusted originators may result in the attentions of loan brokers that will see an opportunity to push loan participations interests by less well known originators on less experienced credit unions.

   The effect of this restriction on smaller credit unions will be especially disruptive because smaller credit unions do not have the resources to initiate and conduct ongoing monitoring of a number of loan originators. In addition large credit unions may be reluctant to sell participations to small credit unions if the amount they can sell is limited to 25% of net worth. (E.g., the loan participations of a well capitalized credit union with assets of $3 million and a net worth of 8% with a single credit union originator could not exceed a paltry $60,000.)

   This limit is outrageously low, and it seems very odd that the 25% limit on purchases from one originator is only slightly higher than the limit on participation loans of one member (15% of net worth).

2. Imposition of a limit of 15% of net worth on loan participations from one borrower (proposed §701.22(b)(5)(iv)).

   The proposed limitation does not appear to be justified by any substantiated safety and soundness concerns. It may be appropriate, however, to require the amount of participation loans to one borrower to be included in the credit union's limits on loans to a single member.

(While we oppose the proposal in its entirety, if the agency does decide to go forward with a regulation setting specific limits on participations purchased from one originator and loan participations from one borrower, the 25% and 15% concentration limits must be substantially raised and credit unions should be allowed to obtain waivers from <u>both</u> of those limits on a program basis and not be required to seek a waiver for each purchase.)

3. A requirement that state-chartered CUs that are selling loan participations (originating lenders) must retain a 10% interest in the loan originated (proposed §701.22(b)(3)).

   The proposal would impose the standard imposed on FCUs by the Federal Credit Union Act (FCUA) and the NCUA's current rule on state chartered credit unions. We understand that banks are not subject to such a restriction and the NCUA should not expand the restriction to sales or purchases of loan participations by FISCUs absent substantial real safety and soundness issues. (As discussed above, we do not believe that FISCUs should be subject to any aspect of the NCUA's participation rule.)

4. A requirement that the loan is one the purchasing credit union is empowered to grant (introductory paragraph to proposed §701.22(b)).

   The intent of this requirement is unclear. We believe that a purchasing credit union should not be able to purchase participations that exceed the credit union's authorized loan amount, interest rate or term. However a small credit union that is not able to fund an entire first mortgage loan should not be prohibited from purchasing a participation interest in such a loan provided the amount purchased does not exceed the amount the credit union could loan to a member for such a loan and does not exceed the purchasing credit unions maximum authorized interest rate and term.

5. A requirement that "[t]he borrower is a member of a participating credit union before the credit union purchases a loan participation" (proposed §701.22(b)(4)).

   The Supplementary information does not provide any information regarding the intent of this requirement. It could be interpreted to mean that the borrower must be a member of <u>each</u> credit union participating in the loan. It appears however that this is not the NCUA's intent given the language of the first paragraph of the proposed rule: "[t]his section applies only to a federally insured credit union's purchase of a loan participation where the borrower is not a member of that credit union." 76 FR 79552.

We cannot believe that the NCUA's intent is that the borrower must become a member of the purchasing credit union since in most cases this would be prohibited by the limitations on the common bond. We assume the NCUA's intent is that if the loan participation was purchased from an "eligible organization" other than a credit union (a credit union organization or financial organization) that the borrower must be a member of the purchasing credit union or if there is more than one purchasing credit union then a member of one of the purchasing credit unions.

NCUA's proposed new §741.225 would extend the coverage of the participation rule to FISCUs but would exempt FISCUs from the requirement that the borrower is a member of a participating credit union before the credit union purchases a loan participation. The Supplementary Information does not discuss the reason for the exemption, and the exemption further clouds the issue of the intent of §701.22(b)(4).

Recommendations for Less Intrusive Means for the NCUA to Address Loan Participation Issues

We endorse CUNAs suggestions regarding a reasonable alternative to the proposal consistent with Executive Order 13563 and the NCUA's Regulatory Modernization Initiative. We believe the alternative would address appropriate regulatory safety and soundness concerns and provide the flexibility for credit unions to continue to utilize loan participation programs.

- NCUA should update its 2008 Supervisory Letter regarding loan participations and send it to all federally insured credit unions and examiners.

- The Letter should spell out what is expected of credit unions that sell and purchase loan participations in light of any recent agency concerns.

- The Letter should make it clear that credit unions purchasing loan participations must adopt board policies that address key issues flagged in the proposal. Such issues include limitations on participations from one originator and participations involving one borrower. (The Letter should also be very clear that it is up to the board of each credit union to set such limits that are appropriate for its operations, resources and capacity to manage risks associated with loan participations, whether the credit union is selling or purchasing them.)

- The Letter should reinforce that credit unions must perform initial and ongoing due diligence as it relates to loan participations and provide that board policies should require a credit union to undertake additional monitoring and other due diligence steps as the credit union reaches progressively higher concentration levels regarding loan participations.

- The Letter should reinforce the importance of loan participation agreements and elements that should be addressed in them.

- The Letter should clarify that purchasing credit unions are not limited to loan participations that conform to the credit union's loan origination standards.
- The Letter should also clarify that loans may be purchased from any financial organization; as long as the credit union has performed proper due diligence and the loan participation is otherwise in compliance with regulatory requirements.
- NCUA should provide additional training for examiners on loan participations and work with state regulators to ensure regulators are addressing problem areas promptly but without undermining robust loan participation programs.
- NCUA should revise the 5300 Call Report to ensure information is captured that only reflects charge-offs and delinquencies for loan participations that are purchased (retained loan participations should be reported with wholly retained loans).
- It may be appropriate for the NCUA to consider whether credit unions that purchase loan participations equaling more than, a certain percentage of their net worth should be subject to additional reporting requirements, as long as such requirements are well-tailored and not unduly burdensome. This step should be taken only after an additional notice and comment period to invite input from the credit union system.

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We appreciate the opportunity to respond to NCUA's request for comment regarding its proposed rule on Loan Participations. For the reasons stated above, we believe the rule should be withdrawn and that any loan participation issues that need to be addressed can be addressed in a much less intrusive manner. We will be happy to respond to any questions regarding these comments.

Very truly yours,

ILLINOIS CREDIT UNION LEAGUE

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