



AUG28'15 AM 7:43 BOARD

August 12, 2015

Mr. Gerard S. Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Dear Mr. Poliquin:

On behalf of Apple Federal Credit Union, I am writing you regarding the National Credit Union Administration's proposed rule amending Part 723. I appreciate the NCUA's initiative in this rulemaking to provide meaningful regulatory relief to credit unions and welcome the opportunity to provide comments on this proposal. The credit union industry has long advocated for each individual credit union and its membership. While legislative changes to the Federal Credit Union Act are ultimately needed to raise the cap, NCUA's proposal constitutes an important step to achieving the goal of member business lending rules.

Intent and Purpose of Regulation-Preamble to Proposed Regulation

General Comments-

Well trained commercial loan staff that is well versed in origination, underwriting and servicing warrant salaries that are competitive with the market for commercial banks. This is a substantial investment for credit unions. From a business standpoint why should a credit union make the investment if it isn't for the long term? If credit unions business lending portfolios are capped to a small percentage of assets where is the return on investment? The business model to address this problem is the business lending CUSO and participation infrastructure which is being addressed in the proposed regulations. Exempting non-member MBL participation loans from the cap will provide overdue relief to many credit unions and the quality of participation loans will improve. MBL performance history demonstrates that even with limited resources at hand the credit unions have a safe and prudent history in business lending.

The existing prescriptive regulations have protected credit union assets as the business service industry has matured. These rules have served us well and have allowed the credit unions to build a foundation of solid business loan relationships. Part of the success of the credit unions in member business lending has been our ability to provide stability and service when many of the community banks are merged and the continuity is lost. Credit Unions fund many small business loans that larger commercial banks are unwilling to do because they don't fit in with a larger bank's cost structure. Business lending is critical to the economic infrastructure of small communities, and Credit Unions have played a critical role in providing capital to small businesses.

Now that the business lending foundation is here and been tested over the years with credit unions, I applaud the proposed changes to the regulation. The proposed changes will allow the credit unions to competitively compete and preserve the safety and soundness of business lending programs. There are positive trends in credit union business lending portfolios in terms of growth and the slowdown in delinquencies, as greater focus occurs in the management of portfolio's and risk monitoring.

A summary of the proposed rule indicates that if the final rules were adopted, NCUA would publish supervisory guidance to examiners. In our experience supervisory guidance becomes the rule/regulation and is interpreted as such by examiners. The summary states that the supervisory guidance would be shared with credit unions, to provide more extensive discussion of expectations in relation to the revised rule. When the supervisory guidance is shared with the credit unions will we have any input into this? Can any changes be made in the supervisory guidance after the rule is adopted? With overreaching supervisory guidance, the prescriptive approach may negate principle based management, reversing the intent of the regulation. We would like the opportunity to comment on supervisory expectations.

Please consider the implication of the proposed granular amendments concerning definitions and underwriting procedures:

723.3 –Definitions

Key Point

The proposed definition clarifies that the denominator of the LTV ratio is the market value for the collateral held longer than 12 months, and the lesser of the purchase price and the market value for collateral held 12 months or less.

Comment

The purchase price should only be taken into consideration when the borrower is actually purchasing the collateral in a financing transaction. After the purchase has occurred the borrower can add value to real estate by changing the zoning, securing long term leases, and adding utilities etc. In some cases, these improvements will occur in less than 12 months at the borrower's expense. Adhering to USPAP rules and regulations in ordering and reviewing appraisals will provide for adequate collateral protection. The way the regulation is written it appears to address real estate collateral rather than negotiable, inventory, and equipment collateral.

723.4 Commercial Loan Policy—

Key Point

The proposal provides more detail for credit unions by establishing the minimum risk assessment practices and procedures that are consistent with accepted safe and sound practice within the commercial lending industry.

The commercial loan policy should also set the requirements for the financial reporting to support a credit decision. It should address the minimum criteria for historic reporting at the inception of the loan, as well as regular reporting after the loan is closed, and the required quality of financial information to establish an accurate and reliable assessment of financial trends. The proposal also notes that underwriting standards must address the quality of the financial information used to make

the credit decision and ensure that the degree of verification reflected in the financial information is sufficient to support the financial analysis and the risk assessment of the credit decision.

Further in this section as stated “ For more complex and larger borrowing relationships, such as those involving borrowers or principals with significant loans outstanding or multiple or interrelated operations, the credit union should require borrowers and principals to provide either (i) an auditor’s review of the financial statements prepared consistent with GAAP to obtain limited assurance (i.e. a “review quality” financial statement), or (ii) an independent financial statement audit under generally accepted auditing standards (GAAS) for the expression of an opinion on the financial statements prepared in accordance with GAAP (i.e. and “audit quality” financial statement).

Comment

The expectations concerning the quality of financial statements should be left to the credit union’s policies and procedures. Larger borrowing relationships with significant loans may primarily be commercial real estate borrowers with straight forward tax returns without complex interpretation. Interrelated operations can also involve nested real estate partnerships with the same. Examiners may interpret a large or complex relationship differently than commercial underwriters. The quality of financial statements received from the borrower and mitigation of that risk is better left to underwriting the specific borrower and situation rather than a broad sweeping policy. Prudent underwriting will dictate what level of quality is needed i.e. Commercial and Industrial loans would require reviewed or audited financial statements.

723.6-Construction and Development Loans

Key Point

The proposal also clarifies that a construction and development loan includes any loan for the construction and or renovation of real estate where prudent practice requires multiple disbursements as the project progresses and the ultimate valuation of the project and collateral protection is determined from the completed project. The proposed rule requires a submission of a line item budget by the borrower and calls for it to be reviewed and accepted by a qualified individual representing the credit union interest.

Comment

This is unclear as to whether the qualified individual can be a credit union employee. It can be cost prohibitive on smaller projects that submit a draw schedule to hire a third party to review line item budgets.

723.8-Aggregate Member Business Loan Limit; Exclusions and Exceptions

Key Point

The exclusion of Non-Member Participation loans from the business lending cap will allow credit unions to increase portfolios in a safe and sound manner. Underwriting best practices require the same level of due diligence in purchasing loans as underwriting loans to retain in portfolios. Prudent lending would not include buying and selling to circumvent regulations. This is the economically feasible alternative to hiring the expertise necessary for successful operations with a cap limit.

Comment

The exemption of non-member participation loans from the statutory cap without application for a waiver will result in better credit quality and diversification among portfolios.

Key Point

Background: The *Credit Union Membership Access Act of 1998* (CUMAA) amended the *Federal Credit Union Act* (FCU Act) to, among other things, impose an aggregate limit on an insured credit union's outstanding member business loans (MBLs). Specifically, the law caps an insured credit union's total amount of outstanding MBLs to the lesser of 1.75 times the credit union's net worth or 12.25 percent of the credit union's total assets ("the MBL cap"). CUMAA provides an exception to the MBL cap for "an insured credit union chartered for the purpose of making, or that has a history of primarily making, member business loans to its members, as determined by the Board." 12 U.S.C. 1757a.

Issue: NCUA's proposed rule does not alter this statutory cap. Altering the statutory cap will require legislative amendment to the FCU Act. The credit union industry applauds NCUA's continued support for such legislative reform to the FCU Act regarding MBLs, including Chairman Matz's recent testimony before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit where the agency reiterated its support for H.R. 1188, the *Credit Union Small Business Jobs Creation Act*.

Comment

Credit Unions that have the low income designation and /or were chartered for the purpose of making commercial loans are exempt from compliance with the aggregate MBL limit. An additional statutory exemption was provided for credit unions that had a history of primarily making member business loans, determined as of the date of the enactment of the Credit Union Membership Access Act of 1998 (CUMMA), which amended the FCU Act to include certain new restrictions on member business loans. The Board continues to apply the "history of primarily making member business loans" exemption by reference to the date of CUMAA's enactment. The proposal removes the outdated provisions in the current rule that relate to the evidentiary documentation necessary to demonstrate a credit union's qualification for the exemption. We support continuing to advocate broadening the interpretation of the CUMMA regulation to include lifting the cap for credit unions with a history of making Member Business Loans; irrespective of the historical time period. Over the last 15 years member business lending has become an integral part of credit union services.

Thank you very much for the opportunity to comment on this proposed regulation. I applaud the agency's willingness to amend Part 723 to provide much needed relief for the credit union industry. While I strongly support this proposal, I encourage the agency to address the recommendations outlined above as I believe these suggestions will achieve true regulatory relief for credit unions. If I can be a source of any further information on this comment letter, please do not hesitate to contact me at ssterling@applefcu.org or by phone at (703) 788-4827.

Sincerely,

Sherry Sterling

Director of Business Services

