Board Action Bulletin

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NCUA BOARD MEETING RESULTS FOR JUNE 20, 2013

Loan Participation Rule Provides Flexibility for Credit Unions, Security for Industry

NCUA Board Adopts Changes Reflected in Industry Recommendations

ALEXANDRIA, Va. (June 20, 2013) – The National Credit Union Administration (NCUA) Board convened its sixth scheduled open meeting of 2013 at the agency's headquarters here today. The Board unanimously approved:

- A final rule updating the regulation of loan participations for all federally insured credit unions to ensure that as the industry grows, it grows safely.
- A proposed rule from the Illinois Department of Financial and Professional Regulation regulating member business lending by Illinois-chartered, federally insured credit unions.

NCUA Board Approves New Rule for Loan Participations

The steady growth of loan participations in the credit union industry prompted NCUA to update the rule (Parts 701 and 741) under which these transactions are conducted.

NCUA's Board first proposed a new rule in December 2011. In 2012, the agency formed a technical working group of NCUA staff and industry officials from federal and state-chartered credit unions with loan participation experience to comment on the proposal. The 18-month effort resulted in significant and constructive changes incorporated into the final rule with the goal of minimizing regulatory burdens without discouraging participations.

According to NCUA Board Chairman Debbie Matz, the "new rule is intended to minimize losses to the system by requiring *purchasers* to carefully evaluate all participations and their originators."

She commented, "We are mindful that loan participations strengthen the credit union industry by providing a useful way for credit unions to diversify their loan portfolios, improve earnings, generate loan growth, manage their balance sheets and comply with regulatory requirements. As a regulator, however, we need to put in place appropriate safeguards to ensure the loans are made safely," Matz said.

Nearly half of all federally insured credit unions with assets of more than $50 million hold or sell loan participations. Over the last five years, the number of credit unions purchasing loan

participations increased 15 percent, and the dollar value of loan participations on credit unions' balance sheets grew by more than 40 percent. During that same period, loan participation charge-offs increased by more than 160 percent.

Losses on loan participations pose a risk to the National Credit Union Share Insurance Fund due to the interconnectedness between participants. For example, large volumes of participated loans may be tied to a single originator, borrower or industry, or they may be serviced by a single entity. If any one of those entities experiences a financial or other problem, the effects of such concentration could impact multiple credit unions.

Additionally, because both federal credit unions and federally insured, state-chartered credit unions actively engage in loan participations, it is important to safety and soundness that all federally insured credit unions adhere to appropriate standards when transacting loan participations.

"However," Matz said, "this new rule will not be burdensome to the industry. The substantial adjustments we have made from the proposed rule to the final rule achieve the agency's key objective of mitigating risk while providing sufficient flexibility to federally insured credit unions to meet their operational needs."

Changes under the new rule include:

- Purchasing credit unions will be subject to a single-originator concentration limit of $5 million or 100 percent of net worth, whichever is greater.
- The risk retention requirement for originating federal credit unions will be 10 percent, as required by the Federal Credit Union Act.
- The risk retention requirement for other originating eligible organizations—including federally insured, state-chartered credit unions—will be five percent, consistent with the standard for securitizers under the Dodd-Frank Act (unless state law requires a higher percentage).
- Federally insured credit unions may establish different underwriting standards for loan participations than they use when originating their own loans.
- Credit unions will have the ability to apply for waivers on certain key provisions of the rule.

A chart comparing key provisions of the proposed rule versus the final rule is available online here.

The final loan participation rule, available online here, will be effective 30 days from the date of publication in the *Federal Register*.

Member Business Lending Rule Approved for Illinois-Chartered Credit Unions

Federally insured, state-chartered credit unions in Illinois that currently offer member business loans would continue to do so under a new state regulation approved by NCUA's Board at the state regulator's request. The rule must now be approved by the state legislature.

By law, NCUA may exempt federally insured, state-chartered credit unions in a particular state from compliance with NCUA's business lending regulations if the Board approves a rule created

by that state's regulator. The state rule must minimize risk and accomplish the overall objectives of NCUA's regulations. A proposed state member business lending rule is reviewed by an NCUA Regional Director and then submitted to the NCUA Board for final authorization. The Regional Director's review focuses on:

- The definition of a member business loan;
- Appropriate safety and soundess practices;
- Loan limits to one borrower and associated borrowers;
- Written loan policies;
- Collateral and security requirements; and
- Construction and development lending.

Although substantially similar to NCUA's member business lending rules, as proposed by the Illinois regulator, the rule preempts federally insured, Illinois-chartered credit unions under $30 million in assets from making member business loans unless they receive approval from the state regulator.

Previous NCUA Boards have granted similar member business loan exemptions in Connecticut, Maryland, Oregon, Texas, Washington and Wisconsin.

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