August 17, 2015

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

Re: Comments on Proposed Rulemaking for Part 723

Dear Mr. Poliquin:

Local Government Federal Credit Union (LGFCU) appreciates the opportunity to comment on the NCUA Board's proposed rulemaking for Part 723, Member Business Loans; Commercial Lending. LGFCU strongly supports the Board's stated intent to modernize the regulations governing credit union business lending by eliminating prescriptive underwriting criteria and waiver requirements in favor of a principles-based approach. In one critically important respect, however, the proposed rulemaking fails to meet that intent. Specifically, the proposal retains very prescriptive loan-to-one-borrower limits for commercial loans, but eliminates the opportunity for a waiver. We urge the NCUA Board to reconsider the prescriptive loan-to-one-borrower limits that have been proposed, and to carefully consider our comments and the alternatives discussed below.

Background

NCUA's current member business loan rule, at Section 723.8, restricts business loans to one borrower or group of associated borrowers to an aggregate amount of up to 15% of the credit union's net worth (or $100,000 if greater), but establishes a waiver process in Section 723.10(h), affording credit unions the opportunity to exceed this limit for deserving loans. The proposed rule, at Section 723.4(c), retains the restriction but eliminates any opportunity for a waiver. The proposal would allow an additional 10% of net worth in business loans to one borrower (for a total of 25%), but only if secured by marketable financial instruments that are simply not available to most credit union small business borrowers.

The proposed rule provides no support for this more restrictive approach to business loans to one borrower, other than to state in the preamble discussion of Section 723.4 that the proposal "is consistent with the limit allowed by other banking regulators." As further addressed below, this statement does not appear to be entirely accurate. In fact, the banking rules referred to create an exception for small business loans (loans of $1 million or less) and allow those loans to be made to one borrower in amounts up to 25% of net worth without restrictive collateral requirements (albeit subject to an overall limit and an application process).

NCUA Should Follow the FCU Act

NCUA's general lending regulations, which apply to all loans to members (including commercial loans to the extent that Part 723 is not more restrictive), follow the less restrictive loan-to-one-borrower limit of the FCU Act – 10% of shares and undivided earnings. 12 U.S.C. 1757(5)(A)(x), 12 CFR 701.21(c)(5). The statutory loan-to-one-borrower limit is supplemented by other existing regulatory restrictions, including those on loans to officials and their family members (12 C.F.R. 701.21(d)) and on commercial loans to compensated management officials (12 C.F.R. 723.2 of the current rule, 723.7(a) of the proposal).

These rules, together with sound management and effective supervision, have served to prevent abusive concentrations of loans to one borrower. Therefore, if NCUA is intent on eliminating the waiver option for the loan-to-one-borrower limit on commercial loans, the Agency should revert to the general statutory and regulatory limit. The proposed rule provides no explanation, and no empirical support, for imposing a more restrictive limit on commercial loans.

Reliance on Bank Agency Rules is Inappropriate

Relying on the bank agency rules as the sole support for a more restrictive limit on member business loans is inappropriate for two reasons. First, the banking agency limit – 15% of net worth plus another 10% secured by marketable financial instruments, cited by NCUA at 12 C.F.R. 32.3 – is a limit on all loans, not just business loans. As addressed above, NCUA has its own loan-to-one-borrower limit for all loans, and NCUA has provided no justification for singling out member business loans for application of banking agency rules. Second, the banking agency rules create numerous exceptions to this limit, including an exception for small business loans. Section 32.7 of the banking rules allows small business loans to be made to one borrower up to an additional 10% of net worth without restriction on the nature of the collateral. (This section also places a limit on the aggregate amount over 15%, and creates an application process.)

The banking regulations define small business loans (at 12 C.F.R. 32.2) by referencing the instructions for the banking agencies' Consolidated Report of Condition and Income. Those instructions appear to treat any business loan of $1 million or less as a small business loan. The result is that the very loans that NCUA would propose to more restrictively regulate on the basis of general bank lending regulations are in the case of banks subject to an exception from those regulations.

If the NCUA Board determines to follow the banking agency rules, we urge the Board to both provide a clear explanation of why this is appropriate and to carefully consider the banking rules in their entirety. Given the very complicated structure of the banking rules, and the numerous exceptions, a simpler parallel to the banking rules would be to allow business loans to one borrower in amounts up to 25% of net worth.

The Proposal is Especially Burdensome to Small Credit Unions

Newly chartered and small credit unions should have the opportunity to serve the business loan needs of their members to the same extent as larger credit unions. NCUA has provided no meaningful support for applying a more restrictive loan-to-one-borrower standard to member business loans. These loans, when carefully underwritten and collateralized, are every bit as safe and reliable as other member loans. A good example is LGFCU's program for lending to volunteer fire departments. Through this program, we finance fire trucks, other fire department vehicles, and development or improvement of physical facilities for volunteer fire departments throughout the State of North Carolina. These loans are fully secured, and are repaid from tax assessments made by the local government units that are served by the fire departments. LGFCU has made over 347 of these loans totaling over $87.4 million over the last 8 years and has never suffered a loss.

The loan-to-one-borrower restriction of the proposed rule would hamper the ability of newly chartered FCUs and small credit unions to be fully supportive of their members' business loan needs. It is for these credit unions and their members that we urge the Board to carefully reconsider the loan-to-one-borrower limits of the proposed rule.

Related Issue

While not part of the member business loan rule, a related NCUA rule hampers FCUs in their efforts to support the business credit needs of their members. NCUA rule 701.23, Purchase Sale and Pledge of Eligible Obligations, limits certain FCU purchases of member loans originated by other lenders to a total of 5% of shares and undivided earnings. The rule provides exceptions to the limit, including an exception for loans "that are refinanced so that they are loans the purchaser is empowered to grant." 12 C.F.R. 701.23(b)(4)(iii). Thus, when an FCU is purchasing a member loan that was originated by another lender and it is a loan that the purchasing FCU would already be legally entitled to grant, the rule may nonetheless require that the loan be refinanced so that it is a "loan the purchaser is entitled to grant." This doesn't seem rational from any standpoint. Refinancing in this circumstance is merely an exercise in unnecessary expense and red tape. Any issues of credit quality and underwriting standards can and should be addressed as part of the purchasing FCU's normal due diligence in deciding whether to purchase the loan. We request that the NCUA Board, in its overall review of its lending regulations, either revise the eligible obligations rule or interpret the rule to clarify that refinancing is not required in these circumstances. We realize that this is a matter of either interpretation or separate rulemaking, but raise it now because of its relevance to all loans to members, including commercial loans.

Conclusion

LGFCU commends NCUA's efforts to eliminate prescriptive limits from Part 723 and move to a principles-based approach. With respect to loan-to-one-borrower limits, however, the proposal is significantly more restrictive than the existing Part 723. NCUA should reconsider this aspect of the proposal. The Agency should apply to commercial loans the same statutory and regulatory limits that apply to other member loans, or provide clear empirical support for a more restrictive limit, rather than relying on very complex banking agency rules.

If it is unavoidable that NCUA will impose a more restrictive loan-to-one-borrower limit on member business loans than the statutory limit and can support doing so, NCUA should establish a simpler and more straightforward limit, such as 25% of net worth. NCUA should avoid relying on an unsupported application and erroneous reading of complicated banking agency rules.

Thank you for considering our comments.

Sincerely,

Maurice R. Smith
President

cc. LGFCU Board of Directors