August 21, 2015

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

Re: Proposed Rulemaking for Part 723

Dear Mr. Poliquin:

The National Credit Union Administration (NCUA) Board (the Board) is proposing substantial changes to its member business loans (MBL) rule. The proposed rule would replace the current MBL rule's prescriptive requirements and limitations with a broad principles-based regulatory approach. Explicitly, the proposal eliminates loan-to-value requirements, aggregate limits on construction and development loans and the requirement of a personal guarantee.

My comments will address two sections of the proposed rule that could significantly expand the amount of business lending by federally-insured credit unions (FICUs). First, the Board proposes to exclude non-member business loans and non-member participation interest in business loans from the definition of a MBL. Second, the Board is proposing that the MBL limit should not be expressed as an absolute percentage of assets but rather as 1.75 times the applicable net worth requirement for a credit union to be categorized as well-capitalized. If adopted, ***these two provisions would make the statutory MBL cap meaningless***.

Background

As of March 2015, federally-insured credit unions reported holding approximately $6.5 billion in NMBLs on their books. According to the proposed rule, any non-member loan or non-member participation interest in a commercial, industrial, agricultural, or professional loan is a commercial loan (NMBL) but generally not an MBL. So, while a NMBL is subject to NCUA's MBL regulations, a NMBL is excluded from the aggregate MBL cap.

The proposed Section 723.8 also sets out the statutory aggregate limits of Section 107A of the Federal Credit Union Act (FCUA). Section 203 provides that no insured credit union may make any member business loan that would result in a total amount of such loans outstanding at that credit union at any one time that exceeds the lesser of (1) 1.75 times the actual net worth of the credit union, or (2) 1.75 times the minimum net worth required for a well-capitalized credit union as described under section 1790d(c)(1)(A) of the FCUA.

The Board notes that while the minimum net worth requirement for most credit unions to be well-capitalized is the 7 percent leverage ratio, it can be a higher amount if a credit union is subject to a risk-based net worth requirement that is higher than the amount required by the 7 percent leverage ratio. Thus the Board is proposing that the MBL limit should not be expressed as an absolute percentage of assets but rather as 1.75 times the applicable net worth requirement for a credit union to be categorized as well-capitalized.

My Position

The Board's proposed MBL rule is contrary to congressional intent to limit business lending by federally-insured credit unions.

Congress in 1998 for the first time placed significant restrictions on member business loans of federally insured credit unions. According to the Senate Report 105-193, these "restrictions are intended to ensure that credit unions continue to fulfill their specified mission of meeting the credit and savings needs of consumers, especially persons of modest means, through an emphasis on consumer rather than business loans."

In addition, these limitations were meant to "prevent significant amounts of credit union resources from being allocated in the future to large commercial loans that may present additional safety and soundness concerns for credit unions, and that could potentially increase the risk of taxpayer losses through the National Credit Union Share Insurance Fund."

1. *Non-member Business Loans Should Count Against the MBL Cap*

Section 107A(c) of the FCUA defines a MBL as "any loan, line of credit, or letter of credit, the proceeds of which will be used for a commercial, corporate or other business investment property or venture, or agricultural purpose." The FCUA only excludes the following extensions of credit from the definition of a MBL:

> (i) that is fully secured by a lien on a 1-to 4- family dwelling that is the primary residence of a member;
> (ii) that is fully secured by shares in the credit union making the extension of credit or deposits in other financial institutions;
> (iii) that is described in subparagraph (A), if it was made to a borrower or an associated member that has a total of all such extensions of credit in an amount equal to less than $50,000;
> (iv) the repayment of which is fully insured or fully guaranteed by, or where there is an advance commitment to purchase in full by, any agency of the Federal Government or of a State, or any political subdivision thereof; or
> (v) that is granted by a corporate credit union (as that term is defined by the Board) to another credit union.

In other words, Congress <u>only</u> intended that these extensions of credit for business purposes to not count against the aggregate MBL limit.

However, by excluding NMBLs from the aggregate MBL cap, the Board is substituting its judgment for that of Congress. If Congress intended to give the Board the authority to exclude any other forms of business loans from the MBL limit, it would have articulated this in Section 107A of the FCUA; ***but it did not***. Therefore, the Board has overstepped its authority in excluding NMBLs from the MBL cap.

In addition, when Congress imposed the MBL limit for the first time in 1998, Congress never envisioned that credit union resources would go to fund a commercial, industrial, agricultural, or professional loan to non-members. If the Board believes that NMBLs should not count against the MBL cap, then it should seek to amend the FCUA to <u>*explicitly*</u> exclude NMBLs from the MBL cap.

Furthermore, these business loans are excluded from both the seller's and the purchaser's aggregate MBL caps. The seller of business loans and participation interest in business loans does not count the portion of business loans sold or participated out against its MBL cap, as these loans are no longer on its book. Also, the proposed rule will allow the buyer of business loans and participation interest in business loans to non-members to exclude these loans from the aggregate MBL cap. This effectively means more credit union resources will be allocated to commercial purposes than would otherwise occur if these NMBLs counted against the MBL cap, contrary to congressional intent.

In summary, excluding NMBLs from the MBL cap is contrary to congressional intent. When Congress imposed the MBL limit in 1998, it did so ***to prevent significant amounts of credit union resources from being allocated in the future to large commercial loan***s <u>and</u> ***to ensure that credit unions continue to fulfill their specified mission of meeting the credit and savings needs of consumers, especially persons of modest means***. Therefore, the Board should rescind this provision of its proposed rule and count all business loans other than those enumerated in the FCUA from the aggregate MBL limit.

But if the Board proceeds with this provision, the Board needs to adopt a meaningful anti-evasion provision so that credit unions do not trade or swap NMBLs in order to evade the congressionally mandated MBL cap. When the Board first excluded NMBLs from the MBL cap in 2003, the Board, beyond paying lip service that NMBLs should not be swapped between FICUs to allow FICUs to evade the MBL cap, failed to clearly articulate how an anti-evasion provision would be enforced. The absence of this anti-evasion provision is a glaring omission that must be addressed before the Board considers this proposal. It is not enough for the Board to simply say trust us to do the right thing. The Board must understand that it has a <u>trust deficit</u>. Federal judges have previously called NCUA a cheerleader and a rubberstamp. An anti-evasion provision must address how NCUA will monitor and enforce compliance so that FICUs do not trade NMBLs to escape the MBL cap. Moreover, whatever the Board proposes regarding an anti-evasion provision, it must be transparent and verifiable to the public and must hold the Board accountable.

The MBL Cap Equals 1.75 Times the Net Worth Requirement for a Credit Union to be Well-Capitalized.

According to the FCUA, the MBL cap is equal to the lesser of—
(1) 1.75 times the actual net worth of the credit union; or
(2) 1.75 times the minimum net worth required under section 1790d(c)(1)(A) of this title for a credit union to be well capitalized.

The minimum net worth ratio for most federally-insured credit unions to be well capitalized is 7 percent of assets. As a result, the MBL cap equaled 12.25 percent of assets.

However, complex credit unions are subject to a risk-based net worth requirement. For some complex credit unions, the minimum risk-based capital requirement to be well-capitalized could exceed 7 percent and thus the MBL limit could exceed 12.25 percent of assets,

2. *Risk-Based Net Worth Requirement Is **<u>Not</u>** the Same as Risk-Based Capital Requirement*

NCUA is proposing to replace its risk-based net worth requirement with a risk-based capital requirement. The agency will require a complex credit union to have at least a risk-based capital ratio of 10 percent to be well capitalized. Also, NCUA is proposing to define a complex credit union as an institution with more than $100 million in assets.

However, the FCUA links the MBL cap to net worth, not capital. Section 1790d(c)(1)(A) of the FCUA addresses risk-based net worth requirements, not risk-based capital requirements.

Furthermore, the components in the numerator of NCUA's proposed risk-based capital ratio proposal do not align with the statutory definition of net worth. As the Board has previously stated, the capital elements in its proposed risk-based capital numerator are broader than the statutory definition of net worth.

The FCUA defines net worth as

> (A) with respect to any insured credit union, means the retained earnings balance of the credit union, as determined under generally accepted accounting principles, together with any amounts that were previously retained earnings of any other credit union with which the credit union has combined;
>
> (B) with respect to any insured credit union, includes, at the Board's discretion and subject to rules and regulations established by the Board, assistance provided under section 208 to facilitate a least-cost resolution consistent with the best interests of the credit union system; and
>
> (C) with respect to a low-income credit union, includes secondary capital accounts that are—
>
> > (i) uninsured; and
> >
> > (ii) subordinate to all other claims against the credit union, including the claims of creditors, shareholders, and the Fund.

However, the numerator for the proposed risk-based capital ratio is defined as the sum of the specific capital elements in paragraph (b)(1) of this section, minus the regulatory adjustments in paragraph (b)(2) of this section.

The capital elements in paragraph (b)(1) are:

- (i) Undivided earnings;
- (ii) Appropriation for non-conforming investments;
- (iii) Other reserves;
- (iv) Equity acquired in merger;
- (v) Net income
- (vi) Allowances for Loan and Lease Losses, maintained in accordance with GAAP;
- (vii) Secondary capital accounts included in net worth (as defined in § 702.2); and
- (viii) Section 208 assistance included in net worth (as defined in § 702.2).

The deductions from (b)(2) are:

- (i) NCUSIF Capitalization Deposit;
- (ii) Goodwill;
- (iii) Other intangible assets; and
- (iv) Identified losses not reflected in the risk-based capital ratio numerator.

Therefore, there is **<u>not</u>** a legal foundation to use the proposed risk-based capital requirement of well-capitalized to determine the MBL cap. The Board should not substitute its judgment for that of Congress.

But if NCUA decides that it can substitute its proposed risk-based capital requirement for its risk-based net worth requirement, the 10 percent risk-based capital requirement is based upon risk weighted assets, not total assets. So, for consistency, the MBL limit would need to equal 17.5 percent of risk weighted assets.

Conclusion

If the proposed rule is adopted as currently proposed, it would make the statutory MBL cap meaningless. The Board should not use regulatory fiat to circumvent congressional intent. Therefore, the Board should count NMBLs against the MBL cap and should not use its proposed risk-based capital rule to enhance the ability of complex credit unions to originate even more business loans.

If the agency has any questions regarding my comments, I can be contacted at klcuwatch@gmail.com.

Sincerely,

Keith Leggett

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