August 19, 2015

Mr. Gerard Poliquin
Secretary to the NCUA Board
1775 Duke Street
Alexandria, VA 22314

Re: Comment Letter on the Proposed Amendments to NCUA's MBL Rule

Dear Mr. Poliquin:

AltaOne Federal Credit Union is excited to comment on the proposed Rulemaking for 12 CFR Part 723 regarding the potential change to the Member Business Loan (MBL) Regulations currently in force. We highly recommend these changes in order to not only help AltaOne better serve our Business Members' growth but also help their businesses succeed.

AltaOne has been in business since 1947. We have grown considerably since that time into a $610MM Credit Union serving over 53,000 Members throughout our field of membership. AltaOne started offering business loans in 2002 and continues to grow its portfolio. We also partner with other Credit Unions to purchase and sell participation loans.

AltaOne is pleased with the proposed changes allowing us and our fellow Credit Unions the ability to further grow our portfolios and the latitude to make decisions based on our strategic goals and risk tolerances.

We agree with the elimination of the two year minimum experience requirement for underwriting MBLs. I have been managing the MBL department for over 10 years and still find the need to reach out to some of our CUSO partners with greater experience when underwriting loans that we are not familiar with or feel the need for a second opinion on. Frankly two years of experience is very little and to make the change requiring experience commensurate with specific loan underwriting and portfolio risk is what all business lending departments should operate under in order to manage risk and make prudent loans.

For Credit Unions to compete against Banks we need to see these changes implemented as quickly as possible. We understand that it takes time to implement change and for NCUA examiners and Credit Unions alike to get up to speed on the regulatory changes. That being said, however, there are some changes that we would ask to be accelerated due to the simple nature of the changes. Those changes would include:

> <u>Credit Risk Rating System</u> – Most credit unions already have a credit risk rating system in place and simply need to shore up measurement and reporting. Those that do not have a robust system can establish and implement one as an integral part of their MBL policy update without substantial additional manpower and technological effort. [Reference Proposed Regulation 723.4(g)(3)]

Construction Loan Soft Costs – The regulatory definition that specifically identifies which costs may be included in construction soft costs is now clear, and this change can immediately be implemented in credit union policies and practices. [723.6(b)(1)]

Loan to Value Definitions for Construction Loans – The new definitions that require using

1) the lower of the cost to build, or

2) either the projected “as-stabilized” or “as completed” values, are now clear and can immediately be implemented in credit union policies and practices. [723.6(b)(2)]

Unsecured Lending – Credit unions can relatively easily define circumstances when appropriate and well-supported unsecured lending limits can be utilized. Credit unions can also set unsecured loan limits for loans to one borrower and portfolio limits that tie to net worth. These can be established in credit union policies and practices in a relatively short time. [723.5(a)]

Loans to One Borrower Limit – The new regulatory definition will allow a credit union to exceed the current 15% of net worth limit by an additional 10%, as long as the higher advance is fully secured by marketable securities or cash accounts. This is a clear provision and can be quickly implemented in credit union policies and practices. [723.4(c)]

Personal Guaranties – AltaOne agrees with the Preamble to the Proposed Rule in that credit unions should always obtain full personal guaranties whenever possible. While eliminating guaranties does pose additional risk, we believe this change can be implemented sooner in various ways. Credit unions could revise their policies to require a graduated scale for guaranties, where they would use other limited guaranty options before waiving a personal guaranty altogether. For example, credit unions are often asked to allow proportional guaranties when a business or property is owned by several individuals. Permitting this limited guaranty is a better alternative than declining a well-supported loan request when the owners are not willing to provide joint and several guaranties. Another graduated scale option would be to allow "carve-out" guaranties that would give the credit union the ability to pursue these limited guaranties for certain acts of default, such as the borrower filing bankruptcy. A third option is to require a guaranty only from the guarantor that is key to the success of the business, e.g. a managing partner, even though that guaranty percentage is below the 51% required today. [723.5(b)]

In AltaOne’s opinion, the guaranty issue is clearly the most important timing change that should be made in the new regulation. Credit unions today are forced to turn away many excellent lending opportunities because of the regulation-mandated guaranties, and 18 months is far too long to wait for this change.

There are several proposed changes that AltaOne agrees with our partner C.U. Business Group LLC (C.U.B.G) that further clarification or Modification by NCUA is needed. Those specific items are listed below with our concerns and/or comments consistent with those submitted by our partners at CUBG.

Common Enterprise and Control – The Proposed Regulation is quite specific on the definitions and stated percentages for determining borrower associational relationships. We question why this section of the new regulation seems to be more prescriptive rather than less so, as this portion of the new rule seems to run counter to the Control definition that should drive the Associated Borrower rules. In particular, the 50% Common Enterprise Rule and the 25% Control Rules are quite specific. We believe credit unions should be allowed to take a conservative approach and count any borrower who has a joint interest with another borrower or entity as an Associate Borrower. In addition, credit unions should be able to use prudent judgment to determine who has Control, as was suggested in Exhibit 3 of the *2013 Supervisory Letter on Evaluating Credit Union Requests for Waivers of Provisions in NCUA Rules and Regulations Part 723, Member Business Loans.* [723.2 and 701.22(a)]

Calculation of the MBL Cap – The Proposed Regulation eliminates the 12.25% of assets Cap, with the sole definition of the MBL Cap changed to "the lesser of 1.75 times a credit union's net worth or 1.75 times the minimum net worth requirement to be considered well-capitalized." We would request a clarification of what is intended by this change. Will the 7.0% definition of well-capitalized (under §1790d(c)(1)(A)(i) of the Federal Credit Union Act remain in place or will the paragraph that follows, [§1790d(c)(1)(A)(ii)], leave room to redefine "well-capitalized" at a higher level once the pending Risk Based Capital rules go into effect? The former interpretation would seem to leave most credit unions' current Portfolio Caps in place. However, if there is a higher threshold for well-capitalized under RBC, it may allow for more space under the MBL Cap. Naturally, most credit unions would prefer the second option to take effect. [723.8(a)]

State Regulations on Loan to Value – The Proposed Rule calls for each credit union to set its own loan to value limitation by product type while maintaining adequate collateral cushions. However, no maximums are set in the regulation, which may bring some credit unions into conflict with state regulations that do have maximum loan to value ratios. This potential conflict would not be limited to only the seven states that have their own MBL regulations but could also apply to many state chartered credit unions. NCUA could have the Proposed Regulation direct the credit unions to set their LTV limits no higher than allowed by their respective state regulations. [723.4(f)(5) and 723.5(a)]

Classification of an MBL vs. Commercial Loan – In reading the Proposed Regulation, loans that are included and excluded in these two definitions seem too complex to the point where it appears NCUA is creating exceptions to the exceptions. If the new definitions need to remain as shown in the Proposed Regulation for call reporting purposes then we would recommend the table found on page 56 of the Proposed Regulation Preamble be included in the finalized version of Section 723. This would provide the needed guidance to both credit unions and regulators when determining underwriting standards and call report classification of a loan. [723.8(a)]

Non-Member Participations – The Proposed Rule excludes these from the MBL Cap and each credit union can set its own portfolio limit on the amount of non-member participation loans that can be purchased. Therefore, a credit union could potentially buy as many non-member participations as desired. This is good for geographic diversification and balance sheet management. However, these participations are most often far outside a credit union's geographic field of membership or home state. From a safety and soundness perspective, it would seem to carry more risk for a credit union to hold a large amount of its portfolio in non-member participations, while they are constrained by the MBL Cap on member business loans within their core market area.

Accordingly, we would suggest the Final Rule include similar direction to what was provided to the banking industry by their regulators in the *2006 Interagency Guidance on Concentrations in Commercial*

Real Estate Lending, Sound Risk Management Practices. In that publication the OCC, FRB, and FDIC strongly suggested commercial real estate concentrations held by banks be limited to 300% of net worth and construction loan concentrations be limited to 100% of net worth. The Interagency Guidance did not mandate these levels though, but went on to indicate that failure to abide by these limits could subject the offending institution to increased regulatory scrutiny. A recent regulatory review paper validated these thresholds by reviewing bank failures during the Great Recession concluding that many banks with high levels of non-owner occupied commercial real estate loans either failed or threatened safety and soundness as commercial real estate market valuations significantly declined.

Of course, there will need to be exceptions to this general guidance, specifically for those credit unions that have been grandfathered in with no MBL Cap. [723.8]

<u>Prepayment Penalties</u> – It is necessary to bring up one issue that was not directly addressed in the Proposed Rule but which we believe warrants <u>high consideration by the NCUA for regulatory revision</u>. Federally chartered credit unions are prohibited by regulation from having a prepayment penalty on any type of loan. CUBG understands the rationale for prepayment penalties to exist in consumer lending. However, business lending is very different and is most often a longer, more costly process requiring specialized expertise and systems. The investment made in originating and managing a commercial real estate loan, for example, will typically be thousands of dollars in staff time, systems, and third party costs.

If a business member takes out a commercial real estate loan with no prepayment penalty then refinances or pays off that loan a few months later the credit union which <u>by regulation</u> could not charge a prepayment penalty will not have had sufficient time to earn interest and recoup the high costs of making the loan. This results in an economic hardship for the credit union that was strictly caused by regulation. Many state chartered credit unions can charge prepayment penalties whereas federally chartered credit unions cannot. This uneven playing field within our own industry is difficult to understand.

We understand that NCUA regulations allow for a “cost recovery” clause, which acts similar to a prepayment penalty. In practice, however, this clause is rarely, if ever, used. It is confusing to credit unions and certainly to borrowers, versus a prepayment penalty which is standard practice in commercial lending. Frankly, the cost recovery clause does not effectively substitute for even the most simple prepayment penalty.

We suggest that an easy solution to rectify this unintended regulatory burden is to allow loans defined as Member Business Loans under Regulation 723 to be exempt from the prepayment penalty prohibition. We respectfully request that the NCUA consider adding this important revision to the Proposed Regulation. [701.21(c)(6)]

We thank you for the opportunity to comment on these proposed changes.

Best Regards,

Kelly Carroll
Member Business Lending Manager
AltaOne Federal Credit Union