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AUG24'15 AM 8:37 BOARD

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

RE: NCUA Board Call for Comments – Member Business Lending

Mr. Poliquin,

As per the request of the NCUA Board, Citadel Federal Credit Union would like to submit the following comments for consideration in regards to the proposed changes to Sections 701, 723 and 741 of the NCUA Rules and Regulations impacting member business lending.

Citadel FCU is a $2.3 billion credit union serving the southeast Pennsylvania area. Our business lending portfolio is approximately $100 million and we have intentions of further commercial lending growth.

<u>Our Approach to Business Lending</u>

In comparison to consumer or residential mortgage lending, commercial lending presents a larger landscape encompassing a variety of industries, cash flow generation, and financing structures. This landscape also includes a mixture of credit & legal risks which require an experienced understanding of risk identification, assessment and mitigation.

In determining our target market for commercial lending Citadel has been conservative, inasmuch as we are seeking to build our commercial portfolio on a foundation of "owner" businesses while minimizing exposure to construction & development, large commercial investment properties, land development and other higher-risk transactions. Our focus has primarily been on two types of commercial relationships:

1) *<u>Small Family-Owned Businesses</u>*

This category includes local retail, service, and wholesale businesses with revenues generally under $1 million and a potential lending relationship up to $500,000.

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2) *Professionals & Trades*

These are defined as relationships to legal & medical professionals, architects, wholesalers, small or custom manufacturers, specialty contractors, information technology companies & other services. The businesses have revenues between $500,000 and $5 million with a potential lending relationship up to $2.5 million.

It should be noted that competition from regional and community banks for both categories above is strong.

A third category of borrower is also common in our marketplace although, as mentioned above, Citadel is not actively seeking to increase lending exposure in this area. We would entertain a loan request from this type of borrower provided the risk profile is acceptable.

3) *Builders & Investors*

This category represents large manufacturers, real estate developers & contractors, hotels & motels, residential builders, large contractors, & larger real estate investment properties. These borrowers have revenues between $500,000 and $30 million with a potential lending relationship between $1.5 million and $25 million.

Relationships vs. Transactions

Lending relationships with family-owned businesses or professionals & trades tends to provide less risk and more stability to an MBL portfolio. There is also potential to expand the relationship on the personal side for consumer services from the company owners.

Commercial loans to builders & investors are usually transaction-based and may not necessarily provide long-term stability to the lending portfolio (especially for construction-only loans to developers, large contractors, and builders). These loans generally represent higher risk and require specialized lending expertise to identify, analyze, structure and mitigate the credit and documentation risks.

Most loan participation opportunities from national commercial brokers tend to fit into the builders & investors category.

It should be noted that the existing NCUA regulation section 723 correctly seeks to minimize the risk from transactions with builders & investors but while doing so also impairs the ability of credit unions to be competitive in establishing relationships on the first two categories of borrowers.

MBL Changes Proposed by the NCUA Board

The NCUA has proposed changes to Sections 701, 723 and 741 of the Rules and Regulations which will impact how credit unions conduct commercial lending activities. The purpose of the changes is stated to be two-fold; 1) to ensure adoption and implementation by credit unions of a "safe and sound commercial lending program" and 2) to clarify and re-define some of the statutory items associated with member business loans. Citadel offers the following comments concerning the proposal:

1) A change in emphasis to a principle-based rule from a prescriptive rule would be beneficial in allowing a credit union to more specifically tailor its commercial lending efforts to meet the needs of its membership and local marketplace. For Citadel, a principle-based approach will provide us with more flexibility in meeting the financing needs of our target market. In particular, the current limitations and inflexibility on loan-to-value and unsecured lending have hindered attempts to be competitive with this market segment in relation to other financial institutions.

2) The adjustments in the calculations of loans that count for the MBL statutory cap appear to be minor and are primarily associated with expanding the definition of government-back loans as well as the exemption of participations or commercial loans to non-members made by another lender. In the long-run, the proposed adjustments do not address the more pressing issue of increasing the MBL cap from the current 12.25% cap to allow for more organic loan growth.

3) A principle-based approach will benefit many credit unions including Citadel. While it will require us to make some minor changes to our policies and procedures it will not represent a significant change from our current approach to commercial lending. We have a well-established relationship with our examination team and regional lending specialist and the recent examinations have already focused on commercial lending from a safety and soundness perspective. There did not seem to be an unreasonable focus on prescriptive items. When a prescriptive item was cited, it was within the context of an individual lending decision related to a specific borrower. While there is the potential for examiners to introduce biases or personal judgment into the examination process under a principle-based rule, we would expect the NCUA appeal process to address any overreach.

4) The elimination of the waiver process will definitely allow for a quicker response time to meet the needs of our member businesses. The waiver process was cumbersome, time-consuming and uncompetitive. It does not serve as a reliable control on the excesses of commercial lending.

5) It is not clear how the proposal to create a distinction between commercial loans and member business loans will be of benefit either to credit unions or to the NCUA. It would be more desirable if the distinction was eliminated and the definitions were synced. By classifying some items as member business loans and other as commercial loans, it creates unnecessary work for compliance and in preparing the call reports.

   Why are 1 to 4 residential investment properties or business vehicle loans reportable for MBL classifications? There does not seem to be any justification for inclusion of these items under the MBL cap as most non-credit union financial institutions recognize such exposure as residential or consumer lending risk, not commercial risk. Likewise, the non-classification as an MBL of a non-member commercial loan or non-member participation interest made by another lender appears to be solely a way of allowing for a loophole in 12.25% cap. This non-classification would benefit commercial loan brokers and the participation market to the detriment of natural "in-house" growth by credit unions.

6) The elimination of the limitation on construction & development loans to 15% of net worth may present an overall risk to the NCUA insurance fund which would negatively impact the industry and individual credit unions. Even when properly structured and fully-monitored the risk associated with construction lending is significant. By allowing the industry to increase exposure to this type of lending without some type of control mechanism other than the 12.25% cap, the NCUA may be creating a situation whereby the risks to the insurance fund significantly increase.

7) It is the responsibility of the Board of Directors to maintain oversight of lending which includes annually reviewing and updating the commercial loan policy if there is a material changed in circumstances (i.e. portfolio performance, economic conditions, etc.). The items which must be addressed in the commercial loan policy are being expanded to include lending authority, the loan approval process, underwriting standards and risk management processes.

   Historically, lending *policies* have addressed overall risk parameters and strategic objectives. The *implementation* of credit policy has been more appropriately handled by senior management through *operating & control procedures* which determine the specifics of risk management in a day-to-day environment. The proposed changes in section 723.4 increase the likelihood for disagreements to arise with examiners. The level of specificity proposed by the NCUA in defining "underwriting standards" and "risk management processes" to be included in the commercial lending *policy* is very detailed and seems to create an expectation of micro-management by the Board beyond what is customary. There is little allowance for a differentiation by the Board and senior management as to the appropriate level of oversight called for by the experience and capabilities of management and staff.

Under the proposed changes it is not clear if the commercial loan policy can remain succinct and still allow for a separation of "policy" items from "operational & control procedures". Is it possible for the commercial lending policy to reference the operational & control procedures instead of including everything in a policy which must be addressed by the Board for all changes? Does representation from a Board member on the business loan committee provide acceptable oversight for larger loan approvals and portfolio risk management (work-outs and problem loans)?

Overall, we feel the proposed changes will greatly benefit us in competitive situations while continuing to emphasize safety and soundness through a principle-based approach.

Citadel Federal Credit Union is appreciative of the opportunity provided by the NCUA Board to comment on the proposed changes to the member business lending rules and regulations during its re-consideration of Section 723.

Respectfully,

Kevin S. Dion

Kevin S. Dion
Vice President of Business Lending