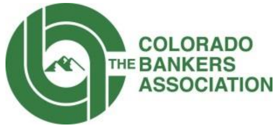

Don A. Childears
CBA President/CEO

Creating a stronger economy and helping Coloradans realize dreams by building better banks.

August 28, 2015

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

Re: NCUA MBL Proposed Rule – Proposed Rulemaking for Part 723

Dear Mr. Poliquin:

The Colorado Bankers Association (CBA) represents commercial banks in Colorado; our members have over 95% of the assets, bank employees and branches in our state. CBA requests that the National Credit Union Administration (NCUA) Board (the Board) withdraw its proposed substantial changes to its member business loans (MBL) rule for reasons detailed below.

Overview

The proposal should be withdrawn since it would do these things:

- Permit or even promote unsafe and unsound lending practices in a lenient NCUA regulatory environment by eliminating loan-to-value requirements, aggregate limits on construction and development loans and the requirement of a personal guarantee. NCUA's actions are reminiscent of greatly relaxed regulation of S&Ls in the early 1980s that was a great contributor to the crash of that industry.
- Significantly expand the amount of business lending by credit unions by excluding non-member business loans and non-member participations in business loans from the definition of MBL, making the Congressional statutory MBL cap meaningless and rejecting the sound rationale Congress used in making that decision.
- Violate a Congressional limit, contradict Congressional intent and usurp Congressional authority by replacing the current MBL requirements and limitations with a broad, lax regulatory approach.
- Demonstrate that NCUA is a captive of the entities it regulates by serving as an advocate rather than a regulator on the proposed rule.

Comments

1) Unsafe and unsound lending – The proposal introduces dangerously lax regulation that permits unsafe and unsound banking practices.
   a) Eliminate loan-to-value (LTV) requirements – LTV requirements protect borrowers from taking on too much debt. That was a central theme of the Dodd/Frank Act and the Qualified Mortgage regulation from the Consumer Financial Protection Bureau. LTV requirements are a basic regulatory framework for loans and high LTV mortgage lending was a significant contributor to the 2008 housing bust and

contributed to the meltdown that year. Loans to small businesses carry substantial risk to both the lender and borrower. Removing restrictions such as this only contribute to that risk for both parties. With the public and public officials, how do you defend this proposal to remove "speed limits" on credit union commercial lending in light of the critical need to have rational limits, especially when credit unions generally do not possess much experience or expertise in commercial lending?

b) Remove aggregate limits on construction and development (C&D) loans – To underscore the significant risk of C&D loans, bank regulators risk-weight them at 150%. We remember the obvious lessons from the failure of Norlarco Credit Union (Fort Collins, CO) doing construction lending on speculative housing development in Florida. This judgment of bank regulators and many examples like Norlarco demonstrate the necessity of such limits.

c) Delete the requirement of a personal guarantee – Recognizing that lending to small businesses has considerable risk, the personal guarantee is widely used to backstop the loan and protect the lender. No personal guarantee can be akin to no backup plan or a financial institution operating without capital to absorb losses. These reserves are needed as "plan B" protection. Elimination is unwise.

d) **Questions:** What protections remain (after elimination of these three items) to control the risk taken on by credit unions in a kind of lending where there is considerable risk and they have limited experience? How do you think this differs from the run-up to the S&L crisis and why will there be a different result of removing limits on higher risk lending? Have these changes been considered by the Federal Financial Institutions Examination Council (FFIEC) in regard to their more experienced assessment of business lending?

Expands limits – Through changes in definitions and by excluding various kinds of commercial loans from being considered MBLs, NCUA is negating the decisions of Congress.

2) Definition of MBL – The FCUA defines a MBL as "<u>any</u> 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." (emphasis added) The FCUA statute 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.

a) It is clear Congress intended that extensions of credit for business purposes count against the aggregate MBL limit unless they are in one of the five exceptions.

NCUA's proposed rule is not consistent with the statute and negates that statutory provision.

   b) **Question:** What specific law authorizes NCUA to ignore federal law and put credit unions, the insurance fund and credit union members at risk? The recently popular legal doctrine of "disparate impact," where intent is irrelevant and liability can be imposed based on a later review of consequences of actions, is relevant. What will be NCUA's defense when it is accused (in the court of public opinion or public officials' political judgment) of promoting risky lending based not on NCUA's intent but the detrimental consequences of adopting this proposal?

3) Non-member Business Loans Should Count Against the MBL Cap
   a) Changing definitions excludes non-member business loans (NMBL) and non-member participations in business loans from the definition of a MBL. 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 but generally not an MBL. What kind of logic explains that a NMBL is not a MBL? So, while a NMBL is subject to NCUA's MBL regulations, a NMBL is excluded from the aggregate MBL cap. The result of this change in definition makes the Congressional limit meaningless.
   b) If the Board believes that NMBLs should not count against the MBL cap, then it should seek to amend the FCUA to explicitly exclude NMBLs from the MBL cap.
   c) NCUA already has classified NMBLs and MBLs yet would not count it as a MBL. If it walks like a duck and quacks like a duck then it is a duck. Such loans should not be exempted and should be counted against the limit.
   d) **Question:** How does a credit union make a loan to a non-member? We were under the impression credit unions provided service only to its field of membership, as one of the arguments tax exemption. What specific law authorizes NCUA to render an act of Congress moot?

4) Participations excluded completely
   a) Limits in FCUA are in place to protect credit unions, the share insurance fund and ultimately the credit union member. Participations have all the features of a MBL except 100% ownership, but the risk reflects the degree of ownership. Refer to the FCUA definition of a MBL (in #2 above); there is no exception that covers participations and no grant of authority of NCUA to create one.
   b) NMBLs are excluded from both the seller's and the purchaser's aggregate MBL caps. The seller of business loans and participations in business loans does not count these since these loans no longer are on its book. The proposed rule specifically would allow the buyer of business loans and participations in business loans to non-members to exclude these loans from the aggregate MBL cap. That permits MBLs on a credit union's books to not be counted as a MBL simply because another entity originated it. There is no difference between these categories. 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.
   c) **Question:** What specific law authorizes NCUA to render a provision of FCUA meaningless? Does NCUA really want to damage its credibility by ignoring the law and casting itself as a rogue agency?

5) Contradicts Congress – Violates a Congressional limit, nullifies Congressional intent and usurps Congressional authority. The FCUA provides:

12 U.S. Code § 1757a - Limitation on member business loans
(a) In general On and after August 7, 1998, 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 equal to more than 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.
…
(c) Definitions as used in this section—
(1) the term "member business loan"—
(A) means 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; and
(B) does not include an extension of credit—
(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.
(emphasis added)

a) For the first time in 1998 Congress placed significant restrictions on member business loans of federally insured credit unions. Note that the statute says in two places "any member business loan" not "any member business loan as defined by NCUA". According to the Senate Report, 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."
b) Excluding NMBLs from the MBL cap is contrary to Congressional intent. When Congress in 1998 imposed the MBL limit, it did so to prevent significant amounts of credit union resources from being allocated in the future to large commercial loans and 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. The Board should withdraw its proposed rule and count all business loans (other than those enumerated in the FCUA) toward the aggregate MBL limit.
c) Words used by Congress in statutes and legislative history have meaning. The combination of the specific MBL limit and the motionless status of Congressional proposals since 1998 to increase those MBL limits clearly express Congressional intent: these MBL limits apply. Congressional disinterest in bills attempting to increase the MBL authority (or hostility toward those bills when viewed as unwise) is demonstrated by the fact that no bill to increase the limit even received a hearing in

its committee of jurisdiction. Congress didn't take those proposals seriously; they didn't get to first base; yet NCUA has proposed making that limit meaningless.

d) The Congress didn't simply express a preference. It adopted this language in H.R. 1151 by overwhelming votes. On April 1, 1998, in House vote #92 the House adopted H.R. 1151 by 411-8-11 (adopted with 98% of votes cast). On July 28, 1998, in Senate vote #239 H.R. 1151 was adopted in the Senate by 92-6-2 (adopted with 94% of votes cast).

e) The NCUA Board is substituting its judgment for that of Congress by excluding small MBLs, NMBLs and participations from the aggregate MBL cap. If Congress intended to give the Board the authority to exclude any other forms of business loans from the MBL limit, it would have included an additional exception for "other loans as approved by NCUA." Congress did not do that. NCUA now appears to be flaunting its nullification of Congressionally established limits.

f) **Question:** What authorizes NCUA to countermand Congressional decisions and commandeer Congressional authority? Which specific law authorizes NCUA to permit an activity contrary to federal law and Congressional intent in enacting that law? What specific law authorizes NCUA to violate a Congressional limit, nullify Congressional intent and usurp Congressional authority by defining away a specific limit imposed by Congress?

6) Regulatory capture – Against the backdrop of NCUA's reputation for having been captured by the entities it is supposed to regulate and its appearance for acting as their advocate, NCUA is furthering this undesirable repute and straining its credibility. Federal judges previously have called NCUA a cheerleader and a rubberstamp. NCUA contradicting statute and the intent of Congress so obviously amounts to NCUA blatantly giving the finger to Congress.

7) Broader arguments – Other arguments are relevant to the broader debate NCUA's proposal and action will spark with the public and public officials.

a) The action of shifting taxable commercial lending from banks to tax exempt credit unions will lower federal tax revenues, add to the deficit and cost all other U.S. taxpayers. That is even more aggravating when you recognize that practically every U.S. taxpayer paid more in income taxes than all credit unions combined in this almost $1 trillion industry. What law authorized NCUA to produce this result?

b) There is an alternative for those big aggressive credit unions that have morphed into tax-exempt banks: convert to a bank charter and make commercial loans with the same regulation as the banks they envy and emulate. That avoids their actions jeopardizing the tax exempt status of more traditional credit unions.

c) Frequent justification for expanded MBL is that banks can do more commercial lending now. We welcome them to a level playing field with banks by their conversion to a bank charter where they will have the exact same regulation and pay their fair share of taxes.

d) Those who perceive bank regulation (especially since enactment of the Dodd/Frank Act) as light and diminish banking's expertise in commercial lending are naïve. Treating MBLs by credit unions with less experience and under the proposal fewer rational restrictions is not authorized, warranted or wise.

e) Only some MBLs are counted now toward the 12¼% cap. Currently business loans under $50,000 aren't counted as MBLs. It can be argued that these smaller business loans carry more risk to the lender than larger ones. Where was NCUA

authorized to determine that only some MBLs actually are counted toward the MBL cap?

f) Expanded MBL authority isn't needed by most credit unions since only about 0.5% of credit unions are near the existing 12¼% cap.

g) Business lending is not in the "serving people of modest means" mission of credit unions.

In case you think problems can't develop, consider the recent development of FCS Southwest (part of the Farm Credit System (FCS)) that per a July 29, 2015, letter to its borrower/stockholders, reported "cumulative losses resulting from [certain] identifiable loans totaled $49.7 million." After discovering this problem during the third quarter of 2014, FCS Southwest withdrew its annual reports dating back to the 2010. At the same time, the Farm Credit Administration (FCA, regulator of the FCS) pulled from its website all FCS Southwest call reports filed after 2009, pending an audit and restatement of FCS Southwest's financial statements from 2010 forward.

This and Norlarco are but a few examples that demonstrate that lenders and their regulators are fallible and that huge mistakes can remain undetected for years. If the NCUA proposal is adopted it can and likely will lead to this same kind of result.

Conclusion

If the proposed rule is adopted as currently proposed, it would remove safeguards and restrictions and jeopardize protections for credit unions, the credit union insurance fund, and credit union members that Congress put in place. The Board should not use regulatory fiat to circumvent Congress and make the statutory MBL cap meaningless. Therefore, the Board should withdraw the proposal.

THE COLORADO BANKERS ASSOCIATION

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U.S. Representative Jared Polis
U.S. Representative Scott Tipton (member House Financial Services Committee)
U.S. Representative Ken Buck
U.S. Representative Doug Lamborn
U.S. Representative Mike Coffman
U.S. Representative Ed Perlmutter (member House Financial Services Committee)

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