Niagara's Choice
CREDIT UNION
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August 31, 2015

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

Re: Comments on Notice of Proposed Rulemaking for Part 723, Member Business Loans

Dear Mr. Poliquin:

Niagara's Choice FCU (NCFCU) appreciates the opportunity to submit comments regarding the NCUA Board's proposed changes to its member business lending (MBL) rule.

Credit unions have a very well established history of making loans to members for business purposes. In fact, some of the first credit unions in the United States were organized to lend for business purposes. This activity is fully consistent with credit unions' mission to promote thrift and provide access to credit for provident purposes. While not the largest portion of credit union lending, small business lending is the fastest growing segment by a significant margin. Many aspects of this proposal would remove barriers to credit union small business lending and enable credit unions to better meet the lending needs of their small business members. We applaud the approach this proposal takes and encourage NCUA to finalize it taking into consideration the improvements and concerns suggested in this letter.

The proposed MBL rule would overhaul NCUA's current MBL regulation in Part 723 by shifting from a prescriptive regulation that contains many detailed requirements to a principles-based regulation that gives credit unions more flexibility in the construction and operation of an MBL or commercial lending program that best fits their members' needs. NCFCU supports NCUA's approach because it simplifies the regulation and removes many onerous business lending restrictions in the current rule not mandated by the Federal Credit Union Act (FCUA). The prescriptive approach may have been appropriate in the early years of business lending; however, in spite of the FCUA limitations and this prescriptive approach, credit unions across the country have developed robust commercial lending programs with experienced management and sound lending practices. Removing most of the specific requirements that currently require waivers, including the personal guarantee requirement, and lifting all unnecessary and arbitrary limits on construction and development (C&D) loans would ultimately allow credit unions to better serve their communities and members.

Summary of Comments Addressed In This Letter

- NCFCU supports the change from the current prescriptive approach to a more principle-based methodology.

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- NCUA should release and permit comment on the supervisory guidance prior to the issuance of the final rule. The absence of supervisory guidance creates uncertainty that makes it impossible to fully assess the proposed rule's potential impact on credit unions.
- NCUA should detail the minimum requirement that are acceptable for establishing a safe and sound MBL program.
- NCFCU supports the elimination of all prescriptive requirements necessitating waivers. Eliminating these requirements should give credit unions much needed regulatory relief.
- NCFCU supports the new definitions including the newly created definition of "commercial loan" that helps distinguish those loans subject to the MBL cap from commercial loans that invoke the safety and soundness provisions.
- NCFCU does not support the requirement of the credit-risk rating system that may not be appropriate or necessary in a commercial loan policy.
- NCFCU has concerns over the newly imposed duties on our already heavily burdened volunteer credit union board of directors, particularly in light of the absence of guidance by the NCUA on specific requirements.
- NCUA must provide consistent training and guidance to examiners as part of the implementation of this rule since the rule will require more thorough examination of loans and policies by examiners.

NCFCU feels strongly that the absence of supervisory guidance creates uncertainty that makes it impossible to fully assess the proposed rules potential impact on credit unions. Because many of the current regulatory restraints would be removed from Part 723, NCUA will issue guidance that details the parameters of a safe and sound commercial lending program and many other possible examiner-driven requirements that are not detailed in the proposed rule. This guidance will detail many of the standards credit union examiners will use when reviewing commercial lending programs and thus stands in the place of the current prescriptive requirements. NCUA plans to issue this companion guidance well after the comment period for this proposed rule has ended, and, according to NCUA staff, stakeholders will not have the opportunity to comment on the guidance. It has been shown in the past that NCUA leadership and staff have repeatedly stated the Administrative Procedures Act does not require public comment for guidance. This absence of a requirement does not preclude NCUA from opening the guidance to public comment; in fact, the NCUA has discretion to allow or not to allow public comment on guidance. A case in point is NCUA's 2011 proposed interest rate risk rule where NCUA included guidance in a proposed rule for public comment as precedent of the issuance of important guidance with a rule. We strongly urge NCUA to permit stakeholder comment on the supervisory guidance and believe this could be accomplished without delaying the implementation of the final rule.

In speaking with other credit unions I have heard concerns that the principles-based approach in the proposed rule could complicate management of an MBL program because the proposed rule would shift to credit unions the responsibility to develop a commercial lending program that is safe and sound and meets examiner approval. Without guidance, the amount of detail NCUA will give credit unions on how to construct and operate a safe and sound lending program is unclear. NCUA could alleviate these concerns by specifying minimum acceptable requirements, which credit unions looking for a simple commercial lending program could incorporate into a commercial lending policy that would automatically receive examiner approval. In adopting this approach, it would be important for the rule and accompanying guidance to emphasize such a "safe harbor" policy is not the standard from which deviations would be considered unusual or extraordinary. We urge NCUA to address this concern when finalizing the proposal.

The current MBL rule contains many prescriptive requirements not required by the FCUA. Because these restrictions are in many cases more restrictive than is warranted by safety and soundness concerns, NCUA has given credit unions the ability to receive a waiver from many of them. However, credit unions found the waiver process to be time consuming and burdensome, and often leads to credit unions being uncompetitive with other financial institutions that do not have these restrictions. Also, there is a degree of uncertainty when applying for a waiver that might cause credit unions to avoid even considering making an MBL due to the time and expense associated with applying for a waiver when there is no guarantee one will be granted.

NCFCU fully supports the loan-to-value ratio revised definition. Revising the definition to clarify that junior debt from other lenders does not need to be included in calculating loan-to-value (LTV) ratios, and further clarifies the valuation basis for collateral. It brings LTV calculations in line with customary commercial loan calculations.

With respect to the requirement to use the "lesser of purchase price or market value for collateral held 12 months or less," NCFCU suggests NCUA provide some flexibility on this standard because there are several situations where this standard is either unreasonable or unworkable. This is particularly true where there have been non-purchase transactions which require a thorough understanding of the credit's dynamics and a "one size fits all" rule can be problematic and have undesired consequences.

While we appreciate that the 12-month standard is being considered out of concern over the reliability of appraisals, a better approach is that credit unions use robust appraisal review and underwriting processes to manage risk. The LTV calculation will create an unfair disadvantage for credit unions and cause unnecessary administrative burdens. We agree a level of "skin in the game" by the borrower is an important part of evaluating a credit transaction, but the blanket LTV rule for non-purchase transactions is not necessarily the best approach.

Credit Risk Rating System is defined in the proposed rule as a formal process that identifies and assigns a relative credit risk score to each commercial loan in a portfolio. It is to be determined through an evaluation of quantitative factors based on financial performance and qualitative factors based on management, operational, market, and business environmental circumstances. NCFCU supports NCUA's goal of ensuring sound underwriting practices and managing risk appropriately for the credit union. NCFCU agrees the use of a Credit Risk Rating System is useful in this regard and does not object to the requirement, and notes that NCUA acknowledges over 90 percent of credit unions already have systems for their commercial loans. The NCUA should allow some flexibility to credit unions in determining where such a system should reside in their policies. The proposed rule, as drafted, requires the system to exist in the commercial loan policy. Many credit unions may choose to include it in other policies, such as an enterprise risk management process, or otherwise include it as part of the overall holistic management of the portfolio risk. We also note the definition requires the use of an "ordinal number" to represent the degree of risk. This suggests that only the use of a natural number or integer for a risk score would satisfy the rule. A credit union may wish to use a "Low/Medium/High" designation, grade loans as "A, B, C, D", or "Red Light, Yellow Light, Green Light" for purposes of rating the risk, all of which would serve the same purpose and accomplish the same goal. NCUA should provide flexibility in this regard.

NCFCU supports the change clarifying that loans secured by a 1- to 4- family residential property are not commercial loans for purposes of the rule. Excluding these loans from the definition of commercial loan is important because credit unions that would otherwise not make commercial loans would be required to have a commercial lending policy and additional board responsibilities if these were considered commercial loans.

In regards to our Board of Directors and Management Responsibilities proposed § 723.3 would place the ultimate responsibility for a safe and sound commercial lending program on a credit union's board of directors. Whereas that may be appropriate in principle, this section is more prescriptive with respect to credit union board requirements than the current § 723.5 that it would replace. The proposed board requirements would require boards to be much more involved in the details of a credit union's commercial lending program. NCFCU has concern these additional board duties could make developing and running a commercial lending program more burdensome because of the increased reliance on volunteer boards for approval and monitoring of all aspects of a program.

We are concerned the proposed § 723.3 could require too much ongoing supervision from volunteer credit union boards. Furthermore, without guidance to review with this section, credit unions will not know the true burden a board would face in the supervision of a commercial lending program. These additional board responsibilities may also cause credit union boards to become overly involved in operations instead of setting policies for management to execute.

NCFCU supports the elimination of the specific two-year staff experience requirement. This requirement is replaced with requirements for different levels of staff to have experience in the areas of managing commercial lending staff, underwriting and processing loans, overseeing and evaluating performance, and conducting collection and loss mitigation activities. While management should have experience in all three areas, the staff will not necessarily have this particular experience. For example, a credit analyst will not have, nor need, training for collections in order to effectively perform their duties. The final rule and guidance should clarify this point.

NCFCU also believes the experience requirements can be met by a third party or third parties, such as CUBG. Credit unions often rely on third parties to outsource experience and other needs that might not be necessary or cost effective to have in-house.

The proposed § 723.4 requirements are more detailed than NCUA's current MBL policy requirement in § 723.6. Prior to engaging in commercial lending, a federally insured credit union must adopt and implement a comprehensive written commercial loan policy and establish procedures for commercial lending. This section, in conjunction with the requirements in § 723.3, details a board's duties in the operation of a credit union's commercial lending program.

Even though the proposal eliminates most of the current rule's specific limits, these limits could still very likely be imposed by examiners as policy limitations. Instead of relying on statutory limitations, a credit union board will be responsible for developing and defending to examiners their credit union's policy on LTV ratios, minimum equity investments, portfolio concentration limits for types of loans, and personal guarantees.

NCUA has stated the proposal will give credit unions the ability to adopt commercial lending standards and a commercial lending program that best meets their members' needs. The difference is by requiring credit unions to incorporate their own limitations in a commercial lending policy, credit union staff and their boards could have more stringent limitations than what is required by the current statute if NCUA examiners elect to hold credit unions to a higher standard.

Furthermore, some credit unions may adopt more stringent standards than what are required now out of fear of excessive scrutiny from NCUA examination staff. Further, the proposed requirements of § 723.4(f)(3) that require a projected balance sheet and income and expense statements may be appropriate for construction and improvement loans, however, in many real estate purchase loans, projected balance sheets are not necessary. NCFCU recommends amending the language to read as follows: "Projected income and expense or other projections commensurate with the particular transaction type should be obtained."

NCFCU supports the proposed § 723.5 which would eliminate the personal guarantee requirement. Currently, § 723.7 requires a personal guarantee or a waiver from a regional director. This requirement is cumbersome and time consuming and even if granted, hampers a credit union's ability to offer commercial loans.

The proposed section would not give credit unions carte blanche to make commercial loans without a personal guarantee; instead, it would allow credit unions to make loans without a personal guarantee when it is reasonably prudent to do so. Our concern here again stems from the lack of the issuance of contemporaneous guidance from the NCUA. There is uncertainty as to which situations a credit union would be permitted to make a loan without a personal guarantee. A credit union could now be subject to potential examiner criticism when it makes a loan without a personal guarantee. NCFCU also requests NCUA to provide more detail on the action the agency will take if a loan made without a personal guarantee is deemed by an examiner to be imprudent.

NCFCU has serious concern regarding the future commercial loan examination process. We understand the proposed rule and can even develop a commercial lending program without the necessary guidance that NCUA has not published for public comment. However, the potential for inexperienced examiners second guessing loan decisions, credit union policies and other business decisions concerns NCFCU and many credit unions.

Examination consistency is an additional concern for NCFCU and many credit unions. NCFCU believes examiners receive and apply inconsistent safety and soundness guidance. With many aspects of a commercial lending program being subjectively reviewed, we fear they may be subjected to the application of differing "rules" from one examination to another based on individual examiner opinion.

NCUA staff acknowledges the agency will need to train and hire additional staff to examine credit unions making commercial loans. Having qualified examiners review commercial loans is paramount to the success of the proposed MBL regulation because examiners will be unable to rely on the regulation for requirements and will need to have a thorough understanding of commercial lending to properly evaluate and examine non-uniform commercial lending programs. We strongly encourage consistent training and guidance for these examiners given their significant role in the process. In addition, especially during the first few years after implementation, there should be ample supervision by senior NCUA staff of examiners' reviews of credit union commercial lending policies. Credit unions should be able to elevate policy disagreements up the chain without initiating a formal procedure.

NCFCU appreciates that NCUA plans an 18-month delayed implementation period for the requirements in the proposed MBL rule. Both credit unions and the NCUA will require adequate time to fully implement the new requirements. However, a more effective approach would be to allow credit unions to comply with the new provisions earlier than 18 months if the credit union has satisfied the new requirements. This approach would allow for credit unions that wish to meet the new requirements to do so earlier, and would give the NCUA a head start on approving policies and examining based on the new regulatory requirements.

NCUA has indicated the implementation of the requirements in the proposed MBL rule would cost the agency approximately $1.9 million. This would be primarily a one-time cost for specialized training for examiners before implementing the rule. We urge NCUA to find these funds by increasing efficiencies in other areas. For example, NCUA could find the funds by wringing out inefficiencies in the examination process. This could be accomplished by modernizing examination procedures and reducing the examination burden on well-performing credit unions, which would allow NCUA to deploy these resources to modernize its examination procedures for the requirements in this proposed MBL regulation.

In conclusion, many of the provisions of the proposed rule could ultimately enable credit unions to operate more efficient and robust commercial lending programs; however, without the ability to review and comment on the guidance, we cannot completely evaluate and project the impact it will have on us. Nevertheless, NCFCU is willing to push forward with this approach as the current rule magnifies the stifling MBL restrictions in the FCUA by placing many unnecessary burdens on credit unions seeking to provide commercial loans to members. Notwithstanding the concerns we have raised herein, NCFCU supports this proposed rule and applauds NCUA for this approach.

Thank you for the opportunity to express our views. If you have any questions about our comments, please do not hesitate to contact me.

Sincerely,

Daniel Keleher, Executive Vice President
Niagara's Choice FCU