August 28, 2015

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

RE: PROPOSED REGULATIONS – MBL; COMMERCIAL

Mr. Poliquin:

Lake Michigan Credit Union (LMCU) appreciates the NCUA's proposal to update its Member Business Lending (MBL) regulations and allowing us the opportunity to provide commentary as to the proposed changes. During the past five years, LMCU has worked diligently to develop a commercial lending department, focusing not only on growing our business loan portfolio, but on credit quality. LMCU and its Commercial Lending Department appreciates the NCUA recognized in its proposed rule issuance, "Generally, credit unions have conducted business lending safely and served their small business members' needs well." Credit Unions with a dedicated commercial department stand best prepared to embrace these proposed changes.

LMCU fully supports the following proposed MBL changes, believing these changes will create better underwriting and risk management practices.

- Taking the step to define "associated borrower", replacing the current definition of "associated member", better aligns the calculation of aggregate loan exposure with all financial institutions, as well as requiring credit unions to place greater emphasis on evaluating and underwriting an entire relationship as opposed to a stand-alone loan transaction. Entity ownership structures can be complex. Failing to examine all parties in a relationship can unintentionally expose the credit union to risk.

- LMCU supports removing loans secured by a 1-4 family residential property from the definition of a MBL. These loans are typically direct to an individual or a single member entity and do not present a commensurate level of risk to that of a business loan.

- Defining allowable costs for valuation and funding purposes of a Construction and Development loan. In the past there has been confusion and disagreements amongst members of the Credit Union and examiners as to what are and are not allowable construction costs. Incorporating this in the new regulation will provide necessary clarity.

As communicated by the NCUA multiple times, its goal with the proposed changes is to transition from a prescriptive approach to a principles-based approach. Requiring the development and implementation of a risk rating policy supports the principles-based approach. At the core of sound underwriting is the ability to properly identify and quantify risk. A well-defined risk rating policy aides in both these efforts, and accomplishes the single most important responsibility of a commercial lending department, proper risk identification. LMCU supports the general requirement that MBL programs incorporate a risk rating system, and that these risk ratings be periodically re-evaluated. Additionally, this should be the major focus of examinations and aligns with the primary focus of all other supervisory agencies.

There are proposed changes and additions that LMCU would request additional clarity. Detailed below are those sections, including page numbers taken from the proposed rule, 12 CFR Part 723, issued by the Board on June 18, 2015.

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- Covered Loans – Page 13 – The proposed rule would continue to exclude loans less than $50,000. As part of this change, LMCU would ask that the Board consider increasing this limit to $100,000. We believe that increasing the limit will allow credit unions to better serve its smaller business membership base. Typically smaller businesses are not as financially astute as larger businesses and do not have the internal sophistication to comply with requirements that larger companies can comply. To mitigate this risk, smaller business loans are typically direct to the business AND the owner(s). As the owner(s) of the business is a direct obligor, typically the loan is approved on his or her financial capacity and credit score.

- Loan-to-value ratio – Page 18 – In instances of new purchases, LMCU supports limiting advances to the lesser of cost or appraised value. However, instituting a time limit of 12 months as part of the definition of cost is prescriptive and not consistent with a principles-based approach. In instances where a Borrower acquires a property below market cost, as verified by an appraisal, it should not be held captive to that value for the next 12-months. If there is true equity held in an asset, a financial institution should not penalize a Borrower for such a transaction. Additionally, there are instances in which a Borrower may acquire a property, improve the property with its own dollars, and then request to access the equity. In instances where the property has been improved, the Borrower should be allowed to access this equity regardless of the time since acquisition. LMCU requests that a time limitation not be incorporated into the final issued rule.

- Commercial loan policy – Page 36 – The NCUA has stated it will "incorporate expectations regarding risk management practices, such as LTV ratios and portfolio concentration limits, into supervisory guidance issued with any final rule adopted by the Board." While LMCU fully expects the NCUA to issue supervisory guidance regarding maximum limits for LTV and concentration limits, it requests the NCUA to make these no more punitive than existing regulatory limits imposed by the other supervisory agencies. Further, LMCU requests the NCUA allow a comment period specific to these limits once issued by the Board.

- Trade area – Page 36 – LMCU is asking that within this section, the final issued rule allow either "the credit union ***or a qualified, independent agent of the credit union*** the ability to make periodic site visits". In instances where LMCU has extended a business loan to a Member outside of its immediate geographic trade location, we should maintain the ability to contract a qualified, independent agent to complete work on our behalf. Credit Union's purchasing loan participations should be expected to also inspect collateral as part of its due diligence. If these participations are outside of its immediate trade area, then a qualified, independent agent should be contracted to complete such inspections.

- Underwriting standards – Pages 39 – 40 – Several new requirements which the NCUA is proposing so as to establish minimum underwriting standards are too broad, and could result in disagreements between credit union and examiners. For example, the proposed rule states that "The credit approval document should be in a standard, ***logical*** format and provide all relevant information." (page 39, 2nd paragraph). LMCU is concerned with the requirement for the approval document to be "logical". Interpretation of this word will vary from person to person. In its place, LMCU would recommend requiring the approval document be "consistent".

  To take it a step further, to require that a credit policy "outline the required components of the credit approval document" (page 39) is a broad requirement and one that would create disagreement and dissent between Sales and Credit Administration. Many times Credit will customize the approval document including additional information or detail specific to a Borrower and/or loan request. If these are not details or requirements of the approval document outlined in policy, Sales staff could not provide the information or contest Credit requiring the information.

Further, in the third paragraph of the same page, it is indicated borrower analysis should be "based on a ***reasonably*** long period to establish a reliable trend". Again, the definition of reasonable is left up to interpretation. The credit union should maintain the ability to determine what is satisfactory so as to establish a reliable trend. Again, so as to implement a principles-based approach, such minimum standards need to be left to the credit union to define and not the Board.

- Collateral – Page 47 – Collateral monitoring – The requirements set forth on page 47 regarding inspection requirements does not take into consideration a corresponding loan structure. For example, for a line of credit secured by accounts receivable, advanced at 75%, and used minimally, more frequent collateral monitoring may not be necessary, especially if the accounts receivable are highly diversified. The point being, requiring a policy to set forth specific collateral monitoring requirements is prescriptive.

- Commercial loan policy – Page 90 – A requirement of a commercial loan policy's underwriting standards would be a "thorough due diligence of the principal(s)". We request that "principal" be defined as this could be interrupted to be any owner of a business even if this owner is not a guarantor.

- LMCU's last comment is that it seems the proposed rule attempts to incorporate processes and procedures requirements as opposed to actual policy requirements. Again, this is prescriptive and outside of the principles-based approach. For example, for Construction and Development Loans the proposed rule would set forth a requirement that ". . . outlines required procedures to be followed in the administration of construction and development loans." (page 50). Typically an institution's loan policy speaks to the permitted loan terms and loan structure with guidelines being written as a supplement to the policy. Committing to policy processes and procedures that will change in response to industry changes, such as title and insurance, is not prudent and results in a cumbersome loan policy.

  Additionally, requiring that a loan policy set forth requirements for the quality of financial statement reporting (page 40) is excessive as a loan policy could not begin to account for every loan type and structure. For example, if a $5MM loan would typically require the submission of audited statements, however, the loan is advanced at 25% against a highly liquid investment, audited statements wouldn't necessarily be required. The point being, so as to maintain a principles-based approach, a credit union should be allowed flexibility in defining its credit policy and underwriting requirements in terms of the quality of financial statement requirements.

In addition to providing the above comments, the proposed rule requested credit unions weigh in on the regulation of business lending by FISCU's. Of the three options provided by the Board, LMCU fully supports Option C, permitting SSAs to preserve their rules current format, thus permitting FISCUs in those states to continue operating in compliance with the applicable state rules.

Thank you again for opening up Part 723 for change and discussion. Here at LMCU we view these proposed changes as a step in the right direction, and are changes that if implemented correctly, will expand business memberships across all credit unions.

Sincerely,

Jeremiah Kossen
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Grand Rapids, MI