The Wisconsin Credit Union League

One League, One Focus - Your Success!

Submitted via email: regcomments@ncua.gov

Aug. 31, 2015

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

Re: Proposed Amendments to NCUA Regulations, Part 723, on Member Business Loans & Commercial Lending
RIN 3133–AE37

Dear Mr. Poliquin:

On behalf of Wisconsin's Credit Unions® and their 2.6 million members, the Wisconsin Credit Union League is writing to express its support for the National Credit Union Administration's (NCUA's) proposal to overhaul its member business loan (MBL) and commercial lending rules.

We applaud the NCUA for taking steps to remove unnecessary regulatory hurdles in favor of a new "principles-based" approach. These changes would both modernize and simplify the rules. The current "prescriptive" underwriting criteria for MBLs leave much to be desired. They go far beyond what the Federal Credit Union Act (FCUA) requires; their arbitrary requirements are more restrictive than warranted by safety and soundness concerns; and their one-size-fits-all approach has led credit unions to manage their commercial lending practices with an eye on regulatory criteria instead of focusing on sound business lending decisions and member service.

The proposed rules would shift the onus for setting sound commercial lending standards to credit union boards and management. That would be a weighty responsibility, but in exchange, credit unions would gain much-needed flexibility to meet their members' needs and to compete more effectively in commercial lending. The net result would benefit credit unions, their members, and the national economy.

While we offer our support and appreciation for these revisions to the MBL rules, no proposal is perfect. We have some concerns and recommendations, which the remainder of this letter will address.

NCUA Guidance & Examinations

Two of our primary concerns arise not from the proposal itself, but from the NCUA's plans for implementing it.

First, the NCUA says that it plans to publish extensive supervisory guidance for examiners, which would be shared with credit unions, laying out the NCUA's expectations for compliance with the amended rules. We believe that the credit union system would be best served if the NCUA releases a draft of that guidance and allows interested parties to comment on it before these rules are finalized. Presumably, the guidance will detail the minimum requirements that examiners will deem acceptable for safe and sound commercial lending and MBL programs. It will essentially replace the prescriptive requirements found in the current rule, telling credit unions and examiners what will be expected of them under the broad (and somewhat vague) new rules. Until the guidance is released, no one can effectively predict how these new rules will

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work. Without knowing what the guidance will say, interested parties cannot assess how the new rules and guidance combination will impact credit unions, and their comments on this proposal can offer only limited insights.

Second, the NCUA says that it plans to conduct specialized training to help examiners understand how to review credit union commercial loan portfolios and policies under the new principles-based rules. Individual examiners – both from the NCUA and from state supervisory agencies – will have considerable latitude to determine whether a credit union's commercial lending policies and procedures are adequate and whether individual loans meet subjective definitions of safety and soundness. We believe that certain steps would be critical to the success of this system:

- Examiners must be consistent in their approach to evaluating commercial lending programs. They (and credit unions) must work from soundly vetted guidance, published for public comment, so that all parties have a foundation of predictable and reliable minimum standards. Training must give examiners consistent guidance on safety and soundness, to minimize the vagaries of individual examiner's opinions.

- Examiners assigned to credit unions with MBL or commercial lending programs must be experienced, with a thorough understanding of business lending, so that they can properly examine non-uniform lending programs. Inexperienced examiners might be more inclined to second-guess credit union lending decisions based on arbitrary personal standards.

- Regardless of examiner experience, examiners reviewing commercial lending program must have adequate supervision by senior NCUA staff, and credit unions should have a mechanism to address disagreements without having to initiate a formal appeals process.

- State examiners must undergo the same specialized training as their NCUA colleagues, so that state-chartered credit unions have a level playing field with FCUs and equal flexibility under the new principles-based approach.

Waivers & the Cap on Commercial Loans to One Borrower

Faced with the prescriptive limits in the current MBL rules – such as the personal guarantee requirement and loan-to-value ratio requirements – many credit unions have applied for and received MBL waivers. Waivers were originally intended as case-by-case exceptions to the MBL rule, but the NCUA notes that they have become the "norm." More than 1,000 MBL-related waivers are active currently, and 115 waivers were granted in 2014 alone. We understand why the NCUA wants to get "out of the waiver business," as Vice Chairman Rick Metsger said in a recent statement.

Credit unions have sometimes found the waiver process to be time-consuming, burdensome, and unpredictable. Having to wait for a waiver (and lacking certainty that it will be granted) has put credit unions at a competitive disadvantage against other lenders. For these reasons, The League supports the NCUA's goal of eliminating the waiver process and giving credit unions more latitude to determine their own commercial lending standards.

However, the rules retain one very specific, prescriptive requirement for which a waiver process should be retained.

Currently, the MBL rules cap business loans to one borrower or group of associated borrowers at an aggregate amount of up to 15% of the credit union's net worth or $100,000, whichever is greater. The rules provide a waiver process (§723.10(h)), giving credit unions a way to exceed this limit when appropriate. The proposed rules (at §723.4(c)) retain the prescriptive restriction – requiring credit unions to include the cap in their policies – but they eliminate the waiver. The proposal would allow an additional 10% of net worth in business loans to one borrower (for a total of 25%), but only

if secured by marketable financial instruments – which are simply not available to most credit union small business borrowers.

The NCUA has provided little empirical support for this cap, saying only that it "is consistent with the limit allowed by other banking regulators." That statement is inaccurate, for several reasons:

- The NCUA has cited a federal OCC (Office of the Comptroller of Currency) regulation that limits lending by national banks and savings associations to 15% of net worth plus another 10% secured by marketable financial instruments (12 CFR §32.3); however, that bank lending limit applies to all loans, not just business loans. NCUA has its own loan-to-one-borrower limit for all loans by credit unions. It makes no sense to apply the banks' general lending limit to credit union MBLs.

- Part 32 of the OCC regulations makes numerous exceptions to this limit, including an exception for small business loans. The OCC regulations allow small business loans to one borrower up to an additional 10% of net worth without restriction on the nature of the collateral. They also limit the aggregate amount over 15%, and create an application process. (12 CFR §32.7)

- The OCC rules define small business loans (12 CFR §32.2) by referencing the instructions for the OCC's Consolidated Report of Condition and Income. Those instructions treat all business loans of $1 million or less as "loans to small business":

  > For purposes of this schedule, "**loans to small businesses**" consist of the following:
  >
  > (1) Loans with original amounts of $1 million or less that have been reported as "Loans secured by nonfarm nonresidential properties" (in domestic offices) in Schedule RC-C, part I, items 1.e.(1) and 1.e.(2), column B, and
  >
  > (2) Loans with original amounts of $1 million or less that have been reported in Schedule RC-C, part I:

The result: The OCC allows small business loans (of $1 million or less) to one borrower in amounts up to 25% of net worth without restrictive collateral requirements (although subject to an overall limit and an application process). The NCUA's proposal would restrict similar loans by credit unions more harshly than the OCC does for banks, which is not what the NCUA said it intends.

A simple solution is that the NCUA should continue to make waivers available for its proposed limit on the aggregate dollar amount of commercial loans a credit union can make to any one borrower or group of associated borrowers. We understand the NCUA's desire to remove the waiver system from its commercial lending regulations; however this cap is one area of the proposed rules that remains explicitly prescriptive. Waivers should continue to be available if credit unions are to retain the flexibility to make necessary and appropriate commercial loans to one borrower or group of associated borrowers.

Otherwise, if the NCUA intends to mirror OCC caps on commercial loans to one borrower, it should revise the proposal to better track the OCC rules in their entirety. Rather than parroting the many definitions and exceptions in the complicated OCC rules, the NCUA rules could achieve substantially the same result by simply allowing commercial loans to one borrower or group of associated borrowers in an amount of up to 25% of net worth – without restrictive collateral requirements.

"Commercial Loan" Exemptions

The current MBL rules do not distinguish between "commercial loans" and MBLs. The FCUA defines MBLs, but not commercial loans. As a result, the NCUA's rules for non-consumer (business/commercial) lending now address only those loans that are statutorily defined as MBLs, and the safety and soundness risk management requirements in the MBL rules have not been consistently applied to commercial loans that are not technically MBLs.

The proposal would introduce a definition of "commercial loans," and the proposals' safety and soundness risk management provisions would apply to all such loans, whether or not they are MBLs. Those provisions would require a credit union to develop a board-approved commercial loan policy and commercial lending organizational infrastructure. Only MBLs, however, would be subject to the proposed MBL rules, and only MBLs would apply toward the proposed MBL cap (1.75 times the amount of net worth up to the amount of net worth required to be well-capitalized).

We support the proposed new definition of "commercial loan" as well as the seven categories of loans excluded from that definition, but we believe that more types of loans should be exempt. For example, a commercial, industrial, agricultural, or professional loan in which a federal or state agency (or its political subdivision) has committed to fully insure repayment, fully guarantee payment, or provide an advance commitment to purchase the loan in full would be a commercial loan but not an MBL. All such loans, regardless of aggregate loan balance, should be exempt from the "commercial loan" definition, since they present no risk to the credit union system and no safety/soundness concerns.

Small Credit Union Exemption

The proposed rules' commercial loan program requirements would not apply to credit unions with assets less than $250 million and total commercial loans less than 15% of net worth, so long as those credit unions do not regularly originate and sell or participate out commercial loans. (MBL requirements would still apply, however.)

We support the exemption for credit unions with minimal commercial lending, but we do not believe that including an asset size threshold is necessary or appropriate. Asset size is not a meaningful proxy for the complexity of a credit union's commercial lending operations, and the risks in a credit union's business loan portfolio do not depend on its asset size.

We believe that the exemption should apply to any credit union with total commercial loans less than 15% of net worth that does not regularly originate and sell or participate out commercial loans – regardless of that credit union's size. This would provide meaningful regulatory relief to all credit unions.

Staff Experience Requirement

The League favors the proposed elimination of the two-year staff experience requirement for MBL programs. Instead, senior executive officers would need a comprehensive understanding of the role of commercial lending in the credit union's overall business model. In addition, the credit union would have to employ qualified staff with experience in: 1) underwriting and processing for the type(s) of commercial lending in which the credit union is engaged; 2) overseeing and evaluating the performance of a commercial loan portfolio, including rating and quantifying risk through a credit risk rating system; and 3) conducting collection and loss mitigation activities for the type(s) of commercial lending in which the credit union is engaged. A credit union would be able to meet the expertise and experience requirement by conducting internal training to develop the expertise, by hiring qualified individuals, or by use of a third party.

These are all sound and appropriate changes. We simply want to point out that no individual staff member is likely to have experience in all three areas. The rules should be clarified to explain that each staff member is not expected to meet all three experience requirements.

Modification of State MBL Laws

Under Part 723.20 of the current MBL Regulation, the NCUA has approved member business lending rules passed in seven states, including Wisconsin. The NCUA has asked for comments on how to deal with those state regulations in light of these proposed amendments. We believe that Wisconsin and the other states should have the opportunity to make conforming amendments to state MBL regulations and resubmit them to NCUA for updated approval. (Option B in the NCUA's proposal.) This would help state-chartered credit unions here and elsewhere become more competitive in business lending services, while eliminating inconsistencies and ensuring a level playing field for state-chartered credit unions.

Bankers' Misrepresentations

Before closing, we would like to urge the NCUA to disregard the chorus of bankers' form letters opposing this change (a number of which state in their closing lines that "credit unions lack the experience and the expertise to safely conduct business lending, and the NCUA lacks experience in supervising business lending.")

The statistics prove that credit unions have a history of responsible commercial lending. As the NCUA has pointed out, overall credit union MBL portfolios have grown 14% annually for the past 10 years. At the same time, outstanding MBLs as a percentage of total assets grew from 1.9% to 4.3% and as a percentage of total loans from 3% to 6.8%. That growth has been healthy and safe, as shown by the improved performance of credit unions' MBLs. Delinquency and charge-off rates of business loans decreased from 2010 to 2014, reverting to pre-recession levels. In addition, 98% of credit unions with MBLs at end of 2014 were well-capitalized, and 81% of credit unions with MBLs at the end of 2014 had overall CAMEL ratings of 1 or 2. The commenters' criticism of credit unions' business lending acumen is untrue, pure and simple.

Some comment letters have also misrepresented the consequences of the proposed change to the MBL cap calculation. The proposal would replace the current expression of the MBL cap (12.25% of assets) with a cap of 1.75 times the amount of net worth up to the amount of net worth required to be well-capitalized, as required by the FCUA. The League supports this change, since the 12.25% of assets language is not part of the FCUA, and the change would provide some relief to certain credit unions. CUNA, in its comment letter (p. 5), points out that "some commenters have incorrectly suggested this change would effectively raise the MBL cap from 12.25% of assets to 17.5% of assets." CUNA's letter clearly explains why such statements are wrong, and we will not belabor the point. Suffice it to say that claims of a 17.5% MBL cap are disingenuous and call into question the political motives of those commenters.

Conclusion

We support the NCUA's proposal to overhaul and modernize its MBL and commercial lending regulations. On the whole, the changes would give credit unions much-needed flexibility to meet their members' needs and to compete effectively in commercial lending. We respectfully ask, however, that the NCUA consider several recommendations to improve the proposed rules, including:

- Releasing proposed supervisory guidance and allowing interested parties to comment on it before finalizing the rule;

- Taking steps to ensure that the examiners who review commercial lending programs are experienced, well-trained and adequately supervised, at both the federal and state levels, and that they apply consistent standards;

- Making waivers available for the cap on the amount of commercial loans a credit union can make to any one borrower or group of associated borrowers;

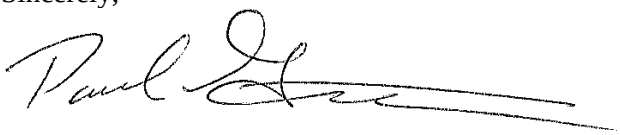
- Expanding the exemptions from the definition of "commercial loan";

- Removing the asset size threshold on the small credit union exemption from commercial loan program requirements; and

- Disregarding commenters who misrepresent the rules' consequences and unfairly criticize the ability of credit unions to manage commercial lending programs.

Thank you.

Sincerely,



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