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August 31, 2015

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

Re: Comments on Notice of Proposed Rulemaking, Part 723, Member Business Loans
RIN 3133-AE37

Dear Mr. Poliquin:

The Pennsylvania Credit Union Association (PCUA) appreciates this opportunity to comment on the National Credit Union Administration's (NCUA) proposed rule addressing member business loans (MBL). PCUA is a statewide advocacy organization that represents a majority of the nearly 450 credit unions in the Commonwealth of Pennsylvania.

PCUA consulted with its Regulatory Review Committee and State Credit Union Advisory Committee (the Committees) in order to provide comments on the proposal. The Committees consist of credit union CEOs and senior management staff. Members of the Committees also represent credit unions of all asset sizes. The comments contained in this letter reflect the input of the Committees and PCUA staff.

General Comments

The Federal Credit Union Act (FCUA) states that the purpose of a credit union is to make loans for provident or productive purposes. 12 U.S.C.A. § 1752.(1). Extending credit to meet the business needs of members fulfills this vital purpose. Small business lending does not represent the largest composition of assets on the balance sheets of Pennsylvania's credit unions. However, credit unions in the Commonwealth have endeavored to satisfy the business needs of their members. Our history includes lending for purposes such as school buses, emergency vehicles, equipment for machine shops and similar small ventures. As the needs of the membership evolved, Pennsylvania's credit unions have adapted evidenced by growing MBL portfolios that include credit facilities for wide ranging activities.

NCUA's proposed rule represents a major change in the agency's approach to regulating business credit. Current Part 723 is a prescriptive rule containing many fixed limits on certain MBL activities. The proposed rule is a principles-based approach that offers credit unions greater flexibility and autonomy to meet the business credit needs of their members. We support NCUA's approach and offer the following comments with the aim of further improving the proposal and striking an appropriate balance between safety and soundness concerns and efficient credit union operations that satisfy the needs of members.

723.1 Partial Exemption

Proposed section 723.1(b) exempts credit unions with assets less than $250 million, total commercial loans less than 15% of net worth, and do not regularly originate or sell commercial loans from the board and management responsibilities of 723.3 and the commercial loan policy requirements of 723.4. We support NCUA's effort to extend regulatory relief to credit unions of any asset size. We encourage NCUA to continue balancing safety and soundness requirements with appropriate regulatory relief.

Our Committee members from the peer group of credit unions with assets below $250 million applaud the proposed exemption. They stated that the proposed rule would help them serve small business within their fields of membership. Specifically, a measure of regulatory relief assists these credit unions extending a one-time loan to a sponsor group to finance an emergency vehicle or similar types of credit facilities that do not comprise a substantial portion of such a credit union's balance sheet.

Recognizing that commercial lending is specialized, the Committees reached a consensus on a different approach to affording regulatory relief that could apply on a broader scale. Quite simply, if the commercial loan policy requirements of proposed section 723.4 were modified, any credit union could engage in commercial lending with the benefit of adopting an appropriate policy. Commercial lending creates a degree of risk greater than that associated with consumer lending. Accordingly, a credit union should enter the field with some knowledge/experience and a purpose in mind to serve its membership. If each policy is scaled appropriately, a credit union of any asset size can satisfy reasonable and non-burdensome compliance requirements while providing services to small businesses within its field of membership. We will offer additional detail in conjunction with our comments on section 723.4.

NCUA could afford additional relief to credit unions that do not regularly originate or purchase commercial loans by adjusting its supervisory approach and codifying it in this regulation. The Committees and PCUA staff noted that the very credit unions that could benefit from the partial exemption are pressured to divest of a performing asset when it is discovered during an examination. In some cases, the original credit facility was not intended as a business loan, but evolved into one as a result of subsequent behavior of the borrower. For example, the credit union might have extended a loan on a 1-to-4 family residential property with no knowledge that there might be rental income. If such a loan is reclassified as a business loan, it may be outside of the credit union's loan policy. Then comes the pressure to get back into compliance and that may result in the sale of an otherwise performing asset.

In light of the above, we suggest that the final rule state that federally insured credit unions that do not regularly originate or purchase commercial loans will not be required to divest of performing assets in the event that loans require reclassification as a commercial loan and all outside of the loan policy. The Board and management should be educated to adopt an appropriate loan policy, tailored to infrequent extensions of commercial credit. We maintain this strikes an appropriate balance between safety and soundness and regulatory relief for all federally insured credit unions.

Finally, we note that banks and their trade groups have attempted to characterize the partial exemption as a blanket exemption and disregard of statutory limits on commercial lending established by the FCUA. Those comments amount to hyperbole. NCUA can craft regulatory relief consistent with the Administrative Procedure Act. Proposed section 723.1(b) is a valid exercise of NCUA's discretion to interpret the FCUA, balancing safety and soundness with potential risk presented to the share insurance fund.

723.8 Aggregate Member Business Loan Limit, Exclusions & Exceptions

Proposed section 723.8, accurately restates the limits to which a federally insured credit union can hold commercial loans or member business loans on its balance sheet. The exclusions for commercial loans fully insured or guaranteed by a federal or state agency or the non-member loans or participation interests in 723.8(b)(1) and (2) are consistent with the FCUA and NCUA's discretion. Contrary to inaccurate commentary offered by bank interest groups, these exclusions do not permit credit unions to exceed the limits on member business lending set by the FCUA.

Credit unions are effective and valuable resources for small businesses, offering business credit in denominations that banks are unwilling to accommodate. The cap on member business lending placed in the FCUA in 1998 imposes an artificial barrier to access to credit. We urge NCUA to lend its support to amending the FCUA to raise the limits on member business lending in a modest way. For example H.R. 1188, would increase the limit to 27.5% of assets. Additional relief could come from amending the definition of a member business loan. Currently, section 107A of the FCUA and Regulation 723 establish a threshold of $50,000 before an extension of credit constitutes a member business loan. 12 U.S.C.A. § 1757a.(c)(1)(B)(iii), 12 C.F.R. § 723.1(b)(3). We think that threshold should be much higher, $250,000, for example, before an extension of credit is deemed to be a commercial loan and counted against the cap.

Overall, we support the proposed definition of the term, commercial loan. The Committees noted that the new definition can assist with underwriting business loans and loans secured by 1-to-4 family residential property. We also urge NCUA to support any efforts that would remove 1-4 family non-owner occupied dwellings as MBLs and counted toward the MBL portfolio cap.

FCUA, History of Making MBL

The discussion of limits on MBL would not be complete without mention of a significant exception to the MBL cap. The FCUA states, in part:

Subsection (a) of this section does not apply in the case of –(1) an insured credit union chartered for the purpose of making, or that has a history of primarily making, member business loans to its members, as determined by the Board… 12 U.S.C.A. § 1757a.(b).

Based on the language of the FCUA, the NCUA Board has discretion to adopt criteria or a regulation addressing what constitutes: (1) what is an insured credit union that is chartered for the purpose of making MBLs to its members; and (2) what is an insured credit union that has a history of primarily making MBLs to its members?

It would be appropriate for NCUA to draft a proposed rule offering an interpretation of this section of the FCUA. In the case of a credit union that is chartered for the purpose of making MBLs, it seems reasonable to create a process for credit unions to adopt such a charter. Likewise, with respect to a credit union having a history of primarily making MBLs, the record would survey such a credit union's entire history. Other relevant criteria would include the percentage of MBLs on the credit union's balance sheet. Because credit unions exist to make loans for provident purposes NCUA and its stakeholders should explore every avenue to ensure the availability of small business credit.

Section 723.3 Board and Management Responsibilities

From a safety and soundness perspective we agree that the board of directors of a federally insured credit union should play a role in developing, amending and ensuring that the member business lending policy is adhered to by management staff. First, it is important to note that the board of directors is composed of volunteers. In addition to the propose rule, credit union volunteers assume the same liability as their counter parts who serve on the boards of for-profit financial institutions. With that in mind, some kind of relief is appropriate in the case of the board of a federally insured credit union. Where a credit union has hired qualified executive management and staff, the volunteer board's role in connection with any specific aspect of the operation, should be limited to adopting adequate policies and strategic oversight.

The manner in which proposed 723.3(a) is written renders the Board's responsibilities more tactical than strategic. By extension, that pulls the board into operational or compliance-related questions during the credit union's examination. The board's role should be strategic and high level. Where a board retains qualified executive management, who, in turn, hire qualified staff to build and maintain the business lending portfolio, the board has discharged its responsibility. For the avoidance of doubt, 723.3(a) should include an additional provision creating a presumption that a board of a federally insured credit union has discharged it obligations where it has adopted a policy and receives periodic briefings on the performance of the portfolio and actions taken by management to mitigate risk.

The requirements imposed on management by 723.3(b) are reasonable and consistent with the obligations established by the current rule. The Committees raised a question about 723.3(b)(2)(i) which requires qualified personnel for the "types of commercial lending in which the federally insured credit union is engaged." 80 F.R. 37916. As written, this section of the rule is arguably too granular and could lead to over scrutiny of staff in the examination context. We maintain that types of loans should be interpreted broadly. The credit union's policy combined with the experience of staff defines the outside limits of the lending that the credit union will offer. For example, the staff may have experience with commercial real estate and the policy will reflect that. Should a cell tower be added to property that is collateral for a loan, such activity should be permissible without a need for detailed understanding of cellular towers and related equipment.

723.4 Commercial Loan Policy

Revised part 723.4 establishes elaborate and detailed criteria for a commercial loan policy. We agree and support the notion that a federally insured credit union should have an adequate policy that sets appropriate limits and safeguards on its commercial lending activities. The policy should be adopted by the board and serve as the road map for executive management and operations staff when conducting the business. The policy should be strategic in nature.

Proposed section 723.4 is very detailed. Several sections, in our view, go beyond setting requirements for a policy and take on the aspects of a procedure. The broader statements, such as sections 723.4 (a) through (d), establish appropriate criteria for the contents of a commercial loan policy. In contrast, sections 723.4(f) and (g) and their numbered subsections are more in the nature of a procedure, a document for use by the lending staff when it is underwriting or processing a loan. The specificity of those subsections erodes the policy as a strategic document. In sum, these provisions of the rule should be scaled back and more general.

As noted above, we appreciate the reform efforts articulated in this proposed rule and the greater flexibility and autonomy afforded to federally insured credit unions in terms of making commercial loans.

That policy can be further advanced by creating a presumption of compliance in the final rule. Specifically a commercial loan policy that articulates the principals detailed in the rule should be deemed to be in compliance. This would avoid undue scrutiny or the potential for reviews and ultimately rewriting the commercial loan policy in the wake of an examination.

Section 723.4(g)(4) requires that the loan policy include a "process to identify, report and monitor loans approved as exceptions to the credit union's loan policy." This is another illustration of our point that the policy requirements of the rule force a credit union's hand in terms of including procedure in policy. Credit unions, as a general rule track exceptions. We are concerned that this particular provision creates opportunities for critical examination findings if every provision of the policy is not included in a board-adopted laundry list.

The regulatory flexibility sought by section 723.1(b), the partial exemption, could be addressed here, achieving appropriate regulatory relief and safety and soundness. The final rule should state that federally insured credit unions that do not regularly originate, sell or participate out commercial loans have the option of adopting a commercial loan policy that is limited in scope but anticipates that small businesses within the field of membership may have credit needs on an infrequent basis. The dollar volume of loan permissible pursuant to such a policy would be 15% of net worth.

723.5 Collateral and Security

If finalized, section 723.5 would require a federally insured credit union to require collateral commensurate with the level of risk associated with the size and type of any commercial loan. This proposed rule is appropriate. Section 723.5(b) requires a federally insured credit union to articulate mitigating factors sufficient to offset relevant risk if it does not require the full and unconditional guarantee from the principals of the borrower. Additional flexibility with respect to personal guarantees is critical to afford credit unions a competitive playing field with banks. The credit memorandum combined with evidence of debt servicing ratios, value of collateral, and similar factors must be conclusive evidence of a credit union's decision to waive or require only a partial guarantee from a principal. This has to be established clearly and firmly in the final rule or else credit unions will not be able to rely upon it or take appropriate advantage of the flexibility offered by the proposal.

723.6 Construction and Development Loans

Overall, the Committees prefer the approach to construction and development lending in the proposed rule versus the treatment of such loans in current Part 723. Section 723.6(b)(2) requires two valuation opinions to capture the passage of time between development, construction and occupancy. We think this provision should be revised to state that two valuation opinions may be required based on the amount and complexity of the credit facility. The mere passage of time does not justify the expense of a second opinion.

Proposed 723.6(c)(4) requires confirmation that no intervening liens have been filed before each loan disbursement. This can be an expensive and time consuming requirement, especially for a loan that is structured to have several, repeat draws. Credit unions should conduct lien searches when they deem appropriate given the circumstances and their understanding of lien priority in the jurisdiction where the loan is being extended.

723.7 Prohibited Activities

Proposed section 723.7 essentially prohibits loans to "insiders," prohibits so-called joint ventures and requires that any third party used in connection with commercial loan be independent from the transaction. We question why NCUA is expanding the group of ineligible borrowers in connection with commercial loans. Loans to an official require board approval if the loan amount exceeds $20,000 plus pledged shares. 12 CFR 701.21(d). It seems logical to create an appropriate mechanism for commercial loans to credit union officials and members of senior management. For example, board approval could be required for a commercial loan request of $100,000 or greater. The official or member of senior management can have no participation in the approval of the loan. Such loans would be monitored for payment and compliance with the covenants and conditions of the loan on a regular basis.

Delayed Implementation

In the preamble to the proposed regulation, NCUA states its intention to delay implementation of any final rule for 18 months allowing the NCUA, state regulators and credit unions to adjust to the new requirements. In the case of credit unions, this rule is permissive. It does not establish new or intricate disclosure requirements. Adjustments to core processing or internal training, while relevant will not be as demanding as rules such as Risk Based Capital or the Integrated Disclosures for Truth-in-Lending and RESPA. Therefore, once this regulation is finalized, a federally insured credit union should be able to operate pursuant to it at such time as the credit union is ready.

Supervisory Guidance

The summary of the proposed rule indicates that NCUA will publish updated supervisory guidance with the adoption of the final rule. The guidance is intended for examiners, recognizing the significant changes to the MBL regulation. The summary also states that the guidance will be shared with credit unions. We recommend that the guidance be made available for public comment. Since this guidance will be the basis for examinations, we believe that public comment on the guidance will allow for greater clarity and understanding of the intent of the rule and will reduce the possibility for disagreements in the examination context.

Expenses Associated with Implementation

The preamble to the rule notes that implementation may cost the NCUA $1.9 million. The costs are largely associated with specialized training for examiners. We strongly urge NCUA to implement the regulation within the confines of its current budget and find the necessary funds by increasing efficiencies.

Appeals Process

Federally insured credit unions have invested significant time in their commercial lending policies and related procedures. They will execute at a pace designed to satisfy the needs of their members. With the principles-based approach incorporated in the new regulation, it is reasonable to expect differences of opinion about the nature of the credit union's commercial loan policy when reviewed by examination teams. Due to the discretionary nature of examinations and the consequences of a negative examination, we maintain that the final rule should include an appeals process. We encourage the NCUA to include a provision that outlines a meaningful appeals process, one that allows the FCU to present its position to an independent administrative law judge (ALJ). The results of the review must be supported by findings of

fact and conclusions of law. The ALJ's ruling should constitute final agency action that can be appealed to the federal court system should either party want to seek further redress.

Conclusion

The principles-based approach of the proposed MBL regulation should enable federally insured credit unions to offer enhanced small business lending opportunities to their members. We applaud NCUA's proposed rule and look forward to working with the agency in implementation. The principles-based approach creates the possibility for some disagreement over matters such as whether a commercial loan policy contains all of the requirements or whether foregoing of a personal guarantee was adequately documented. Accordingly, we offered constructive suggestions for clarifying the rule. Further, the appeals process that we advocate provides necessary protections and redress.

PCUA is willing to discuss the comments detailed in this letter at NCUA's convenience.

Very truly yours,

Richard T Wargo

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Executive Vice President/General Counsel

RTW:llb

cc: Regulatory Review Committee
State Credit Union Advisory Committee
Credit Union National Association