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 – RIN 3133-AE37

Dear Mr. Poliquin:

Vermont Federal Credit Union (VFCU) appreciates the opportunity to submit comments regarding the National Credit Union Administration (NCUA) Board's proposed changes to its member business lending (MBL) rule.

Prior to offering our suggested modifications to the proposed member business lending regulation, VFCU would like to begin its comment letter by expressing its commendation to NCUA for the positive change in regulatory approach taken by NCUA in this proposed regulation as it relates to member business lending. As business lending to credit union members has been an authorized authority for credit unions and credit union service organizations (CUSOs) for decades, the historical approach of NCUA has been very restrictive in the past with a resulting diminution in both available credit for small businesses and a deterrent to healthy diversification in many credit union lending portfolios.

The replacement of a one-size-fits all approach by a much more performance based rules regime is appropriate and will give credit unions the flexibility to better serve their members in the very competitive marketplace of business lending - and to do so within both the established law and the bounds of safety and soundness.

Our specific comments regarding the provisions of the proposed amendments to the MBL rule are provided below. We appreciate your consideration of these comments on behalf of VFCU.

The Absence of Supervisory Guidance Creates Uncertainty that Makes it Impossible to Fully Assess the Proposed Rule's Potential Impact on Credit Unions

VFCU's support of this proposed rule is tempered by two major concerns.

First, 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 stakeholders will not have the opportunity to comment on the guidance. Although 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. We point to 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.

Our second concern also stems from the present uncertainty related to supervisory guidance. 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.

NCUA Should Go Much Further Than This Proposal to Remove Barriers to Credit Union Small Business Lending

The proposed MBL rule represents a good first step to effective policymaking, but the NCUA should do more. H.R. 1151, the Credit Union Membership Access Act of 1998 (CUMAA), amended the Federal Credit Union Act (FCUA) by placing an aggregate limit on a federally insured credit union's MBLs. CUMAA limited a credit union's total amount of outstanding MBLs to 1.75 times the credit union's net worth, up to the amount of net worth required to be well capitalized under Prompt Corrective Action (PCA). CUMAA did provide two exceptions to the MBL cap. It is clear from a plain reading of the FCUA that NCUA could go further by defining the parameters of this exemption, which is further supported by the legislative history of H.R. 1151. The language of 12 U.S.C. Section 1757a(b) states, in part, the following:

> 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…

The plain language provides for two exceptions: (1) An insured credit union chartered for the purpose of making MBLs to its members; or (2) An insured credit union that has a history of primarily making MBLs to its members.

It appears that NCUA does not have criteria or has not made the criteria public as to what constitutes a credit union that is "chartered for the purpose of making" MBLs. NCUA should

develop a process where a credit union could amend its charter to provide as one of its purposes "member business lending" and thus qualify for the exception. A credit union requesting this type of charter amendment would likely be near the statutory MBL cap and would be truly operating for the purpose of making MBLs. The statutory language does not use the word "primarily" for this exception as is used for the "has a history" exception. Thus, it is a reasonable interpretation to allow a credit union that makes business loans as its purpose to exceed the cap, under some criteria.

In addition, the exception for credit unions with a "history of primarily making member business loans" has not been reviewed since the inception of the regulation. The FCUA does not require the NCUA to set a credit union's history contemporaneously with the passage of the CUMAA. NCUA could provide that a credit union that has originated or granted a threshold amount of MBLs over a significant period could qualify for the exemption. This would qualify as having a history of primarily making member business loans. The legislative history of H.R. 1151 supports this interpretation, encouraging the Board to permit worthy projects access to affordable credit union financing.

We believe that a credit union which has had a successful MBL program in place for a period of five years or greater would be a reasonable definition for "a history of primarily making MBLs." In fact, in response to Representative Ed Royce's question for the record at the April 8, 2014, House Financial Services Committee Hearing on Regulation and Supervision of Financial Institutions, NCUA's General Counsel noted that the agency has the statutory authority to create this definition. In his response to Representative Ed Royce's question, NCUA's General Counsel confirmed that "NCUA has the statutory authority to define if a credit union, which has had a significant proportion of its portfolio in member business loans for the last five years, has a history of primarily making member business loans and would therefore qualify for an exemption from the statutory cap."

Elimination of Waivers

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, the waiver process can 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.

VFCU strongly supports the elimination of all prescriptive requirements necessitating waivers. Eliminating these requirements should provide much needed relief from the regulatory hurdles imposed on credit unions. Section 723.4(c) provides that that the limitation of loans to one borrower or group of associated borrowers many not exceed the greater of 15% of the credit union's net worth or $100,000, plus an additional 10% of the credit union's net worth if the amount that exceeds the credit union's 15% general limit is fully secured at all times with a perfected security interest by readily marketable collateral. VFCU commends the NCUA for that well-balanced approach and supports providing this regulatory flexibility as a prudent means to

extend, within the bounds of the current statute, the credit union's lending powers to serve its members. Unfortunately, one requirement remains in place for which waivers should remain available: the limitation that the aggregate dollar amount of commercial loans to any one borrower or group of associated borrowers may not exceed 15 % net worth or $100,000, whichever is greater. Credit unions can currently receive a waiver from this requirement; however, this waiver would not be available under the proposed rule. This requirement has an outsized impact on small credit unions as well as larger credit unions that have an associated borrower on several loans if that one borrower or group of associated borrowers only have real estate available as collateral as opposed to readily marketable collateral up to an additional 10% of the Credit Union's net worth. NCUA should eliminate this provision, as it is prescriptive, or continue to allow credit unions to apply for waivers from the requirement.

MBL Cap Calculation

VFCU supports the proposed change to the MBL cap calculation. The proposal would replace the current expression of the MBL cap as 12.25% of assets with a cap expressed as 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 12.25% of assets language is not part of the FCUA. The current minimum capital requirement for a credit union to be well capitalized is 7% of total assets, hence the current shorthand of 12.25% of assets (1.75 times 7%). However, if the current version of NCUA's proposed Risk-Based Capital (RBC) rule is adopted, the amount of capital required to be well capitalized will be the greater of 7% of total assets or 10% of risk assets.

Some commenters have incorrectly suggested this change would effectively raise the MBL cap from 12.25% of assets to 17.5% of assets (1.75 times 10%). This would only be the case if risk assets equaled total assets. Actually, for the vast majority of credit unions, under the RBC proposal risk assets would amount to less than 70% of total assets, so that the 7% of total assets requirement would exceed 10% of risk assets. For all of these credit unions, the calculated cap would remain 12.25% of assets. This correction of the specification of the MBL cap would have almost no effect on the aggregate cap, but it would provide modest relief to a few credit unions.

Definitions

The proposed rule would amend and add the following definitions to Section 723.2:

Associated Borrower, Common Enterprise, Control, and Direct Benefit:

> The definitions of Associated Borrower, Common Enterprise, Control, and Direct Benefit are all intertwined and being revised to bring the definitions in line with other banking regulatory standards, generally mirroring the combination rule (See 12 CFR 32.5). VFCU supports bringing the "Associated Member" concept in line with federal bank regulation; however, we note the special treatment rules for partnerships, joint ventures, and associations were not included in the definition. NCUA should consider incorporating the special rule for partnerships, joint ventures, and associations as this would bring greater clarification to certain relationships that may or may not fall under the rule.

Loan-to-Value Ratio:

This definition is revised 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. This brings LTV calculations in line with customary commercial loan calculations. VFCU supports this much-needed change.

With respect to the requirement to use the "lesser of purchase price or market value for collateral held 12 months or less," VFCU 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.

First, several states are considered "non-disclosure" states where the consideration of a property transfer is not publicly available or readily ascertainable. Further, in some states the consideration indicated on a publicly recorded deed may not reflect the actual price or value paid in a transaction or be representative of the transferee's purchase price. In such cases, an LTV calculation based on the "lower of purchase price or market value" will be misleading, often with the effect of overstating the actual LTV. Examples might include property acquired as a gift or inheritance, or as a result of a variety of other non-market transactions.

While we appreciate that the 12-month standard is being considered out of concern over the reliability of appraisals, a better approach is to suggest 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.

Commercial Loan:

The FCUA's statutory business lending restrictions are not safety and soundness restrictions. These MBL restrictions were included in the CUMAA to address political concerns raised by bank trade associations regarding business lending competition from credit unions. Nevertheless, NCUA's current business lending regulation bases many of the agency's safety and soundness policies unnecessarily on loans defined as MBLs for purposes of the statutory cap. The proposed rule would create a new definition of commercial loan in Section 723.2. With this definition, the MBL regulation would separate loans meeting the proposed Section 723.2 commercial loan definition from loans meeting the 12 U.S.C. 1757a statutory MBL definition, therefore more appropriately applying business lending safety and soundness requirements only to business loans.

Although many commercial loans in the proposed Section 723.2 would overlap with statutorily defined MBLs, separating the two types of loans is important, because the proposed regulation decouples safety and soundness from statutory restrictions. We support this proposed change as it shifts NCUA's focus to safety and soundness for commercial loans instead of relying on statutory restrictions for safety and soundness. This is especially relevant as it relates to proposed Section 723.8(b)(4) for any non-

member loan or non-member participation interest in a commercial, industrial, agricultural, or professional loan being a commercial loan but generally not an MBL. The proposed rule does stipulate, as it should, that in order for the exclusion to apply, these loans must be in compliance with applicable laws and regulations and it must not be swapping or trading MBLs with other credit unions to circumvent the limit.

VFCU also supports the seven categories of loans excluded from the commercial loan definition; however, more types of loans should be exempt from the definition, including loans that present zero or only a remote risk of loss to a credit union. For example, loans fully guaranteed by a federal or state agency should also be excluded from the commercial loan definition because they are risk free and thus do not present any safety and soundness concerns.

Furthermore, NCUA should clarify the treatment for those loans that are partial cash-secured loans, since the definition as written suggests the loan must be "fully" secured by shares or deposits. The portion that is partially secured should fall within the exception for purposes of the cap. The 5300 forms will need to be amended for the reporting on this subject as well.

Loan Secured By a 1- to 4- Family Residential Property:

VFCU 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.

Residential Property:

This definition clarifies that loans secured by a 1- to 4- family residential property are excluded from the definition of a commercial loan. VFCU supports this change.

Board of Directors and Management Responsibilities

Proposed Section 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 Section 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. 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.

Although VFCU supports this proposed rule, we are concerned the proposed Section 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.

In addition, VFCU 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.

VFCU also believes experience requirements can be met by a third party or third parties. 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.

Commercial Loan Policy

The proposed requirements of Section 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. We recommend amending the language to read as follows: "Projected income and expense or other projections commensurate with the particular transaction type should be obtained."

Collateral and Security

VFCU supports the proposed Section 723.5 and is in agreement with the proposed provision that the credit union has both the risk management interest and underwriting ability to effectively analyze whether a personal guarantee is required in the risk mitigation of any particular business loan. This will enable credit unions to more effectively compete for loans where the personal guarantee requirement disqualified credit unions from common sense lending opportunities. We recognize that, as is appropriate, the overwhelming majority of business loans will still require a personal guarantee. Should any credit union become unsafe in its utilization of this authority to waive the personal guarantee, we would expect that NCUA would address those concerns through the supervisory process. VFCU sees no justifiable reason for a restrictive approach that substitutes a single, inflexible regulatory requirement for the discretion of proven business lenders as a part of a credit union's risk management protocols.

Construction and Development Loans

VFCU supports the NCUA's amendments to the Construction and Development requirements. These changes should make these requirements more consistent with the expectations of commercial borrowers and thus help credit unions effectively provide loans to their members.

Prohibited Activities – Section 723.7(a)(1) and (2)

VFCU questions whether an outright prohibition for a management employee or other officer of the credit union to receive a business loan, within established credit union lending policy and sound underwriting standards, is truly necessary. It would seem that if senior management employees and their immediate families are indeed able to obtain a mortgage, car, and other

consumer loans from the credit union, why should member business loans be treated differently? We certainly agree that there should be safeguards in the lending policies and conflict of interest provisions in place to protect from insider abuse; however, we feel these could best be handled through full disclosure of the insider relationship, lending caps, types of loans and board approval. In our view, an outright prohibition seems to be overkill.

Prohibited Activities – Section 723.7(c)-Conflict of Interest

This section prevents a third party that is providing business loan advice to a credit union from receiving compensation contingent upon closing of a loan. Some financial institutions charge an application fee but whether they do or not, the bulk of their fee is typically earned only if the loan closes. The condition of the loan closing is not improper as long as it does not create a potential conflict of interest. While we understand the concern of NCUA as to some third parties that provide advice to credit unions, we respectfully disagree that CUSOs pose the same conflict risks. To this end, we recommend that the rule be clarified to exempt from the prohibition engagements between credit unions and the CUSOs that are owned by those credit unions for origination support irrespective of the timing or methodology of payment. This improves the understanding that the issue is with borrower paid loan finders, brokers, etc. and not with regularly contracted CUSOs that support their credit unions with more than just the underwriting elements of a loan.

Many credit unions that offer business loans to their members have done so with the use of CUSOs to help them better manage and even to share their risk. CUSOs permit credit unions to aggregate business lending expertise at lower costs than if each credit union provided the services internally. The credit unions are the owner/users of the CUSO's services. The CUSOs are, in effect, the collaborative extension of the respective owner credit unions. We respectfully request that NCUA keep that concept in mind as there is a great distinction between the motivation of an entity that is serving its owner/users as opposed to that of an entity which is either serving that borrower or has no formal affiliation with credit union governance. The conflict of interests situations that may arise in purely client relationship do not exist in an owner/client relationship.

Just as there is a carve out of the conflict of interest issue for CUSOs providing advice when the CUSO is not independent in a transaction if the credit union owns a controlling interest in the CUSO, a corresponding carve out should exist to enable a credit union owner to pay its CUSO contingent on a loan closing. As the CUSO is the collaborative extension of its owner/users, a CUSO is not going to act against the best interests of its owner/users.

Examination

NCUA 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. VFCU strongly encourages 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.

Implementation

VFCU 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 experienced 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.

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, credit unions cannot completely evaluate and project the impact it will have on them. VFCU would like to, once again, thank the NCUA Board for the opportunity to comment on this proposed regulatory change. As can be seen by our comments on the proposal, we are largely in support of the changes and commend the NCUA Board on its balanced approach to business lending through this proposal. Our suggested areas of improvement are designed to help make an already improved regulation even more balanced and appropriate to the risk involved in business lending for credit unions and CUSOs.

We hope that you will give our viewpoint your careful consideration. If we can answer any questions or be a source of further information on this matter, please do not hesitate to contact me at (802) 923-1133.

Sincerely,

Bernard P. Isabelle, C.P.A.
President & CEO