August 31, 2015

National Credit Union Administration
1775 Duke St.
Board Secretary
Alexandria, VA 22314

RE: Comments on Proposed Rulemaking for Part 723; RIN 3133–AE37

Dear Gerard Poliquin,

I am writing on behalf of the California and Nevada Credit Union Leagues (Leagues), one of the largest state trade associations for credit unions in the United States, representing the interests of approximately 400 credit unions and their 10 million members. The Leagues welcome the opportunity to provide comments to the National Credit Union Administration (NCUA) on its proposal to modernize its member business loans (MBL) rule.

The Leagues applaud the NCUA for seeking to provide federally insured credit unions (FICUs) with greater flexibility and individual autonomy in safely and soundly providing commercial and business loans to their members. The Leagues support NCUA's approach of shifting from a prescriptive regulation to a principles-based regulation. This overhaul of the MBL rules will allow credit unions to better serve their members and their communities.

We support many of the proposed changes as they put business lending decisions back in credit unions – allowing them to establish credit risk management programs that are appropriate for the size, complexity, and risk profile of their organization and to operate MBL programs in a safe and sound manner. The Leagues offer the following comments on how the rule can be further improved.

Supervisory Guidance

With adoption of a final rule, NCUA would publish updated supervisory guidance to examiners, which would be shared with credit unions, to provide more extensive discussion of expectations in relation to the revised rule. This supervisory guidance will detail standards that credit union examiners will use when reviewing credit unions' commercial lending programs.

The Leagues are concerned that this guidance will simply move the prescriptive requirements from the current rule to the supervisory guidance and examiners will treat the guidance as equivalent to the regulation – effectively not providing credit unions the flexibility to manage their commercial lending programs. While the Administrative Procedures Act does not require public comment for guidance, the Leagues strongly encourage the NCUA to publish the proposed guidance for public

comment so credit unions may determine and comment on how the guidance will impact their ability to serve their members.

Scope

The proposed rule applies to all FICUs and exempts certain credit unions from the commercial loan policy and board and management requirements. Credit unions are exempt from these requirements if they have both assets less than $250 million and total commercial loans less than 15 percent of net worth and they are not regularly originating and selling or participating out commercial loans.

We understand and support the need to provide regulatory relief to small credit unions; however, we do not believe an asset size threshold is appropriate in this case. The asset size threshold is not relevant in determining the risk of a credit union with a small number and a minimum amount of commercial loans. The Leagues recommend this exception apply to all credit unions with total commercial loans less than 15 percent of net worth. NCUA should remove the asset size threshold.

The Leagues seek clarification for our credit unions regarding the applicability of the rule on privately insured state-chartered credit unions. Some have reported that while the current MBL rules do not apply to privately-insured state chartered credit unions, these credit unions have been held subject to the rule if they use a credit union service organization (CUSO) for their business lending activities and that CUSO also serves FICUs. We ask the NCUA to clarify and justify this in the final rule.

MBLs and Commercial Loans

The proposal introduces the concept of commercial lending to distinguish between (a) the safety and soundness objectives applicable to all loans for commercial, industrial, agricultural, and professional purposes (whether an MBL or not), and (b) the statutory limits for MBLs. The Leagues support this proposed change as it better aligns credit unions' and NCUA's safety and soundness focus.

The proposed rule clarifies several loan types that are a MBL, a commercial loan, or neither. The Leagues request the final rule makes clear that credit unions classify the loan at the time the loan is originated. For example, if a loan fully secured by a 1- to 4-unit family residential property that is the borrower's primary residence, this loan is neither a MBL nor a commercial loan. Should the occupancy change over the life of the loan, the credit union should not be required to reclassify the loan as a MBL.

<u>Residential Property – Non-Owner Occupied</u>

The proposal clarifies that member business loans secured by a 1- to 4-unit family residential property (not the borrower's primary residence) are not commercial loans, although they are considered MBLs in the statute and count towards the credit union's MBL cap.

First, the Leagues implore NCUA to support legislation that would provide parity between credit unions and banks to count non-owner occupied 1- to 4-unit dwellings as residential loans and not business loans.

Second, while NCUA's proposal clarifies in Part 723.8(c) that a non-owner occupied 1- to 4-unit family residential property is not a commercial loan, the Leagues note NCUA's caution in the preamble that states these loans have risks similar to commercial loans and underwriting and complexity of risk analysis should increase as the number of properties for the same or associated borrowers increase. When repayment of the loan depends on successful operation of the multiple rental units, underwriting should include a comprehensive global cash-flow analysis. This is an example of the types of information that may be included in supervisory guidance, but is not in the regulation. Again, the Leagues urge the NCUA to issue the supervisory guidance for review and comment.

Primary Residence Loans

The Leagues request clarification in regard to 1- 4-unit primary residences with other living unit(s) on the subject property and detached from the primary residence. We recommend such properties be specifically excluded from the definition of MBLs. Excluding primary residences with detached living units from the definition of MBL will permit longer loan terms and remove the competitive disadvantages enjoyed by banks and independent lenders who treat these properties as primary residence loans.

Non-Member Commercial Loans and Non-Member Participation Interest

The Leagues thank the NCUA for clarifying that non-member commercial loans and non-member participation interest in a commercial loan made by another lender are not MBLs and do not count toward the MBL cap and for removing the approval requirement for these loans to exceed the statutory cap.

Cash-Secured Loans

The proposal excludes from the definition of MBLs and commercial loans, any commercial loan fully secured by shares in the credit union making the extension of credit or deposits in other financial institutions. The Leagues recommend NCUA clarify the treatment of loans partially cash-secured, since the proposal suggests the loans must be "fully" secured by shares or deposits. The portion that is secured should not count toward the MBL cap.

Government Guaranteed Loans

Similarly, the proposal excludes from the definition of MBL any commercial loan in which a federal or state agency (or its political subdivision) fully insures repayment, fully guarantees repayment, or provides an advance commitment to purchase the loan in full. The Leagues recommend NCUA clarify the treatment of loans partially insured or guaranteed, since this also suggest the loans must be fully insured or

guaranteed. For example, Small Business Administration (SBA) loans are guaranteed from 50 – 85 percent. The portion that is insured or guaranteed should not count toward the MBL cap.

Commercial Lending Experience

The Leagues agree with eliminating the prescriptive and arbitrary 2-year experience requirement and replacing it with a principles-based requirement for qualified staff in key areas. We also support that FICUs can meet the experience requirements by using a third-party, such as a CUSO.

Collateral and Security

All of the specific prescriptive limits and requirements related to collateral in the current rule have been eliminated and replaced with the fundamental principle that commercial loans must be appropriately collateralized. Proposed Part 723.5(a) states a FICU must require collateral commensurate with the level of risk associated with the size and type of any commercial loan. Collateral must be sufficient to ensure adequate loan balance protection along with appropriate risk sharing with the borrower and principal(s).

Unsecured Commercial Lending

Further, Part 723.5(a) provides that a FICU making an unsecured loan must determine and document in the loan file that mitigating factors sufficiently offset the relevant risk. However, in the preamble to the proposal, NCUA states unsecured commercial lending should be limited and treated as an exception, to be offered only when the additional risk is adequately offset by appropriate risk mitigants.

Prescribing that unsecured lending be limited and treated as an exception undermines the point of allowing unsecured lending. We recommend that FICUs be allowed to set appropriate limits for unsecured lending in policy and that the NCUA not consider unsecured loans “exceptions.”

Personal Guarantees

The Leagues support removing the requirement that credit unions obtain a personal guarantee from the principal(s) of the borrower. This requirement has hampered credit unions’ ability to serve their members. Even when credit unions apply for a waiver, the time it takes to receive such a wavier impedes their members’ ability to move on a business opportunity causing them to take their business elsewhere.

In removing the explicit personal guarantee requirement, the rule requires a credit union to determine and document in the loan file that mitigating factors sufficiently offset the relevant risk.

The Leagues are concerned that the preamble notes that NCUA believes that

personal guarantees “in most cases” are very important and expects there will be few loans without a personal guarantee. The preamble also discusses NCUA’s expectations that FICUs set portfolio limits for these types of loans, measured in a reasonable percentage of the credit union’s net worth, and that these loans be tracked and periodically reported to senior management and the board. This is another example of the types of information that may be included in supervisory guidance, but is not in the regulation. Again, the Leagues urge the NCUA to issue the supervisory guidance for review and comment.

Single Obligor Limit

The proposed rule increases the single obligor limit from 15% of net worth to 25%, if the amount greater than 15% is supported by “readily marketable collateral.” The proposal also eliminates the waiver process. The Leagues recommend the NCUA leave a waiver process in place for its single borrower limit.

The Leagues agree that if a FICU has an existing waiver, the waiver will remain in effect until the aggregate balance of loans to the borrower are reduced to new requirements.

Modified Loan-to-Value Definition

The proposed rule clarifies that the denominator of the LTV ratio is the market value for collateral held longer than 12 months, and the lesser of the purchase price and the market value for collateral held 12 months. The Leagues recommend the denominator of the LTV for any real estate transaction should be the market value, regardless of whether the actual purchase price is lower. Such a practice is appropriate because that market value represents the best approximation of what the credit union could expect to yield if it were forced to liquidate the collateral.

MBL Cap

The general aggregate statutory limit on MBLs is applied in the current rule as the lesser of 1.75 times the credit union’s net worth or 12.25 percent of the credit union’s total assets. (In the current rule, the 12.25 percent is a shorthand reference to how the cap applies to the requirement to maintain at least 7 percent of total assets to be well-capitalized; 1.75 x 7% = 12.25%).

The proposed rule interprets the statutory requirement as 1.75 times the applicable net worth requirement for a FICU to be well-capitalized. Thus, the proposal removes the 12.25 percentage and modifies the regulation to be the lesser of 1.75 times the FICUs actual net worth, or 1.75 times the minimum net worth requirement to be categorized as well-capitalized. The Leagues support the proposed change to the MBL cap calculation and agree that the proposed change provides greater consistency with the statute.

Delayed Implementation

The NCUA proposes to delay implementation of the final rule for 18 months, to allow NCUA and state supervisory authorities adequate time to adjust to the new requirements, including training staff, and for affected credit unions to make necessary changes to their commercial lending policies, processes, and procedures in compliance with the new rule.

Examiner Training

The Leagues agree NCUA must provide consistent and thorough training and guidance to examiners as part of the implementation of this rule. A broad principles-based rule will require examiners have an in-depth understanding of commercial lending to properly evaluate and examine credit unions' commercial lending programs. Credit unions should be able to escalate commercial lending policy disagreements during an exam to NCUA specialists in this area without initiating a formal procedure.

State supervisory authorities (SSAs) will also require extensive training and resources to properly implement the rule. The proposed rule does not address how NCUA will coordinate with SSAs to ensure they receive consistent and specialized training.

Allow Early Adoption

Many credit unions already have robust business lending experience and meet many of the requirements in the proposed rule. The Leagues recommend the NCUA allow credit unions to implement new provisions sooner than 18 months when they have satisfied the requirements for any provision they choose to implement. For example, credit unions should be able to waive the personal guarantee when they are able to document that mitigating factors sufficiently offset the risk, they have established portfolio limits for these types of loans, and the loans are tracked and reported to senior management.

Conclusion

In conclusion, the Leagues support a principles-based regulatory approach to member business and commercial lending; however, we seek clarification on several issues identified in this letter. We strongly urge the NCUA to publish the proposed supervisory guidance for comment so credit unions can determine how the guidance, along with the rule, will impact their ability to serve their members. We also strongly urge the NCUA to ensure examiners receive consistent and in-depth training on commercial lending and have specialists to whom disagreements can be escalated to during an exam.

We thank you for the opportunity to comment on the proposal and for considering our views.

Sincerely,

Diana R. Dykstra
President and CEO
California and Nevada Credit Union Leagues

cc: CUNA, CCUL