

August 31, 2015

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

Via email: regcomments@ncua.gov

RE: Comments on Proposed Rule for Part 723

Dear Mr. Poliquin:

The Boeing Employees' Credit Union ("BECU") takes this opportunity to provide comments on NCUA's proposed rule regarding member business loans ("MBL"). Located in Washington state, BECU is the fourth largest credit union in the United States¹, and is a state-chartered credit union that currently complies with a state specific MBL rule. We welcome NCUA's efforts to update and streamline member business lending for the credit union industry. In particular, BECU is supportive of NCUA's approach of transitioning away from prescriptive regulation towards regulatory oversight based on sound underwriting, management and servicing principles.

BECU is confident that greater flexibility based on risk-based policies developed by each credit union will permit those credit unions to better serve the businesses in their local communities. This will help support the growth of lending to small and medium sized businesses. Chairman Debbie Matz noted as much in NCUA's press release dated June 18, 2015.² However, in this comment letter, we seek to clarify a few points in an effort to understand the proposed rule's effects on credit unions, including state chartered credit unions currently subject to state MBL rules. A principle-based approach to member business lending makes sense as long as examiners, credit union management, and administrators understand NCUA's expectations.

NCUA's proposal attempts to modify many provisions related to MBLs. In this comment letter, BECU will focus on four discrete issues identified in the proposal: (1) preference regarding treatment of current state MBL rules; (2) the definition of construction/development loans; (3) the level of detail required for a commercial loan policy; and (4) NCUA's decision not to issue guidance contemporaneously with this proposal.

BECU does a fair amount of business lending and has made significant investments to its business lending program over the last four years by hiring experienced staff from large national as well as local community banks, upgrading systems, and creating new policies and procedures

¹ As of the most recent Call Report, BECU has assets of \$13.8 billion and 930,941 members.

² "Member business lending produces three tangible benefits: (1) it provides affordable small business loans (with an average balance of \$217,000), which business owners may not be able to obtain from other institutions; (2) it diversifies loan portfolios, improving credit unions' ability to withstand economic downturns; and (3) it develops communities by creating jobs and expanding consumers' access to local goods and services." NCUA Press Release, June 18, 2015.

that govern the Credit Union's business lending program. Many of these changes were driven by the demands of our business owner members who requested business loans from BECU. These business members have successfully created thriving businesses in our local economy. As such, we refute the banking industry's opposition to the proposal as it applies to credit unions' staff lack of experience or depth in this arena.

State Authority

The current NCUA MBL rule allows a state supervisory authority ("SSA") to apply for an exemption from the federal MBL rule for credit unions chartered in that state, subject to the NCUA Board's ("Board" or "NCUA") determination that the state has adopted an MBL rule that minimizes risk and accomplishes the overall objectives of NCUA's rule. Allowing an SSA to administer its own MBL rules permits the SSA to take consideration of its knowledge of local conditions, including the competency and sophistication of credit unions in that state, as well as the competitive financial environment. Washington state is one of the seven states where NCUA has approved the state rule on the theory that the rule is consistent with NCUA's interpretation of the Federal Credit Union Act and Part 723.

The Board is seeking comment on three options currently under consideration (ranging from terminating a state's ability to seek permission from NCUA to follow its own rules, to allowing states such authority), as well as any alternative approaches.

BECU believes that allowing SSAs to administer their own MBL rule has worked well in Washington state and has not led to any serious threat to the insurance fund. The Washington state Department of Financial Institutions has shown that it is able to administer its rule and focus on appropriate safety and soundness concerns when necessary. An SSA is in the best position to regulate a state chartered credit union's business lending program because the SSA understands the nuances of the local market and can therefore request appropriate risk management solutions for a credit union to take if necessary.

Therefore, BECU advocates that NCUA adopt the option identified as "Option C" in the proposed rule as the best policy. This option preserves the current exemptions from the federal MBL rule for those seven states that have adopted a separate MBL rule, but also allows other states to seek NCUA's approval of state-specific rules as long as they comply with §723.20(a). Option C allows those states with current exemptions from the federal MBL rule to modify their current rules to adopt a principle/risk-based MBL rule similar to the proposed rule, subject to NCUA approval. Doing so allows SSAs in these states to better plan transitions for the credit unions they supervise.

Construction and Development Loans Definitions

NCUA's current MBL rules limit construction and development lending and are unduly restrictive and difficult to understand. The proposal amends §723.6 by eliminating the current prescriptive portfolio limit of 15 percent of net worth for construction and development loans. The Board explains that the change is necessary in order to provide credit unions flexibility in setting their own prudent limit for their construction and development portfolio. It also eliminates the need for waivers and the waiver provisions in the current rule. In the proposal, the

Board has created a specific definition of construction and development loans to include a financing arrangement in which a borrower intends to renovate an income producing property. In general, “a construction and development loan means any financing arrangement to enable the borrower to acquire property or rights to property, including land or structures, with the intent to construct or renovate an income producing property . . .” (Page 37917 Federal Register, Vol. 80 No. 126).

BECU advocates that the proposed rule appropriately differentiate between a renovation loan (that permits certain remodeling, upgrades and property improvements financed through future advances) from a true construction and development loan that involves extensive investment and risk in the construction process. Often a true construction and development project starts from bare land and a large portion of the ultimate value securing the loan proceeds will only be available once the construction and development is complete. In contrast, future advances on a renovation loan will likely finance only a relatively smaller portion of the value in the completed structure and therefore entails lesser risk to the lender if some portion of the renovation is not completed satisfactorily.

BECU recognizes that many of the specific requirements in the proposed rule for underwriting, staff training and experience, inspections, disbursements, and reporting are entirely appropriate as safe and sound practices for the higher risk construction and development loans. However, for renovation loans where the future advances for improvements or additions to the property are minor compared to the total property value (particularly where current uses indicate income streams from the property will support the debt service even without the improvements), some of these strict requirements for construction and development loans appear to be overly burdensome.

The proposed rule does state that “A loan to finance maintenance, repairs, or improvements to an existing income producing property that does not change its use or materially impact the property is not a construction or development loan.” (Page 37917 Federal Register, Vol. 80 No. 126). BECU asks NCUA to clarify that this exemption provides sufficient flexibility for each credit union to set policies that distinguish between construction and development loans (subject to more stringent risk controls) and normal renovation loans that bear much less construction and development risk, based on those important risk characteristics such as loan to value, current uses and income streams, percentage of loan proceeds used for improvements, etc.

Commercial Loan Policy Requirements

BECU recognizes and appreciates the Board’s goal of moving toward a principle-based approach regarding MBLs and eliminating the waiver process. However, we are concerned that by requiring an inordinate amount of detail in a credit union’s commercial loan policy, as well as requiring board of directors’ management and oversight on even the most detailed and tangential aspects of the policy, the rule may be counterproductive.

In particular, the proposal requires that a credit union’s loan policy include details about the qualifications and experience requirements for various personnel involved in all aspects of member business lending (underwriting, processing, loan approval, administration, and collection). The loan policy must also include details of the loan approval process, including *but*

not limited to the levels of loan approval authority. The proposal seems to require quite detailed provisions in the loan policy on all aspects of the underwriting process, including the levels and depth of financial analysis required for various types of loans, details of the due diligence process, requirements for evaluations of projections of income, standards for acceptable financial statements, and acceptable methods for collateral evaluations. In addition, the loan policy must include details about the credit risk management, loan review, risk rating systems and reporting and monitoring procedures.

This level of detail in a board-approved policy requires the board of directors to take on tasks that are best left within the expertise of the credit union management and experienced lending, risk management, servicing and collection personnel. BECU is concerned that by requiring the board of directors to approve and monitor such detailed operational processes regarding business lending (along with all the other regulatory requirements for policy approval and monitoring), the board of directors will be diverted from its primary functions and responsibilities – that of establishing the Credit Union’s strategic direction.

The board of directors is, of course, responsible for oversight of credit union management and must ensure that management is following safe and sound practices. But the board of directors should be responsible for directing a credit union’s strategy and not be bogged down with operational decisions. Requiring the board of directors to deal with such levels of operational detail may ultimately hamstring a credit union’s operations and limit the credit union from responding to challenges in the market place or problems that require quick corrections at the operational level.

Additionally, requiring this level of detail in a credit union’s commercial loan policy may mean that the board of directors does not concentrate on the important strategic risks in a commercial loan program. Pushing too much information to the board of directors may result in not getting the proper review. Therefore, as a solution, BECU requests that: (1) at a minimum, the board of directors has the option to delegate this authority to a board level committee and (2) some of the details in the loan policy may be transferred to the operational procedures (maintained by the appropriate business unit). Regarding the first point, BECU’s preference is to allow the board of directors to delegate this role to management, who will have the requisite experience levels to assess the adequacy of the policy, with ultimate oversight and approval by the board of directors.

The Role of Guidance

In the Summary section of the proposed rule, NCUA announced a decision to publish updated supervisory guidance for examiners concurrent with the adoption of the final rule. We expect that the supervisory guidance would incorporate NCUA’s expectations regarding risk management practices, loan policy requirements, construction and development lending, credit risk rating and other details that are theoretically left to individual credit unions to establish as part of the credit union’s commercial loan program.

BECU is concerned that the Board will rely in large part on this supervisory guidance to interpret the final rule. Inappropriate or overly detailed supervisory guidance may have the effect of converting the new rule from a risk management, principle-based rule into just another prescriptive-based rule. Without reference to the scope and detail of the supervisory guidance, it

is difficult for the credit union industry to fully comment on pain points that may be imposed by the proposed rule. In our experience, supervisory guidance is cited by examiners as having equivalent authority as adopted regulations and the rule of law. So there is also the possibility that credit unions implementing the new rule will not interpret the guidance in the same way examiners do if there is no opportunity to ask for clarification about the supervisory guidance before the rule is adopted.

It is imperative for credit unions to fully understand the areas of emphasis and expectations that examiners will focus on in their work. BECU is concerned that yet to be released supervisory guidance may have the effect of undoing the latitude which NCUA is trying to provide under its principle-based risk management approach. Therefore, BECU respectfully requests the Board to release any supporting guidance associated with this proposal before finalizing the rule, so that credit unions may comment on the guidance as well as the rule.

Additionally, BECU puts forth the following questions and hopes that NCUA will address them in drafting a final rule: (i) the level of detail that will be addressed in the guidance; (ii) the aspects of the new rule that will be covered in the guidance; (iii) those areas where examiners should allow more flexibility and variation in development or implementation of a credit union commercial loan program; (iv) how examiners should treat the guidance when reviewing a credit union's commercial loan program.

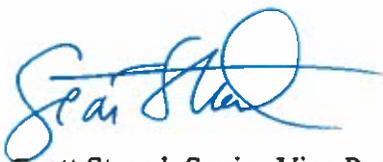
BECU also requests that to the extent such examination guidance is intended for examinations of state chartered credit unions, SSAs should be allowed to participate in the creation of the supervisory guidance, particularly to allow for state-administered MBLs rules that might be adopted in the future.

Conclusion

In summary, BECU is heartened by NCUA's efforts to modernize rules impacting commercial lending and MBLs. However, we are seeking clarification of the four issues raised in this comment letter impacting state authority, the definition of construction and development loans, the level of detail in a credit union's commercial loan policy, and the role guidance plays in the ultimate implementation.

Thank you for considering BECU's comments on this proposal.

Sincerely,



Scott Strand, Senior Vice President
Member Lending, Business and Wealth/CLO