Credit Union
ASSOCIATION
New York

February 16, 2012

Secretary of the Board, National Credit
Union Administration, 1775 Duke
Street, Alexandria, Virginia 22314

Dear Ms. Rupp,

On behalf of the Credit Union Association of New York (the Association), I would like to take this opportunity to express several concerns regarding NCUA's proposed amendments to its regulations, which would, among other things, impose concentration limits on participation interests. The proposal would also impose federal loan participation standards on state-chartered credit unions.

For the following reasons, the Association, after gathering input from our membership through surveys and in conversations, believes the proposal (1) is a drastic step not justified by past experience or potential harm; (2) runs the risk of creating a liquidity crunch for larger credit unions and making it more difficult for smaller credit unions to purchase or originate loan participations; (3) does not provide credit unions with adequate flexibility to establish lending programs unique to the needs of their members or their financial condition; (4) infringes on the sovereignty of state-chartered credit unions by further usurping the authority of state regulators to apply their own criteria when assessing the safety and soundness of state-chartered institutions; and (5) takes all these steps when existing regulations and guidance address NCUA’s loan participation concerns.

NCUA has not demonstrated a need for these regulations

Participation agreements represent a primary means for credit unions to ensure adequate liquidity. They ensure that credit unions have a network to maximize the amount of funds that can be made available to members. They also allow a broader range of qualified credit unions to diversify their lending portfolios. The need for participations is made all the more acute for credit unions since the industry does not have the ability to acquire secondary capital, which could otherwise be used to cushion potential risks and provide a capital baseline from which to further expand lending activities.

Given the importance of participations to the industry, NCUA should not take any steps that have the effect of reducing the use of participations absent compelling evidence that such steps are necessary. NCUA has provided virtually no evidence that participations have been so misused that the continuation of the current regulatory framework represents a systemic risk to the industry.

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NCUA argues that loan participations pose a systemic risk to the share insurance fund "due to the resulting interconnection between credit unions." If this is NCUA's interpretation of systemic risk, then virtually any activity taken by a credit union is systemic in nature and susceptible to greater regulation. If NCUA's goal is to eliminate risk, then it should restrict loan participations or even eliminate them altogether.

If NCUA's goal is to manage the risk inherent in any financial system, then it should balance the risk posed by a given activity against its value to the industry. Using the later paradigm, NCUA should do more than point to a hypothetical risk to the industry as a result of offering loan participations. It should offer a definition of systemic risk and then present evidence that it exists before going forward with this regulation.

Just as some credit unions are better managed than others, is inevitable that some participation agreements are better designed and managed than others; no amount of regulation is going to change that. The vast majority of credit unions should not be penalized because of isolated mismanagement.

Not only are these regulations unnecessary, but their promulgation will have negative consequences for well managed institutions. The accompanying preamble concentrates almost exclusively on the potential harm of participation concentration. Virtually no attention is given to the fact that this proposal will have a negative impact on the availability of liquidity for credit unions.

For example, suppose you are a successful credit union that currently is able to lend out 100% of its assets. Presumably, the loans you provide are in demand and you have a proven track record of appropriately monitoring and underwriting loans, as well as providing the type of quality service members expect of credit unions. At the same time many financial institutions have either reduced or eliminated lines of credit.

This successful credit union is now more dependent than ever on participations to provide an outlet for its liquidity. Nevertheless, under this proposal a successful credit union will not have as many outlets to sell participation loans and may very well have to reduce its lending activity. In short, in its goal to prevent what it perceives as a potential risk in participations, NCUA is actually harming credit unions that use participations precisely the way in which they were intended.

Consequently, as will be discussed in more detail below, if NCUA feels the need to go forward with this proposal is should do so with more flexible concentration limits and phase the restrictions in over several years to ensure that they are fully implemented in an economic

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environment conducive to credit expansion. This is simply not the time to be placing limits on lending activity. There is also concern among credit unions that this proposal will have the practical impact of reducing the number of participation opportunities available to them. The

Concern is that, as large credit unions seek to sell off participation interests, it will simply be easier to deal with larger credit unions which will be able to take in more participation while complying with the concentration limits.

A 25% Cap is too severe

The most problematic aspect of this proposal is its proposed concentration limit on the aggregate amount of loan participations a credit union may purchase from any originator at 25% of net worth.

In many ways, this aspect of the proposal is counterintuitive as it presupposes that no matter how prudent a credit union or group of credit unions has been creating loan participations, no credit union should exceed a numerical cap in participating with this originator. NCUA's goal should be to allow credit unions to appropriately manage risk and hold those that don't accountable. Consequently, when a credit union has the expertise to manage the loan participation it has acquired and, in its judgment, feels that an existing credit union or group of credit unions is best equipped to provide quality loans, it should be able to exercise such judgment independent of any cap.

John Walsh, the acting director of the OCC, recently commented to community bank directors, "credit concentrations are always a matter for concern, but I recognize that concentrations are a fact of life for community banks. However, the banks that maintained 1 or 2 ratings through the downturn were the ones that understood and managed the concentrations on their balance sheets. They developed prudent limits and stuck to them, despite tempting returns when times were good. They also engaged in careful underwriting and structured loans appropriately to limit risk to the bank in the event of unexpected declines in the borrowers' performance."

NCUA should likewise recognize that concentration is inevitable and that the emphasis of regulators should be on ensuring that credit unions manage that risk appropriately rather than trying to develop a regulatory construct that seeks to avoid concentration at the expense of sound financial practice.

In addition, many credit unions reviewing this aspect of the regulation describe the imposition of a 25% cap as arbitrary. As one credit union commented, establishing this concentration limit might actually force credit unions to enter participation pools with less qualified originators.

Accordingly, before finalizing this proposal, NCUA should justify to credit unions the significance of 25% as a concentration limit. It should also provide a mechanism for credit

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unions to seek a waiver from this restriction. Again, credit unions should be able to exercise their own underwriting judgment and, to the extent that they can, show an examiner how exceeding this concentration limit actually advances the goals of safety and soundness.

Similarly, the proposed 15% net worth concentration limit is equally unnecessary for many of the same reasons. The goal should be to ensure that lending is conducted consistent with prudent

Underwriting standards rather than categorically assume that any activity exceeding a somewhat arbitrary concentration limit poses a systemic risk.

The existing regulatory framework is sufficient to address NCUA's concerns

What NCUA categorizes as systemic risk can and should be adequately dealt with through the rigorous application of existing due diligence guidance. In addition, existing participation regulations already impose adequate constraints on credit unions. For example, credit unions can take a participation interest only in loans that they themselves are qualified to make. Credit unions are already required to have staff qualified to underwrite and monitor these loans. Consequently, examiners already have the authority to prevent credit unions from taking part in loan participations when they reasonably believe that credit unions lack the required expertise. Judicious use of this power avoids the categorical assumption that all participations past a certain concentration limit represent a systemic harm to the industry.

In this regard, certain aspects of the proposal are actually beneficial to credit unions by clarifying existing law to enhance understanding. For instance, clarifying that loan participation by definition involves a loan other than one involving the credit union's own members resolves a common compliance misconception for many credit unions. In addition, the reformatting of the existing layout will help members better understand that loan participation authorization only extends to loans that the credit union itself is authorized to make. These changes, coupled with more rigorous enforcement of existing due diligence requirements, would accomplish all the goals NCUA believes are covered in this regulation without needlessly restricting the activities of credit unions.

NCUA should not extend these regulations to state-chartered credit unions

NCUA seeks to utilize its power to ensure the safety and soundness of the Share Insurance Fund to mandate that state-chartered credit unions be subject to the same participation regulations imposed on their federal counterparts. This proposal is the latest in an increasingly long list of examples of NCUA expanding its oversight authority without adequately demonstrating how state regulators have inadequately discharged their responsibility to ensure the safety of credit

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unions that have chosen their charter. It is beyond dispute that there are state-chartered credit unions large enough to potentially harm the credit union industry as a whole. It does not follow that these credit unions have not been adequately supervised by their state examiners.

Furthermore, the decision as to whether to be a state or federally chartered credit union is among the most important made by a credit union's management. But, given the increasing tendency of NCUA to substitute its judgment for that of state regulators, we are in danger of reaching a point that NCUA so dominates the examination process that there is no practical distinction between the two charters. As an Association that strongly believes that the dual charter benefits credit

Unions and members alike by providing a mechanism for balancing the need for safety and soundness against the need for flexible regulations, we believe that NCUA should take care not to overstep its authority regarding state-charters.

Clearly, the Association has many concerns about this recommendation. At best, it is unnecessary, at worst, it will inhibit the ability of credit unions to grow and provide lending to their members while restricting liquidity as we enter a period of structural adjustment within the industry. NCUA should withdraw this proposal. If it insists on going forward, it should only do so after raising the suggested concentration limits, ensuring that waivers can be granted in appropriate circumstances, and applying such restrictions only to federally chartered credit unions.

Sincerely,

William Mellin
President/CEO
Credit Union Association of New York

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