MICHIGAN CREDIT UNION LEAGUE & AFFILIATES

August 31, 2015

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

RE: Member Business Loans; Commercial Lending RIN 3133-AE37

Via e-mail: regcomments@ncua.gov

Dear Mr. Poliquin,

The Michigan Credit Union League (MCUL), the statewide trade association representing 98% of the credit unions located in Michigan and their 4.7 million members, appreciates the opportunity to comment on the National Credit Union Administration's (NCUA) Member Business Lending (MBL) proposal. The MCUL commends the NCUA on its efforts in crafting a rule designed to give credit unions greater flexibility and autonomy in offering commercial loans. After careful analysis and discussion with our membership, the MCUL is supportive of the general direction of the NCUA's proposal. However, we believe there are areas in need of improvement.

Definitions

Commercial Loan

The NCUA's newly proposed definition of Commercial Loan is defined as any credit extended to a borrower for commercial, industrial, agricultural, and professional purposes. The definition would also provide for a number of exceptions including: loans made by a corporate credit union, loans made by a federally insured credit union to another federally insured credit union, loans made by a federally insured credit union to a CUSO, loans secured by a 1-4 family residential property (whether or not it is the borrower's primary residence, loans secured by a vehicle manufactured for household use, any loan fully secured by shares in the credit union making the extension of credit or deposits in other financial institutions and any loan(s) to a borrower or an associated borrower, the aggregate balance of which is equal to less than $50,000.

The MCUL is supportive of the new definitions including the newly created definition of commercial loan. The new definition provides for a delineation between those loans subject to the MBL cap and commercial loans that invoke safety and soundness provisions. The proposed definition will provide relief to credit unions making loans secured by the aforementioned collateral. However, the MCUL believes more loan types should be exempt from the definition including loans that present minimal or no 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 a safety and soundness concern.

The MCUL also encourages the NCUA to be conscious of limitations it may impose upon credit unions by requiring a credit-risk rating system that may not be appropriate or necessary in a commercial loan policy as identified in proposed 723.4.

Associated Borrower

The MCUL is pleased to see the NCUA's change in the definition of "associated member" and its replacement with the definition of "associated borrower." In a 2013 letter to the NCUA addressing the Annual Regulatory Review, the MCUL advocated for a change in the definition of "associated member" by encouraging the NCUA to consider implementing a minimum ownership level to qualify as an "associated member."

The NCUA listened to commenters from the credit union industry in redefining "associated borrower". The proposed definition better aligns the calculation of aggregate loan exposure with all financial institutions, as well as requires credit unions to place greater emphasis on evaluating and underwriting an entire relationship as opposed to a stand-alone transaction. The ownership structure of an entity can be quite complex and failing to examine all parties in a transactional relationship can unintentionally expose the credit union to unnecessary risk.

Principle-based Methodology

The MCUL supports the change from the current prescriptive approach to a more principle-based methodology. The NCUA has repeatedly communicated its position with regard to proposed changes to MBL by stating it would include a transition from a prescriptive approach to a principles-based approach. Shifting the authority for establishing a commercial lending policy to the credit unions, as well as requiring the development and implementation of a risk rating policy, supports a principles-based approach.

Consistent with a principles-based approach the proposal eliminates a number of current waiver requirements. The MCUL is especially pleased to see the removal of the personal guarantee requirement as this change will provide credit unions with flexibility in setting their own underwriting criteria related to personal guarantees. It will also eliminate the need for a credit union to obtain a waiver from a regional office. Further, the MCUL is pleased to see the proposed change to the current loan-to-value requirements, with the principle that sufficient collateral is obtained when warranted and in relation to risk. Again, this change provides credit unions with greater flexibility in setting their own portfolio limits and loan-to-value requirements while eliminating the need for regulatory waivers present in the current rule.

The proposed rule also eliminates the waiver requirement for credit unions to purchase non-member participation interests in commercial loans made by other lenders without impacting the MBL cap. This is made possible by not including non-member participations in the MBL cap. It is likely that credit unions make infrequent use of such waivers, but this ultimately provides another form of regulatory relief by allowing credit unions to offer more business loans to their membership. The MCUL is supportive of this change.

Credit unions take pride in developing and maintaining sound underwriting standards which encompass the ability to properly identify and quantify risk associated with each loan application presented. Such well-defined risk rating policies aid in these efforts and provides for assurance that the commercial lending department is properly identifying material risks associated with commercial loans. Unfortunately certain elements of the NCUA's proposal attempt to incorporate process and procedure requirements as opposed to actual policy requirements. This runs counterintuitive to a principles-based approach and is reflective of the prescriptive approach the NCUA is attempting to move away from with this proposal.

Supervisory Guidance

The NCUA will be developing and issuing amended Supervisory Guidance for its examiners that reflect changes to the MBL rule. The MCUL strongly encourages the NCUA to release the supervisory guidance to credit unions with an opportunity for the industry to comment prior to issuance of a final rule. This guidance will ultimately be the road map NCUA's examiners will follow when reviewing credit unions' commercial lending programs. This makes credit union input critical.

First, since many of the current regulatory restraints would be removed from Part 723, NCUA's guidance will detail the parameters of a safe and sound commercial lending program, as well as many other examiner-driven requirements that are not detailed in the proposed rule. This guidance will detail 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 according to NCUA staff, stakeholders will not have the opportunity to comment on the guidance.

To echo CUNA's comments and concerns; NCUA leadership and staff have repeatedly stated 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. To the contrary, the NCUA has discretion to allow or not to allow public comment on guidance. 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.

Secondly, and of equal importance, there is concern among a number of credit unions and trade associations including CUNA and the MCUL that the shift to the principles-based approach could complicate management of an MBL program. This complication arises because the proposed rule would shift responsibility for the development of commercial lending programs that are safe and sound and while also meeting examiner approval. For smaller credit unions new to commercial lending this could prove problematic. Without appropriate guidance, the amount of detail NCUA will give credit unions on how to construct and operate safe and sound lending programs is unclear and provides a level of subjectivity among examiners. The NCUA could alleviate this concern 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. Such policies would be different for individual credit unions depending on size, complexity and level of sophistication, but guidance would offer an important tool for credit unions.

The absence of supervisory guidance creates uncertainty for credit unions which makes it difficult for credit unions to fully assess the proposed rule's potential impact to credit unions. The MCUL strongly encourages the NCUA to address this concern prior to issuing a final rule.

MBL Cap Calculation

The MCUL is supportive of a change that would allow credit unions to continue to serve their membership with less concern of bumping up against the arbitrary cap of 12.25%. Specifically, the proposal would replace the current expression of the MBL cap as 12.25% with an updated standard. The new standard would allow a credit union to be well capitalized if they have capital covering1.75 times the amount of 7% of total assets or 10% of risk assets.

A key point to consider when analyzing credit union business lending is the deterrent that the cap itself poses to becoming involved with MBLs. MBLs are considerably more complex, and have increased regulatory and staffing requirements as compared to other types of loans. Many credit unions find that the cap is so low that investing in the necessary infrastructure of an MBL program is not worth the expense when weighed against limited return and increased risk. For those that are participating, the cap is low enough that more active lenders must make careful decisions on new loans so as to not restrict future credit for existing business members.

The MCUL would also note that misinformation from some commenters related to the MBL cap is being submitted to NCUA. These commenters are incorrectly stating that the MBL cap would increase to 17.5% for all credit unions. In fact, this higher level would only be realized if risk assets equaled total assets. Further, only a small number of credit unions would see their MBL cap increase above 12.5%.

The MCUL would also take this opportunity to encourage the NCUA to support H.R. 1188, The Credit Union Small Business Jobs Creation Act. H.R. 1188 would amend the Federal Credit Union Act to prohibit an insured credit union from making any member business loan that would result in the total amount of such loans outstanding at that credit union at any one time exceeding either: (1) 1.75 times the actual net worth of the credit union, or (2) 12.25% of the total assets of the credit union. It would also authorize the National Credit Union Administration Board to approve an application by a credit union to make one or more member business loans that would result in a total amount of such loans outstanding at any one time of up to 27.5 % of the total assets of the credit union, if the credit union meets specified safety and soundness criteria. Further, the proposed law would direct the Board to develop a tiered approval process, including lending standards, under which an insured credit union gradually increases the amount of member business lending in a manner consistent with safe and sound operations.

Board of Directors and Management Responsibilities

Proposed § 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 § 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. Some credit unions have voiced concern that 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 the MCUL together with CUNA supports this proposed rule, there is concern that proposed § 723.3 could require too much ongoing supervision from volunteer credit union boards. 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.

The MCUL 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 each of these areas, the staff will not necessarily be required to have this particular experience. The final rule and guidance should clarify this point. The MCUL believes the experience requirements could also be met by a third party, such as a CUSO, as credit unions often rely on third parties to outsource experience and other needs that might not be necessary or cost effective to maintain in-house.

Small Credit Union Exemption

The MCUL would like to take this opportunity to express our support for a small credit union credit union exemption. The NCUA is well aware of the need for regulatory relief on all fronts for credit unions, especially smaller credit unions who lack the staff and resources afforded to larger institutions. As such, the MCUL strongly supports an exemption for credit unions that hold a de minimis number and amount of commercial loans. The proposal, however, would exempt a credit union from these risk management policy and infrastructure requirements only if the credit union has both assets less than $250 million and total commercial loans less than 15% of net worth. The MCUL understands and is supportive of the NCUA's intention to provide regulatory relief for small credit unions. Nevertheless, we think the asset size threshold is arbitrary in establishing exemption and therefore is not a good proxy for determining the risk of a credit union with a de minimis number in amount and size of commercial loans.

The MCUL supports CUNA's recommendation to make this exemption open to all credit unions through a de minimis commercial loan exemption. This could be accomplished by removing the $250 million asset requirement from § 723.1(b) and coupling it with the 15% hard cap on the net worth limitation. By removing the asset requirement for the exemption, larger credit unions that meet the other requirements of the exception, but only have a minimal engagement in commercial lending relative to their net worth and assets, would also receive regulatory relief.

State Chartered Credit Unions

The NCUA is soliciting comments on three options to transition existing regulatory schemes maintained in seven states that currently have NCUA Board-approved MBL rules. Option A, would grandfather existing state adopted regulatory schemes but not allow for any future approval for other states. Option B would require existing states to resubmit existing schemes to the NCUA with conforming amendments if necessary. Option B would further allow for new state MBL rules by other states that conform to the new rules but could be more restrictive if the state so choses. Option C would grandfather existing state MBL rules and permit other state supervisory authorities to submit their own state rules for consideration so long as they conform with the current § 723.20.

While Michigan is not one of the seven states to currently have a NCUA Board-approved MBL rule, Michigan is a state known for a progressive and well respected state regulator. MCUL strongly supports the autonomy of state regulators as part of a vibrant dual chartering system. Providing states with the greatest flexibility to adopt rules appropriate to their local region is the most favorable approach. Most state supervisory authorities have been cognizant of maintaining regulatory equivalence with federally chartered credit unions and we believe they can and will make appropriate decisions for state-chartered credit unions while striving to maintain safety and soundness principles. NCUA should allow this authority to continue.

The MCUL agrees with CUNA's comment that Option C is the best option to provide maximum flexibility for states in this regard. Option C allows states to continue with their existing regulatory schemes, and will ease the transition while maintaining federally insured state chartered credit unions remain in compliance with existing law. It would also allow a mechanism for states to update their regulatory scheme if they deem it appropriate and for new states to adopt their own schemes if they so choose. One of the hallmarks of the dual-chartering system is that it encourages innovation by the states and places both authority and responsibility at the state level, thus assuring mutual accountability as between regulator and credit union stakeholders.

The MCUL also encourages the NCUA to maintain existing § 723.20(c) which allows for a transition back to the NCUA's rule in the event a state rescinds its existing rule.

Examination and Supervisory Concern

Examination consistency is an ongoing concern for many credit unions. Today, many of our credit unions believe examiners receive and apply inconsistent safety and soundness guidance or "best practices." With many aspects of a commercial lending program being subjectively reviewed, credit unions are concerned they may be subjected to the application of differing "rules" or so called "best practices" from one examination to another based on individual examiner opinion.

NCUA staff acknowledges the agency 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.

The MCUL strongly encourages consistent training and guidance for these examiners given their significant role in the process. Additionally, especially during the few first years after implementation, credit unions and senior NCUA examiners should work together through the examination and review process. Credit unions should be able to elevate policy disagreements up the chain without initiating a formal procedure.

Not only will NCUA examiners require sufficient training and resources, the state supervisory authorities and their examination staff will also need to have specialized training and be able to fully understand the MBL regulation and commercial lending standards. As credit unions continue to merge and as the insurer of federal and state chartered credit unions, the NCUA and the state supervisory authority are conducting dual examinations. Due to this collaborative process between agencies the MCUL also encourages the NCUA to create a training module that could be replicated at the state level for consistency. Without the proper training of state examiners, the principles based approach could result in less flexibility for state-chartered credit unions.

Lastly, relating to the enhanced training of examination staff, the estimated cost for training of examination staff is $1.9 million. The MCUL encourages the NCUA to increase efficiencies in other areas or allocate current training resources to this specific training need as it anticipates training to be a one-time specialized training cost which should not be borne by credit unions.

Conclusion

The MCUL is pleased to see the significant and ultimately positive changes that the NCUA's proposal provides. A number of provisions within the proposal would enable credit unions to operate more efficient and robust commercial lending programs; however, as discussed in previous comments, without the ability to review and comment on supervisory guidance prior to issuance of a final rule, the MCUL and our credit unions cannot fully assess the impact the proposal will have.

Notwithstanding concerns addressed throughout our comments, the MCUL applauds the NCUA's efforts to provide regulatory relief and greater access to credit union members seeking a business loan.

Sincerely,

Ken Ross
Executive Vice President & Chief Operating Officer