NAFCU
3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
f: 703.524.1082
nafcu@nafcu.org | nafcu.org
National Association of Federally-Insured Credit Unions

March 15, 2022

The Honorable Todd M. Harper, Chairman
The Honorable Kyle S. Hauptman, Vice Chairman
The Honorable Rodney E. Hood, Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: Loan Participations

Dear Chairman Harper, Vice Chairman Hauptman, and Board Member Hood:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing to you today regarding key aspects of the National Credit Union Administration's (NCUA) loan participation regulations. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 127 million consumers with personal and small business financial services products. NAFCU urges the NCUA to immediately initiate, as part of the NCUA's addressing important components of its Regulatory Reform Agenda, a rulemaking that amends 12 CFR §701.22 to eliminate all aggregate limits on loan participations a federally-insured credit union (FICU) may purchase from any one originating lender or to expressly exclude all loan participations purchased from a FICU from any aggregate limits on loan participations a FICU may purchase from any one originating lender.

In the alternative, NAFCU urges the NCUA to immediately and simultaneously issue an interim final rule (IFR) extending the automatic expiration of §701.22(e) from December 31, 2022, to December 31, 2023, and a Notice of Proposed Rulemaking (NPRM) outlining how the NCUA may effectuate the above-requested permanent regulatory relief and such other permanent regulatory relief as the NCUA may deem appropriate and necessary to modernize the NCUA's loan participation regulations.

NAFCU also encourages the NCUA to explore how the NCUA may streamline §701.22(c)'s loan participation waiver process and make its outcomes more consistent, how the NCUA may provide FICUs clarity around the definition of a "loan participation", and how the NCUA may enhance FICU-purchased loan participations' marketability.

General Comments

Various forms of temporary regulatory relief granted by the NCUA to FICUs in the early, most uncertain days of the COVID-19 pandemic helped ensure FICUs remained well-positioned to serve their members. The temporary regulatory relief contained in 12 CFR §701.22(e) also afforded FICUs the opportunity to demonstrate they can prudently manage their balance sheets beyond historical regulatory limitations and can increase affordable access to high-quality credit in the credit union system.

NAFCU applauds the NCUA's continued commitment to updating and modernizing its most overly prescriptive and unnecessary regulations to better support the credit union system and drive broader financial inclusion, but there remain significant opportunities, especially when it comes to modernizing the NCUA's loan participation regulations.

When it issued the Temporary Regulatory Relief in Response to COVID-19[1] IFR on April 21, 2020, the NCUA temporarily raised the maximum aggregate amount of loan participations a FICU may purchase from any one originating lender from the greater of $5 million or 100 percent of the FICU's net worth to the greater of $5 million or 200 percent of the FICU's net worth. In a follow-up Letter to Credit Unions[2] published shortly thereafter, the NCUA recognized that the recently published IFR temporarily amending loan participation regulations contained in §701.22 and eligible obligation regulations contained in §701.23 reflected the NCUA's broader embrace of principles-based regulation.

At the outset of the pandemic, the NCUA acted quickly and decisively to ensure FICUs remained liquid and operational. As the NCUA has regularly recognized, the vast majority of FICUs were working tirelessly to serve their members while managing through local- and state-mandated pandemic safety protocols, transitioning some employees to a work-from-home posture of indefinite length, juggling staffing shortages, and assessing countless other uncertainties. Consistent with its commitment to ensuring the safety and soundness of the credit union system, the NCUA, at least temporarily, provided a regulatory framework that better enables FICUs to determine for themselves the best way to structure lending and investment operations to better meet their individual economic challenges.

Just as the pandemic's greatest burdens have fallen unevenly on Americans, those burdens have fallen unevenly on their FICUs. While the vast majority of FICUs have experienced unprecedented share growth during the pandemic, some FICUs enjoy plentiful lending opportunities while other FICUs serve communities in which personal and business borrowing has severely contracted below pre-pandemic levels. Trying economic times make clear that even in our non-profit, cooperative credit union system designed to expand affordable access to high-quality credit and promote thrift, capital can become stubbornly lodged in one corner of the economy when it is most urgently required in another.

If the NCUA is to be successful in empowering and encouraging FICUs to more fully serve the unserved and underserved in their communities, the NCUA must first more fully recognize its own power and continue to develop principles-based regulation that best articulates the *Federal Credit Union Act*'s (FCU Act) cooperative focus.

NCUA's Regulatory Discretion Under the FCU Act's Express Powers

As NAFCU pointed out in a September 15, 2021, letter to the NCUA, the NCUA enjoys near absolute regulatory discretion under 12 U.S.C. §1757(5)(E). Section 1757(5)(E) of the FCU Act expressly grants a federal credit union the power "to participate with other credit unions, credit union organizations, or financial organizations in making loans to credit union members" provided

[1] https://www.regulations.gov/document/NCUA-2022-0035-0001
[2] https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/temporary-regulatory-relief-response-covid-19-pandemic

such loan participation purchases are made in accordance with the written policies of the federal credit union's board of directors and any originating credit union retains at least 10 percent of the face amount of the loan underlying the loan participation. While the FCU Act does not permit the NCUA to adopt regulation that either expressly or effectively divests federal credit unions of this express power, nothing in the FCU Act requires that the NCUA adopt any relevant regulation or prevents the NCUA from eliminating or amending any previously adopted relevant regulation.

This regulatory discretion has been confirmed by the NCUA's own Regulatory Reform Taskforce and even the NCUA directly when it adopted the present, higher-than-then-proposed aggregate loan participation limit in 2013. Eliminating §701.22's aggregate loan participation limits, as was suggested by the Regulatory Reform Task Force, or at least excluding loan participations purchased by one FICU from another FICU from §701.22's scope, would permanently enable FICUs to better manage their unique interest rate and loan concentration risks, among others, without incurring materially offsetting risks.

As a conscious shift to principles-based regulation recognizes, FICU's management and its board of directors are best situated to evaluate a FICU's unique needs and opportunities. NAFCU unequivocally believes the NCUA should make clear in the NCUA Examiner's Guide that NCUA examiners should afford a FICU's management and board of directors great deference on issues related to investment risk evaluation, management, and tolerance as well as on issues related to a FICU's due diligence and oversight of third-party relationships, not just concerning loan participations, but in all cases. Similarly, with respect to §701.22(a)'s definition of loan participation, NAFCU encourages the NCUA to expressly confirm that a third-party merchant with whom a FICU contracts to originate loans at the point of a sale is not required to establish or maintain any interest in such loans. FICUs' persistently divergent experiences with NCUA examiners reviewing indirect lending relationships and related risk management strongly suggest such additional NCUA guidance is necessary.

Evolution of Loan Participations

Section 1757(5)(E) of the FCU Act and the NCUA's regulatory history with 12 CFR §701.22's loan participation authorities both plainly recognize that it is antithetical to the core purposes of our cooperative credit union system that capital should be sequestered unproductively in one FICU when it may be prudently deployed by another. For years, FICUs on both sides of these transactions have relied on these authorities to better respond to their individual economic challenges. The natural and obvious results of FICUs with excess deposits partnering with FICUs with excess member loan demands have been that the financial wellbeing of all parties is strengthened. Loan participation purchasers can support their members with higher dividends and expanded member services, including free checking products and financial education – pillars of broader financial inclusion. Loan originators can offer more of their members affordable alternatives to higher rate, higher fee lending products pushed by for-profit banks – engines of financial empowerment.

Now, however, with the credit union system's collective experience with §701.22(e) firmly in mind, we can more fully appreciate that §701.22 has unnecessarily constrained those natural efficiencies. When it temporarily adopted §701.22(e), the NCUA effectively acknowledged that FICUs may deepen relationships with their most trusted lending partners without engendering unmanageable risks to themselves or the National Credit Union Share Insurance Fund (NCUSIF).

FICUs have rewarded that faith well and proven themselves capable of prudently managing their balance sheets beyond §701.22's aggregate loan participation limits even during the most challenging times, particularly when they partner with one another.

By eliminating §701.22's aggregate loan participation limits, the NCUA would not relinquish any measure of its oversight of FICUs' lending practices or undermine more comprehensive portfolio management safeguards. Neither a purchasing nor originating FICU would be excused from other relevant lending and portfolio risk management standards and examinations designed to ensure the safety and soundness of the credit union system. In fact, FICUs that, based on modest fields of membership or limited geographic footprints, find themselves naturally exposed to certain loan concentration risks, may more effectively reduce risks to themselves and the NCUSIF. FICUs enabled to expand affordable lending programs may help bring more and younger members into the credit union system. As the NCUA continues to embrace principles-based regulation, it should take every opportunity to support smoothly functioning frameworks that enable participating FICUs to better, more fully serve their communities and, perhaps, reduce present and future risks to themselves and the NCUSIF.

At a minimum, the NCUA must act promptly to ensure the temporary regulatory relief contained in §701.22(e) does not lapse at a time when it is obvious to all that FICUs continue to face meaningful micro-and macro-economic challenges arising from a pandemic now measured in years. As Chairman Harper poignantly expressed in the February 17, 2022, NCUA Board Meeting, the pandemic's full impact on FICUs' balance sheets is presently unclear and will likely remain unclear through at least the end of 2022.

Modernizing the Loan Participation Limitations Waiver Process

As the NCUA pursues its published rulemaking agenda, NAFCU urges the NCUA to provide FICUs greater clarity throughout the §701.22(c) loan participation waiver process and drive greater regulatory consistency across the NCUA's three regional offices. By developing and making publicly available an optional, streamlined §701.22(c) waiver request template and related guidance, the NCUA would support both FICUs and the NCUA Regional Directors responsible for evaluating and responding to §701.22(c) waiver requests. The facts and circumstances underlying certain §701.22(c) waiver requests may be best expressed in a freeform request. However, the NCUA has time and again proven itself capable of effectively streamlining NCUA Regional Directors' evaluation of inarguably more complicated FICU issues – the NCUA's recent extension of temporary regulatory relief from its prompt corrective action regulations is just one example.

Under a streamlined §701.22(c) loan participation waiver process, the NCUA should revisit and revise relevant NCUA Regional Director response timeframes. Presently, a FICU may submit a §701.22(c) waiver request to its NCUA regional director only to be informed 45 calendar days later that its request is somehow incomplete or insufficient. The availability of a streamlined §701.22(c) waiver request template and related guidance may not only help FICUs avoid submitting incomplete or insufficient requests but may also enable NCUA Regional Directors to respond to FICUs submitting streamlined §701.22(c) waiver requests within an improved response timeframe. Accordingly, NAFCU encourages the NCUA to reduce the timeline for NCUA

Regional Directors' responses to §701.22(c) waiver requests from 45 calendar days to 30 calendar days.

Harmonizing Loan Participation and Eligible Obligations Regulations

Section 701.22(b) and §701.23(b)(1)(a) are operationally similar in that both subsections generally limit the universe of debt a FICU may purchase under their respective regulatory sections to loans a FICU is "empowered to grant". As part of the temporary regulatory relief it granted FICUs in April 2020, the NCUA adopted §701.23(h)(3)(i), which suspends the above-described arbitrary limit contained in §701.23(b)(1)(a). In part, this temporary subsection provides that a FICU may, within the limitations of its board of directors' written purchase policies, purchase its members' eligible obligations without regard to whether the FICU is "empowered to grant" such loans or whether the FICU will refinance such loans.

By temporarily adopting this subsection, the NCUA in no way reduced FICUs' responsibilities to perform all necessary due diligence on an originating lender or the debts to be purchased, nor did the NCUA imperil commonsense underwriting and portfolio management guardrails. Rather, the NCUA recognized that a FICU may prudently evaluate and purchase types of its members' eligible obligations that the FICU has, for one reason or another, not sought the authority to originate in-house. This particular embrace of principles-based regulation appropriately recognizes many FICUs' all-too-obvious economic reality – expenditures of limited financial and personnel resources must be precisely targeted to produce the maximum likely good.

Before a FICU can reliably quantify the marketing, underwriting, processing, and servicing staff and budget needed to safely offer its members a new lending product, the FICU must investigate and work to thoroughly understand the lending product's risks and the FICU's related opportunities. Perhaps the expenditures likely necessary for a FICU to safely stand up a new lending product – like solar panel financing – outweigh the FICU's current opportunities or capacity or are not as attractive as other in-community investments. The overwhelming majority of FICUs simply do not have the deep-pocketed capacity to adopt a moonshot mentality.

However, a FICU's inability or unwillingness to stand up a new lending product is not determinative of the FICU's ability to understand how to quantify, price, and manage the underlying risks of the lending product. FICU portfolio managers are certainly capable of safely investing in a far broader universe of loan types than most FICUs could ever likely offer directly to their members. The credit union system's continued and stable financial successes are a testament to its ability to attract and retain excellent investment talent. A FICU should not be forced to suffer the disuse of these immense investment talents to the extent such talents exceed the FICU's present capacity to expand its lending product suite.

Section 701.22(b) and §701.23(b)(1)(a), as they operate today, wholly ignore that a FICU could deeply and thoroughly understand a loan type's economics without being in a position to undertake more fully the steps necessary to grant such loans. At best, these subsections require a FICU to undertake needless expenditures of precious resources before it may endeavor to further strengthen its balance sheet and the credit union system through purchases of loan participations and eligible obligations. NAFCU urges the NCUA to undertake a rulemaking that eliminates regulatory obstacles, including §701.22(b)'s and §701.23(b)(1)(a)'s general prohibitions against FICUs purchasing loan participations and eligible obligations they are not "empowered to grant", that needlessly stand in the way of FICUs purchasing debts they can prudently evaluate and manage.

Making Loan Participations More Marketable

Section 701.23(b)(iii) and (iv) permit a FICU to purchase as eligible obligations student loans and real estate secured loans, respectively, from any source. Liquidity risk is an important component in any investment evaluation, and these exceptions to NCUA's more stringent eligible obligations regulations reflect an effort to support FICUs' secondary market operations by enabling FICUs to better market their student and mortgage debt. Section 701.22(b)(2), on the other hand, magnifies the liquidity risks of FICUs' purchased loan participations unnecessarily by requiring that a purchasing FICU establish a "written loan participation agreement with the originating lender."

While compliance with this subsection may not be a great hurdle in a primary loan participation transaction between FICUs and originating lenders, the subsection operates to prohibit a FICU loan participation purchaser from subsequently reselling a loan participation to a third-party FICU purchaser without involving the originating lender. NAFCU encourages the NCUA to amend §701.22(b)(2) to provide that a FICU may purchase a loan participation if the FICU has executed a written loan participation agreement with the originating lender or with any FICU that is a successor in interest to a written loan participation agreement with the originating lender and the agreement meets the minimum requirements for a loan participation agreement as described in §701.22(d).

In the alternative, NAFCU encourages the NCUA to amend §701.22(b)(2) to provide that a FICU may purchase a loan participation if the FICU has executed a written loan participation agreement with the originating lender or the FICU executes a written loan participation agreement with a FICU that has directly executed a loan participation agreement with the originating lender and the agreement meets the minimum requirements for a loan participation agreement as described in §701.22(d).

Conclusion

The temporary regulatory relief provided by §701.22(e) has not only operated as intended to allow FICUs to better weather the pandemic's economic challenges, but it also set the stage for a natural experiment. Without attracting unmanageable risk to themselves or the NCUSIF, FICUs around the country leaned into their cooperative nature. Communities on both sides of expanded loan participation purchases have benefitted – be it from knowing their FICU can continue to offer attractive dividend rates even in a prolonged low-rate environment or from knowing their FICU can meet their individual and business borrowing needs when for-profit banks are pulling out of many communities.

NAFCU's recommendations in this letter are designed to ensure these cooperative efficiencies endure and can be leveraged to more fully engage and support not only the more than 127 million Americans who rely on the credit union system but the tens of millions of unserved and underserved Americans credit unions are best positioned to reach. NAFCU urges the NCUA to prioritize modernizing its loan participation regulations, to streamline existing processes, provide greater flexibility, and more fully support the natural efficiencies of our credit union system by eliminating §701.22's aggregate loan participation limits and otherwise building on the credit union system's successes attributable to cooperative lending.

If you have any questions or concerns, please do not hesitate to contact me at (703) 842-2212 or akossachev@nafcu.org or Dale Baker, NAFCU's Regulatory Affairs Counsel, at (703) 842-2803 or dbaker@nafcu.org.

Sincerely,

Ann C. Kossachev

Ann C. Kossachev
Vice President of Regulatory Affairs