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August 25, 2008

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Comments on Advance Notice of Proposed Rulemaking on 12 C.F.R. Part 723, Member Business Loans

Dear Ms. Rupp:

On behalf of the Credit Union National Association, I am providing comments to the National Credit Union Administration on the Board's advance notice and request for comments on its member business loan (MBL) rule, 12 C.F.R. Part 723. By way of background, CUNA is the largest credit union advocacy organization in this country, representing approximately 90% of our nation's 8,200 federal and state-chartered credit unions, which serve 91 million members. CUNA's letter was developed under the auspices of our Federal Credit Union Subcommittee and the Lending Council.

Summary of CUNA's Views

- Credit unions are an important source of funding for businesses in their fields of membership. Such activity benefits not only the individual businesses but also the communities in which the business is located. Further, credit union business lending helps to strengthen our economy.
- In light of these factors, CUNA supports NCUA's efforts to improve the regulation of member business lending for credit unions and believes the ANPR is very timely.
- Absent other considerations, CUNA would support a regulatory approach to MBLs under which the rule only implements the statutory provisions of the Federal Credit Union Act and other issues, such as loan-to-value ratios, are addressed through guidance or an appendix to the regulation.
- However, recognizing that this may not be achievable, CUNA agrees that the agency can and should make clarifications to the MBL rule in a number of

areas. These include: loan to value ratios, loan participations, waivers, and regulatory restrictions generally as they relate to MBLs in order to improve the rule and facilitate lending to small businesses.

- CUNA's letter also takes the opportunity to address the misinformation about member business lending that is contained in comment letters from banking trade groups.
- Contrary to the portrayal of member business lending in banker letters, as the facts we discuss demonstrate, credit union member business lending is a safe and prudent endeavor. Net charge-off rates for MBLs at credit unions are lower than for all other loan types combined. Also, MBLs at credit unions have lower delinquency rates than commercial loans for banks and are certainly much safer than the subprime mortgages that a number of banks have originated.

Discussion of CUNA's Positions

Facts About CU Member Business Lending

Before turning to aspects of the ANPR, we would like to address the nature and scope of credit union member business lending which, as the facts demonstrate, is a generally safe activity for credit unions and an important source of credit for small businesses across the country.

As then Small Business Administrator Steven Preston stated in the SBA's November 2007 press release, "Credit Unions and the SBA, Perfect Together":

> Successful small businesses bring economic growth and employment opportunities, not to mention useful goods and services, into communities across the country. And this power is particularly effective in communities that have higher than average unemployment and poverty – our underserved markets.

He noted that serving such markets is a mission shared "with many credit unions across the country."

Whether through SBA programs or through member business loans that are not guaranteed by the federal government, small businesses are increasingly turning to credit unions for funding.

The may be the result of small businesses having trouble getting a loan from a bank, a topic that is addressed in a 2005 study of the SBA entitled, "The Effects of Mergers and Acquisitions on Small Business Lending by Large Banks." More recently, the Federal Reserve Board's July 2008 "Senior Loan Officer Opinion Survey on Bank Lending Practices" reported that 60% of domestic banks, more than in the previous survey this year, disclosed tighter lending standards on loans to larger businesses and about 65% said they tightened standards for smaller firms. The banks cited a more uncertain economic outlook, their increased concerns about managing risk, and industry-specific conditions as the reasons for the increased limits on credit.

Yet, while banks in some markets are curtailing businesses lending, banking group advocates seek to limit credit union business lending, even if it means portraying such lending as an unsafe activity that is escalating imprudently.

The facts do not support those claims. As of June 2008 only one-fourth of federally insured credit unions, about 2,100, had at least one MBL outstanding, and the average size of the loan was $208,126, much smaller than the commercial loans made by domestic banks, which average $348,000 (larger bank commercial loans average $1.8 million, according to the Federal Reserve Board's Business Lending Survey.) Also, MBLs as of March 2008 are only 3.62% of credit unions' assets and only 5.38% of all loans. More importantly, the delinquency rate is at 1.62%, compared to 4.24% for banks. As these figures indicate, MBLs for federally insured credit unions are generally safe and productive for the credit union as well for as the member business borrower.

Further, as the agency is aware, concerns regarding MBLs have been isolated incidences and not systemic as say, mortgage problems have been in the banking sector. (Already in 2008 there have been nine bank failures, including IndyMac, which was the third largest bank failure in U.S. history. Some market experts are predicting there will be many more this year and in 2009, which is one of the reasons the Federal Deposit Insurance Corporation established its new website, "Failed Bank Information." Were we to use the type of analysis that the bankers have with MBLs, these bank failures should preclude the banking industry from making mortgage loans.)

However, as NCUA's MBL data show, member business lending has grown moderately but steadily, partly because business borrowing needs are not being fully met by banks. Recognizing the potential for further growth and the relevance of member business lending to underserved markets, current NCUA Board Members have supported credit union business lending. For example, in 2007, Vice Chairman Rodney Hood stated:

> I encourage credit unions to continue providing innovative member business lending products which help member-owners establishes viable businesses that create jobs and sustain local communities.

Also in 2007, Board Member Gigi Hyland stated:

> Whether starting or expanding a business, entrepreneurs need access to sufficient capital. Credit unions are ideally suited to meet that need.

Yet, credit unions operate under a member business loan rule that remains highly restrictive, despite positive changes in 2003 (68 Federal Register 56537, final amendments to the MBL Rule). The rule forces limitations on them that are anticompetitive. Of course, the biggest impediment to member business lending is the 12.25% cap on MBLs contained in the FCU Act. However, there are other limitations in the rule that are not directed by the Act and that are, in our view, unnecessary for safety and soundness. It is those provisions of the rule that we want to address in this comment letter.

NCUA Should Consider Confining the MBL Rule to the Provisions of the FCU Act

The FCU Act contains few provisions that address MBLs. In general, in addition to limits on one borrower, the provisions in the Act that cover MBLs are the total asset limitations and exceptions (12 U.S. C. 1757a) and the provisions under prompt corrective action that limit new MBLs for undercapitalized credit unions (2 U.S. C. 1790d(g)(2)). In light of the limited provisions in the Act regarding MBLs, we think NCUA has latitude to develop an improved approach to MBL regulation.

Rather than setting parameters on MBLs that restrict the ability of credit unions to serve businesses, we think NCUA has the authority to pare down the rule dramatically to include only those provisions that are directed by the Act. Other issues in the nature of safety and soundness concerns, such as LTV ratios, minimum borrower equity requirements, requirements for personal liability, what should be in the credit union's MBL policy, recordkeeping requirements, and similar limitations could be addressed in credit unions' policies that would be subject to examiner review and as NCUA guidance in an appendix to the rule.

However recognizing that NCUA has in the past wanted to keep a firm hand on MBLs, if the Board feels it must include additional provisions in the rule, we think improvements in the regulation can nonetheless be made to facilitate MBLs for credit unions.

NCUA Should Exempt Reg-Flex Credit Unions from All of the MBL Limits That May Be Waived

One important change that we feel would have limited or no safety and soundness consequences would be to allow Reg-Flex credit unions to be exempt from all the provisions in the rule that may be waived under 12 C.F. R. 723.10. Currently, Reg-Flex federal credit unions and state chartered credit unions that meet the Reg-Flex criteria may be exempt from the requirement to obtain the personal liability and guarantee of their member business borrowers.

We believe this approach can be readily applied to the other limits in the rule from which credit unions may seek a waiver. These restrictions are: the appraisal requirements; aggregate construction and development loan limits; maximum borrower equity requirements; LTV ratios, maximum unsecured business loans to one member or group of members; maximum aggregate unsecured loans; and maximum aggregate net member business loan balance to any one member or group of members.

Reg-Flex credit unions have shown themselves capable of managing the range of risks involved with operating a credit union. The approach to MBL regulation for Reg-Flex credit unions that we are recommending would provide a set of important incentives for them to remain well run and for other credit unions to achieve Reg-Flex status. Our recommendation is consistent with NCUA's treatment of these well-capitalized credit unions and would enhance their operations as well as facilitate their capabilities to make member business loans.

Changes to the MBL Rule To Facilitate Lending – LTV Ratios

The proposal raises issues regarding the loan-to-value ratios that are included in the regulation. Under the rule, the LTV ratio may not exceed 80%, unless the value over that amount is insured, guaranteed or otherwise permitted under the rule. The LTV ratio for construction and development loans is generally 75%. Credit unions that make member business loans have uniformly told us that the ratios, particularly regarding vehicle loans and construction and development loans, are too restrictive and place them at a competitive disadvantage to other financial institutions.

As CUNA has stated in previous comment letters on MBLs, in light of the fact that LTV ratio requirements may be already be waived, NCUA's regulation should provide more latitude generally to credit unions to determine what the appropriate LTV should be for any MBL, based on the credit union's assessment of each borrower's credit history, type of project being funded and other relevant information.

Regarding vehicle loans, credit unions have questioned whether there is any safety and soundness justification for the LTV requirements in the rule being applied to vehicles loans. Currently, certain vehicles that are not part of a fleet may be exempt from the LTV requirements. We agree that no particular safety and soundness concerns are attached to vehicle lending, including vehicles that are in a fleet, and that NCUA should no longer require these loans to be subject to the LTV requirements.

Regarding construction and development loans, we think the equity requirement for borrowers should only be 20%, instead of the current 25% level, which would allow an LTV ratio of 80% for these loans. We believe this is consistent with the limits set by the Federal Financial Institutions Examination Council, which allow an 80% LTV for construction loans (12 C.F. R. 34, Subpart D, Appendix A). We urge NCUA to consider these changes, which will permit credit union MBLs to be more competitive.

Another issue that CUNA has raised in the past is how to value a construction project, which remains a concern for some credit unions making MBLs. Currently, construction projects are valued based on the market value of the project at the time the loan is made, rather than on the appraised value of the project at completion.

NCUA's requirement for the valuation of construction projects is based on its concern with risk. However, some credit unions feel that by regulating issues such as how to value a project, NCUA is attempting to micromanage MBLs. We request that the agency reconsider whether credit unions could be able to value projects based on the appraised value of the completed project.

Waiver Process

As addressed above, credit unions may apply to NCUA to receive waivers from eight separate requirements in the regulation. CUNA encourages NCUA to consider whether these requirements could be deregulated and addressed through credit union policy and NCUA guidance. If the agency feels that is not possible, then we urge the agency to consider improvements in the current waiver process.

The current waiver process is cumbersome and time consuming; this is particularly true for state chartered credit unions that have to first receive approval from their state regulator, which then forwards the request to NCUA. We strongly encourage NCUA to consider how the waiver process can be streamlined and improved. For example, NCUA has 45 days to approve a request, which seems to be an unnecessarily long period of time, considering the borrower (or borrowers since waivers may be obtained for categories of loans), may be waiting for approval while NCUA is reviewing the waiver request. The period of time would be even longer for a state chartered credit union. Absent significant safety and soundness issues, we question why NCUA must approve the request for a state credit union if the state regulator has already approved it.

Also, we encourage NCUA to consider whether a credit union that has received a waiver for previous loans needs to resubmit all the documentation listed in the regulation for subsequent waiver applications.

Loan Participations

Under the MBL rule, loan participations count toward the MBL aggregate limit unless the credit union has first received approval from NCUA. As we have stated previously, CUNA supports a change n the regulation that would routinely allow participations to be excluded from the MBL aggregate without having to apply to the agency for approval.

At the very least, we believe the process for approval should be simplified and NCUA should establish criteria under which loan participations could be excluded. Under this process, credit unions would be responsible for notifying NCUA that their loan participations meet the criteria and be prepared to respond to questions form their examiner about their participations. . If further information is needed by NCUA at a later time, it could request it.

If the current process to determine whether participations may be excluded from the cap remains in place, NCUA should make its determination and respond to the credit union within 10 calendar days, not the 30 days that the regulation provides for NCUA. In the case of a state credit union, as with the wavier provision, the state regulator's approval should generally be sufficient.

MBL Loan Fees

CUNA has asked the NCUA General Counsel's office for guidance regarding fees that may be associated with MBLs, and we are hopeful that letter will be issued soon.

Examination Issues

Credit unions making MBLs, most notably those with a good track record with these loans, have raised the concern that some examiners do not understand MBLs as thoroughly as they should. These credit unions feel their examiners want to limit their capabilities in making MBLs and as a result, businesses in their communities may have to look elsewhere for their lending needs.

We urge NCUA to address this issue and to ensure examiners have the training and background they need regarding MBL products.

Thank you for consideration of our comments on the MBL rule. This is an extremely important issue for credit unions making these loans and for those that are interested in entering this market. Small businesses need credit unions, and credit unions can meet their financial needs. We urge you to consider how the MLB rule and regulatory process can be improved, such as through the recommendations contained in this letter. We would welcome the opportunity to discuss our comments with you.

Sincerely,

Mary Mitchell Dunn

Mary Mitchell Dunn
CUNA Senior Vice President and General Counsel