



December 19, 2011

NCUA Issues Proposal on Loan Participations

Executive Summary of the Proposal (click [here](#) to go to the discussion of the proposal)

On December 15, 2011 the NCUA Board approved a new proposal on loan participations. The proposal addresses:

- Requirements for a federally insured credit union that is purchasing a loan participation where the borrower is not a member of the purchasing credit union.
- New limitations on participations;
- What should be included in loan participation policies;
- What should be included in loan participation agreements;
- Ongoing monitoring responsibilities for credit unions regarding loan participations.

Comment Process/CUNA's Plan for Comments

Interested parties, including credit union officials and leagues, may file a comment letter with NCUA for up to sixty days from when it is published in the Federal Register. The proposal has not yet been published; this Comment Call will include the comment deadline as soon as it is available. Click [here](#) for a copy of the agency's proposal. Comments may be filed with NCUA at regcomments@ncua.gov.

While some concerns about the proposal are identified in this document, CUNA will be providing to leagues and posting on our website soon a separate document with our initial reaction to the proposal and will also share our comment letter, which we plan to develop by January 15, 2012. We will also be updating Operation Comment shortly to facilitate comment letters. For more information about the loan participation proposal, please feel free to contact CUNA SVP and Deputy General Counsel Mary Dunn at mdunn@cuna.coop.

Key Provisions of the Proposal

- **How The Loan Participation Rule Would Be Changed**

Click [here](#) for the document CUNA has prepared showing how NCUA's current rules would be changed by the proposal.

1. **Loan Participation Limits/Requirements.** The **most significant changes** the proposal would make involve adding caps on loan participations from a single originator and that involve a single borrower or group of associated borrowers. (A new definition of "associated borrower" would be added. It would mean any borrower with a shared ownership or financial interest in a business or commercial endeavor with the borrower.)
 - i. **Single Originator.** The proposal would impose a limit on loan participation purchases for federal and state chartered federally insured credit unions from a single originator to 25% of the purchasing credit unions net worth. No waivers would be permitted from this limitation
 - ii. **Loans to One Borrower.** Loan participation purchases involving one borrower or group of associated borrowers would be 15% of the purchasing credit union's net worth. However, purchasing CUs could apply to the appropriate regional director for a waiver.
 - iii. **Originating Lender.** The originating lender must retain 10% of the loan throughout the life of the loan (FCUS must comply with this requirement now).
 - iv. **Other Limits Continued/Clarified.** NCUA would retain provisions that loan participations may only be purchased from a credit union, credit union organization or financial organization and would clarify that the loan must be one that the purchasing credit union is authorized to make under regulations and its own loan policies and the seller must be an eligible organization.
 - v. **Different Underwriting Standards No Longer Permitted.** NCUA would remove the current language that allows an FCU to purchase a loan participation that was originated with different underwriting standards than its own.

2. **Loan Participation Agreements.** Currently, loan participation agreements must be in writing. The proposal would establish **minimum provisions** that the loan participation agreement must address:
 - vi. **Identification of Loan Participation.** Prior to purchase, the identification of the specific loan participation(s) being purchase (either direct in the agreement or in a document incorporated into the agreement by reference).
 - vii. **Interest Held by Originating Lender.** Percent of the loan participation retained by the originating lender throughout the life of the loan, which must be at least 10%. (FCUs must meet this requirement now.)
 - viii. **Location of Loan Documents.** The location of and custodian for the original loan documents;
 - ix. **Access to information.** Access to periodic financial and other performance information about the loan, borrower, and the servicer;
 - x. **Roles of the parties to the agreement.** Duties and responsibilities of the originating lender, servicer and participants in respect of servicing, default, foreclosure, collection, and other matters involving the administration of the loan; and
 - xi. **Servicers.** Circumstances and conditions under which participants may replace the servicer.
3. **Loan Participation Policies.** The purchasing credit union's written policy must address:
 - xii. **Underwriting standards.** Establish underwriting standards for loan participations which, at a minimum, meet the same underwriting standards the credit union uses when it originates a loan;
 - xiii. **Aggregate of participations from one originator.** Establish a limit on the aggregate amount of loan participations that may be purchased from any one originating lender (up to 25% of the purchasing credit union's net worth);
 - xiv. **Limits by loan type.** Establish limits on the amount of loan participations that may be purchased by each loan type, not to exceed a specific percentage of the credit union's net worth; and

xv. **Loans involving one borrower.** Establish a limit on the aggregate amount of loan participations that may be purchased involving a single borrower, (up to 15% of the purchasing credit union's net worth, unless a higher limit is approved by NCUA.)

xvi. **Other factors.** Take into account other factors based on a credit union's size, complexity, and lending experience.

4. **Application of All Federally Insured Credit Unions.** The proposal would add a new subsection to NCUA's rules, 12 CFR 741.225, to require any credit union that has federal insurance (and is engaging in loan participations) must comply with the loan participation rule, including the proposed changes once they are adopted.

- **Why NCUA Thinks The proposal Is Necessary**

While the proposal states, and NCUA Board members agreed during the meeting in which the proposal was approved for comments, that "loan participations strengthen the credit union industry" the agency also said that "loan participations create more systemic risk to the NCUSIF." As a result, the Board is proposing greater limitations on loan participations for the following reasons:

- o Large volumes of participated loans in the system tied to a single originator, borrower, or industry or serviced by a single entity have the potential to impact multiple credit unions if a problem arises.
- o It is important to the NCUA that all federally insured credit unions adhere to the same minimum standards;
- o Such minimum standards are necessary to ensure the NCUSIF consistently recognizes and accounts for the risk associated with the purchase of loan participations;
- o During examination and other contacts, the agency has encountered confusion concerning the application of current loan participation requirements.

The Supplementary Information to the proposal provides no other information or quantifiable data to support the proposal.

- **Implications of the Proposal for Dual Chartering**

Concerns are increasing that NCUA is expanding its reach over stated-chartered credit unions. In that connection, there are some negative implications of the proposal for dual chartering. Until now, the loan participation rule was directed to federal credit unions. If

the proposal is adopted, state regulators will have no leeway to develop their own regulatory approach to loan participations, even though NCUA has not provided sufficient justification for the expansion. (At the Board meeting, agency staff reinforced that the proposal in their view is needed for safety and soundness; while more federals participate loans, there is a greater volume in loan participations among state credit unions.)

Under the proposal, state chartered credit unions would follow the same requirements as federal credit unions. While a waiver is permitted from the limit on participations involving the same borrower, the state chartered credit unions would have to apply to the NCUA Regional Director for approval.

CUNA is analyzing the data on loan participations to determine the extent to which problem loan participations involve state or federal credit unions.

- **What Does NCUA Say would be the Burden on Credit Unions of this proposal?**

NCUA is required to analyze the impact of its rules under the Regulatory Flexibility and Paperwork Reduction Acts. Under the Reg Flex Act, NCUA must analyze a significant economic impact on a substantial number of small credit unions. The catch is that NCUA gets to define "small" credit unions, which it defines as those under \$10 million in assets. This is approximately 2,700 credit unions. NCUA says it does not believe the proposal rule would have a significant impact on a number substantial number of small credit unions. However, it does not appear that NCUA has undertaken a real analysis regarding the impact of the proposal.

The Paperwork Reduction Act requires NCUA to analyze the paperwork and reporting burden of its proposals. The Board indicates the burden will be minimal. It said only about 2,000 credit unions will need to modify a written loan participation policy. Also, it estimates it will only take credit unions about 4 hours to modify agreements. NCUA says the total burden will be about 8,000 hours. It is very difficult to assess NCUA's estimates because it does not provide information on how the estimates were developed.

- **NCUA Waiver Process**

Under the proposal, credit unions could seek a waiver from the appropriate NCUA regional office from the 15% of net worth assets limit on loan involving one grouper associated group of borrowers. However, NCUA has acknowledged that there are problems with it's waiver process, such as taking too long. NCUA is asking for comments on how to improve it's waiver process.

Questions to Consider

1. Is there a need for a new rule on loan participations?

2. Has NCUA provided sufficient justification for the proposal?

3. Should the proposal apply to state chartered credit unions?

4. Do you agree with the 25% of net worth limit on loan participations from one originator?

5. If you do not support the 25% limit, do you agree there should be any limit on participations from one originator?

6. If you agree there should be a limit on participations involving one originator, what should the limit be?

7. Whatever the limit on participations involving one originator, should waivers from the limit be allowed?

8. Do you agree with a net worth limit on loan participations involving one borrower?

9. If yes, should such a limit be 15%?

10. If you agree there should be a limit but don't support 15%, what should the limit be?

11. Are you concerned about Inefficiencies in NCUA's waiver process?

12. How do you think NCUA's waiver process can be improved?

13. Should credit unions be permitted to purchase participations involving loans that have been made using different underwriting standards than those of the purchasing credit union?

14. Do you agree with NCUA's analysis regarding the impact of the proposal on small credit unions under the Reg Flex Act?

15. Do you agree with NCUA's analysis regarding the Paperwork Reduction Act?

16. Other comments or concerns about the proposal.

Please send comments to Senior Vice President and Deputy General Counsel [Mary Dunn](#) or contact us at (800) 356-9655 ext. 6735.