



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

June 2, 2003

Ms. Becky Baker
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Dear Ms. Baker:

I am writing to you on behalf of the U.S. Treasury Department concerning the National Credit Union Administration's (NCUA's) proposed rule on member business lending.

Credit unions have demonstrated a great commitment to their members through the member business loan (MBL) programs. Such efforts have benefited the individual members and their communities, and we would like to see credit unions' MBL programs continue to prosper.

The Treasury has serious concerns, however, with certain provisions of the NCUA's MBL proposal. The proposed rule's treatment of MBL participation interests and MBLs originated by credit union service organizations (CUSOs) would undermine the intent of congressional limitations on credit union business lending established in the Credit Union Membership Access Act of 1998 (CUMAA) and may not be authorized under the statute. Such changes to these limitations should be left for Congress to determine. In addition, provisions that expand credit unions' ability to make unsecured MBLs and remove the personal guarantee requirement raise safety and soundness concerns by eliminating two key safeguards that have effectively limited the credit risk associated with these types of loans.

Treatment of MBL Participation Interests

Currently, MBL participation interests sold without recourse do not count towards the selling credit union's MBL limit. The proposed rule, however, would also exclude purchased participation interests from the purchaser's MBL limit. Allowing both the seller and purchaser of a participation interest to exclude the participation balance from counting toward the MBL cap would create a loophole for credit union business loans to escape the aggregate limit set by Congress. In fact, the NCUA itself previously rejected excluding purchased participation interests from the MBL limits when the issue was raised in the notice and comment process for the MBL rule currently in place. The NCUA stated that such an exclusion:

“would promote form over substance and result in a large block of member business loans suddenly vanishing from the books of credit unions for purposes of calculating the aggregate loan limit.” (64 FR 28727).

We agree with this assessment and find no explanation by the agency as to why this assessment is no longer valid.

As noted in the section by section analysis of CUMAA in the Senate Banking Committee's report (Senate Report 105-193), the MBL limit "will prevent significant amounts of credit union resources from being allocated in the future to large commercial loans that may present additional safety and soundness concerns for credit unions, and that could potentially increase the risk of taxpayer losses through the National Credit Union Share Insurance Fund." Whether the MBL is originated or purchased by the credit union does not alter these safety and soundness concerns.

The NCUA now argues that the purchase of participation interests is based on "normal investment considerations," presumably rather than lending considerations, to justify exclusion of these interests from the MBL limit. Yet, asserting that investment, rather than lending, considerations apply to MBL participation interests is inconsistent with both the current and proposed regulatory treatment of these assets. Purchased participation loans are now, and will continue to be, subject to the same PCA risk-based net worth standard and loan-to-one-borrower limits as if the purchasing credit union had originated the MBLs. The NCUA would therefore treat purchased participation interests as investments in applying the aggregate MBL limit and as loans for all other purposes, which we believe sets a harmful precedent. The preamble to the 1999 final MBL rule explicitly acknowledged that the Federal Credit Union Act, the historical practice of the NCUA, and the industry have generally treated loan participations as loans, rather than investments. Again, the proposed rule provides no explanation as to why the NCUA now wants to depart from this treatment in applying selected provisions of the law.

Nor do we believe that the requirement (stated in the preamble but not stated in the proposed rule) that the participation purchase must be a *bona fide* business transaction, would achieve its objective of preventing undermining the MBL cap by any credit union that wants to do so. The proposal enumerates sufficient justifications for the sale or purchase of virtually any participation interest, e.g., obtaining liquidity or diversifying risks.

Treatment of Business Loans Originated by CUSOs

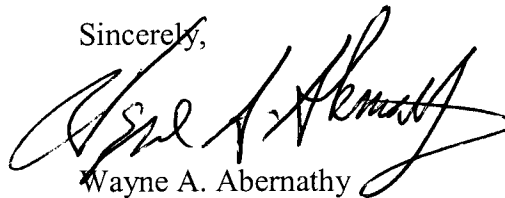
We do not object to allowing CUSO business loan origination in itself. However, the proposed rule would exclude participation interests in CUSO-originated MBLs purchased by credit unions from counting towards the MBL cap. Therefore, allowing CUSO business loan originations would facilitate the ability of credit unions, particularly those that would be more dependent on a CUSO's expertise, to avoid the constraints of the statutory MBL cap. Instead of directly originating the loans, credit unions would be able to provide both equity capital and loans to CUSOs to fund MBLs that would not count towards their cap. Although the preamble states that the *bona fide* business transaction requirement would also apply, NCUA's own stated justification for allowing CUSOs to engage in business loan origination would probably cover most credit union purchases of interests in CUSO-originated loans.

Unsecured Member Business Loans and Removal of Personal Guarantees

The NCUA has on occasion cited the Treasury's findings, in its 2001 study on credit union member business lending, that MBLs are less risky than bank and thrift commercial lending. The Treasury study concluded that MBLs "are generally less risky than commercial loans made by banks and thrifts because they generally require the personal guarantee of the borrower and generally must be fully collateralized." By removing the personal guarantee requirement and expanding the ability to make unsecured MBLs, the proposed rule would remove the core reasons why MBLs have been less risky than bank and thrift commercial loans. In the preamble to the proposed rule the NCUA recognized the risk reduction of such practices when it stated, "Credit unions may still require loan applicants to provide principal guarantees as a risk-reducing business practice." Without the collateralization and personal guarantees, one would expect the future credit loss experience of member business lending to be relatively greater. Yet, it is not clear from the proposal what steps, if any, the NCUA proposes that credit unions take in response. In fact, the NCUA is also proposing some reductions in credit union net worth requirements for member business lending. We also question the appropriateness of removing the personal guarantee requirement in member business lending given the long history of personal guarantees made by credit union members when taking out a business loan.

We appreciate the opportunity to voice our concerns about this proposed rule. If you have any questions concerning these comments, please feel free to contact me.

Sincerely,



Wayne A. Abernathy
Assistant Secretary for Financial Institutions

cc: Dennis Dollar
JoAnn Johnson
Deborah Matz