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February 28, 2023

Ms. Melane Conyers-Ausbrooks
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Re: Financial Innovation: Loan Participations, Eligible Obligations, and Notes of Liquidating Credit Unions; RIN 3133–AF49, 3133–AE96

Dear Ms. Conyers-Ausbrooks:

On behalf of America's credit unions, we are writing to the National Credit Union Administration (NCUA) Board regarding the Financial Innovation proposal that would amend sections 701.21, 701.22, 701.23, and part 714 of the NCUA's regulations pertaining to loan participations, eligible obligations, and notes of liquidating credit unions. The Credit Union National Association (CUNA) represents America's credit unions and their more than 130 million members.

General Comments

Over the last several years, the NCUA has modernized and updated several of its regulations to shift from a prescriptive to a principles-based approach. The NCUA believes shifting to a more principles-based approach with respect to loan participations and eligible obligations is appropriate and will be beneficial to credit unions.

We agree that by removing certain prescriptive limits and other qualifying conditions, and replacing them with risk-focused, principles-based requirements, this proposal will strike an appropriate balance between mitigating risk to the National Credit Union Share Insurance Fund, protecting credit union members, and fostering growth and stability in the credit union system. Further, the proposed changes should increase credit unions' ability to engage in lending arrangements with other financial institutions and third parties, including fintech companies providing lending services, expanding their access to diverse loan origination channels, new markets and potential new services to their members.

We appreciate the NCUA's effort to update sections 701.22 and 701.23. We provided comments on the agency's 2022 regulatory review pertaining to the loan participation and

eligible obligation rules, which we believe need to be clarified and updated.[1] Consistent with our previous requests, we greatly appreciate the proposed changes moving away from prescriptive limitations and other qualifying requirements. The ability to conduct transactions under these rules is extremely valuable to credit unions. Specifically, the ability to buy and sell loan participations is a very valuable tool for managing the balance sheet and addressing liquidity needs.

Proposed Changes

Section 701.21(c) General Rules

The proposal would add new provisions to section 701.21 regarding indirect lending arrangements and indirect leasing arrangements; these new provisions would replace a provision in section 701.23. Specifically, current section 701.23(b)(4)(iv) provides that an indirect lending or indirect leasing arrangement that is classified as a loan and not the purchase of an eligible obligation because the federal credit union (FCU) makes the final underwriting decision, and the sales or lease contract is assigned to the FCU very soon after it is signed by the member and the dealer or leasing company, is excluded in calculating the 5% limit on eligible obligations. The NCUA believes splitting the provision in paragraph (b)(4)(iv) into two definitions will help clarify the existing requirements. Accordingly, proposed new section 701.21(c)(9)(i) would define:

- "Indirect leasing arrangement" as a written agreement to purchase leases from the leasing company where the purchaser makes the final underwriting decision, and the lease agreement is assigned to the purchaser very soon after it is signed by the member and the leasing company.
- "Indirect lending arrangement" as a written agreement to purchase loans from the loan originator where the purchaser makes the final underwriting decision regarding making the loan, and the loan is assigned to the purchaser very soon after the inception of the obligation to extend credit.

Both proposed definitions would use language that is generally similar, but not identical, to the language in current section 701.23(b)(4)(iv). The proposed changes are intended to clarify but not change the current meaning of both terms.

While we agree with inclusion of proposed paragraph (c)(9), as this is a sensical change, we do not believe it is likely to have a material impact on credit unions' existing and future indirect lending or indirect leasing arrangements.

Section 701.22 Loan Participations

The proposal would make several clarifying amendments to this section. These changes are primarily intended to clarify FCUs' authority to purchase loan participations and the

[1] CUNA Comment Letter to NCUA re 2022 Regulatory Review (Aug. 15, 2022), *available at* https://www.cuna.org/content/dam/cuna/advocacy/letters-and-testimonials/2022/081522_CL%20-%20NCUA%202022%20Reg%20Review.pdf.

requirements applicable to the purchase of loan participations by federally insured state-chartered credit unions (FISCU).

Section 701.22 Introductory Paragraph

The introductory paragraph to current section 701.22 sets forth the scope and limitations of the section. Since adopting the introductory language in both section 701.22 and section 701.23 in 2013, the NCUA has received inquiries from NCUA examiners, federally insured credit unions (FICU), fintech companies, and others regarding confusion on how to interpret many of these provisions. The confusion has led to inconsistent reporting of loan interests by FICUs and uncertainty about whether section 701.22 or section 701.23 applies to certain transactions.

One significant issue with the current introductory paragraph that parties have raised is when a FICU's partial loan purchase is subject to this section. In particular, parties have cited the continuing contractual obligation qualifier as a source of confusion. The fourth sentence in the current introductory paragraph provides that the section applies only to a FICU's purchase of a loan participation where the borrower is not a member of that credit union *and where a continuing contractual obligation between the seller and purchaser is contemplated*. The fifth sentence in the paragraph provides further that, generally, an FCU's purchase of all or part of a loan made to one of its own members, subject to a limited exception for certain well-capitalized FCUs in section 701.23(b)(2), *where no continuing contractual obligation between the seller and purchaser is contemplated*, is governed by section 701.23. Similarly, the introductory paragraph to section 701.23 provides that section 701.23 governs an FCU's purchase, sale, or pledge of all or part of a loan to one of its own members, subject to a limited exception for certain well-capitalized FCUs, *where no continuing contractual obligation between the seller and purchaser is contemplated*.

In practice, however, purchase agreements, regardless of whether the transactions involve the purchase of an eligible obligation or a loan participation, frequently contain some form of continuing contractual obligation between the buyer and the seller. The NCUA believes the continuing contractual obligation clauses in the introductory paragraphs in section 701.22 and section 701.23 are unnecessary when determining whether a loan purchase agreement qualifies as either a loan participation or an eligible obligation. As such, the proposal would remove these clauses to clarify and reduce confusion as to whether section 701.22 or section 701.23 applies to certain transactions.

We agree with deleting the continuing contractual obligation clauses in the introductory paragraphs to section 701.22 and section 701.23. Making this section less wordy should help clarify when the section applies to certain transactions. However, as discussed below, we believe more needs to be done to provide sufficient clarity to credit unions to determine which section properly governs a given transaction.

Section 701.22(a)

The application of the definition of "originating lender" to CUSOs or other entities in the context of indirect lending arrangements was left unaddressed in the 2013 Final Rule on

loan participations.[2] Thus, the proposed rule would amend the current definition of "originating lender" in section 701.22(a) to codify and further clarify a 2015 NCUA Legal Opinion (15–0813) regarding loan participations in indirect loans. Through the codification of the legal opinion, the proposed rule would clarify that a FICU engaged in an indirect lending relationship can meet the definition of "eligible organization" under section 701.22 if certain conditions are met.

The NCUA believes that codifying the 2015 Legal Opinion will clarify the loan participations rule and facilitate further growth in credit unions' purchase and sale of indirect loan participations. As such, the proposal would codify into the NCUA's regulations the interpretation from the 2015 Legal Opinion that an eligible organization may be considered an "originating lender" where the eligible organization generates a loan through an indirect lending arrangement. Further, the proposal would clarify in the regulation that any "eligible organization" that acquires a loan through an indirect lending arrangement acts as the originating lender for purposes of this section, provided the eligible organization made the final underwriting decision regarding making the loan and was assigned the loan or sales contract very soon after the inception of the obligation to extend credit.

We agree with codifying the legal opinion into the regulation, as doing so should provide greater clarity in terms of compliance with the loan participation rule. In regard to making the final underwriting decision, it would be logistically challenging if the rule were to specify that a credit union in an indirect lending arrangement must be involved or consulted at the time of the extension of credit. Given the timeliness of loans for automobile purchases, for example, such a requirement would likely result in fewer loans through indirect lending arrangements described above.

In addition, we ask for clarity on the phrase "inception of the obligation to extend credit." For example, does this mean when the credit union verifies underwriting criteria, when the borrower has a sufficient credit score according to the credit union, or some other step in the process of extending credit?

Further, the NCUA should consider providing additional clarity around the meaning of "very soon after" for the assignment of the loan or contract to the credit union. We suggest providing a set number of days following the borrower's execution of the loan or contract. We believe five or seven business days would be appropriate; we caution the NCUA from adopting a window that is excessive, such as 10 days.

The current lack of a specific rule pertaining to indirect lending has been a source of confusion. Greater clarity will likely encourage greater participation in this area. Thus, we ask the agency to consider proposing a separate rule on indirect lending.

[2] 78 Fed. Reg. 37,946 (June 25, 2013).

Section 701.22(e) Temporary Regulatory Relief in Response to COVID–19

Current section 701.22(e) provides that notwithstanding paragraph (b)(5)(ii) of section 701.22, between April 21, 2020 and December 31, 2022, the aggregate amount of loan participations that may be purchased from any one originating lender shall not exceed the greater of $5,000,000 or 200% of the FICU's net worth. This temporary increase from "the greater of $5,000,000 or *100%*" was intended to help ensure that FICUs remained operational and had sufficient liquidity during the pandemic. Since this increase was temporary, the proposal would remove this paragraph.

As we raised previously,[3] we ask the NCUA to consider eliminating the limit on the aggregate amount of loan participations that may be purchased from any one originating lender, not to exceed the greater of $5,000,000 or 100% of the credit union's net worth, absent a waiver by the regional director.[4] In addition to the benefit of increased flexibility, it is evident as shown by section 701.22(e) that the NCUA understands the potential benefit of increasing, if not eliminating, the existing limitation. If the NCUA is unable to eliminate the existing limitation entirely, we ask the agency to permanently change the limit to "the greater of $5,000,000 or 200%," as was provided during the pandemic.

Section 701.23 Purchase, Sale, and Pledge of Loans

The proposal would make several clarifying changes to this section as well as provide FCUs expanded authority and autonomy to transact business with fintech companies and other institutions that provide services associated with the origination and sale of loans made to members of FCUs.

Section 701.23(a) Definitions

The proposal would revise the definition of an eligible obligation under section 701.23(a)(1) to clarify the distinction between transactions treated as loan participations and those treated as eligible obligations. The current definition of "eligible obligation" is simply "a loan or group of loans." The proposed definition would be "a whole loan or part of a loan (other than a note held by a liquidating credit union) that does not meet the definition of a loan participation under section 701.22(a)."

While the proposed changes to the definitions of the terms "eligible obligation" and "loan participation" will be helpful, we believe additional clarity is needed. As noted previously, the single greatest source of confusion regarding loan participations and eligible obligations is determining which section (701.22 or 701.23) applies to a given transaction.

Further, the proposal would add a definition for "liquidating credit union" to specify the point in time when a credit union meets the definition of a liquidating credit union for purposes of applying the 5% limit in paragraph 701.23(b)(4). "Liquidating credit union" would be defined as "(1) In the case of a voluntary liquidation, a credit union is a

[3] CUNA Comment Letter to NCUA re 2022 Regulatory Review, *supra* 1.
[4] 12 C.F.R. § 701.22(b)(5)(ii).

liquidating credit union as of the date the members vote to approve liquidation; and (2) In the case of an involuntary liquidation, a credit union is a liquidating credit union as of the date the board of directors is served an order of liquidation issued by either the NCUA or the state supervisory authority."

We agree with the proposed definition of "liquidating credit union," as we believe it will be helpful as credit unions assess which transactions are included in the 5% limit.

Lastly, we believe the NCUA should consider defining the term "empowered to grant." This term has a particular bearing on credit union activity under section 701.22 and section 701.23. The agency has addressed the term outside of official rulemakings on several occasions, including in a 2004 Legal Opinion.[5] We ask the NCUA to solicit specific feedback on what should and should not fall within the scope of "empowered to grant."

Section 701.23(b)(2) Purchase of Obligations From a FICU

Regarding the introductory paragraph to section 701.23(b)(2), the proposal would remove the CAMELS rating and capital classification requirements. The NCUA intends this change to simplify the rule and provide FCUs additional authority to purchase loans.

We support the proposed removal of the CAMELS rating requirement and capital classification requirement. While the vast majority of credit unions currently meet both of these qualifying criteria, this proposed change has the potential to benefit FCUs while not causing a material increase in risk to the Share Insurance Fund. Specifically, we agree with the NCUA that any increased risk associated with removing the CAMELS rating and capital classification requirement would be minimized by the addition of the proposed due diligence, risk assessment, and risk management requirements, which we support as discussed below.

Section 701.23(b)(4)

This section limits the aggregate unpaid balance of certain eligible obligations purchased by an FCU to a maximum of 5% of the FCU's unimpaired capital and surplus. More specifically, the current 5% limit applies to eligible obligations purchased by an FCU under paragraphs 701.23(b)(1) and (b)(2)(ii). In general, paragraph (b)(1) authorizes an FCU to purchase (1) eligible obligations of its members; (2) eligible obligations of a liquidating credit union's members from the liquidating credit union; and (3) student loans and real estate-secured loans from any source to facilitate the purchasing FCU's packaging of a pool of such loans to be sold or pledged on the secondary market. Paragraph (b)(2)(ii), which is on purchases from FICUs, authorizes an FCU to purchase the "eligible obligations of a liquidating credit union without regard to whether they are obligations of the liquidating credit union's members."

Under the proposal, the 5% limit would apply solely to the purchase by an FCU of the notes made by a liquidating credit union to the liquidating credit union's members; the

[5] NCUA Legal Opinion No. 04-0713 (Oct. 2004).

limit would apply only to notes purchased under paragraphs (b)(1)(ii) and (b)(2)(ii) of section 701.23.

We support the proposed change to narrow the application of the 5% limit on the purchase of eligible obligations from covering the purchase of most eligible obligations to only "notes" purchased by an FCU from a liquidating credit union. Narrowing the 5% limit should not present any safety and soundness concerns due to the addition of the risk management requirements included in proposed section 701.23(b)(6). Further, we agree that this change will enhance the ability for FCUs to determine their own risk tolerance limits for loan purchases made from a source other than a liquidating credit union, such as other financial institutions, fintech firms, or CUSOs.

New section 701.23(b)(6)

The proposal would add safety and soundness requirements in a new section 701.23(b)(6) concerning the purchase of eligible obligations, to offset risks associated with removing the CAMELS and well-capitalized requirements, and narrowing the application of the 5% limit. Credit unions would need to develop loan purchase policies that are commensurate with the size, scope, type, complexity, and level of risk posed by the planned loan purchase activities. The proposed changes are intended to provide principles-based requirements for credit unions of any size or complexity to implement the appropriate level of due diligence, risk assessment, and management.

Under the proposal, an FCU's internal written purchase policies would need to address the following:

(i) Require that the purchasing FCU conduct due diligence on the seller of the loans and other counterparties to the transaction prior to the purchase.
(ii) Establish risk assessment and risk management process requirements that are commensurate with the size, scope, type, complexity, and level of risk posed by the planned loan purchase activities.
(iii) Establish internal underwriting and ongoing monitoring standards that are commensurate with the size, scope, type, complexity, and level of risk posed by the loan purchase activities. Underwriting and ongoing monitoring standards must address the borrower's creditworthiness and ability to repay, and the support provided by collateral if the collateral was used as part of the credit decision.
(iv) Require that the written purchase agreement include:
    (A) The specific loans being purchased;
    (B) The location and custodian for the original loan documents;
    (C) An explanation of the duties and responsibilities of the seller, servicer, and all parties with respect to all aspects of the loans being purchased, including servicing, default, foreclosure, collection, and other matters involving the ongoing administration of the loans; and
    (D) The circumstances and conditions under which the parties to the agreement may replace the servicer when the seller retains the servicing rights for the loans being purchased.

(v) Establish portfolio concentration limits by loan type and risk category in relation to net worth that are commensurate with the size, scope, and complexity of the credit union's loan purchases. The policy limits must take into account the potential impact of loan concentrations on the purchasing credit union's earnings, loan loss reserves, and net worth.
(vi) Address when a legal review of agreements or contracts will be performed to ensure that the legal and business interests of the credit union are protected against undue risk.

The requirements included in proposed section 701.23(b)(6) appear reasonable. It is our understanding that most, if not all, of these requirements are already done as a matter of course. Further, since we have heard from some credit unions that examiners are already looking to see if these steps are taken, it makes sense to incorporate them into the regulation to enhance transparency and aid credit unions in preparing for exams.

As addressed below, new section 701.23(c)(3) would require a selling credit union to conduct a legal review. While we agree with not requiring a legal review under section 701.23(b)(6)(vi) as proposed above, we believe it is important that a purchasing credit union conduct a legal review when appropriate. Thus, it might be helpful to add some language to (vi) above encouraging such a review if the credit union determines doing so is feasible and appropriate.

New section 701.23(c)(3)

The proposal would add new paragraph (c)(3) to require a legal review of the written agreement. A legal review of the written loan sales agreements and contracts will help an FCU ensure that the board of directors and management understand the rights and responsibilities of each party. The legal review would also ensure that the written loan sales agreement complies with all applicable state and federal laws, helping to minimize a credit union's legal, compliance, and reputation risk.

Specifically, this section would require a legal review of the written agreement is completed that includes the terms, recourse, and risk-sharing arrangements, and, as applicable, loan administration and controls, to ensure that the selling FCU's legal and business interests are protected from undue risks.

We agree with the proposed requirement of a legal review regarding the sale of eligible obligations. As noted above, this is a commonsense requirement and one that is already part of the normal course of business for most credit unions involved in these types of transactions.

Section 701.23(i) Temporary Regulatory Relief in Response to COVID–19

Current paragraph (i) provides that, notwithstanding section 701.23(b), between April 21, 2020 and December 31, 2022, an FCU may: purchase eligible obligations pursuant to paragraph (b)(1)(i) and (b)(2)(i) without regard to whether they are loans the credit union is empowered to grant or are refinancing to ensure the obligations are ones the purchasing

credit union is empowered to grant; and purchase and hold the obligations described in paragraphs 701.23(b)(2)(i) through (iv) if the FCU's CAMELS composite rating is 1, 2, or 3. This temporary regulatory relief expired on December 31, 2022.

The NCUA temporarily modified certain regulatory requirements to help ensure that credit unions remained operational and liquid during the COVID–19 pandemic. The NCUA concluded, at the time, that the amendments would provide credit unions with the necessary flexibility in a manner consistent with the NCUA's responsibility to maintain the safety and soundness of the credit union system.

It is our understanding that this regulatory relief was helpful as credit unions dealt with unprecedented issues during the pandemic. We ask the NCUA to look into the extent to which this flexibility was utilized by credit unions, along with any increased risk associated with transactions made under this flexibility that would not otherwise have been permitted. Depending on the results of the NCUA's analysis, we encourage the agency to consider providing such regulatory relief to address future system challenges that may not necessarily rise to the level of the COVID–19 pandemic.

Conclusion

On behalf of America's credit unions and their more than 130 million members, thank you for considering our comments regarding the Financial Innovation proposal to amend the NCUA's regulations pertaining to loan participations, eligible obligations, and notes of liquidating credit unions. If you have questions about our comments, please do not hesitate to contact me at (202) 508-6743 or LMartone@cuna.coop.

Sincerely,

Luke Martone
Senior Director of Advocacy & Counsel