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

Re: National Credit Union Administration; Organization and Operation of Federal Credit Unions; Appraisals; Member Business Loans; and Requirements for Insurance; 12 CFR Parts 701, 722, 723 and 741; 63 Federal Register 51793, September 29, 1998

Dear Ms. Baker:

The National Credit Union Administration ("NCUA") through its Board ("Board") has issued an interim final rule reflecting NCUA's review and modification of its existing rules relating to member business loans while implementing *Section 203* of the Credit Union Membership Access Act ("Act"). The Act imposes specific restrictions on business lending activity by federally insured credit unions. While effective September 29, 1998, the Board has requested public comment on the substance of the rule. The American Bankers Association ("ABA") wishes to express its views on this important subject.

The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes the ABA the largest banking trade association in the country.

Overview of ABA's Position

The ABA believes that the Board has altogether failed to appropriately implement the Act's statutory language. *The clear intent of Congress in enacting Section 203 was to establish* ***limitations*** *on the member business loan activities of federally insured credit unions, based upon a belief that (1) credit unions should maintain their focus on consumer lending, not business lending, and (2) continued credit union safety and* *soundness required restrictions in this area.* The Board has totally disregarded Congressional intent in issuing this interim final rule, going out of its way to facilitate such activities rather than restrict them. Such action clearly represents an unreasonable exercise of agency discretion.

Section 203 of the Act for the first time imposes aggregate restrictions on the amount of business lending that may be engaged in by any federally insured credit union, whether state- or federally chartered. Likewise, the Act increases credit union capital requirements, subjects all federally insured credit unions to tough bank-like prompt corrective action rules, directs NCUA to develop risk-based capital rules for complex credit unions, and imposes new annual independent audit requirements on larger institutions. All of this evidences a clear intent of Congress to reduce the risk to the National Credit Union Share Insurance Fund ("NCUSIF"), the credit union federal deposit insurance fund. Moreover, the Congress explicitly stated its intent that credit unions maintain their emphasis on consumer, not business lending.

Yet, with respect to the Board's interim final rule on business lending, the Board ignores the statute and the Congressional intent it reflects. It does so by:

- virtually ignoring the main component of the statute – the establishment of a statutory cap on credit union lending at 12.25% of assets – and its intent to "restrict" credit union business lending, opting instead to focus NCUA's energies on setting forth ways to get around this new, Congressionally-mandated limitation. This once again evidences the Board's desire to continue to be a "cheerleader" for the credit union industry, rather than a prudent and independent regulator charged with implementing Congressional intent;

- misinterpreting the express language of the statute to broaden the category of credit unions exempt from the aggregate limits imposed under the Act. The Board has stretched the statutory language on exemptions – which, among other things, exempts credit unions which have a "history of primarily making" member business loans from the aggregate limits in the Act – well beyond the intent of Congress. The ABA believes that NCUA's interpretation of "primarily making" is incorrect in its establishment of a broad exemption standard from the general limits of the statute. The interim rule's alternative exemption tests – one which sets forth a 25% of assets business loan threshold, the other a "business loans are larger than any other category of loan" criteria – will easily permit evasion of the aggregate limits on business lending mandated by Congress under the Act. This is clearly in contravention of the plain meaning of the statute and makes a mockery of Congressional action in this area.

- using the interim final rule to reduce the level of oversight of credit union business lending activities in a variety of other areas, including rules governing loans-to-one borrower, employee lending experience, loan-to-value ratios, appraisal rules, reporting requirements, review of financial statements, and state waiver authority. This again flouts the intent of Congress, and evidences the Board's lack of prudent judgment in the business lending area;

- eliminating certain reporting requirements involving credit union business lending activities which will result in reducing the ability of the U.S. Department of the Treasury to report to Congress on the business lending activities of insured credit unions, as mandated under the Act; and

- further obfuscating the ability of regulators, the Congress, and the public to assess the degree of risk in credit union portfolios associated with business lending activities by reducing the amount of information available regarding such activities.

The ABA believes that the Board should withdraw its interim final rule and propose a new rule on credit union business lending activities which better reflects Congressional intent to *impose limitations* on such lending, *not facilitate* such activities. The Board should generate this new proposed rule through the normal administrative process, thus permitting the Board time to more adequately consider the intent of Congress and any input received from the public. The current expedited process, whereby the Board has already implemented the rule (albeit on an interim basis), prior to its receipt of any public comment, violates the Administrative Procedures Act and fails to reflect an appropriate level of deliberation expected of a federal agency implementing the intent of Congress.

Background

For several years, NCUA, without direct statutory authority, has authorized credit unions to engage in business lending activities for its members. This specifically included loans and lines of credit or letters of credit for "commercial, corporate, business, investment property or venture or agricultural purposes." The Board provided for certain exceptions from the definition of a member business loan to include loans such as those for 1-to-4 family primary residences or loans which in the aggregate total $50,000 or less, among others. (12 CFR 701.21(h)). The Board also identified specific activities that must be addressed in a credit union board of directors' written business loan policy. Among other factors, these include the "qualifications and experience of personnel involved in making and administering business loans with a minimum of two years direct experience with this type of lending." The Board never imposed any aggregate limit on the amount of business lending that a credit union may engage in, notwithstanding a historical and legislative emphasis for credit unions to stay focused on consumer lending to people of small means.

Because of Congressional concerns over the problems inherent in business lending by credit unions, Section 203 of the Act imposed limitations on member business loans. These include specific aggregate limitations on this activity so as not to exceed the lesser of 1.75 times the actual net worth of the credit union or 1.75 times the minimum net worth under the Act to qualify as well-capitalized. This effectively sets a cap on the aggregate amount of business lending at a well-capitalized credit union at 12.25% of assets; lesser capitalized institutions are subject to lower limits. Exceptions to this limitation are authorized for "an insured credit union chartered for the purpose of making, or that has a history of primarily making, member business loans to its members, as determined by the Board," or credit unions that serve predominantly low-income members or are defined as a community development financial institution. The Act further defines "member business loan" and the exceptions to that definition, in keeping with NCUA's existing definitions and exceptions contained in its regulation.

The Act also directs the Secretary of the Treasury to conduct a study of member business lending which, among other items, must include "an examination of member business lending over $500,000 and under $50,000, and a breakdown of the types and sizes of businesses that receive member business loans." The NCUA is further directed to cooperate with the Secretary in this study.

NCUA's interim final rule attempts to track the statutory language regarding the definition of a member business loan and the five exceptions to that definition. NCUA, however, has modified the language of the statute in promulgating the rule as it relates to the aggregate limit on member business loans. The Act provides an exception to the aggregate limit for "an insured credit union chartered for the purpose of making, ... member business loans to its members, as determined by the Board" (*Section 203(b)(1)*). NCUA has modified the language to read: "credit unions that were chartered for the purpose of *primarily* making member business loans..." (12 CFR 723.17, emphasis added). Moreover, the NCUA has interpreted the exception relating to a "history of primarily making member business loans" so as to include situations in which member business loans comprise at least 25% of the credit union's outstanding loans or where such loans comprise the largest position of the credit union's loan portfolio.

NCUA has also included a variety of other modifications to the business lending rules which were not the subject of the Act, but which all go towards relaxing the requirements imposed upon credit unions in this area. The rule includes guidance in such areas as an increase in the amount that a credit union may loan to one borrower, the ability of credit unions to obtain waivers from the current restrictions on loan-to-value ratios or on loans-to-one borrower, and the elimination of certain reporting requirements involving smaller business loans.

NCUA has also relaxed the business lending experience requirement relating to the qualifications and experience of personnel involved in making and administering business loans. NCUA's existing regulation requires that a credit union's written loan policy require that these personnel have "a minimum of two years direct experience with this type of lending." However, in its preamble to the new interim final rule, the NCUA advises that a credit union must use the services of an individual who has two years of direct experience, but that individual need not be responsible for making or administering the loan. Instead, the credit union can meet the requirement of experience through the use of the services of a credit union services organization, an employee of another credit union, or an independent contractor or other third party who in some manner is involved in the lending process.

ABA Position

I. Procedural Objection

As a preliminary matter, the ABA strongly objects to the process through which the NCUA has issued this new regulation. The Board, by issuing this rule in the form of an immediately-effective "interim final rule," has violated the Administrative Procedures Act (APA), since that Act mandates that no rule will be "final" prior to the completion of the Act's time and other requirements, except where an emergency is present. The Board has not established, nor has it made a claim, that such an "emergency" exists warranting this expedited process. *See*, Thrift Depositors of America v. OTS, 862 F. Supp. 586 (DDC, 1994)

In adopting the procedure that it has, the Board has undercut the very purpose of the APA – to ensure adequate public review and comment of proposed government regulations prior to the time that they are implemented. The current expedited process, whereby the Board has *already put its regulation into effect (albeit in interim form) without the benefit of any public input*, is in clear contravention of both the letter and the spirit of that law.[1] This once again illustrates the Board's utter contempt for complying with the mandates of the law, and raises questions over whether it is willing to entertain public comments which conflict with its own position. The ABA strongly urges the Board to withdraw its interim final rule and resubmit it under the normal administrative process.

II. Congressional Intent

[1] Indeed, the Board's extension of the comment period for an additional two months past the comment deadline, from November 30, 1998 to January 29, 1999, on the sole basis that "'a' request [was] made" without providing any further elaboration (Federal Register, November 27, 1998, p. 65532), merely compounds the NCUA's utter disregard for the APA. In effect, the Board has extended the time period during which the interim final rule will apply without the benefit of the public comment process.

Regarding the substance of the Board's proposal, without question, Congress intended that Section 203 serve as the specific framework for imposing *limitations* on credit union business lending, not as a means of *facilitating* entry into such activities as the interim final rule proposes to do. Congress was concerned that credit unions not shift their focus away from the consumer and into areas of commercial lending with which they are unfamiliar and ill-prepared. As evidence of that intent one only has to look at the express language of the statute – *for the first time, Congress imposed an aggregate limit on the amount of commercial lending in which a federally-insured credit union may engage.* This reflects a Congressional desire to restrict credit union commercial lending activities.

The report of the Senate Committee on Banking, Housing & Urban Affairs further supports the position that this aggregate limit should be viewed as a limitation on credit union activities in this area:

> In new section 107A(a), the Committee has imposed *substantial new restrictions* on commercial business lending by insured credit unions. Those restrictions are intended to ensure that credit unions continue to fulfill their specified mission of meeting the credit and savings needs of consumers, especially persons of modest means, *through an emphasis on consumer rather than business loans*. The Committee action 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 potentially increase the risk of taxpayer losses through the National Credit Union Share Insurance Fund ....
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> (*Senate Report* 105-193, pp. 9-10, emphasis added)

The report further states that the "Committee appreciates the necessity to minimize additional risk to the safety and soundness of insured credit unions through the extensive growth of commercial lending activity." (Senate Report 105-193, p. 10) The Additional Views of Senator Jack Reed (D-RI) further support this Congressional concern for the impact of business lending on the safety and soundness of credit unions. Senator Reed specifically refers to NCUA data which has demonstrated that "the delinquency rate on credit union business loans (3.1 percent) is more than three times the delinquency rate on credit unions' overall loan portfolio (0.97 percent)." (*Senate Report* 105-193, p. 29).

Senator Phil Gramm (R-TX), in his floor statement of July 24, 1998 during Senate debate on the Act, perhaps said it best:

> ... the bill, for the first time, begins to put appropriate limits on the amount of business loans that credit unions can make. There are those who believe, and I happen to be one of them, that credit unions were chartered to provide *consumer* credit to their members as part of a

cooperative effort. *A dramatic movement of credit unions into commercial lending would circumvent the whole intent of the credit union movement*, and in my opinion, it would be a negative factor on the progress of the credit union movement. In this bill, we for the first time set limits on the amount of credit union assets that can go into commercial loans. That is a very positive step.

(*Congressional Record*, July 24, 1998, p. S8966, emphasis added)

It is clear from the statutory language and its attendant legislative history that Congress intends that any implementing regulations involving credit union business lending activities reflect such a "limiting" approach to such activities.

III. Board Action

Contrary to the above-cited statutory language and legislative history, the Board has set forth an interim final rule which has as its primary focus and intended effect a desire to circumvent the very restrictions that Congress intended to set.

A. Intent of the Interim Final Rule

The express terms of the interim final rule clearly set forth the Board's intent to promulgate a rule which lessens, not increases, the restrictions placed on the commercial lending activities of federally-insured credit unions. For example, within the Board's summary of the rule, it states the intended effect of the rule is not to impose limits on such commercial lending, but to "provide an *exception* for qualifying credit unions from the statutory aggregate limit on a credit union's outstanding member business loans." (Federal Register, September 29, 1998, p. 51793, emphasis added) This focus on "exceptions to the rule" and not the rule itself clearly illustrates the Board's desire to reduce any impediments that the Congressionally-mandated aggregate cap on business lending would impose upon credit unions. This basic premise is borne out by nearly the entire remainder of the interim final rule, where the Board lays out a variety of exceptions to the rule and reductions in regulatory requirements (a number of which are addressed below) which in fact would facilitate credit union involvement in commercial lending activities.

The ABA strongly believes that, contrary to Congressional direction, NCUA has failed to impose limitations and standards sufficient to ensure that credit unions' business lending conforms to the intent of Congress. The emphasis in the interim final rule is on ensuring that credit unions have the greatest flexibility in engaging in business lending rather than incorporating strict limitations on this activity in concert with Congressional intent. We believe that such action reflects both a disregard for that intent and a continuing desire of NCUA to act as a proponent of the very industry it is charged with supervising.

B. NCUA Proposed Exemptions to the Rule

As an example of this bias towards facilitating credit union commercial lending activities, the NCUA has created a large loophole which may permit many credit unions to avoid being subject to the aggregate limit on member business loans set in the statute. Pursuant to the interim final rule, credit unions which have a "history of primarily making member business loans" would be exempt from the cap. In determining how to qualify for this exemption, the Board's rule would exempt any credit union which either holds business loans that comprise at least 25% of the credit union's outstanding loans in 1998 or any of the prior three years, or which holds business loans which comprise the "largest" portion of the credit union's portfolio.

1. History of Business Lending

As a preliminary matter, NCUA's interpretation of the exception for a "<u>history</u> of primarily making member business loans" (emphasis added) does not truly require a "history" of such activity, as it does not require a pattern <u>over time</u> of this type of activity. Instead it measures the activity at a moment in time evidenced either by the credit union's call report for 1998 or for *any one* of three prior years. This is <u>not</u> a "history." It is a point in time at which the member business loans reflects a specified percentage of overall assets. History is not reflected in one event. Moreover, the Board's other proposed test – where business loans comprise the "largest" portion of the credit union portfolio – has *absolutely nothing to* do with a "history" of credit union behavior over time reflecting that institution's commitment to being a business lender. The Board has created this latter exemption test out of "whole cloth," without any basis in the statute or its legislative history.

In establishing this exemption, Congress clearly intended that only those credit unions which demonstrate a long-term "history" of commitment to business lending as their "primary" line of business would be eligible. Put simply, the Congress merely meant to exempt those credit unions which had evolved over time into business, not consumer, lenders. The regulation must incorporate some reasonable measure of credit unions' participation in business lending over time. This better ensures that credit unions have the experience and success in this activity to warrant growing this line of business in excess of the statutory limitation.

2. Percentage of Loans

More importantly, the ABA believes that when Congress set forth an exemption for those institutions with a history of "primarily" making business loans, it intended to require <u>at least</u> a "majority" of the credit union's loans be involved in business lending over an extended period of time. In stating that a credit union may qualify for the "primarily making" exemption from the aggregate limits if merely ¼ of its loans are business loans, or if business loans represent the largest category of loans at the credit union (and thus could realistically reflect loan levels even *below* 20% of the institution's loans), the Board makes a potential mockery of the Congressionally-mandated aggregate cap. In light of Congress' intent to keep credit unions focused on consumer lending and not business lending, it is ludicrous to suggest that a credit union with over 75% of its loans – and maybe even more than 80% – in other areas is somehow "primarily" a business lender.

In fact, comments made by Board Chairman Norman D'Amours and Vice Chairman Dennis Dollar at the September 23, 1998 public board meeting support the ABA's contention that a much higher exemption percentage should be adopted. At that meeting, both Chairman D'Amours and Vice Chairman Dollar expressed that such a 25% standard was reasonable and employs the standard adopted by a bank regulator – the Federal Reserve Board – in that Agency's interpretation of the Glass-Steagall Act. As such, the NCUA believes that "primarily making" is equivalent to the "principally engaged" criteria used by the Federal Reserve. Under that criteria, the Federal Reserve Board has ruled that a bank is "not principally engaged" in nontraditional securities activities so long as its revenue from such nontraditional activities is less than 25 percent of the combined organizations' revenue.

If NCUA intends to parallel the Federal Reserve's Glass-Steagall test with its new "25%" business loan test – the publicly-stated intent of its highest ranking board members – then the NCUA *must* impose a much greater minimum percentage of business loans in order to qualify for the exemption. In establishing its test, the Federal Reserve uses the term "principally" to equate to 75% of an organization's activities, not 25% (the latter equating to the activities in which an organization is "not principally" engaged). Thus, if NCUA seeks to parallel "primarily" with "principally," the term "primarily" *must* equal at least 75%. *Moreover, by setting up this primarily/principally parallel, it can be argued that Congress intended to ensure that the Board set up a sufficiently high threshold for a credit union to become eligible for this exemption.* Adopting such a higher percentage – or one which goes to at least 50% – as the threshold for eligibility for the exemption is clearly appropriate and would be consistent with the expressed intent of Congress to adopt a "limiting" rule regarding credit union business loan activity.[2]

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[2] Moreover, implementing the proposed exemption, as set forth by the Board, is inherently in conflict with the statute and the history of the credit union movement. Congress created credit unions to act almost exclusively as consumer lending institutions, and the industry has generally retained such focus. The Act reinforces this consumer lending orientation by, for the first time, imposing aggregate limits on credit union commercial lending activities. Yet the Board, in creating this 25% exemption test, has stated that a credit union may at the same time be both "primarily consumer-oriented" (*e.g.*, three quarters of its loans being consumer-type loans) for general purposes <u>and</u> "primarily a business lender" for purposes of the exemption. Such a contradictory reading is insupportable – clearly, Congress did not intend that a credit union could be both "types" of lenders at the same time. Only an interpretation which requires a credit union to have over 50% of its lending in business loans – and thus be "primarily" a business lender and not "primarily" a consumer lender – can satisfy the Act's statutory "primarily" test.

The ABA believes that there is no justification for the 25 % criteria set forth by the NCUA, and that such a standard runs directly contrary to Congressional intent. The term "history of primarily making member business loans" must require that credit unions not only demonstrate a history, over time, of making these loans, but also that credit unions have more than 50% of their entire loan portfolio comprised of such loans.

3. The "Largest Category" Exemption

The ABA also strongly believes that the proposed exemption from the aggregate lending limits for credit unions which hold business loans as their "largest category" of loans has no basis in statute, and that such action undercuts the very goal of Congress in attempting to establish such aggregate limits on credit union business lending activities. Under that proposed exemption, the NCUA would permit credit unions to subdivide non-business loan categories in a manner that greatly facilitates the ability of credit unions to qualify for the exemption. Thus, credit unions could "jury-rig" loan categories and avoid the aggregate business lending limits set forth under the law.

As stated above, under the interim final rule, a credit union would be exempt from the aggregate business loan limits of the law when the "largest" category of lending at the credit union is business lending. Under the rule, the NCUA aggregates all types of business loans within the "business loan" category for purposes of the rule, including member agricultural loans and other loans made for commercial, corporate or other business investment purposes. This reflects a broad categorization of the term "business." Yet the Board fails to adopt an equally-encompassing definition of "non-business" loans for purposes of determining whether "business" loans surpass "non-business" loans under the exemption standard. NCUA does not explicitly define in the regulation how credit union's should categorize its non-business loan portfolio, even suggesting that credit unions can subdivide consumer loan categories so as to artificially drive down the percentage of loans in such categories. ***This leaves such categorization open to manipulation by both the industry and its regulator, a result Congress clearly could not have intended.*** For example, in both the explanation of the rule and Section 723.18 itself, the Board has stated that new automobile loans and credit card loans would be in separate categories for purposes of determining whether any one category of loans held a higher percentage of the overall loan portfolio than business loans. Clearly, both automobile and credit card loans are "consumer" loans, and should be aggregated as such – yet the Board has set forth an interim final rule which allows, and even encourages, the gerrymandering of loan categories so as to qualify for an exemption.[3] This was clearly

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[3] As stated, the ABA does not believe that the Act provides a basis for the Board's action in this area. Even if such basis did exist, the Board would have to make substantial revisions to the proposed test. For example, based upon the principal of parallel construction, the NCUA would have to change the rule so that it requires broad categories of loans to be similarly aggregated, explicitly setting forth in the rule how such loans should be categorized. Specifically, **Consumer Loans** should include *all unsecured personal loans plus new and used vehicle loans*; **Real Estate Loans** should include *first mortgage real estate loans and other real estate loans*; and **Other Loans** should include those loans subject to such categorization under the credit union call report rules. (As a matter of comparison, the FDIC in the Quarterly Banking

not the goal of Congress when it enacted the limitation on business lending contained in the Act.

The ABA believes that the Board has no statutory basis for creating this "largest portion" exemption to the aggregate limitation on credit union business loans. Given that this exemption standard (1) has no connection to the Act's "history" requirement (as discussed above), (2) is so broadly defined so as to effectively undercut the aggregate limit set in the statute, and (3) would clearly contravene Congress' goal of imposing effective limitations on credit union business lending, we would strongly urge the Board to drop this exemption from the rule.

4. Falling Out of Compliance

The ABA is also concerned that NCUA has not established any process for determining whether a credit union has failed to maintain its eligibility for the "history of primarily making member business loan" exemption, nor has the Board set forth any guidance as to what would happen if that occurred. *Under the plain language of the statute, a credit union that does not satisfy the exemption test must immediately become subject to the aggregate limits of the law.* Under new section 107A of the Federal Credit Union Act (as added by the new law), "**no** insured credit union may make any member business loan that would result in a total amount of such loans" exceeding statutorily imposed limits (Section 107A(a), emphasis added); only those eligible for an exemption would be able to avoid this limit. Thus, where the exemption no longer applies – *e.g.*, the credit union's business loan portfolio no longer exceeds all other categories, or no longer exceeds 25% – the plain language of the statute requires that the credit union *must* comply with the statutory limit.[4]

However, pursuant to the interim final rule, it appears that once a credit union meets the exemption it qualifies forever unless revoked by the state regulator (for a state chartered credit union) or the NCUA Regional Director (for a federal credit union). The Board does not set forth any procedure regarding ongoing compliance with the statutory test, the consequences for failure to meet the Act's requirements, the process under which regulators will proceed in determining continued compliance, or how any revocation

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Profile broadly aggregates bank loans into five groupings: loans secured by real estate, commercial & industrial loans, farm loans, loans to individuals, and other loans & leases.) The key point is that NCUA *must* compare apples to apples – if it broadly aggregates components to define the "business loan" category, then it must similarly adopt a rule which broadly aggregates other loan categories. It is disingenuous to compare an aggregated loan category to a disaggregated loan category; in doing so under the interim final rule, NCUA has again demonstrated its intent to fail in carrying out the will of Congress while at the same time coddling the very industry it is charged with regulating.

[4] Such a reading is further supported by other language in the statute. New Section 107A(d) of the Federal Credit Union Act provides credit unions which, *on date of enactment*, fail to conform with the aggregate limits of the new law with three years to get into compliance. The new law includes *no transition provision* for those credit unions which thereafter fall out of compliance, thereby immediately subjecting such institutions to the aggregate limits of the Act.

process would work – leading to the conclusion that NCUA intends a "once granted, always in effect" exception. This is not what the law states or Congress intends, and represents another example of NCUA's failure to implement the law as mandated by Congress. NCUA must set forth explicit rules which apply the aggregate limits on business lending of the Act to credit unions which no longer are eligible for the exemption.

5. Chartered for the Purpose of Making Business Loans

In implementing the Act, NCUA has changed the statutory language regarding the exception from aggregate business loan limitations for credit unions chartered "for the purpose of making member business loans." In the rule, the exception applies to credit unions chartered for the purpose of <u>primarily</u> making member business loans (emphasis added). In doing so, NCUA has changed the meaning of the exception to significantly expand its meaning.

Congress intended for the exception to cover instances in which the credit union was chartered for a specific business purpose such as "members who are of a specialized vocation, for example: fisherman, farmers, truck drivers, and taxi cab drivers." (*Senate Report* 105-193, p. 5). The report further discusses the exception in the context of the "expertise developed in specialized credit unions, such as those that serve members of specific vocations, the religious community and members of the agricultural community." (*Senate Report*,105-193, p. 10). Also, in reviewing the Senate version of *HR 1151* and the chartering exception, Senator Hagel stated that "a credit union that is chartered for the purpose of business lending will not be subject to the cap." (*Congressional Record*, July 27, 1998, p. S9067).

Thus, it is clear that the exception depends on the chartering of the credit union for "the" purpose of making member business loans, not as "one" of the purposes of the credit union. Insertion of the word "primarily" would dilute the intent of Congress and provide this exception for credit unions that are chartered not solely for the purpose of making business loans but also for other purposes.

The ABA urges NCUA to mirror the explicit language of the statute so that the exception only applies to credit unions chartered for "the" purpose of making business loans and not for other activities.

C. Other Elements of Interim Final Rule Evidencing Lessening of Business Loan Oversight

Notwithstanding Congress' clear intent under the Act to impose restrictions on credit union business lending activity, NCUA has also taken the opportunity to use the interim final rule to further relax its business lending regulation in areas not covered by the Act. The ABA believes that such actions run contrary to the general intent, if not the letter, of the newly-enacted law, and that any such proposals should be reexamined in light of passage of the Act and its stated concerns of safety and soundness in the commercial lending area. Moreover, by taking such "other action" and loosening business lending restrictions, NCUA is undermining the very basis upon which Congress relied – the then-current regulations and their perceived weaknesses – in enacting new restrictions. This again illustrates the continuing way in which NCUA fails to act in a manner consistent with statutory directives, with complete disregard for its role as an independent regulator charged with implementing the will of Congress.

Specifically, the Board's interim final rule takes the following actions:

- Loan-to-One Borrower Restrictions: slightly relaxes the loan-to-one borrower restrictions currently applicable to insured credit unions by increasing the current limits on loans to one borrower from the higher of 15% of credit union reserves or $75,000, to 15% or $100,000. More importantly, the interim final rule continues to permit credit unions to obtain waivers from the loan-to-one borrower rules for whole categories of loans. NCUA has clearly abused this waiver process in the past. *As of June 1998, NCUA has permitted* ***over 50%*** *of the business loan portfolio of 182 credit unions (some $379 million in business loans out of $674 million in such loans held by these credit unions) to exceed the loan-to-one borrower limit.* This again reflects a pattern of irresponsible regulatory activity, only to be further aggravated by the changes set forth in the interim final rule. The use of such waivers exposes individual credit unions and the insurance fund to significant risk, and is a clear abuse of regulatory authority.

  NCUA should reexamine this waiver process in light of Congress' intent in passing the Act and substantially narrow any waiver authority granted in this area. Moreover, it should require any institution seeking a waiver to obtain affirmative NCUA approval, along with an explanation, of any waiver granted, rather than rely on Board "inaction" as a sign of Board approval. This would ensure that the Board has sufficiently reviewed the waiver application to determine that the institution's actions are not creating safety and soundness concerns. (The Board should also eliminate the ability, as permitted under the interim final rule, of an institution which has had its waiver denied to operate as if the waiver has been granted pending its appeal of the denial to the Board. To do otherwise would be again to turn the rule on its head – notwithstanding the lack of legal authority to engage in an impermissible activity, the Board would be permitting a credit union to do so.)

- Loan-to-Value Ratios: permits similar waivers from restrictions on loan-to-value ratios for individual business loans, as well as whole categories of business loans or business loan programs. Given the increased risk to institutions of high loan-to-value loans, the implementation of such a blanket waiver authority by NCUA leads us to question the appropriateness of such action, given Congress' recently-stated concern over credit union business lending activities. As discussed above, the Board should also not permit any waiver of these requirements unless the Board has affirmatively granted the waiver and provided an explanation substantiating the Board's position. The Board should also require compliance with the general prohibition of the rule pending any appeal of the Board's denial.

- Experience Requirements: substantially lessens the experience requirements for individuals making business loans. The ABA objects to the NCUA's decision to effectively gut the requirement relating to the experience component of a credit union's written business lending policy. Prior to this new interim final rule, NCUA has always tied its 2-year direct business lending experience requirement to actual credit union personnel involved in making and administering business loans. NCUA has now interpreted this language so as to allow credit unions to satisfy this requirement by obtaining the services of individuals who are not employees of the credit union, not directly responsible for business lending decisions and not reportable to management, the board of directors and ultimately the members. Consulting third parties, no matter the level of their business lending experience, is not a substitute for ensuring that those individuals responsible for the loans are experienced in business lending. Moreover, such a new rule undercuts the very ability of NCUA to evaluate the controls, practices and individuals responsible for ensuring that credit union business lending practices conform to required levels of safety and soundness. This again illustrates NCUA's inability to take prudent regulatory action to uphold its statutorily-mandated responsibility to oversee the safety and soundness of our nation's federally-insured credit unions.

  The point at which Congress has for the first time imposed limitations on business lending is not the time for NCUA to interpret its own regulation so as to relax the underwriting process for business lending. The ABA urges NCUA to retain the interpretation that personnel of credit unions who actually make or administer business loans should be the only individuals authorized to engage in such activities.

- Appraisal Practices: lessens credit union appraisal practices. Under NCUA's previous regulation, credit unions were required to obtain an appraisal by a state licensed or certified real estate appraiser for those transactions involving business loans secured by real estate in which the transaction value was greater than $50,000. In instances in which a state licensed or certified real estate appraiser was not required, the credit union would still have been required to obtain an "evaluation" – defined as a written estimate of market value performed by a qualified, experienced person with no direct or indirect interest in the real estate in question. Banks and other financial institutions follow similar criteria except that the dollar limitations differ based in large part on these institutions' experience with this type of lending activity. Regardless of this exemption, banks and other financial institutions are required to obtain at least an evaluation of the real estate by an experienced and knowledgeable person who has no interest in the property.

The interim final rule modifies NCUA's appraisal regulation so as to exempt, from both the state licensed or certified real estate appraiser and evaluation requirements, a category of member business loans as determined by the credit union and granted by the Regional Director. Thus, it would be possible for a credit union to request a waiver for all its business loans which, for example, involve members' professional offices and the underlying real estate, and upon approval, allow the credit union to avoid any type of independent collateral evaluation.

The ABA objects to this blanket waiver process exempting categories of member business loans from any form of collateral evaluation. At a time when Congress has imposed limitations on business lending, NCUA should not initiate a program which effectively removes certain business loan programs from the protection afforded by independent collateral evaluations.

- Review of Financial Statements: eliminates a previously-proposed requirement that credit unions review financial statements of their business borrowers. In its explanation of the interim final rule regarding what credit unions must address in their written loan policies, the Board states that it "does not see any significant benefit requiring a review of financial statements on all member business loans." (Federal Register, September 29, 1998, p. 51795) In today's unsettled economic environment, borrowers' financial conditions may rapidly change, particularly those of small business owners. Thus, NCUA should be imposing more stringent oversight responsibilities on credit union business lending activities, not less, yet the latter is what the Board's action in this area amounts to.

  It is inconceivable that a federal regulator charged with the responsibility for maintaining the safety and soundness of a federally-insured financial institution would take such a stance. In point of fact, lending institutions have been found to be in violation of "safety and soundness" requirements for relying on stale financial statements. *See*, Northwest National Bank v. U.S. Department of the Treasury, 917 F. 2nd 1111, 1115 (8th Circuit, 1990) Here, by failing to require the review of financial statements, whether they be stale or otherwise, NCUA will be subjecting credit unions and their officers and directors to a risk of liability that could have been avoided by more forceful rules. The ABA strongly urges the Board to reinstate the previously-proposed requirement that credit unions review the financial statements of their business borrowers.

- State Waiver Authority: exempts from the member business loan rule federally insured, state-chartered credit unions which satisfy a "substantially equivalent" state rule on the subject which the Board has approved. *See*, Section 723.20 ***There is no statutory authority for this state law exemption.*** The Act subjects ***all*** federally insured credit unions, whether they be federal or state chartered, to the aggregate limits on commercial lending set forth therein. While a state may impose more stringent requirements on its own institutions, the Board may not, by regulatory fiat, permit states to impose less stringent standards. Otherwise, states would be essentially free, as long as the Board gives its blessing, to develop looser rules than those prescribed by Congress. And, incredibly enough, states could take whatever approach they want in creating such rules, since the Board proposes no guidance as to the circumstances under which it will consider granting a state waiver. This again illustrates the Board's utter disregard for the specific mandates of the law, and its willingness to undercut the role of Congress.

D. Action Inconsistent with Statutory Study Requirement

In the Act, Congress has directed the Treasury Department to study a variety of aspects involved in the business lending activities of insured credit unions, including the examination of credit union business lending under $50,000. Moreover, the Act specifically directs NCUA to "provide such information as the Secretary [of the Treasury] may require to conduct the study ..." (Section 203(b)). However, NCUA has failed to address in the interim final rule the collection requirements that it would need to impose on credit unions in order to determine the extent of their business lending below $50,000. Even though not defined as a member business loan in the Act, a business loan is still a business loan regardless of its categorization. (In fact, as set forth in the next subsection, NCUA has even further reduced reporting requirements in this area, thus further limiting the Treasury Department's ability to conduct its Congressionally-mandated study.)

Specifically, Congress has directed the Secretary of the Treasury to examine credit union business lending over $500,000 and under $50,000. To meet this statutory requirement, NCUA will need to establish a mechanism that will permit NCUA and the Treasury to determine the extent of such lending activity, even though business loans of $50,000 or less are not categorized as member business loans. Such lending is still reflective of the credit union's "business" lending activity and is the subject of Congressional concern as to the aggregate impact and risk of all credit union business lending, whether or not categorized as member business loans. The ABA questions the ability of NCUA to evaluate the extent of the risk associated with such loans without having access to the full extent of credit union business lending activity. We would think Congress would share that concern.

Instead of encouraging the illusion that a business loan of $50,000 or under is not a business loan, NCUA should encourage financial transparency, so that credit union members, and the NCUA itself, can fully understand the extent to which their credit unions engage in business lending. Not only will NCUA more fully assist the Treasury Department in its study, credit union members will be better served by understanding the risks assumed by their credit union's management; NCUA will be better able to understand any aggregate risks as well.

Senator Hagel addressed this best during the floor discussion of *HR 1151*. In referring to the exemption for business loans of less than $50,000 he stated:

> "With this loophole, there is no accurate, full, or honest accounting for commercial lending in credit unions. This makes no sense. No other financial institution enjoys this sort of charade and slight of hand. This loophole makes any commercial lending cap meaningless, because it permits an unlimited number of commercial loans so long as each of these loans is less than $50,000".
>
> (*Congressional Record*, July 27, 1998, p. S9007).

How can NCUA assist the Secretary of the Treasury in conducting the study to determine the extent of this business lending activity if there is no mechanism to collect and quantify these loans? NCUA has collected this information in the past, so doing so will not impose any new, significant burdens on credit unions to monitor this activity.

E. Reduced Reporting Requirements for Business Loans

At the same time, NCUA should not delete its existing requirements which (1) relate to the separate identification of member business loans in the records of the credit union and which are to be reported to NCUA, and (2) the periodic disclosures to credit union members of the number and aggregate dollar amount of these loans. Eliminating these requirements in both the context of the overall legislation and the Treasury Department's business lending study requirement undermines this effort and conveys the wrong message to Congress. Moreover, it obfuscates the ability of regulators, the Congress and the public to accurately assess the degree of risk posed by credit union business lending activities. Again, this is inconsistent with the responsibilities of a federal regulator, and contrary to the intent of Congress as embodied in the recently-passed Act.

In fact, the Board's action in this area, as well as its failure to categorize business loans under $50,000 as "business loans" for reporting purposes, runs contrary to NCUA's own regulations (12 CFR 702.3) requiring full and fair disclosure of credit union assets, liabilities and members' equity. Pursuant to that regulation,

> [f]ederal credit union financial statements shall provide for full and fair disclosure of all assets, liabilities, and members' equity, including such valuation allowance accounts as may be necessary to present fairly the financial position; and all income and expenses necessary to present fairly the results of operations for the period concerned. [12 CFR 702.3(b)(1)]

In light of Senator Hagel's comments and the clear desire of Congress in ensuring accuracy of reporting at financial institutions, the ABA believes that the Board's actions in this area are imprudent.

F. Regulatory Flexibility Act

The ABA also wishes to state that the interim final rule is deficient because it fails to comply with the Regulatory Flexibility Act, and incorporates by reference the comments made in our November 13, 1998 Comment Letter to the Board regarding the Board's field of membership proposal.

Thank you for considering our comments. If we can be of further assistance, please do not hesitate to contact us.

Sincerely,

Edward L. Yingling
Deputy Executive Vice President