

Proposed Rules

Federal Register

Vol. 60, No. 148

Wednesday, August 2, 1995

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

Organization and Operations of Federal Credit Unions

AGENCY: National Credit Union Administration (NCUA).

ACTION: Proposed rule.

SUMMARY: The NCUA Board (Board) is committed to providing federal credit unions (FCUs) greater flexibility in pursuing lending opportunities that are consistent with principles of safety and soundness. The NCUA Board is therefore proposing to amend its regulations on loan participation to broaden loan participation authority by removing the requirement that the participation agreement precede loan disbursement.

DATES: Comments must be postmarked or posted on the NCUA electronic bulletin board by October 2, 1995.

ADDRESSES: Send comments to Becky Baker, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.

FOR FURTHER INFORMATION CONTACT: Mary F. Rupp, Staff Attorney, Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428 or telephone: (703) 518-6540.

SUPPLEMENTARY INFORMATION:

A. Background

NCUA's current "participation loan" regulation requires the participation agreement to precede any disbursement of the loan proceeds. When Section 701.22 of NCUA's Rules and Regulations was originally issued, the Board discussed the term "participation" as follows:

In granting Federal credit unions the power to participate in making loans to members, Congress was using the term "participation" to mean arrangements made prior to or at the time of origination and carried out within a

reasonable time thereafter. Thus, 107(13) (of the Federal Credit Union Act, 12 U.S.C. § 1757(13)) was adopted to allow Federal credit unions to sell certain loans subsequent to origination * * *

43 FR 51610 (November 6, 1978). However, the Board amended its opinion in 1981 as follows:

The participation regulation applies where a third party funnels funds into the credit union with the intent of actually participating in making the loan, for example where the participant will assist in preparing the loan documentation and the participant's funds will actually be disbursed at origination. The participation regulation does not apply when an organization merely arranges to purchase loans subsequently originated by the credit union.

49 FR 31660 (June 17, 1981).

In 1991, the Board considered but later rejected changes which would have amended the definition of "participation loan" and deleted the requirement that the loan participation agreement precede loan disbursement. The Board was concerned that:

FCUs may have a decreased interest in properly underwriting a loan if they know they can later reduce their risk by selling participation interests in it. Alternatively, FCUs interested in obtaining a participation after the loan is made may not properly investigate the loan and may instead rely on the original participants to have properly underwritten the loan. FCUs may jump in without a proper due diligence review.

56 FR 15034, 15035 (April 15, 1991).

The Board now believes that the concerns it expressed in 1991 can be addressed through the FCUs exercise of due diligence before entering into participation agreements as required in this proposal. The FCU is still required to have a master participation agreement. The proposal does not specify at what point the agreement must be executed. The Board invites comment on whether the rule should require that the agreement (without identifying the specific loans) must be in place prior to the disbursement of the loan if the loan is intended for participation, and prior to the sale of the loan if the loan was originally made to hold in portfolio.

Although the regulation does not require that specific provisions be included in the master agreement, prudence dictates that at a minimum the agreement shall: (1) Identify types of loans; (2) state servicing and collection requirements; (3) provide that in the

event of a loss each participant shall share in the loss equal to its interest in the participation loan; (4) provide for the distribution of payments of principal to each participant proportionate to its interest in the participation loan; (5) provide for loan status reports to each participant; and (6) state the terms or conditions under which the agreement may be terminated or modified.

Under the proposal, the "originating lender" is required to use the same underwriting standards it uses for loans that are not being sold as participation loans unless there is a participation agreement in place prior to the disbursement of the loan. If a participation agreement is in place prior to disbursement, all of the participating credit unions will have agreed on underwriting standards. The originating lender would reflect those standards either in its loan policies or the participation agreement. Also, the proposal requires the purchaser of a participation interest to have a participation policy in place prior to entering into a participation agreement.

Current Section 701.22(b)(2), as well as the proposed rule, allow either the board of directors or the investment committee to execute the participation agreement. In recognition of the far reaching impact a participation agreement has on an FCU's lending, investment and business strategies, the Board is interested in receiving comments on whether this authority should be solely with the board of directors.

With these safeguards in place, it is contemplated that eliminating the "prior to disbursement" restriction may assist FCUs with their liquidity management and will also provide FCUs with a means of reducing risk. By deleting this requirement, the Board recognizes that there may be some overlap between Sections 701.22 and 701.23 of NCUA's Rules and Regulations; the eligible obligations rule. This is a result of the interplay of Sections 107(5)(E) and 107(13) of the FCU Act. Both of these sections authorize the purchase and sale of a partial interest in certain loans. A loan purchase or sale will be viewed as permissible provided it is authorized under either section.

The Board welcomes comment on this proposal.