NAFCU

3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
F: 703.524.1082
nafcu@nafcu.org

National Association of Federal Credit Unions | www.nafcu.org

June 10, 2015

Mr. Michael Mckenna
General Counsel
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Dear Mr. McKenna:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents federal credit unions, we are writing you regarding Member Business Lending (MBL) reform. NAFCU has long advocated for such reform, and we appreciate the National Credit Union Administration (NCUA) Board's support for modernizing the agency's MBL regulations. As NCUA considers amending its current MBL regulations, NAFCU and our members encourage the agency to fully utilize its statutory authority to provide requisite relief to our industry and the small businesses it serves throughout the United States.

NAFCU continues to hear from our members that NCUA's MBL regulation unnecessarily inhibits their ability to adequately serve the small business needs of their members and communities at large. Additionally, NAFCU, in our ongoing dialogue with the Small Business Administration, has found that small businesses are struggling to find access to capital and liquidity. Credit unions want to provide such funding, in a safe and sound manner, but are arbitrarily limited by NCUA's existing regulation.

Given this current small business environment, NAFCU and our members are pleased that the NCUA Board has indicated that it will propose modernizing amendments to its MBL regulation in 2015. Further, we applaud the agency's continued support for legislative reform to the *Federal Credit Union Act* (FCU Act) regarding MBLs, such as NCUA's recent testimony before the House Financial Services Committee where the agency reiterated its support for H.R. 1188, the Credit Union Small Business Jobs Creation Act.

While we welcome NCUA's legislative support for MBL reform, NAFCU and our members believe that the agency can provide meaningful relief through its current statutory authority. NCUA has indicated that the primary changes it is considering in its MBL modernization initiative involve removing prescriptive underwriting criteria and personal guarantee requirements. These changes, though helpful, do not go far enough.

NAFCU and our members encourage NCUA to amend its current application of the FCU Act's "history of primarily making MBLs" exception to the MBL cap. Traditionally, this exception has been interpreted very narrowly by the agency as Part 723 currently defines credit unions that have a history of primarily making member business loans as credit unions that have either 25 percent of their outstanding loans in member business loans or member business loans comprise the largest portion of their loan portfolios, as evidenced by any Call Report or other document filed between 1995 and 1998. *See* 12 C.F.R. § 723.17(c). NAFCU continues to hear from our members that this definition is overly restrictive and often prevents them from extending sound loans to their small business members, many of whom have been abandoned by other financial institutions due to their smaller size.

While NAFCU believes NCUA has the statutory authority to take a broader interpretation of the "history of primarily making MBLs" provision of the FCU Act, the agency has recently indicated that it interprets this exception to be a grandfather provision, with a retroactive application only from 1995-1998. NAFCU, however, believes that a plain language reading of the statute and a review of its legislative history concludes that this exemption is not a grandfather provision, and should apply to any time period, even after 1998.

We have attached NAFCU's legal and economic analysis of the "history of primarily making MBLs" exemption for your review. NAFCU looks forward to meeting with NCUA staff to discuss this analysis and broader MBL reform in more detail as the agency considers ways to provide credit unions with meaningful regulatory relief. Should you have any questions or if you would like to discuss these issues further, please feel free to contact us at chunt@nafcu.org or anealon@nafcu.org.

Sincerely,

Carrie R. Hunt
SVP of Government Affairs & General Counsel

Alicia Nealon
Director of Regulatory Affairs

cc: Mr. Larry Fazio, Director of the Office of Examination and Insurance
Mr. Todd Harper, Director of the Office of Public and Congressional Affairs

MEMBER BUSINESS LENDING EXCEPTIONS

NAFCU WHITE PAPER

June 2015

NAFCU's Position on NCUA's Interpretation of the Member Business Lending Cap Exceptions in the *Federal Credit Union Act*

NAFCU[1] has a strong history of supporting credit union member business lending (MBL) and has long advocated for MBL reform. Our members have testified before the Senate Banking, House Financial Services, and House Small Business Committees on the importance of this issue. While NAFCU acknowledges that legislation is necessary to lift or relax the current MBL cap, we firmly believe that NCUA has the statutory authority to provide relief to credit unions today. In particular, NAFCU believes that NCUA can amend its current regulatory interpretations of the "history of primarily making MBLs" exception to expand its scope and applicability. Such expansion will allow credit unions to stimulate their local economies by providing credit to small businesses.

This memorandum addresses whether NCUA's interpretation of the "history of primarily making" exception as a grandfathering provision is permissible. A review of the statutory text and its legislative history reveals that such an interpretation is unreasonable under the *Chevron* doctrine. Further, this memorandum suggests an alternative definition for the "history of primarily making" exception that is more closely aligned with the Congressional intent of the statue, and provides economic analysis for how the alternative definition will offer requisite relief to the credit union industry.

---

[1] The National Association of Federal Credit Unions (NAFCU) is a direct membership association committed to representing, assisting, educating and informing its member credit unions and their key audiences. NAFCU is the only trade association that exclusively represents federal credit unions.

I. Background

The *Credit Union Membership Access Act of 1998* (CUMAA) amended the *Federal Credit Union Act* (FCUA) to, among other things, impose an aggregate limit on an insured credit union's outstanding member business loans (MBLs). Specifically, the law caps an insured credit union's total amount of outstanding MBLs to the lesser of 1.75 times the credit union's net worth or 12.25 percent of the credit union's total assets ("the MBL cap"). CUMAA provides an exception to the MBL cap 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." 12 U.S.C. 1757a.

Traditionally, NCUA has construed the "history of primarily making MBLs" exception very narrowly. Recently, the agency confirmed its narrow interpretation. In response to House of Small Business Committee Chairman Steve Chabot's February 27, 2015, letter, NCUA Chairman Debbie Matz indicated that NCUA has interpreted the "history of primarily making MBLs" exception to be a grandfather provision, with a retroactive application. Chairman Matz explained that NCUA believes that because the "history of primarily making MBLs" exception is a grandfather provision, it should only apply to those credit unions in existence on the date of CUMAA's enactment that could document a history of primarily making commercial loans to their memberships. She also noted that, as a practical matter, no credit union today could possibly achieve a "history of primarily making MBLs" after CUMAA imposed the stringent MBL cap in 1998.

As discussed in further detail below, NAFCU believes this interpretation is unreasonable under the *Chevron* doctrine. We believe that a credit union which has had a successful MBL program in place for a period of five years or greater would be a reasonable definition for "a history of primarily making MBLs." In fact, in response to Representative Ed Royce's question for the record at the April 8, 2014, House Financial Services Committee Hearing on Regulation and Supervision of Financial Institutions, NCUA's General Counsel noted that the agency has the statutory authority to create this definition. In his response to Representative Ed Royce's question, NCUA's General Counsel confirmed that "NCUA has the statutory authority to define if a credit union, which has had a significant proportion of its portfolio in member business loans for the last five years, has a history of primarily making member business loans and would therefore qualify for an exemption from the statutory cap."

II. NCUA's Current Regulation and Interpretation

In 1999, NCUA promulgated a final regulation implementing the MBL cap. *See* 64 FR 28721 (May 27, 1999). Under this regulation, NCUA exercised its interpretative authority to define a credit union with "a history of primarily making MBLs" as one that has either 25 percent of its

outstanding loans in MBLs or MBLs comprise the largest portion of its loan portfolio, as evidenced by any Call Report or other document filed between 1995 and 1998. 12 C.F.R. 723.17(c).

In promulgating this definition, NCUA explained that "[t]he NCUA Board, believes that establishing the level at 25% of assets is consistent with congressional intent and permits credit unions with history and experience with member business loans to continue to engage in that activity." *See* 64 FR 28721, 28726 (May 27, 1999). NCUA further justified its definition by suggesting that the legislative intent of the "history of primarily making MBLs" exception was to allow "credit unions with a history of beneficial member business lending [to] continue that practice." *Id.*

While NAFCU supports NCUA's conclusion that Congress intended to allow credit unions with a history of beneficial member business lending to not be subject to the MBL cap, we firmly believe that NCUA's definition is too narrowly focused on a timeframe that lapsed 20 years ago. Rather than a static retrospective definition, NAFCU believes the statutory text and legislative history of the MBL cap exception permits NCUA to establish a definition of a credit union with "a history of primarily making MBLs" that considers a credit union's lending activity on a prospective basis.

Further, NAFCU believes that NCUA's current grandfathering interpretation is impermissible in light of the standards codified by the Administrative Procedures Act (APA) and its case law. In the sections below, we outline the requirements of an APA challenge to NCUA's interpretation, as well as provide our analysis and conclusions regarding the permissibility of NCUA's interpretation.

III. Interpreting the "history of primarily making" exception to the MBL cap as a grandfathering provision is unreasonable under the *Chevron* doctrine.

The APA provides that "a reviewing court shall hold unlawful and set aside agency action...found to be in excess of statutory...authority" 5 U.S.C. § 706(2)(C). Additionally, the APA requires a court to set aside agency action "found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law" 5 U.S.S. § 706(2)(A).

An agency assertion of its statutory authority is evaluated under the *Chevron* doctrine. *See Util. Air Regulatory Grp. v. E.P.A.*, 134 S. Ct. 2427, 2439 (2014). Under that framework, the initial question is "whether the statutory text forecloses the agency's assertion of authority." *Id.* In interpreting the statute, "a court must exhaust the traditional tools of statutory construction to determine whether Congress has spoken to the precise question at issue," with such tools "includ[ing] examination of the statute's text, legislative history, and structure, as well as its purpose." *See Petit v. U.S. Dept of Educ.*, 675 F.3d 769, 781 (D.C. Cir. 2012).

If the statute is silent or ambiguous on the issue, a court will defer to an agency's reasonable interpretation of the statute. *See Util. Air Regulatory Grp. v. E.P.A.*, 134 S. Ct. at 2439. Agency interpretation will be considered unreasonable if it is arbitrary and capricious. *Id.* An agency interpretation is arbitrary and capricious if "the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *Ass'n of Private Sector Colleges and Universities v. Duncan*, 681 F.3d 427, 441 (D.C. Cir. 2012).

a. Grandfathering interpretation violates a plain language reading the *Federal Credit Union Act*.

Section 107A(b)(1) of the FCUA provides an exception to the MBL cap 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." 12 U.S.C. 1757a.

A plain language reading of this section indicates that Congress did not intend to create the exception as a grandfathering provision. If Congress had intended a grandfathering provision, the drafters would have included the word "grandfathered," as they did in Section 109(c)(1) for *CUMAA*'s field-of-membership amendments. The lack of this word or any similar phrase indicates Congress intended to apply the exception prospectively and any attempt by the NCUA Board to read Section 107A(b)(1) as a retrospective standard contradicts a plain reading of the text. By omitting a reference to "grandfathered" or "grandfathering" in Section 107A(b)(1), Congress created an unambiguous exception from the MBL cap that is capable of both a retrospective and prospective application.

Using these "traditional tools of statutory construction," NAFCU believes that Congress has precluded NCUA from treating the "history of primarily making MBLs" exception as a grandfathering provision. *See Petit*, 675 F.3d at 781.

b. Grandfathering interpretation is arbitrary and capricious because NCUA has relied on factors which Congress did not intend the agency to consider.

If a court were to proceed beyond *Chevron*'s "plain language" analysis, NAFCU believes that a court would likely find that NCUA's grandfathering interpretation is unreasonable under *Chevron*'s "arbitrary and capricious" standard. Specifically, the statutory structure of Section 107A(b)(1) evidences that Congress did not intend to treat the MBL cap exception as a grandfathering provision.

The statutory text expressly includes both prongs of the exception in the same clause. Contrary to the construction of this clause, however, NCUA has chosen to bifurcate Section 107A(b)(1) into

two different exemptions with distinct qualification standards. NCUA argues that the exemption related to credit unions chartered for the purpose of making MBLs can be applied to credit unions meeting this definition at any time after the enactment of CUMAA, while the exemption related to credit unions with the history of primarily making MBLs applies only to each credit union's lending activity as of August 1998. A holistic reading of the text unambiguously indicates that Congress did not intend to apply a "grandfather provision" to the first clause of the sentence while omitting the second clause from this same limitation. If Congress intended for Section 107A(b)(1) to be two separate exemptions with different time periods of applicability, Congress would not have written the statute such that both provisions are included in the same sentence.

By bifurcating Section 107A(b)(1) and applying different periods of applicability, NAFCU believes NCUA simply ignores the statutory structure that Congress actually adopted. Congress intended Section 107A(b)(1) to provide an exemption from the MBL cap for credit unions that can evidence a level of commitment or experience in making MBLs. The construction of Section 107A(b)(1) suggests that Congress did not intend for NCUA to read one provision prospectively, and the other provision retroactively. Instead, NAFCU believes that this approach "relies on factors that Congress did not intend [for NCUA] to consider." *See Duncan*, 681 F.3d, at 441. As such, NAFCU believes a reviewing court could find that NCUA's grandfathering interpretation of Section 107A(b)(1)'s "history of primarily making" is unreasonable under *Chevron*'s "arbitrary and capricious" standard.

c. NCUA's definition of "primarily" in Part 723 is arbitrary and capricious because it runs counter to the legislative history of the MBL cap.

A review of the Congressional record reveals specific evidence of Congress' intent for NCUA to broadly interrupt Section 107A(b)(1)'s "history of primarily making" MBLs exemption. As Congressman Paul Kanjorski, a co-sponsor of CUMAA, stated on the House Floor, the MBL exemptions in the final bill were written so that NCUA could allow meaningful business lending to continue among credit unions with significant experience.

> "In the area of member business loans, Senate amendments provide an important exception to the limitation on member business loans for credit unions that are chartered for the purpose of, or have a history of, primarily making member business loans to their members as determined by the National Credit Union Administration.
>
> Under the bill the NCUA has broad authority to determine whether a credit union is chartered for the purpose of, or has a history of primarily making, member business loans to its members. This broad authority is important because member business loans need not be the largest category of loans in order for a credit union to qualify for this exception.

> Member business lending merely needs to constitute a significant portion of the portfolio or a significant number of loans in order for the NCUA to determine that a credit union is eligible for this exception.
>
> Secretary of the Treasury Robert Rubin has confirmed to us that member business loans by credit unions are not a safety and soundness problem. Quite the contrary, member business loans are an important authority for community credit unions and all credit unions as they attempt to meet all of the credit needs of their members and their communities.
>
> More competition in this area, where many persons of small means have difficulty obtaining credit must be encouraged by the Congress and the National Credit Union Administration." *See* 144 Cong. Rec. 18723 (Aug. 4, 1998) (statement of Representative Paul Kanjorski).

The Congressional authors of CUMAA purposefully gave NCUA broad authority to interpret whether a credit union has a history of primarily making MBLs because Congress fundamentally believed that business lending is an important activity to foster in communities across the country "as [credit unions] attempt to meet all of the credit needs of their members." 144 Cong. Rec. 18723. In particular, the record shows that Congress intended for the exception to be implemented broadly by NCUA, in order to protect the lending activities of credit unions that have proven expertise in making MBLs. This is important because MBLs "need not be the largest category of loans in order for a credit union to qualify for this exception." *Id.* Furthermore, the Congressional Record reiterates the importance of not unduly stifling the existing credit union MBL activities, because "competition in this area, where many persons of small means have difficulty obtaining credit must be encouraged." *Id.*

Given this clear support in the legislative history, NAFCU believes that NCUA's approach "runs counter to the evidence before the agency." *See Duncan*, 681 F.3d, at 441. When the NCUA Board initially codified Section 107A(b)(1) in Part 723, NCUA stated that in order to meet the definition of "primarily," the credit union must show "the primacy or state of being first when business loans form the largest type of lending in a credit union's portfolio." 64 FR 28721 (May 27, 1999). Congress explicitly stated that MBLs "need not be the largest category of loans in order for a credit union to qualify for this exception." 144 Cong. Rec. 18723. Under *Chevron,* "if the intent of Congress is clear," the agency "must give effect to unambiguously expressed intent of Congress." *City of Arlington, Tex. v. F.C.C.*, 133 S. Ct. 1863 (2013). NAFCU believes that NCUA's approach is contrary to the intent memorialized in the Congressional record.

NCUA suggests that even if the agency chooses not to impose a grandfather provision for the "history of primarily making" exception, no credit union would be able to meet Part 723's definition of "primarily making member business loans" given that the 12.25 percent cap was imposed after 1998. Congress, however, as quoted above, has directly spoken on this precise

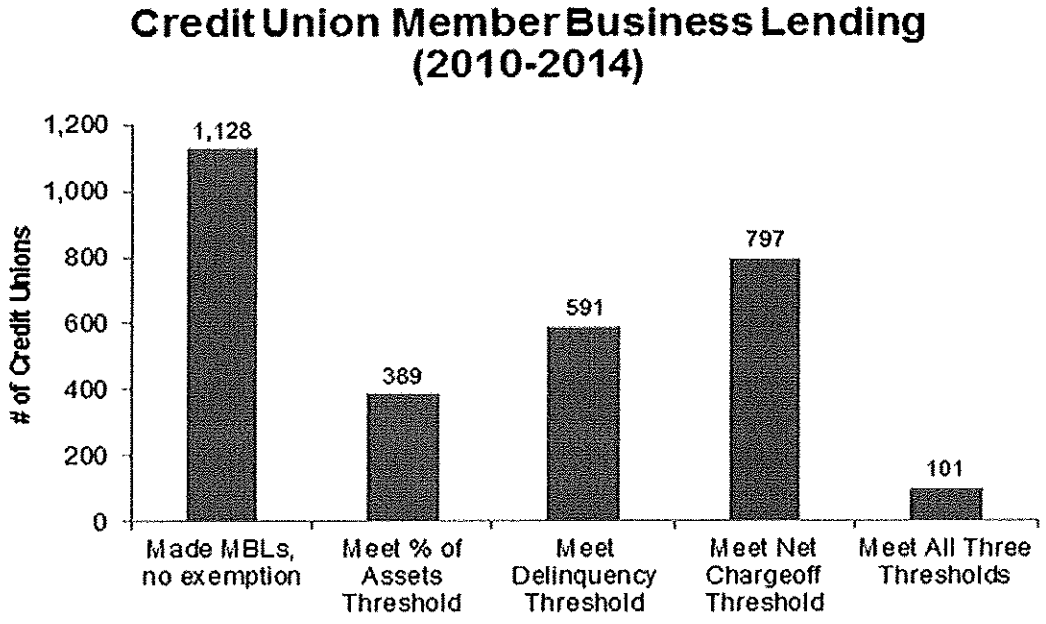
question, and NCUA has still provided "an explanation for its decision that runs counter to" this Congressional intent. *See Ass'n of Private Sector Colleges and Universities*, 681 F.3d at 441. As such, NAFCU believes that a reviewing court would likely find the agency's interpretation to be arbitrary and capricious and strike it down. *Id.*

IV. Alternative Definition

Given the legal analysis discussed above, NAFCU believes NCUA has the clear authority to redefine a credit union that has "a history of primarily making MBLs." We recommend that NCUA consider a successful MBL program in place for a period of five years or more as a qualifying definition for the statutory exemption. Specifically, NAFCU suggests that NCUA amend Section 723.17(c) with language similar to the following:

> "(c) A credit union that has a history of primarily making member business loans, meaning that it has had a successful member business lending program in place for five consecutive years that has utilized no less than 25% of its aggregate member business lending capacity. A member business lending program is successful if its delinquencies are less than or equal to 0.5% of outstanding member business loans and charge offs are less than or equal to 0.5% of average member business loans outstanding."

Using this definition of "a history of primarily making MBLs," NAFCU believes that NCUA's regulation will better align with CUMAA's statutory language and Congressional intent. Specifically, NAFCU found that between 2010 and 2014, over 1,100 credit unions that offered MBLs in their communities were subject to the MBL cap. As demonstrated by the chart below, however, NCUA could have exempted 101 of these credit unions by using NAFCU's recommended definition.



Source: NCUA 5300 Data

Accordingly, NAFCU's recommended definition would not only mirror CUMAA's spirit, but it would also provide meaningful regulatory relief to credit unions and the small businesses they serve throughout the United States.

V. Conclusion

Under a *Chevron* review, NAFCU strongly believes that Congress has clearly precluded NCUA's grandfathering interpretation. As discussed above, the statutory text and its legislative history unambiguously demonstrate that Congress created an exception from the MBL cap that is capable of both a retrospective and prospective application. Therefore, NAFCU believes NCUA has the clear authority to define a credit union which has had a successful MBL program in place for a period of five years or greater would be a reasonable definition for "a history of primarily making MBLs."