

7535-01-U

**NATIONAL CREDIT UNION ADMINISTRATION**

**12 CFR Parts 701 and 714**

**[NCUA-2022-0185]**

**RIN 3133-AF49, 3133-AE96**

**Financial Innovation: Loan Participations, Eligible Obligations, and Notes of Liquidating  
Credit Unions**

**AGENCY:** National Credit Union Administration (NCUA).

**ACTION:** Proposed rule.

**SUMMARY:** The NCUA Board (Board) is seeking comment on a proposed rule that would amend the NCUA's rules regarding the purchase of loan participations and the purchase, sale, and pledge of eligible obligations and other loans (including notes of liquidating credit unions). The proposed rule is intended to clarify the NCUA's current regulations and provide additional flexibility for federally insured credit unions (FICUs) to make use of advanced technologies and opportunities offered by the financial technology (fintech) sector. The proposal would also make

conforming amendments to the NCUA's rule regarding loans to members and lines of credit to members by adding new provisions about indirect lending arrangements and indirect leasing arrangements. Finally, the proposal would make other conforming changes and technical amendments in other sections of the NCUA's regulations. The Board does not view these conforming and technical changes as substantive.

**DATES:** Comments must be received by **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

**ADDRESSES:** You may submit comments by any of the following methods (**Please send comments by one method only**):

- Federal eRulemaking Portal: <https://www.regulations.gov>. The docket number for this notice of proposed rulemaking is NCUA-2022-0185. Follow the instructions for submitting comments.
- Mail: Address to Melane Conyers-Ausbrooks, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.
- Hand Delivery/Courier: Same as mail address.

**Public inspection:** All public comments are available on the Federal eRulemaking Portal at: <https://www.regulations.gov> as submitted, except when impossible for technical reasons. Public comments will not be edited to remove any identifying or contact information.

If you are unable to access public comments on the Internet, you may contact the NCUA for alternative access by calling (703) 518-6540 or e-mailing [OGCMail@ncua.gov](mailto:OGCMail@ncua.gov).

**FOR FURTHER INFORMATION CONTACT:** *For policy questions:* Laura Smith, Senior Credit Specialist, or Naghi Khaled, Director of Credit Markets, Office of Examination and Insurance, at (703) 518-6360; *for legal questions:* Frank Kressman, General Counsel, the Office of General Counsel, at (703) 518-6540; or by mail at National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314.

## **SUPPLEMENTARY INFORMATION:**

### **I. Summary of the Proposed Rule**

#### **A. Background**

The Board is proposing to amend §§ 701.21, 701.22, 701.23, and part 714 of the NCUA's regulations regarding the purchase of loan participations and the purchase, sale, and pledge of eligible obligations and other loans (including notes of liquidating credit unions).<sup>1</sup> The Board intends this proposal provide FICUs with additional flexibility to make use of advanced technologies and opportunities offered by the fintech sector. In addition, the proposed

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<sup>1</sup> Note that the terms credit union, federal credit union, federally insured state-chartered credit union, corporate credit union, and FICU are used throughout the document and are not necessarily interchangeable. Specifically, while § 701.23 applies to FCUs only, § 701.22 applies to all federally insured consumer credit unions, and § 701.21 has provisions that apply to all federally insured credit unions.

amendments are intended to clarify ambiguities related to loan participations and eligible obligations.

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. As a result of this effort, many of the agency's regulations are now principles-based, meaning the regulations provide a framework for a credit union to determine how to structure its operations. The NCUA's principles-based approach to rulemaking is intended to apply a broad, well-defined, set of principles governing the regulated activity. This principles-based approach enables a credit union to establish and adjust its policies and procedures to reflect its board-established risk-tolerance levels, provided those policies and procedures continue to meet the principles outlined in the regulation, including safety and soundness and compliance considerations.

The Board believes shifting to a more principles-based approach with respect to loan participations and eligible obligations is appropriate and will be beneficial to FICUs. By removing certain prescriptive limits and other qualifying conditions, and replacing them with risk-focused, principles-based requirements, the Board believes this proposal will advance the agency's efforts to strike an appropriate balance between mitigating risk to the National Credit Union Share Insurance Fund (Share Insurance Fund), protecting credit union members and fostering growth and stability in the credit union system. In addition, this shift would provide FICUs with flexibility to innovate how they manage their balance sheets while offering new or enhanced services to their members. The Board also believes the proposed changes would increase FICUs' 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. Finally, the Board notes that this proposal would address part of one of the strategic objectives outlined in the 2022 NCUA Annual Performance Plan, which is to ensure NCUA policies and regulations appropriately address emerging and innovative financial technologies.

## **B. Overview of Proposed Changes**

The proposed rule would remove certain prescriptive limitations and other qualifying requirements relating to eligible obligations and provide credit unions with additional flexibility to purchase eligible obligations of their members. Removing the current prescriptive limitations and other qualifying requirements will allow federal credit unions (FCUs) additional flexibility to engage with the advanced technologies and other opportunities offered by the fintech sector. The greater flexibility and individual autonomy will also allow FCUs to establish their own risk tolerance limits and governance policies for these activities, while codifying due diligence, risk assessment, compliance and other management processes that are consistent with the Board's long-standing expectations for safe, sound, fair and affordable lending practices.

The proposed rule would also provide credit unions with additional flexibility to participate in loans acquired through indirect lending arrangements, allowing FICUs to utilize advanced technologies and opportunities offered by the fintech sector.

As discussed in greater detail in the section-by-section analysis, the Board is proposing to amend § 701.21 of the NCUA’s regulations to add new paragraph (c)(9) regarding indirect lending and indirect leasing arrangements. The new paragraph is intended to replace the language defining indirect lending and indirect leasing arrangements under current § 701.23(b)(4)(iv), which would be removed under this proposal for the reasons explained below.

The proposal would also amend § 701.22 of the NCUA’s regulations. In particular, the proposal requests comment on certain clarifying amendments to the introductory paragraph, and would codify NCUA Legal Opinion 15-0813, Loan Participations in Indirect Loans – Originating Lender.<sup>2</sup> Through the codification of Legal Opinion 15-0813, this proposed rule would clarify that a FICU engaged in an indirect lending relationship can meet the definition of “eligible organization” under § 701.22 of the NCUA’s regulations, provided the FICU meets certain conditions. Specifically, under this proposal, for purposes of § 701.22, a FICU would be considered the originating lender and meet the definition of an “eligible organization” if the FICU makes the final underwriting decision regarding the loan, and the loan is assigned to the purchaser very soon after the inception of the obligation to extend credit.

The Board notes that it intends the codification of the aforementioned legal opinion to clarify that a FICU can meet the definition of “originating lender” in certain transactions where the FICU is engaging in indirect lending arrangements with fintech companies and other third-

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<sup>2</sup> NCUA Legal Op. 15-0813 (Aug. 10, 2015) available at <https://www.ncua.gov/regulation-supervision/legal-opinions/2015/loan-participations-indirect-loans-originating-lenders>.

party loan acquisition channels, such as Credit Union Service Organizations (CUSOs) and other loan-originating retailers.

In addition, this proposed rule would amend § 701.23 of the NCUA's current regulations as follows:

- Proposing certain clarifying and conforming amendments to the introductory paragraph to § 701.23.
- Removing the CAMELS ratings and well-capitalized requirements under § 701.23(b)(2) for FCU purchases of certain non-member loans from FICUs.
- Narrowing the application of the 5-percent limit on the purchase of eligible obligations to notes of a liquidating credit union.
- Adding safety and soundness requirements to section § 701.23(b)(6)(i)–(vi) concerning the purchase of eligible obligations, to offset risks associated with removing the CAMELS and well-capitalized requirements from § 701.23(b)(2), and narrowing the application of the 5-percent limit to notes of liquidating credit unions. Safety and soundness and compliance requirements would apply to all FCUs engaged in the purchase of eligible obligations and notes from a liquidating credit union. In particular, the proposed rule would require an FCU purchasing eligible obligations or notes from a liquidating credit union to:

- establish written, board-approved policies, risk assessments, and risk management process requirements that are commensurate with the size, scope, type, complexity, and level of risk posed by the planned purchase activities. These policies would include underwriting standards for the loans, ongoing performance and risk monitoring, including compliance risk, tailored to the types of loans purchased and the sellers as applicable, and portfolio concentration limits by loan types and risk categories in relation to net worth;
  - conduct due diligence on a seller prior to the purchase; and
  - require the written loan purchase agreements to contain certain contract language and provisions (similar to the standards currently established for loan participation agreements under § 701.22 of the NCUA's regulations);
  - provide for a legal review and assessment of applicable loan purchase agreements or contracts to protect the FCU's legal and business interests from undue risk.
- Revising the definition of an eligible obligation under §701.23(a)(1) to clarify the distinction between transactions treated as loan participations and those treated as eligible obligations.



- Revising the applicability of the 5-percent limit, discussed in more detail later in this document, from covering the purchase of most eligible obligations to only “notes” purchased by an FCU from a liquidating credit union.
  
- Revising the “grandfathered purchases” section of the current rule to include eligible obligation purchases that were executed before the effective date of this proposed rule (if adopted) and complied with § 701.23 at the time the transaction was executed, subject to safety and soundness and compliance considerations.
  
- Adding safety and soundness requirements to section §701.23(c) concerning the sale of eligible obligations, requiring the selling FCU to do the following:
  - obtain a legal review and assessment of all applicable loan sale agreements or contracts to protect the FCU’s legal and business interests; and
  
  - identify the specific loan(s) being sold either directly in the written loan sale agreement or through a document that is incorporated by reference into the loan sale agreement.

The Board is also proposing to amend § 714.9 of the NCUA’s regulations to make certain conforming amendments related to proposed changes to § 701.23(b)(4).

Finally, the proposal would make certain other conforming changes and technical amendments in other sections of the NCUA’s regulations. The Board does not view these additional conforming technical changes as substantive.

## II. Legal Authority

Section 120(a)<sup>3</sup> of the Federal Credit Union Act (FCU Act or Act) authorizes the Board to prescribe rules and regulations for the administration of the Act.<sup>4</sup> Similarly, section 209<sup>5</sup> of the FCU Act authorizes the Board to prescribe such rules and regulations as it may deem necessary or appropriate to carry out the share insurance provisions of subchapter II of the Act. In addition, section 206 of the FCU Act provides the Board with broad authority to take enforcement action against a FICU or an “institution-affiliated party”<sup>6</sup> that is engaging or has engaged, or the Board has reasonable cause to believe that is about to engage, in an unsafe or unsound practice in conducting the business of such credit union.<sup>7</sup> Congress chose not to define

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<sup>3</sup> 12 U.S.C. 1766(a) (“The Board may prescribe rules and regulations for the administration of [12 U.S.C.] chapter [14] (including, but not by way of limitation, the merger, consolidation, and dissolution of corporations organized under this chapter). Any central credit union chartered by the Board shall be subject to such rules, regulations, and orders as the Board deems appropriate and, except as otherwise specifically provided in such rules, regulations, or orders, shall be vested with or subject to the same rights, privileges, duties, restrictions, penalties, liabilities, conditions, and limitations that would apply to all Federal credit unions under this chapter.”).

<sup>4</sup> §§ 1751–1795k.

<sup>5</sup> § 1789(11) (providing in relevant part as follows: “In carrying out the purposes of this subchapter, the Board may—[. . .] prescribe such rules and regulations as it may deem necessary or appropriate to carry out the provisions of [12 U.S.C. 1781–1790e].”).

<sup>6</sup> *See* § 1786(r) (providing: “For purposes of [the FCU Act], the term ‘institution-affiliated party’ means—(1) any committee member, director, officer, or employee of, or agent for, an insured credit union; (2) any consultant, joint venture partner, and any other person as determined by the Board (by regulation or on a case-by-case basis) who participates in the conduct of the affairs of an insured credit union; and (3) any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in—(A) any violation of any law or regulation; (B) any breach of fiduciary duty; or (C) any unsafe or unsound practice, which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured credit union.”).

<sup>7</sup> § 1786.

“unsafe or unsound practices” in the FCU Act, leaving determinations regarding which actions are unsafe or unsound to the Board.

Section 107(5)(E) of the FCU Act authorizes FCUs to engage in participation lending with other credit unions, credit union organizations, or financial organizations in accordance with written policies of the board of directors.<sup>8</sup> Section 107(5)(E) also provides that a credit union that originates a loan for which participation arrangements are made in accordance with this subsection shall retain an interest of at least 10 per centum of the face amount of the loan.<sup>9</sup>

Section 107(13) of the FCU Act authorizes FCUs, in accordance with rules and regulations prescribed by the Board, to purchase, sell, pledge, or discount or otherwise receive or dispose of, in whole or in part, any eligible obligation (as defined by the Board) of its members.<sup>10</sup> In addition, section 107(13) authorizes FCUs, in accordance with rules and regulations prescribed by the Board, to purchase from any liquidating credit union notes made by individual members of the liquidating credit union at such prices as may be agreed upon by the board of directors of the liquidating credit union and the board of directors of the purchasing credit union, but no purchase may be made under authority of this paragraph if, upon the making of that purchase, the aggregate of the unpaid balances of notes purchased under authority of this paragraph would exceed 5 per centum of the unimpaired capital and surplus of the credit union.<sup>11</sup>

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<sup>8</sup> § 1757(5)(e).

<sup>9</sup> *Id.*

<sup>10</sup> § 1757(13).

<sup>11</sup> *Id.*

Section 107(14) of the FCU Act authorizes FCUs, subject to regulations of the Board, to sell all or a part of its assets to another credit union, to purchase all or part of the assets of another credit union, and to assume the liabilities of the selling credit union and those of its members.<sup>12</sup>

### **III. Section-by-Section Analysis**

#### *A. Part 701 Organization and Operation of Federal Credit Unions*

As discussed in more detail below, this proposal would make several changes to sections in part 701 of the NCUA's regulations. The Board requests comment on all aspects of the proposal and on specific questions and issues mentioned below. These changes are intended to clarify numerous provisions regarding loans to members and lines of credit to members under § 701.21; loan participations under § 701.22; and the purchase, sale, and pledge of eligible obligations under § 701.23. In addition, the proposal would amend the NCUA's current regulatory requirements under §§ 701.22 and 701.23. The amended requirements would provide FICUs authority and autonomy to innovate and transact business with fintech companies and other institutions that provide services associated with the origination and sale of loans made to members of FICUs.

#### *Section 701.21 Loans to Members and Lines of Credit to Members*

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<sup>12</sup> § 1757(14).

As discussed in more detail below, this proposal would, as a conforming amendment, add new provisions to § 701.21 regarding indirect lending arrangements and indirect leasing arrangements. The new provisions are intended to take the place of a provision in current § 701.23, which would be removed under the proposal. No other changes to § 701.21 are proposed.

#### *701.21(c) General Rules*

##### *New 701.21(c)(9) Indirect Lending and Indirect Leasing Agreements*

For reasons discussed in the preamble discussion on current § 701.23(b)(4), the NCUA is proposing to delete paragraph (b)(4)(iv) regarding indirect lending from § 701.23. Current § 701.23(b)(4)(iv) excludes certain loans acquired through indirect lending arrangements and indirect leasing arrangements from the 5-percent limit on the aggregate of the unpaid balance of certain loans purchased under § 701.23. While the language excluding loans and leases acquired through indirect lending and indirect leasing arrangements would no longer be needed in § 701.23(b)(4), the definition of such arrangements is still relevant for purposes of other provisions in the NCUA's regulations. Under current paragraph (b)(4), and NCUA's long-standing interpretation,<sup>13</sup> loans acquired by an FCU pursuant to an indirect lending arrangement are considered loans made by the FCU under § 701.21, rather than loans purchased under

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<sup>13</sup> See, e.g., NCUA Legal Op. 97-0546 (Aug. 6, 1997), available at <https://www.ncua.gov/regulation-supervision/legal-opinions/1997/indirect-lending>.

§ 701.23. Accordingly, the Board is proposing to add to § 701.21 new paragraph (c)(9) regarding indirect lending and indirect leasing arrangements. The new paragraph is intended to replace the language defining indirect lending and indirect leasing arrangements under current § 701.23(b)(4)(iv).

*New 701.21(c)(9)(i) Definitions*

Proposed new § 701.21(c)(9)(i) would define the terms “indirect leasing arrangement” and “indirect lending arrangement” for purposes of the NCUA’s regulations. Current § 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 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-percent limit. The NCUA believes splitting the provision in paragraph (b)(4)(iv) into two definitions will help clarify the existing requirements. Accordingly, proposed new § 701.21(c)(9)(i) would provide that the term *indirect leasing arrangement* means 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. Proposed new paragraph (c)(9)(i) would provide further that the term *indirect lending arrangement* means 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 new definitions would use language that is generally similar, but not identical, to the language in current § 701.23(b)(4)(iv). The NCUA is proposing to revise the language used in current paragraph (b)(4)(iv) to clarify the different requirements that apply to indirect leasing arrangements and indirect lending arrangements. The proposed changes are intended to clarify but not change the current meaning of both terms.

The Board specifically requests comment on whether proposed paragraph (c)(9) would have a material impact on credit unions' existing and future indirect lending arrangements, indirect leasing arrangements, or both.

#### *New 701.21(c)(9)(ii) Indirect Lending*

Proposed new § 701.21(c)(9)(ii), consistent with current § 701.23(b)(4)(iv), would clarify the difference between loans made pursuant to indirect lending arrangements under § 701.21 and loans purchased under § 701.23. Current § 701.23(b)(4)(iv) excludes loans acquired pursuant to certain indirect lending arrangements from the 5-percent limit under current paragraph (b)(4). Paragraph (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 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 from calculating the 5-

percent limit.<sup>14</sup> As previously mentioned, current § 701.23(b)(4)(iv) would be removed under this proposal. Accordingly, proposed new § 701.21(c)(9)(ii) would provide that a loan acquired pursuant to an indirect lending arrangement, and that meets the requirements of § 701.21, is classified as a loan and not the purchase of a loan for purposes of the NCUA's regulations, which are codified in chapter VII of title 12 of the Code of Federal Regulations.

#### *New 701.21(c)(9)(iii) Indirect Leasing*

Proposed new § 701.21(c)(9)(iii), consistent with current §§ 701.23(b)(4)(iv) and 714.9, would clarify the difference between leases made pursuant to indirect leasing arrangements under § 714.2(b)<sup>15</sup> and leases purchased under § 701.23. Current § 701.23(b)(4)(iv) excludes leases acquired pursuant to certain indirect leasing arrangements from the 5-percent limit under current paragraph (b)(4). Paragraph (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 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

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<sup>14</sup> (emphasis added); *see also, e.g.*, NCUA Legal Op. 97-0546 (Aug. 6, 1997) (providing in relevant part: "FCUs may participate in indirect lending arrangements under the authority to make loans to members, 12 U.S.C. §107(5); 12 C.F.R. §701.21, rather than the authority to purchase eligible obligations, 12 U.S.C. §107(13); 12 C.F.R. §701.23, as long as two conditions are met. First, the FCU must make the final underwriting decision. That is, before the retailer and the member complete the loan or sales contract, the FCU must review the application and determine that the transaction conforms to its lending policies. This is because an FCU may not delegate its lending authority to a third party. Second, the retailer must assign the loan or sales contract to the FCU very soon after it is completed. Assignment close in time to the making of the loan allows the retailer to function as the facilitator of the loan while the FCU remains the true lender. As the time between completion and assignment of the loan lengthens, the FCU's payment to the retailer becomes the purchase of the loan rather than part of the processing of the loan.").

<sup>15</sup> (Providing: "[An FCU] may engage in indirect leasing. In indirect leasing, a third party leases property to [the FCU's] member and [the FCU] then purchases that lease from the third party for the purpose of leasing the property to [the FCU's] member. [The FCU does] not have to purchase the leased property if [it complies] with the requirements of § 714.3.").



company, is excluded in calculating the 5-percent limitation.<sup>16</sup> Similarly, current § 714.9 provides that an FCU's indirect leasing arrangements are not subject to the eligible obligation limit if they satisfy the provisions of § 701.23(b)(3)(iv) that require that an FCU make the final underwriting decision and that the lease contract is assigned to the FCU very soon after it is signed by the member and the dealer or leasing company. Accordingly, proposed new § 701.21(c)(9)(iii) would provide that a lease acquired pursuant to an indirect leasing arrangement, and that meets the requirements of part 714 of the NCUA's regulations, is classified as a lease and not the purchase of a lease for purposes of the NCUA's regulations, which are codified in chapter VII of title 12 of the Code of Federal Regulations.

#### *Section 701.22 Loan Participations.*

As discussed in more detail below, the proposal would make several clarifying amendments to § 701.22. These changes are primarily intended to clarify FCUs' authority to purchase loan participations and the requirements applicable to the purchase of loan participations by federally insured, state-chartered credit unions (FISCUs).

#### *701.22 Introductory Paragraph*

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<sup>16</sup> *Id.* (emphasis added); see also 12 CFR §§ 714.2(b) & 714.9; and NCUA Legal Op. 00-0811 (Nov. 2000) (providing in part: "NCUA's leasing regulation recognizes that FCUs may engage in the leasing of personal property and does not distinguish between consumer and business leasing. 12 C.F.R. Part 714. The authority of FCUs to engage in secured lending is the basis for their authority to engage in leasing. Therefore, FCU leasing generally must comply with the statutory and regulatory requirements applicable to secured lending, including the member business loan rule. 12 C.F.R. Part 723. Our leasing regulation, however, notes exceptions from certain provisions of the lending rules that are not pertinent to leasing; for example, the interest rate ceilings. 12 C.F.R. §§714.10, 701.21(c)(7). In a lease, the lessee's payments are periodic rental payments, not the repayment of principal and interest as in a loan.").

The introductory paragraph to current § 701.22 sets forth the scope and limitations of the section. The NCUA Board added the introductory paragraph to § 701.22 as part of a final rule it approved in 2013 (2013 Final Rule).<sup>17</sup> The introductory paragraph was intended to clarify several issues related to the scope and applicability of § 701.22. In particular, the 2013 Final Rule explained:

The introductory text clarifies the scope of the rule and helps distinguish a loan participation under § 701.22 from an eligible obligation under § 701.23. Further, it clarifies that the rule applies to a natural person FICU's purchase of a loan participation where the borrower is not a member of that credit union. Generally, an FCU's purchase, in whole or in part, of its member's loan is covered by NCUA's eligible obligations rule at § 701.23. Additionally, by a cross-reference to Part 741 of NCUA's regulations, the rule also is made applicable to natural person FISCUs. The Board notes that corporate credit unions are subject to the loan participation requirements set forth in Part 704 and, therefore, are not subject to § 701.22 of NCUA's regulations.<sup>18</sup>

The introductory paragraph has seven separate substantive provisions. First, the paragraph provides that this section applies only to loan participations as defined in the section. Second, it provides that the section does not apply to the purchase of an investment interest in a pool of loans. Third, it provides that the section establishes the requirements a FICU must

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<sup>17</sup> 78 FR 37946 (June 25, 2013) (footnote omitted).

<sup>18</sup> 78 FR 37948.

satisfy to purchase a loan participation. Fourth, it provides that the section applies to a FICU's purchase of a loan participation only where the borrower is not a member of the purchasing FICU and where a continuing contractual obligation between the seller and purchaser is contemplated. Fifth, it provides that § 701.23 generally applies to an FCU's purchase of all or part of a loan made to one of its members. Sixth, it provides that § 741.225 requires FISCUs to comply with the requirements of § 701.22, though § 741.225 provides that FISCUs are exempt from the borrower membership requirement in current § 701.22(b)(4). Seventh, the paragraph provides that the section does not apply to corporate credit unions as defined in part 704.

In the 2013 Final Rule, the Board added a similar introductory paragraph to § 701.23 regarding the purchase, sale, and pledge of eligible obligations to clarify the scope of that section and distinguish loan participations from eligible obligations. The provisions included in that introductory paragraph are discussed in detail later in the part of the preamble on the introductory paragraph to § 701.23.

Since adopting the prefatory language in both sections, the NCUA has received inquiries from NCUA examiners, FICUs, fintech companies, and other parties who have expressed confusion about how to interpret many of these provisions. This confusion has led to inconsistent reporting of loan interests by FICUs and uncertainty about which of the two sections, §§ 701.22 or 701.23, to apply to certain transactions, particularly innovative programs that have been designed by FICUs after 2013. In addition, the Board is concerned that continued confusion about lines of authority in this area could discourage FICUs from entering into certain

safe, sound and compliant loan participation, purchase, or sale agreements that are within their statutory authority.

One significant issue with the current introductory paragraph to § 701.22 that parties have raised is when a FICU's partial loan purchase is subject to that section. In particular, parties have cited the continuing contractual obligation qualifier as a source of confusion. The third sentence in the introductory paragraph to current § 701.22 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.*<sup>19</sup> The fourth 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 § 701.23(b)(2), *where no continuing contractual obligation between the seller and purchaser is contemplated,* is governed by § 701.23 of this part.<sup>20</sup> Similarly, the introductory paragraph to § 701.23 provides that § 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.*<sup>21</sup>

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

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<sup>19</sup> (emphasis added).

<sup>20</sup> (emphasis added).

<sup>21</sup> (emphasis added).

continuing contractual obligation between the buyer and the seller, including representations and warranties regarding the loans and loan repurchase agreements, servicing agreements, and other similar types of ongoing obligations set forth under the agreements. The Board believes the continuing contractual obligation clauses in the third and fourth sentences in the introductory paragraphs to current § 701.22 are unnecessary when determining whether a loan purchase agreement qualifies as either a loan participation or an eligible obligation.

In addition to the concerns explained above, the clause *where the borrower is not a member of that credit union* in the first part of the third sentence of the introductory paragraph conflicts with another provision in § 701.22. This language could be misinterpreted to suggest that § 701.22 does not apply to a partial loan purchase where the borrower is a member of the purchasing credit union, even when the transaction otherwise meets the definition of a loan participation under § 701.22. This clause directly conflicts with the more specific requirement in § 701.22(b)(4), which provides that the borrower must become a member of one of the participating credit unions before the purchasing FICU purchases a participation interest in the loan. The NCUA has long interpreted the more specific language in paragraph (b)(4) as controlling and has applied the requirements of § 701.22 to partial loan purchases where the purchase meets the definition of a loan participation and the borrower is a member of the purchasing FICU.

Accordingly, the NCUA believes the removal of this clause will serve to clarify and reduce confusion when § 701.22 applies to certain transactions. As part of this proposal, the Board requests comment on whether deleting the fourth and fifth sentences in the introductory

paragraph to current § 701.22 would clarify when the section applies to certain transactions. After considering any public comments received on this issue, the Board may adopt these amendments in a final rule based on this proposal.

The NCUA recognizes that whether the purchase of a partial loan is a loan participation under § 701.22 or a loan purchase under § 701.23 may still be uncertain in some instances even if these sentences are removed. The NCUA believes, however, that other provisions in § 701.22, such as the definition of loan participation and the conditions outlined in paragraph (b), make clear which transactions are subject to the requirements of § 701.22.

As discussed in more detail in the part of the preamble below regarding § 701.23, the Board is also considering deleting the continuing contractual obligations sentence in current § 701.23, subject to comments received on this proposal. The Board intends this change to work in conjunction with the proposed changes to the introductory paragraph to current § 701.22.

The Board is proposing no other changes to the introductory paragraph to current § 701.22. Another provision in the introductory paragraph that is often misread, however, is the sentence providing that § 701.22 does not apply to the *purchase of an investment interest in a pool of loans*. That sentence is intended to clarify that the purchase of such investment interests, to the extent they are permitted, are governed by part 703 of the NCUA's regulations for FCUs (and under part 741 of the NCUA's regulations and as authorized under state law for FISCUs) and not § 701.22. This continues to be the case under this proposal. The NCUA notes further that this qualification to the section makes clear that § 701.22 neither applies to nor authorizes

FICU investments in either asset-backed securities or the purchase of other similar investment interests in pools of loans.<sup>22</sup> The requirements of § 701.22 apply to each individual loan a FICU purchases a loan participation interest in.<sup>23</sup>

If all the changes proposed above are adopted in a final rule, the introductory text of § 701.22 would provide:

This section applies only to loan participations as defined in paragraph (a) of this section. It does not apply to the purchase of an investment interest in a pool of loans. This section establishes the requirements a federally insured credit union must satisfy to purchase a participation in a loan. Federally insured state-chartered credit unions are required by § 741.225 of this chapter to comply with the loan participation requirements of this section. This section does not apply to corporate credit unions, as that term is defined in § 704.2 of this chapter.

*701.22(a)*

The proposed rule would add a second sentence to the current definition of “originating lender” in §701.22(a) to codify and further clarify a 2015 NCUA legal opinion (2015 Opinion)

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<sup>22</sup> (emphasis added).

<sup>23</sup> See, e.g., NCUA Legal Op. 18-0133 (March 2018), available at <https://www.ncua.gov/regulation-supervision/legal-opinions/2018/loan-participations>.

regarding loan participations in indirect loans.<sup>24</sup> The NCUA’s 2013 Final Rule amended the loan participation regulation to, among other things, clarify that the originating lender must participate in the loan throughout the life of the loan.<sup>25</sup> In the 2013 Final Rule, the NCUA explained that this requirement derives from sections 107(5) and (5)(E) of the FCU Act.<sup>26</sup> Section 107(5) provides in relevant part that an FCU shall have *power to participate with* other credit unions, credit union organizations, or financial organizations in making loans to credit union members.<sup>27</sup> Section 107(5)(E) requires further that participation loans *with* other credit unions, credit union organizations, or financial organizations shall be in accordance with written policies of the credit union’s board of directors, provided that a credit union which *originates* a loan for which participation arrangements are made in accordance with this subsection *shall retain an interest* of at least 10 per centum of the face amount of the loan.<sup>28</sup> While the statutory requirements of section 107(5)(E) primarily pertain to FCUs involved in loan participations, the

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<sup>24</sup> NCUA Legal Op. 15-0813 (Aug. 10, 2015) available at <https://www.ncua.gov/regulation-supervision/legal-opinions/2015/loan-participations-indirect-loans-originating-lenders>.

<sup>25</sup> 78 FR 37946, 37949 (June 25, 2013) (“The proposed rule revised the definitions of ‘originating lender’ and ‘loan participation’ to clarify that the originating lender must participate in the loan throughout the life of the loan.”); see also § 701.22(a) (providing in relevant part: “*Loan participation* means a loan where one or more eligible organizations participate pursuant to a written agreement *with the originating lender*, and the written agreement requires the originating lender’s continuing participation throughout the life of the loan.” (emphasis added)).

<sup>26</sup> See 76 FR 79548, 79549 (Dec. 22, 2011); and 78 FR 37946, 37949 (June 25, 2013) (“The requirement that credit unions only participate with the originating lender derives from the FCU Act’s requirement for originating FCUs to retain at least a 10 percent interest in the face amount of all loans they participate out. Moreover, the Board interprets the authority in the FCU Act for credit unions to participate in loans ‘with’ other lenders to contemplate a shared, continuing lending arrangement. Simply put, the rule requires an originating lender to remain part of the participation arrangement and to retain a continuing interest in the loan in order to be a true participant. Otherwise, the transaction is not a loan participation but more akin to the sale of an eligible obligation.”).

<sup>27</sup> 12 U.S.C. 1757(5) (emphasis added).

<sup>28</sup> § 1757(5)(E) (emphasis added).



Board chose, for safety and soundness reasons, to extend most of the requirements in § 701.22 to cover all FICUs as part of the 2013 Final Rule.<sup>29</sup>

In the 2013 Final Rule, the Board noted two specific safety and soundness concerns as reasons for adopting the current definition of “originating lender,” explaining in relevant part as follows:

[T]he [2013 Final Rule] requires an originating lender to remain part of the participation arrangement and to retain a continuing interest in the loan in order to be a true participant. Otherwise, the transaction is not a loan participation but more akin to the sale of an eligible obligation. As the Board noted in 1991, permitting the sale of participation interests in eligible obligations “will *blur the distinction* between loan participations and loan purchases and sales,” arguably circumventing the purpose of the loan participation and eligible obligations rules. Additionally, the Board believes the continued participation of the lender that initially originated the loan is integral to a safe and sound participation arrangement. In 1991, the Board expressed its concern that a lender “may have a *decreased interest in*

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<sup>29</sup> See 76 FR 79548, 79548 (Dec. 22, 2011) (Explaining in part as follows: “[L]oan participations [. . .] create more systemic risk to the share insurance fund (NCUSIF) due to the resulting interconnection between participants. For example, large volumes of participated loans in the system tied to a single originator, borrower, or industry or serviced by a single entity have the potential to impact multiple credit unions if a problem arises. Additionally, as both federal credit unions (FCUs) and federally insured state-chartered credit unions (FISCU) actively engage in loan participations, it is important to the safety and soundness of the NCUSIF that all federally insured credit unions (FICUs) adhere to the same minimum standards for engaging in loan participations. The Board believes such standards are necessary to ensure the NCUSIF consistently recognizes and accounts for the risks associated with the purchase of loan participations. Finally, during examinations and other FICU contacts, the agency has encountered confusion concerning the application of the current loan participation rule regarding the entities and transactions subject to the rule.”); and 78 FR 37946, 37947 & 37955 (June 25, 2013); and § 741.225.

*properly underwriting a loan* if they know they can later reduce their risk by selling participation interests in it.” The requirement for the originating lender’s continued participation in a loan participation arrangement is intended to address this safety and soundness concern.<sup>30</sup>

As explained in more detail below, these concerns are fully accounted for under the 2015 Opinion and this proposal by limiting the interpretation to indirect loans and requiring that such loans meet the same general requirements applicable to indirect loans made by FCUs under current § 701.23(b)(4)(iv).

The 2013 Final Rule responded to concerns raised by commenters regarding the proposed definition of “originating lender” and its application in situations where a CUSO underwrites and processes a loan, but the FICU funds the loan. In response to this feedback the Board provided the following explanation:

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<sup>30</sup> 78 FR 37946, 37948 & 37949 (emphasis added) (providing also: “In granting [loan participation authority to FCUs], Congress expressed its intent to enhance the ability of FCUs to serve their members’ loan demands. Congress also expressed, however, that originating FCUs must maintain discipline in the origination process. [. . . T]he loan participation authority must not be so broad that loan participations may be originated from any source. [. . .]”); 56 FR 15034, 15034–15035 (April 15, 1991) (“NCUA has interpreted the term ‘participation loan’ to mean arrangements made prior to disbursements of the loan proceeds. In the preamble to the proposed rule, the Board stated that this interpretation may be too restrictive and proposed deleting it. [. . .] One commenter noted that this change will blur the distinction between loan participations and loan purchases and sales. [. . .] There are two basic safety and soundness concerns with the proposed change. 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. [. . .] Accordingly, the NCUA Board declines to adopt the proposed change and will continue to require a written commitment to participate in a loan precede final disbursement.”); *see also* 68 FR 39866, 39867 (July 3, 2003); 68 FR 75110 (Dec. 30, 2003); *and* H.R. Rep. No. 95–23, at 12 (1977), *reprinted in* 1977 U.S.C.C.A.N. 115.

These commenters observed that a CUSO often serves as an originator in name only and, thus, is not the most appropriate party to regard as the originating lender for the purposes of the rule. For example, loans may be *underwritten* and processed by a CUSO, but funded by its owner credit union. The Board acknowledges that this CUSO model is not uncommon within the industry and permissible under § 712.5. For purposes of this final rule, it is the Board's intent that the originating lender is the entity with which the borrower initially or originally contracts for the loan.<sup>31</sup>

As noted above, the Board's responses to commenters in the 2013 Final Rule regarding the definition of originating lender were limited to situations in which a FICU purchased a loan from a CUSO that had underwritten the loan. The Board did not discuss the application of the definition of originating lender to CUSOs or other entities in the context of indirect lending arrangements in which a purchasing FICU underwrites the loan and makes the final underwriting decision. Accordingly, 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 and open to later interpretation by the NCUA, which is what it did two years later in the 2015 Opinion discussed in more detail in the following paragraphs.

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<sup>31</sup> 78 FR 37949-37950 (emphasis added).

The NCUA has long used the act of underwriting a loan as a feature to distinguish between transactions where a FICU makes a loan and transactions where a FICU purchases a loan.<sup>32</sup> In particular, in a 1997 legal opinion the NCUA explained:

FCUs may participate in indirect lending arrangements under the authority to *make loans to members*, 12 U.S.C. §107(5); 12 C.F.R. §701.21, rather than the authority to purchase eligible obligations, 12 U.S.C. §107(13); 12 C.F.R. §701.23, as long as two conditions are met. *First, the FCU must make the final underwriting decision.* That is, before the retailer and the member complete the loan or sales contract, the FCU must review the application and determine that the transaction conforms to its lending policies. This is because an FCU may not delegate its lending authority to a third party. Second, the retailer must assign the loan or sales contract to the FCU very soon after it is completed. Assignment close in time to the making of the loan allows the retailer to function as the facilitator of the loan while the FCU remains the true lender. As the time between completion and assignment of the loan lengthens, the FCU's payment to the retailer becomes the purchase of the loan rather than part of the processing of the loan.<sup>33</sup>

By requiring the purchasing credit union to make the final underwriting decision in an indirect lending transaction, the NCUA ensured that the purchasing credit union was not relying

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<sup>32</sup> See, e.g., NCUA Legal Op. 92-1203 (Jan. 5, 1993); NCUA Legal Op. 92-1203 (May 11, 1993); NCUA Legal Op. 97-0546 (Aug. 6, 1997), available at <https://ncua.gov/regulation-supervision/legal-opinions>; and § 701.23(b)(4)(iv).

<sup>33</sup> NCUA Legal Op. 97-0546 (emphasis added).

on the due diligence of the loan seller who might otherwise have had a decreased interest in properly underwriting the loan knowing it would later be sold. Moreover, under the NCUA's loan participation regulation, the originating lender is required to retain at least a 5-percent interest in any participation interest for the life of the loan.<sup>34</sup> Accordingly, where an eligible organization makes a loan through an indirect lending arrangement there is no greater risk of incentives for lax or improper underwriting for purposes of § 701.22 than if the eligible organization had processed and funded the loan itself.

Furthermore, as discussed in the 1997 legal opinion quoted above, the NCUA has long distinguished between indirect loans, made under section 107(5) of the FCU Act and 12 CFR 701.21, and eligible obligations purchased under section 107(13) of the FCU Act and 12 CFR 701.23.<sup>35</sup> For over 25 years the NCUA has treated indirect loans—as defined under current § 701.23(b)(4)(iv)—made by a credit union to be separate and distinct from eligible obligations. Accordingly, while permitting the sale of participation interests in eligible obligations might blur the distinction between loan participations and loan purchases and sales and circumvent the purpose of the loan participation and eligible obligations rules, allowing the sale of participation interests in indirect loans presents no such risk.

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<sup>34</sup> § 701.22(d)(4)(ii) (“The interest that the originating lender will retain in the loan to be participated. If the originating lender is a federal credit union, the retained interest must be at least 10 percent of the outstanding balance of the loan through the life of the loan. If the originating lender is any other type of eligible organization, the retained interest must be at least 5 percent of the outstanding balance of the loan through the life of the loan, unless a higher percentage is required under state law.”).

<sup>35</sup> NCUA Legal Op. 97-0546.

Working within the regulatory and interpretative history discussed above, the NCUA determined in the 2015 Opinion that an “eligible organization”<sup>36</sup> may be considered the “originating lender” for purposes of § 701.22 where the eligible organization generated the loan through an “*indirect lending arrangement*”<sup>37</sup> with a retailer such as an auto dealer.<sup>38</sup> Current § 701.22(a) defines the term “originating lender” as “the participant with which the borrower initially or originally contracts for a loan and who, thereafter or concurrently with the funding of the loan, sells participations to other lenders.”<sup>39</sup> The 2015 Opinion explained that, in indirect lending arrangements with a retailer such as an auto dealer, the retailer is acting as an agent of the eligible organization, and is simply performing as an administrative functionary processing a loan for the eligible organization, and the retailer’s activities are part and parcel of, and an extension of, the eligible organization’s lending operations. In this context, the 2015 Opinion concluded, the retailer is not acting as a separate lender generating loans for itself and then selling those loans to an eligible organization. Rather, the retailer is a facilitator that is part of the eligible organization’s loan processing mechanism, and the eligible organization is the *de facto* originating lender and, therefore, the originating lender for purposes of the NCUA’s loan participation rule.

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<sup>36</sup> *Id.* (providing in relevant part as follows: “*Eligible organization* means a credit union, credit union organization, or financial organization.”).

<sup>37</sup> See § 701.23(b)(4)(iv) (“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 makes the final underwriting decision and the sales or lease contract is assigned to the Federal credit union very soon after it is signed by the member and the dealer or leasing company.”) (emphasis added).

<sup>38</sup> NCUA Legal Op. 15-0813.

<sup>39</sup> *Id.* (providing in relevant part: “*Originating lender* means the participant with which the borrower initially or originally contracts for a loan and who, thereafter or concurrently with the funding of the loan, sells participations to other lenders.”).

The 2015 Opinion explained further that a loan purchased by an eligible organization must satisfy two conditions to be classified as an “indirect loan” and not the purchase of a loan.<sup>40</sup> First, the eligible organization must make the final underwriting decision regarding the loan. In other words, a loan must be underwritten by the purchasing eligible organization before completion of the loan or sales contract.<sup>41</sup> An eligible organization may use an automated credit scoring system to make its final underwriting decision as long as the “score” obtained from the automated system is the sole determinant for granting credit.<sup>42</sup> When an eligible organization establishes the qualifying criteria for the automated scoring system, it is effectively making an advance decision on a particular application.<sup>43</sup> So long as the party entering the borrower’s application information does not exercise any judgment regarding that information, the score will be deemed to reflect the FCU’s lending policies.<sup>44</sup>

Second, the sales contract must be assigned to the eligible organization *very soon after* it is signed by the borrower and the dealer.<sup>45</sup> As explained in a separate NCUA legal opinion, assignment close in time to the making of the loan allows the retailer to function as the facilitator of the loan while the eligible organization remains the true lender.<sup>46</sup> The length of time that satisfies “very soon after” depends on the nature of the loan and the practical realities of assigning certain kinds of loans in the current marketplace and in accordance with prevailing

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<sup>40</sup> See § 701.22(b)(4)(iv); see also NCUA Legal Op. 15-0813; and 78 FR 37946, 37949 (explaining that “a lender ‘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.’”).

<sup>41</sup> See *id.*

<sup>42</sup> See NCUA Legal Op. 97-0546.

<sup>43</sup> See *id.*

<sup>44</sup> See *id.*

<sup>45</sup> (emphasis added).

<sup>46</sup> See NCUA Legal Op. 97-0546.

industry standards.<sup>47</sup> While “very soon after” is generally determined on a case-by-case basis by loan type and in accordance with commercial reasonableness, the longer the time between the formation of the contract and its assignment, the more likely the program will be viewed as involving the purchase of an eligible obligation rather than the making of a loan.<sup>48</sup>

The Board believes that codifying the 2015 Opinion will clarify the loan participations rule and facilitate further growth in credit unions’ purchase and sale of indirect loan participations. Industry data shows significant growth in credit unions engaging in indirect lending programs, which have become an important channel for credit unions to extend services to their members and provide a viable source of income to support their growth.

Since 2015, FICUs have experienced large growth in indirect lending programs as reflected in Table 1. The \$299 billion outstanding balance of indirect loans as of June 30, 2022, more than doubled the 2015 year-end loan balance.<sup>49</sup>

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<sup>47</sup> The preamble to the 1998 proposal to amend the eligible obligations rule requested public comment on whether the NCUA should specify a certain number of days as constituting “very soon.” 63 FR 41976, 41977 (Aug. 6, 1998). After considering the comments, however, the NCUA Board determined not to specifically define it because it wanted to provide FCUs with flexibility under various circumstances. The NCUA Board also clarified that assignment of the loan means acceptance of the loan and not necessarily the physical receipt of the loan documentation, recognizing that acceptance and payment are often done electronically. However, physical receipt of the loan documents by the FCU should occur within a reasonable time following acceptance of the loan. 63 FR 70997, 70998 (Dec. 23, 1998); *see also* NCUA Legal Op. 97-0546 (Aug. 6, 1997) (Concluding that an indirect lending arrangement where the retailer made a loan and assigned it to the purchasing credit union within one business day met the “very soon after” timing requirement.).

<sup>48</sup> 63 FR 41976, 41977 (Aug. 6, 1998).

<sup>49</sup> NCUA call report data for all federal insured credit unions from the 4th quarter of 2015 through the 2nd quarter of 2022.



During the past seven years, FICUs' indirect lending activities had double-digit increases (ranging from 14 percent to 21 percent) year over year between 2016 and 2018, and a low single-digit increase in 2019 and 2020.<sup>50</sup> The speed of growth went back to double digits in 2021, with FICUs reporting an aggregate 16.26 percent increase as of June 30, 2022, from year-end 2021.<sup>51</sup> The share of indirect loans outstanding in FICUs' total loan portfolio increased from 17.35 percent in 2015 to 21.22 percent in 2018, and reached 21.56 percent as of June 30, 2022, after maintaining at 20 percent for the past three years.<sup>52</sup>

Furthermore, between December 31, 2015, and June 30, 2022, the delinquency rate on the indirect lending program was relatively stable, ranging from 0.77 percent to 0.47 percent, while the net charge-off percent decreased from 0.7 percent in 2017 to 0.24 percent in 2021 and 0.21 percent in June 2022.<sup>53</sup>

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<sup>50</sup> NCUA call report data for all federally insured credit unions from the 4th quarter of 2015 through the 4th quarter of 2021.

<sup>51</sup> NCUA Call Report data for all federally insured credit unions from the 4th quarter of 2015 through the 2nd quarter of 2022.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

**Table 1: FICU Indirect Lending Activities<sup>54</sup>**

<b>(in \$ million)</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022<sup>55</sup></b>
Total Outstanding Indirect Loans	136,583	165,171	194,016	221,477	228,559	233,161	257,271	299,106
% Year over Year Growth		20.93	17.46	14.15	3.20	2.01	10.34	16.26
% Indirect Loans Outstanding / Total Loans	17.35	19.00	20.27	21.22	20.63	20.05	20.50	21.56
Total Del. Indirect Loans (>= 60 Days)	988	1,264	1,391	1,494	1,513	1,291	1,198	1,537
% Loans Delinquent >= 60 Days / Total Indirect Loans	0.72	0.77	0.72	0.67	0.66	0.55	0.47	0.51
Net Indirect Loan Charge-Offs	782	997	1,264	1,318	1,354	1,129	594	288
% Net Charge-Offs / Avg Indirect Loans	0.63	0.66	0.70	0.63	0.60	0.49	0.24	0.21

For the reasons discussed previously, and consistent with sections 107(5) and 107(5)(E) of the FCU Act and the 2015 Opinion, the Board is proposing to codify into the NCUA’s regulations its interpretation that an eligible organization may be considered an “originating lender” for purposes of § 701.22 where the eligible organization generates a loan through an indirect lending arrangement. Moreover, the Board proposes to further clarify in the regulation that any “eligible organization”—as that term is defined under § 701.22(a)—that acquires a loan through an indirect lending arrangement acts as the originating lender for purposes of § 701.22, 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. In such cases, the Board considers the third party processing the loan to be an agent of the eligible organization that performs as an administrative functionary processing the

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<sup>54</sup> *Id.*

<sup>55</sup> Period as of June 30, all other periods were as of December 31.

loan for the eligible organization, and the third party's activities are part and parcel, and an extension, of the eligible organization's lending operations.

Where an indirect loan is underwritten by the purchasing eligible organization before the loan is made and the loan is transferred to the eligible organization very soon after the inception of the obligation to extend credit, the Board believes there is little risk the loan will not be properly underwritten. Accordingly, proposed § 701.22(a) would add to the end of the definition of "originating lender" a second clarifying sentence providing that originating lender includes a participant that acquires a loan through an indirect lending arrangement as defined under § 701.21(c)(9). Proposed paragraph (c)(9) provides, in part, that *indirect lending arrangement* means 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.

The Board specifically requests comment on whether there are certain types of transactions that should be excluded from the interpretation above. In particular, are there transactions in which eligible organizations acquire loans through indirect lending arrangements, but the third parties making the loans do *not* act as administrative functionaries processing the loan on behalf of the eligible organizations, and the third parties' activities are *not* part and parcel, and an extension, of the eligible organizations' lending operations? If there are transactions of this type, please explain why they should be excluded and provide information about the transactions and the specific activities undertaken by the parties.

In addition, the Board requests comment on whether there are other factors, changes, safety and soundness, or compliance implications the NCUA should consider related to the proposed amendments to the definition of “originating lender.” If there are, please explain them in detail and provide supporting data and information. Should the Board consider providing additional clarity such as adding some parameters around the meaning of “very soon after” for the assignment of the loan or contract to the credit union? Examples could be within seven days of the borrower executing the loan or contract, or assignment prior to the first loan payment.

The Board also invites comments on what it means for the credit union to make the final underwriting decision regarding making the loan in an indirect lending arrangement. For example, should the Board specify in the rule that a credit union in an indirect lending arrangement must be involved or consulted at the time of the extension of credit? Or, can the credit union simply provide its underwriting standards to the other party in the indirect lending arrangement and clarify in the indirect lending agreement that only those loans meeting the credit union’s underwriting standards will be accepted for funding? Would a credit union still be making the final underwriting decision if a third party includes significantly more underwriting criteria that are more restrictive, for example, than the credit union requires?

Also, should the Board establish an indirect lending rule? And if so, what specifically should the Board consider in any future indirect lending rulemaking? Should a credit union be considered the originating lender in cases where an intermediary is added to a loan transaction between the initial party extending credit and a credit union, including a third party facilitating the loan transaction? The NCUA received several inquiries from the credit union system related

to CUSOs that work with other lenders to extend credit. The CUSOs in those cases then either receive an immediate assignment of the loans and/or act as a facilitator in immediately assigning loans further to credit unions, where the loans meet the credit unions' underwriting criteria.

Are there structural, safety and soundness, or compliance concerns that would warrant considering that the addition of intermediaries in loan origination transactions, including CUSOs, precludes a credit union assignee from being considered the originating lender under the revised definition in the proposed rule?

Are there any additional safety and soundness or compliance implications concerning the proposed definition of "originating lender" that the Board should consider?

Should the Board consider defining the term "an investment in a pool of loans" in a future rulemaking? If so, how should it be defined and why?

#### *701.22(e) Temporary Regulatory Relief in Response to COVID-19*

Current § 701.22(e) provides that notwithstanding paragraph (b)(5)(ii) of § 701.22, during the period commencing on April 21, 2020, and *concluding on 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 percent of the FICU's net worth.<sup>56</sup> The Board

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<sup>56</sup> (emphasis added).

approved § 701.22(e) to help ensure that FICUs remained operational and had sufficient liquidity during the COVID-19 pandemic.<sup>57</sup> The Board concluded, at the time, that the amendments would provide FICUs with the necessary flexibility in a manner consistent with the NCUA's responsibility to maintain the safety and soundness of the credit union system.<sup>58</sup> As provided in current paragraph (e), the temporary regulatory relief provided under the paragraph will expire on December 31, 2022. Accordingly, the Board is proposing to remove this paragraph as part of any final rule amending § 701.22 issued after December 31, 2022.

The Board welcomes comments on the impact, if any, that was experienced due to the flexibilities provided in the temporary rule. Did the temporary rule have any effect on the participation markets? Are there any safety and soundness or compliance implications related to the expiration of the flexibilities?

Finally, the Board invites comment on what other recommendations it should consider in the loan participation rule. For example, should the Board consider replacing prescriptive limits with principles-based requirements? Should the Board consider removing the limit on the amount of loan participations that could be purchased from any one originating lender under current § 701.22(b)(5)(ii)?

### *Section 701.23 Purchase, Sale, and Pledge of Loans*

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<sup>57</sup> See 85 FR 22010 (April 21, 2020); 85 FR 83405 (Dec. 22, 2020) (extending paragraph (e) through Dec. 31, 2021); and 86 FR 72517 (Dec. 22, 2021) (extending paragraph (e) through Dec. 31, 2022).

<sup>58</sup> 85 FR 22010, 22010 (April 21, 2020).

As discussed in more detail in this portion of the preamble, this proposal would make several changes to current § 701.23 of the NCUA's regulations. These changes are intended to clarify numerous provisions regarding the purchase, sale, and pledge of eligible obligations. The proposal would also amend the NCUA's current regulatory requirements under current § 701.23 to provide FCUs expanded authority and autonomy to innovate and transact business with fintech companies and other institutions that provide services associated with the origination and sale of loans made to members of FCUs.

#### *701.23 Introductory Paragraph*

The introductory paragraph to current § 701.23 sets forth the scope and limitations of the section. The Board added the introductory paragraph to § 701.23 as part of the 2013 Final Rule.<sup>59</sup> The introductory paragraph was added to clarify several issues related to the scope and applicability of § 701.23. In particular, the 2013 Final Rule explained as follows:

The proposal added introductory text to § 701.23 to clarify the scope of § 701.23 and to distinguish transactions under § 701.23 from transactions covered by § 701.22. The final rule adopts the additional language substantially as proposed, but with some amendments to conform it to a 2012 final rule promulgated by NCUA eliminating the Regulatory Flexibility Program (RegFlex).<sup>60</sup> The final rule

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<sup>59</sup> 78 FR 37946 (June 25, 2013).

<sup>60</sup> 77 FR 31981 (May 31, 2012).

regarding RegFlex provides a limited exception to the general requirement that an FCU's purchase, sale, or pledge of all or part of a loan must be to one of its own members.<sup>61</sup> Specifically, the exception permits FCUs that meet the well capitalized standard to buy loans from other FICUs without regard to whether the loans are eligible obligations of the purchasing FCU's members or the members of a liquidating credit union. The final rule also makes a parallel conforming amendment to the introductory text to § 701.22 in this regard.<sup>62</sup>

The introductory paragraph to current § 701.23 has three separate substantive provisions. First, the paragraph provides that the section governs an FCU's purchase, sale, or pledge of all or part of a loan to one of its own members where no continuing contractual obligation is contemplated between the seller and the purchaser. The first provision also notes that there is a limited exception to the membership requirement for certain well-capitalized FCUs. Second, the paragraph elaborates on the membership requirement by providing that the borrower must be a member of the purchasing FCU *before* the purchase is made, except as provided in current §701.23(b)(2). Third, the paragraph provides broadly that an FCU may not purchase a non-member loan to hold in its portfolio.

Since amending § 701.23 as part of the 2013 Final Rule, the NCUA has received numerous inquiries from NCUA examiners, FCUs, fintech companies, and other parties who have expressed confusion about how to interpret these provisions. This confusion has led to

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<sup>61</sup> 12 CFR 701.23(b)(2).

<sup>62</sup> 78 FR 37954-37955.



inconsistent reporting of loan interests by FCUs and uncertainty regarding which of the two sections, §§ 701.22 or 701.23, applies to certain transactions, particularly innovative programs that have been designed by FCUs after 2013. In addition, the Board is concerned that continued confusion about when a borrower is required to be a member under § 701.23 could discourage FCUs from entering into certain safe and sound loan purchase, sale, and pledge agreements that are within their statutory authority.

The clause in the first sentence of the introductory paragraph to current § 701.23 that provides “where no continuing contractual obligation between the seller and purchaser is contemplated” continues to be a source of confusion for examiners and the credit union system. As mentioned above, in practice loan 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, including representations and warranties regarding the loans and loan repurchase agreements, servicing agreements, and other similar types of ongoing obligations. Accordingly, the Board requests comments on deleting the continuing contractual obligations clause in current § 701.23. The Board intends this potential change to work in conjunction with the proposed changes to the introductory paragraph to current § 701.22.

In the introductory paragraph to § 701.23, the Board is considering two other changes in conjunction with amendments made elsewhere in this proposal, which are described in more detail below. First, the Board requests comments on removing the clause referring to the limited exception for well-capitalized FCUs. As discussed in more detail below in the part of the

preamble on § 701.23(b)(2), the Board is proposing to remove the well-capitalized requirements for FCU purchases of certain non-member loans from FICUs. Accordingly, the Board believes that deleting the clause referring to the limited exception for well-capitalized FCUs is a necessary conforming amendment.

Second, the Board is proposing to remove the third sentence in the introductory paragraph to current § 701.23 to clarify the broad prohibition on holding non-member loans in the portfolio. This prohibition appears to have originally been intended to address FCU purchases of non-member loans to complete pools of loans for resale, as authorized for real estate-secured loans and federally guaranteed student loans under current §§ 701.23(b)(1)(iii) and (b)(1)(iv). The prohibition on retaining the non-member loans in portfolio goes together with the authority in paragraphs (b)(1)(iii) and (b)(1)(iv) because those provisions allow an FCU to buy such non-member loans solely to complete a pool of loans for resale.

Moreover, the second sentence in current § 701.23(b)(iv) further confirms this relationship by providing that a pool must include a substantial portion of the credit union's members' loans *and must be sold promptly*.<sup>63</sup> For other purchases of non-member loans under current § 701.23, the authority is not tied to a plan or requirement to resell the loans being purchased. Prohibiting the FCU from retaining the loans in portfolio, as the current wording in the undesignated introductory paragraph implies, unnecessarily restricts FCUs' authority to

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<sup>63</sup> (emphasis added).

purchase and hold non-member loans from FICUs under current §§ 701.23(b)(1)(ii)<sup>64</sup> and (b)(2). Accordingly, the Board requests comment on deleting the third sentence in the introductory paragraph to § 701.23, providing that an FCU may not purchase a non-member loan to hold in its portfolio.

The Board is considering one other change to the introductory paragraph. The second paragraph provides that for purchases of eligible obligations, except as described in paragraph (b)(2) of this section, the borrower must be a member of the purchasing FCU before the purchase is made. As discussed above, there are express exceptions to the membership requirement under paragraph (b)(1) as well as in paragraph (b)(2). For example, paragraphs (b)(1)(iii) and (b)(1)(iv) authorize FCUs to buy non-member loans to complete a pool of loans for resale. Accordingly, the Board requests comment on amending the second sentence in the introductory paragraph to current § 701.23 to provide that for purchases of eligible obligations, except as described under paragraph (b) of this section, the borrower must be a member of the purchasing FCU before the purchase is made.

If the changes proposed above are adopted in a final rule, the introductory text of § 701.23 would provide that this section governs an FCU's purchase, sale, or pledge of all or part of a loan to one of its own members, subject to certain exceptions. The introductory paragraph would provide further that for purchases of eligible obligations, except as otherwise described

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<sup>64</sup> (Authorizing FCUs to purchase eligible obligations of a liquidating credit union's individual members, from the liquidating credit union.)

under paragraph (b) of § 701.23, the borrower must be a member of the purchasing FCU before the purchase is made.

### *701.23(a) Definitions*

The proposed rule would, among other changes discussed below, amend current § 701.23(a) to add the heading “Definitions” to the paragraph and remove the numbering from the individual definitions under paragraph (a). This change is intended to avoid errors and confusion when definitions in this subsection, which may be cross referenced elsewhere in the NCUA’s regulations, are added or removed. Accordingly, the individual definitions included under proposed § 701.23(a) will be listed in alphabetic order but will not be numbered individually.

*Eligible obligation.* Proposed § 701.23(a) would amend the definition of “eligible obligation” to clearly distinguish between an eligible obligation and a note held by a liquidating credit union. Current § 701.23(a) defines the term eligible obligation broadly to mean a loan or group of loans, which includes the notes of a liquidating credit union.”<sup>65</sup> As explained in the part of the preamble on § 701.23(b)(4), under this proposal the statutory 5-percent limitation on the aggregate of the unpaid balance of notes purchased under § 701.23 would apply to only notes of liquidating credit unions and not to eligible obligations as that term is generally used under

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<sup>65</sup> See, e.g., §§ 701.23(b)(1)(ii), (b)(2)(ii), and (b)(4).

section 107(13)<sup>66</sup> of the FCU Act. Accordingly, the proposal would amend the current definition of eligible obligation to clarify that the term does not include a note held by a liquidating credit union.

The proposal would also amend the definition of “eligible obligation” to clarify that the term includes a whole loan or part of a loan. The NCUA has long held the position that the term eligible obligation includes loans, in whole or in part, provided the loan does not meet the definition of a loan participation under § 701.22(a).<sup>67</sup> The Board believes that the amended definition of an eligible obligation would provide clarity and reduce confusion in the credit union system concerning when a transaction involving a loan purchased in part (partial loan) meets the regulatory definition of an eligible obligation. It has come to the Board’s attention that many credit union officials find the eligible obligations rule unclear, specifically when attempting to determine which rule applies to a loan purchased in part. The amended definition will allow FCU officials to differentiate between a transaction involving a partial loan that meets the

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<sup>66</sup> § 1757(13) (authorizing FCUs “in accordance with rules and regulations prescribed by the Board, to purchase, sell, pledge, or discount or otherwise receive or dispose of, in whole or in part, any eligible obligations (as defined by the Board) of its members and to purchase from any liquidating credit union notes made by individual members of the liquidating credit union at such prices as may be agreed upon by the board of directors of the liquidating credit union and the board of directors of the purchasing credit union, but no purchase may be made under authority of this paragraph if, upon the making of that purchase, the aggregate of the unpaid balances of notes purchased under authority of this paragraph would exceed 5 per centum of the unimpaired capital and surplus of the credit union[.]”).

<sup>67</sup> See 78 FR 37946, 37948 (June 25, 2013) (providing in part: “[The introductory paragraph to § 701.22] clarifies that the [section] applies to a natural person FICU’s purchase of a loan participation where the borrower is not a member of that credit union. Generally, an FCU’s purchase, in whole or in part, of its member’s loan is covered by NCUA’s eligible obligations rule at § 701.23.” The 2013 final rule also notes in FN 2 that there is also “a limited exception for certain well capitalized federal credit unions to purchase, subject to certain conditions, non-member eligible obligations from a FICU. 12 CFR 701.23(b)(2).”); see also, 12 U.S.C. 1757(13) (providing in part: An FCU shall have power, “in accordance with rules and regulations prescribed by the Board, to purchase, sell, pledge, or discount or otherwise receive or dispose of, *in whole or in part*, any eligible obligations (as defined by the Board) of its members.” (emphasis added)).

definition of an eligible obligation under § 701.23 and a transaction involving a partial loan that meets the definition of a loan participation under § 701.22.

Current § 701.22(a) provides that loan participation means a loan where one or more eligible organizations participate pursuant to a written agreement with the originating lender, and the written agreement requires the originating lender's continuing participation throughout the life of the loan. For example, if an FCU purchases a partial loan that does not meet the definition of loan participation under proposed § 701.22(a), then the transaction may still be permissible provided it meets the definition of an "eligible obligation" under proposed § 701.23(a) and meets the requirements under that section.

Finally, the proposal would amend the definition of "eligible obligation" to remove the words "group of loans." The words are redundant because the term eligible obligation is used in its plural form, eligible obligations, throughout proposed and current § 701.23 to indicate where the section authorizes or applies to the purchase of one or more loans. The Board believes removing the phrase "group of loans," in conjunction with the other changes discussed in this proposal, will clarify the definition of eligible obligation. Accordingly, for all the reasons discussed above, proposed § 701.23(a) would provide that *eligible obligation* means 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 § 701.22(a).

*Liquidating credit union.* Proposed § 701.23(a) would define the term “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-percent limitation in proposed § 701.23(b)(4). The term liquidating credit union is used but not defined in current § 701.23 because the section does not distinguish between eligible obligations and notes of liquidating credit unions for purposes of calculating the 5-percent limitation on the aggregate of the unpaid balance of loans purchased under current §§ 701.23(b)(1) and (b)(2)(ii). As explained in more detail later in the part of the preamble on proposed § 701.23(b)(4), under this proposal, the 5-percent limitation would apply only to notes purchased from liquidating credit unions, making it necessary for the NCUA to specify the point in time when a credit union meets the definition of a liquidating credit union. Consistent with Congress’ use of the broad term “credit union” in section 107(13) of the FCU Act, the definition of liquidating credit union would include both liquidating FICUs and liquidating credit unions not insured by the NCUA.<sup>68</sup>

Accordingly, the Board proposes to define the term liquidating credit union as follows: Liquidating credit union means: (1) in the case of a voluntary liquidation, a credit union is a 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

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<sup>68</sup> See § 1757(13) (providing in relevant part: “to purchase from any liquidating *credit union* notes made by individual members of the liquidating *credit union* at such prices as may be agreed upon by the board of directors of the liquidating *credit union* and the board of directors of the purchasing credit union, but no purchase may be made under authority of this paragraph if, upon the making of that purchase, the aggregate of the unpaid balances of notes purchased under authority of this paragraph would exceed 5 per centum of the unimpaired capital and surplus of the credit union;” (emphasis added).).

board of directors is served an order of liquidation issued by either the NCUA or the state supervisory authority.

The Board specifically requests comment on whether the Board should provide any additional clarity regarding the definitions of the terms “eligible obligation” and “loan participation.” If so, what further clarification should be provided?

Also, should the Board consider defining the term “empowered to grant” in a future rulemaking? Are there any other terms used in § 701.23 that the Board should consider defining or further clarifying through a future rulemaking?

#### *701.23(b) Purchase of Loans*

Current § 701.23(b) would be amended, as discussed in more detail later in this preamble, to make certain substantive changes and to implement clarifying and conforming changes. Proposed § 701.23(b) would amend the current paragraph heading to current paragraph (b) to clarify which transactions are covered under the paragraph. The current heading for paragraph (b) is “Purchase.” The Board believes that this would result in only a minor technical change to current §701.23(b). The amended rule would only add the two words “of loans” to the current rule text to better clarify the type of eligible obligation transactions for which this section would apply, that being the purchase of loans. Accordingly, the paragraph heading for proposed § 701.23(b) would be revised to read “Purchase of loans.”

#### *701.23(b)(1)*



*701.23(b)(1)(ii)*

Current § 701.23(b)(1)(ii) authorizes FCUs to purchase certain eligible obligations of a liquidating credit union's individual members from the liquidating credit union. As explained previously in the part of the preamble on § 701.23(a) regarding the definition of eligible obligation, under this proposal, notes of liquidating credit unions would no longer be included within the definition of "eligible obligations." Accordingly, subject to the 5-percent limitation, this proposal would amend current § 701.23(b)(1)(ii) to remove the references to eligible obligations and authorize FCUs to purchase notes of a liquidating credit union's individual members from the liquidating credit union.

*701.23(b)(1)(iv)*

The word "mortgage" is misspelled in the first sentence of current § 701.23(b)(1)(iv). Proposed § 701.23(b)(1)(iv) would revise the current rule to correct that misspelling. No substantive changes would be made to current paragraph (b)(1)(iv).

*701.23(b)(2) Purchase of Obligations from a FICU*

Proposed § 701.23(b)(2) would revise the current rule to remove the CAMELS rating requirement and the capital classification requirements in the introductory paragraph. Current § 701.23(b)(2) provides that an FCU that received a composite CAMELS rating of "1" or "2" for the last two (2) full examinations and maintained a capital classification of "well capitalized"

under part 702 of this chapter for the six (6) immediately preceding quarters may purchase and hold certain obligations, provided that it would be empowered to grant them.

The Board is proposing to simplify the rule and provide FCUs additional authority to purchase loans. This includes removing limits on eligible obligations of a credit union's members and removing the CAMELS rating and capital classification requirements.

The CAMELS rating and capital classification requirements were added to the NCUA's regulations as part of a 2001 final rule regarding the NCUA's RegFlex program.<sup>69</sup> The 2001 final rule explained as follows, in response to commenters suggestions that the requirements be removed:

The Board continues to believe that CAMEL ratings and net worth ratios are the best measures of how well a credit union is managed and how much risk it presents to the NCUSIF and the credit union system. That is, consistent with safety and soundness concerns, credit unions with advanced levels of net worth and consistently strong supervisory examination ratings have earned exemptions from certain NCUA Regulations.<sup>70</sup>

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<sup>69</sup> 66 FR 58656 (Nov. 23, 2001).

<sup>70</sup> 66 FR 58656.

FCUs have generally managed their loan purchase, sale, and pledge activity well since the addition of the CAMELS and capital requirements and continue to do so. Approximately 10 percent of FCUs were engaged in the purchase, sale, or pledge of loans during the first half of 2022.<sup>71</sup>

Additionally, the Board notes that this purchase authority is limited to only purchases from a FICU. Therefore, the loans able to be purchased under this authority are already in the credit union system. Moving the obligation from one FICU to another FICU generally is not expected to result in a significant increase to the Share Insurance Fund's risk exposure.

Further, the current CAMELS and net worth restrictions are only applicable to a limited segment of the credit union system given that the vast majority of FCUs have a CAMELS composite rating of 1 or 2 and are well-capitalized.<sup>72</sup> Expansion of this authority would allow slightly more FCUs to purchase obligations from a FICU, potentially creating additional revenue and capital for the purchaser and providing an additional outlet for selling FICUs, creating additional liquidity channels in the credit union system.

Lastly, the NCUA believes any increased risk associated with removing the CAMELS rating and capital classification requirements in current § 701.23 would also be minimized by the

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<sup>71</sup> NCUA Call Report data for all FCUs as of the 2nd quarter of 2022.

<sup>72</sup> As of June 30, 2022, 78 percent of FCUs were rated a CAMELS composite 1 or 2 and were classified as "well capitalized." These FCUs account for 96 percent of total FCU assets. There were only 614 FCUs with a CAMELS composite rating of 3, 4, or 5, and only 166 FCUs not classified as "well capitalized."

addition of the proposed principles-based due diligence, risk assessment, and risk management requirements.

Accordingly, the introductory paragraph to proposed § 701.23(b)(2) would provide that an FCU may purchase and hold certain obligations if it would be empowered to grant them.

*701.23(b)(2)(ii) Notes of a Liquidating Credit Union*

Current § 701.23(b)(2)(ii) authorizes FCUs to purchase certain eligible obligations of a liquidating credit union without regard to whether they are obligations of the liquidating credit union's individual members. As explained earlier in the part of the preamble on § 701.23(a) regarding the definition of eligible obligation, under this proposal notes of liquidating credit unions would no longer be included within the definition of "eligible obligation." Accordingly, this proposal would amend current § 701.23(b)(2)(ii) to remove the words "eligible obligations" and "obligations" and authorize FCUs to purchase notes of a liquidating credit union without regard to whether they are notes of the liquidating credit union's individual members.

*701.23(b)(3) 701.23(b)(3)(ii)*

Proposed § 701.23(b)(3)(ii) would revise the current requirement that written agreements and schedules of loans be retained by the purchaser. Current § 701.23(b)(3)(ii) provides that a written agreement and a schedule of the eligible obligations covered by the agreement are retained in the purchaser's office. Under the proposed rule, the purchasing FCU would still be

required to retain the written loan purchase agreement and a schedule of the eligible obligations covered by the agreement, but the proposal would eliminate the requirement for it to be retained in the purchaser's office.

The Board acknowledges the requirement for the FCU to retain the written loan purchase agreement and schedule of the eligible obligations in the purchaser's office could imply that the written loan purchase agreement and schedule be retained in a hard-copy format, which is outdated given the current digital environment. An FCU might choose to store its records in electronic format, in the cloud, or housed in off-site servers or databases. The Board intends, with this proposed change, that the FCU make the written loan purchase agreement and schedule of the eligible obligations covered by the agreement available upon request.<sup>73</sup> Credit unions that have some or all of their records maintained by an off-site data processor are considered to be in compliance for the storage of those records if the service agreement specifies the data processor safeguards against the simultaneous destruction of production and back-up information.<sup>74</sup> Accordingly, proposed § 701.23(b)(3)(ii) would provide that a written agreement and a schedule of the eligible obligations covered by the agreement are retained by the purchaser.

This proposed change would align this requirement with the NCUA's regulations and guidelines for FICUs on records preservation programs. Under part 749, the NCUA does not require or recommend a particular format for record retention. If the credit union stores records on microfilm, microfiche, or in an electronic format, the stored records must be accurate,

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<sup>73</sup> See § 749.2.

<sup>74</sup> See Appendix A to part 749.

reproducible, and accessible to an NCUA examiner.<sup>75</sup> If records are stored on the credit union premises, they should be immediately accessible upon the examiner's request; if records are stored by a third party or off site, then they should be made available to the examiner within a reasonable time after the examiner's request. The credit union must maintain the necessary equipment or software to permit an examiner to review and reproduce stored records upon request. The credit union should also ensure that the reproduction is acceptable for submission as evidence in a legal proceeding.<sup>76</sup>

#### *701.23(b)(4)*

This proposal would amend current § 701.23(b)(4), which limits the aggregate unpaid balance of certain eligible obligations purchased by an FCU to a maximum of 5 percent of the FCU's unimpaired capital and surplus. Under this proposed rule, the 5-percent limitation would apply solely to notes of a liquidating credit union's members purchased by an FCU from the liquidating credit union. As discussed in the following paragraphs, the Board has determined this change would remove a regulatory limit to the purchase of eligible obligations that the FCU Act does not require. The Board believes adequate safety and soundness of eligible obligations purchases can be accomplished through principles-based regulation rather than a once-size-fits-all limitation.

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<sup>75</sup> See 12 CFR 749.5.

<sup>76</sup> See generally part 749; and NCUA Legal Op. 07-0812 (Jan. 2008), available at <https://www.ncua.gov/regulation-supervision/legal-opinions/2008/electronic-retention-records>.

Section 701.23 provides both the regulatory authority for purchases of eligible obligations by an FCU and the limitations. Currently, the 5-percent limitation applies to eligible obligations purchased by an FCU under § 701.23(b)(1) and § 701.23(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.”

The statutory source of the 5-percent limitation is section 107(13) of the FCU Act.<sup>77</sup> Section 107 generally enumerates the powers of FCUs, and paragraph (13) authorizes an FCU to make certain loan purchases. Specifically, paragraph (13) reads as follows:

(13) in accordance with rules and regulations prescribed by the Board, to purchase, sell, pledge, or discount or otherwise receive or dispose of, in whole or in part, any eligible obligations (as defined by the Board) of its members and to purchase from any liquidating credit union *notes* made by individual members of the liquidating credit union at such prices as may be agreed upon by the board of directors of the liquidating credit union and the board of directors of the

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<sup>77</sup> 12 U.S.C. 1757(13).

purchasing credit union, but no purchase may be made under authority of this paragraph if, upon the making of that purchase, the aggregate of the unpaid balances of *notes* purchased under authority of this paragraph would exceed 5 per centum of the unimpaired capital and surplus of the credit union.<sup>78</sup>

Section 107(13) applies to the purchase of two mutually exclusive categories of loans—“eligible obligations” (as that term may be defined by the Board) of the purchasing FCU’s members and the “notes” of a liquidating credit union made to the liquidating credit union’s members. The 5-percent limitation, however, applies solely to the second category of loans, that is, the notes of a liquidating credit union to its members. The statutory language specifies that “no purchase may be made . . . if, upon the making of that purchase, the aggregate of the unpaid balances of *notes* purchased under authority of this paragraph would exceed 5 per centum of the unimpaired capital and surplus of the credit union.”<sup>79</sup> The 5-percent limitation is specific to the “aggregate unpaid balances of *notes*”<sup>80</sup> purchased “under authority of this paragraph” (that is, paragraph (13) of section 107). As italicized in the preceding quotes, the only notes authorized to be purchased pursuant to section 107(13) are those of a liquidating credit union to its members. Notwithstanding the ambiguity introduced by the reference to the entire “paragraph” (13) in the context of the 5-percent limitation, the following term “notes” narrows the required scope of its application to purchases from a liquidating credit union.

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<sup>78</sup> *Id.* (emphasis added).

<sup>79</sup> (emphasis added).

<sup>80</sup> (emphasis added).



Despite the statutory wording, the NCUA’s implementing regulation at 12 CFR § 701.23 does not distinguish between eligible obligations and notes. Section 107(13) of the FCU Act empowers the NCUA to define the term “eligible obligation.” The NCUA has exercised this discretion by opting to jointly treat notes and other eligible obligations as the same type of instrument under its regulations. Both are encompassed in the regulatory definition of the term “eligible obligation,” which is defined to be “a loan or group of loans.”<sup>81</sup> The proposed rule would amend current § 701.23 to more closely follow the statutory language. Under the proposed rule, the 5-percent limitation 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 limitation would not apply to other loans purchased by an FCU under the authority of section 107(13).

The proposed rule would also amend the definition of “eligible obligations” to reflect the revised scope of the 5-percent limitation. Under the proposed rule, the term “eligible obligation” would be revised to mean “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 § 701.22(a).”<sup>82</sup>

The Board acknowledges that the current scope of the 5-percent limitation reflects or implies an alternate legal reading of the statutory language, which the Board recognizes as a

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<sup>81</sup> 12 CFR 701.23(a).

<sup>82</sup> Under the current definition of “eligible obligation”, there may be instances where the notes of the liquidating credit union members are also eligible obligations of the members of the purchasing FCU. The 5-percent limitation would apply to these loans as they fall within the more specific category of “eligible obligations” purchased from a liquidating credit union.

plausible reading. The alternate reading hinges on the language providing that “no purchase may be made *under authority of this paragraph*.” The term “this paragraph” encompasses paragraph (13) of section 107 in its entirety. This reading applies the 5-percent limitation to all instruments (eligible obligations and notes) purchased pursuant to paragraph (13). The current regulation reflects such an interpretation, and the Board has made past statements in support of this reading.<sup>83</sup> This proposed rule constitutes a reconsideration of the NCUA’s prior position. As noted, the NCUA has determined that the proposed regulatory change is more consistent with the language of the FCU Act and is more aligned with the different safety and soundness considerations with respect to eligible obligations in general and notes purchased from a liquidating credit union.

The proposed reading is better supported by accepted canons of statutory construction. The statutory construction canon of “consistent usage” logically presumes that different words denote different ideas.<sup>84</sup> Accordingly, the use of the terms “eligible obligations” and “notes” is intended to distinguish between two mutually exclusive categories of loans. Further, the canon holds that “a word or phrase is presumed to bear the same meaning throughout a text.”<sup>85</sup> The use of the word “notes” in paragraph 107(13) is appropriately interpreted consistently and exclusively to reference only notes made by a liquidating credit union to its members.

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<sup>83</sup> For example, the preamble to the 1979 final rule implementing the NCUA’s eligible obligations authority contained the following statement: “The Administration feels that the language of Section 107(13) is clear, and that the best interpretation is that adopted in the proposed rule” (that is, the currently codified regulatory text). 44 FR 27068, 27070 (May 9, 1979).

<sup>84</sup> Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts*, 148 (2012).

<sup>85</sup> *Id.*

The proposed reading also aligns with the “surplusage” canon of statutory interpretation. Under this canon, “every word and every provision is to be given effect if possible.”<sup>86</sup> “No word should be ignored. None should needlessly be given an interpretation that causes it to duplicate another provision or have no consequence.”<sup>87</sup> The proposed interpretation accounts for language subsequent to “under authority of this paragraph” that modifies the clause’s scope. This subsequent language specifies that the prohibition applies only “if, upon the making of that purchase, the aggregate of the unpaid balances of *notes* purchased under authority of this paragraph would exceed 5 per centum of the unimpaired capital and surplus of the credit union.” Thus, the limit’s application is required only with respect to the purchase of “notes,” which, as stated previously, is appropriately narrowed to solely cover loans made by liquidating credit unions to their members. Reading the statute to require application of the 5-percent limitation to “eligible obligations” conflates the terms “notes” and “eligible obligations,” despite the different terminology Congress enacted. The effect of treating the terms as duplicative is to effectively ignore the use of the term “notes,” which should be separately considered under the surplusage canon.

It also bears noting that the stated rationale for original enactment of the 5-percent limitation does not apply to the purchase of eligible obligations. The 5-percent limitation language in section 107(13) of the FCU Act was added by Congress in 1968 and referred solely to notes of liquidating credit unions at that time because that statute did not refer to purchases of

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<sup>86</sup> *Id.* at 145.

<sup>87</sup> *Id.*

eligible obligations.<sup>88</sup> That language is identical to the current version of the statutory text and continues to refer solely to “notes” of liquidating credit unions. Prior to the amendment, FCUs lacked express statutory authority to purchase the loans of liquidating credit unions. As a result, liquidating credit unions were hampered in their efforts to dispose of their assets to repay their members. The Senate report accompanying the legislation explained that the change would “greatly increase the market for the notes of liquidating credit unions and will prevent liquidating credit unions from having to go outside the credit union movement to liquidate their assets.”<sup>89</sup> However, Congress was also mindful of the risks that might be posed in purchasing the loans of credit unions compelled to liquidate due to poor management decisions.<sup>90</sup> As a result, it opted to limit the ability of an FCU to purchase notes of liquidating credit unions to 5 percent of its unimpaired capital and surplus.<sup>91</sup>

The express authority to purchase eligible obligations was later added to the text of section 107(13) in 1977.<sup>92</sup> The legislative history from that time shows the amendment was intended to provide FCUs with flexibility to use secondary market facilities to enhance liquidity, especially in relation to real estate loans.<sup>93</sup> The purchase by an FCU of loans made to its own

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<sup>88</sup> Pub. L. 90–375 (approved July 5, 1968) (Providing in relevant part, “(14) in accordance with rules and regulations prescribed by the Director, to purchase from any liquidating credit union notes made by individual members of the liquidating credit union at such prices as may be agreed upon by the board of directors of the liquidating credit union and the board of directors of the purchasing credit union, *but no purchase may be made under authority of this paragraph if, upon the making of that purchase, the aggregate of the unpaid balances of notes purchased under authority of this paragraph would exceed 5 per centum of the unimpaired capital and surplus of the credit union.*” (emphasis added)).

<sup>89</sup> S. Rep. No. 1265, 90th Cong., 2d Sess., at 2 (June 18, 1968).

<sup>90</sup> *Statement of J. Deane Gannon, Director, Bureau of Federal Credit Unions, Social Security Administration, Department of Health, Education and Welfare, FCU Act Amendments, Subcommittee on Financial Institutions of the Comm. on Banking and Currency*, at 11–12 (May 24, 1968).

<sup>91</sup> H.R. Rep. No. 1372 (May 9, 1968).

<sup>92</sup> Public Law 95-22 (approved Apr. 19, 1977).

<sup>93</sup> H.R. Rep. No. 95-23, at 16 (Feb. 22, 1977).

members is not analogous to, and does not pose the same inherent risk that, purchasing the notes of a liquidating credit union does. Accordingly, it is reasonable that Congress would elect not to mandate a limit on the ability of an FCU to make such purchases. This supposition is supported by Congress' decision to use the new term "eligible obligations" (and in granting the NCUA broad authority to define this term), rather than simply revising the existing scope of the term "notes" to include member loans. Further, the legislative history accompanying enactment of the 1977 amendments does not make any mention of the 5-percent limitation being applicable to eligible obligations.

The 1977 legislative history in several instances also refers to the amendment granting FCUs the ability to purchase the "notes" of its members. One could infer from this that the term "eligible obligations" was intended to be read synonymously with "notes."<sup>94</sup> This reading appears at least plausible because the broad category of "notes" could be seen to encompass various debt instruments, including notes or written documents evidencing a member's eligible obligations. Such a reading, however, is not required and is inferior to the interpretation the Board is proposing in this rule for two reasons. First, Congress ultimately opted to use the term "eligible obligations" in the statutory amendment that was enacted. The codified text supersedes non-binding statements in the legislative record.<sup>95</sup> Secondly, and as discussed earlier, accepted

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<sup>94</sup> See, for example, 123 Cong. Rec. H 1521-32, at H-1524 (Daily ed. March 1, 1977) (Describing the amendment as providing for the "Purchase and sale of notes of members."); H.R. Rep. No. 95-23, at 16 (Feb. 22, 1977) (also describing amendment as pertaining to the "Purchase and sale of notes"); and *Statement of C. Austin Montgomery, Administrator, National Credit Union Administration Before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance Committee on Banking, Finance, and Urban Affairs, House of Representatives, 95th Cong. 27 (1977)* ("Temporary liquidity problems experienced by credit unions might be resolved by selling or pledging notes").

<sup>95</sup> Scalia & Garner, *supra* note 7 at 64 ("[T]he purpose must be derived from the text, not from extrinsic sources such as legislative history or an assumption about the legal drafter's desires").

canons of statutory construction favor an interpretation that provides individual terms with their own individual meaning.

For the preceding reasons, the NCUA has determined that the proposed regulatory change is more consistent with the language of the FCU Act. The NCUA also has determined that the amendment will not pose a safety and soundness risk due to the addition of principles-based risk management requirements. By amending the current rule to narrow the application of the 5-percent limitation to the aggregate of the unpaid balances of loans purchased from any source to instead apply to only the “notes” of a liquidating credit union, the Board intends to allow FCUs greater capacity, flexibility, and individual autonomy to establish their own risk tolerance limits for the amount of the loans of its members that can be purchased from any source other than a liquidating credit union. This includes other financial institutions, fintech companies, third-party loan acquisition channels such as CUSOs, and other loan-originating retailers.

While the narrower interpretation of section 107(13) of the FCU Act would remove the existing limit on the amount of eligible obligations that an FCU could purchase, establishing risk management expectations will minimize potential risk to the Share Insurance Fund while allowing FCUs more flexibility in how they manage their eligible obligation purchase activities. Proposed new § 701.23(b)(6), which is discussed in detail later in the part of the preamble on paragraph (b)(6), would outline minimum risk management standards that must be included in the written loan purchase policy for any FCU that plans to purchase eligible obligations. The Board believes these risk management standards should be part of the normal business practices

at well-run FCUs that engage in the purchase of eligible obligations, and as such, should not represent an additional burden. It is the Board's view that the proposed changes would allow well-run FCUs more autonomy and flexibility in how they conduct their business. Provided the FCU can demonstrate and document that its loan purchase activity does not present a material risk to the viability or solvency of the FCU through the standards established in § 701.23(b)(6), the FCU should be able to establish its own internal standards to meet its business needs and the needs of its members.

The proposed rule would amend current § 701.23(b)(4) to remove the exclusions provided in paragraphs (b)(4)(i) through (b)(4)(iv) and revise the current language to apply the 5-percent limit to only notes purchased from liquidating credit unions. While the narrower interpretation of section 107(13) of the FCU Act would remove the existing restriction on the amount of eligible obligations an FCU could purchase, the new risk management requirements will minimize the potential increase in risk to the Share Insurance Fund, while allowing FCUs more flexibility in how they manage their loan purchase activities. Accordingly, proposed § 701.23(b)(4) would provide that the aggregate of the unpaid balance of notes purchased under paragraphs (b)(1)(ii) and (b)(2)(ii) of § 701.23 shall not exceed 5 percent of the unimpaired capital and surplus of the purchaser.

The Board invites comments concerning the proposed rule narrowing the application of the 5-percent limitation to only apply to the aggregate amount of "notes" that can be purchased by an FCU from a liquidating credit union. Should the Board consider defining the term "notes"

as used to calculate the 5-percent limitation for the aggregate of the unpaid balances of notes an FCU could purchase from a liquidating credit union? If so, how should it be defined?

Are there additional changes to this rule that the Board should consider in the future that would further facilitate credit union engagement with fintech companies and other third parties in a safe and sound manner?

#### *701.23(b)(5) Grandfathered Purchases*

Proposed § 701.23(b)(5) would amend the current rule to broaden the grandfathering provision in current paragraph (b)(5). Current § 701.23(b)(5) provides that, subject to safety and soundness considerations, an FCU may hold any of the loans described in paragraph (b)(2) of this section provided it was authorized to purchase the loan and purchased the loan before July 2, 2012. The Board believes the proposed revisions to the current grandfathering provision would avoid placing undue burden on FCUs that were operating in compliance with the existing rule and avoid disrupting the existing eligible obligations market by forcing widespread divestments of the eligible obligations currently held in FCU loan portfolios. While the proposed grandfathering provision would allow FCUs to continue to hold eligible obligations that were purchased prior to the effective date of this rule, it does not exempt FCUs from conducting and updating risk assessments, establishing concentration limits, or monitoring the ongoing condition of the FCU's eligible obligation loan portfolio.



Accordingly, proposed § 701.23(b)(5) would provide that, subject to safety and soundness considerations, an FCU may hold any of the loans described in paragraph (b) of this section that were acquired before the effective date of the final rule approved by the Board; provided the transaction was in compliance with § 701.23 at the time the transaction was executed.

*New 701.23(b)(6)*

The proposal would add a new paragraph (b)(6) to § 701.23, which would set forth basic due diligence, risk assessment, and management requirements that must be addressed in an FCU's internal written purchase policies.<sup>96</sup> An FCU's board of directors is responsible for planning, directing, and controlling the FCU's activities. To fulfill these duties, the board of directors must establish adequate policies. The introductory paragraph to proposed § 701.23(b)(6) would provide that the purchases of eligible obligations and notes of liquidating credit unions must comply with the purchasing FCU's internal written purchase policies, which must contain certain provisions.

The specific policy requirements, which are discussed in detail below, are part of the basic fiduciary responsibilities and duties required of boards of directors.<sup>97</sup> The requirements in

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<sup>96</sup> A credit union's written loan purchase policies may be incorporated into the written lending policies required under § 741.3(b)(2).

<sup>97</sup> See 701.4(b)(4), 701.21(c)(2), and 741.3(b)(2).

the proposed rule address the basic elements necessary to administer a safe and sound loan purchase program.

As discussed previously, the Board is proposing that these requirements be added to mitigate the risk of removing certain regulatory limits on the purchase of loans by FCUs. The new requirements proposed under § 701.23(b)(6) are crafted to encourage credit discipline and promote safe and sound loan purchase programs, which are intended to protect the Share Insurance Fund. These requirements continue the Board's long-standing expectations for FCUs that purchase loans to appropriately identify and mitigate undue risk, while also providing FCUs greater flexibility to establish their own risk tolerance limits. These principles eliminate some unintended consequences of the prescriptive requirements in current § 701.23(b)(2) that, in some cases, resulted in FCUs managing their lending practices and balance sheets to regulatory restrictions instead of broader considerations for safe and sound lending practices.

The proposed framework would provide credit unions with expanded flexibility 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 that are useful for credit unions of any size or complexity to implement the appropriate level of due diligence, risk assessment, and management.

When determining whether to start a loan purchase program and developing related written policies, credit unions should consider whether the proposed loan purchase activities are consistent with the FCU's overall business strategy and risk tolerances, and financial and operational capabilities. Loan purchase, sale, or pledge activities that are inconsistent with the FCU's risk tolerance levels or beyond management's ability to manage can pose material risks to an FCU's financial or operational condition.

The risk management expectations that are outlined in this proposal reflect the key components of long-standing supervisory expectations as communicated to credit unions through NCUA Letters to Credit Unions (LCU), Supervisory Letters, and the Examiner's Guide. The NCUA specifically requests comment on the written purchase policy requirements being proposed in paragraph (b)(6) of the rule. Are the principles-based due diligence, risk assessment, and management requirements proposed sufficient to offset the risk associated with removing the CAMELS rating and "well capitalized" requirements for a credit union to purchase and hold eligible obligations from a FICU? Are there other principles-based safety and soundness or compliance criteria the Board should consider that would mitigate the risk of removing certain prescriptive requirements from the rule?

*New 701.23(b)(6)(i)*

Proposed new § 701.23(b)(6)(i) would require FCUs to perform due diligence on the seller, and any applicable counterparties, before purchasing an eligible obligation. Conducting due diligence on third parties is a long-standing expectation for credit unions engaging in third-

party relationships and when introducing new loan programs and products, as noted in [NCUA LCU 01-CU-20](#) (November 2001), [NCUA LCU 08-CU-26](#) (November 2008), and [NCUA LCU 10-CU-03](#) (March 2010).<sup>98</sup>

Third-party relationships with credit unions have resulted in financial stress due to unexpected costs, legal disputes, and asset losses on several occasions. Due diligence reviews are important because they assist credit unions in risk identification and mitigation when engaging in a new loan program and when partnering with outside parties to enhance services to members. Failure to complete adequate due diligence can result in the acquisition of loan volumes that exceed the board's risk appetite, loan types that go beyond management's ability to manage, or loan types or volume that exceed the capabilities of current loan processing and management information systems. The use of third parties can add complexity and additional risk to a credit union's activities and may also expose the credit union to consumer compliance and other legal risks. For example, failure to conduct adequate due diligence could lead to an FCU entering into agreements with a third party that may discontinue services in the future. This could lead to disruptions in member service, uncollected payments on loans, and potential losses if the third party fails to remit funds that are due to the purchasing FCU.

The responsibility to perform appropriate due diligence remains with the FCU's board of directors and management and cannot be outsourced. Overreliance on the due diligence

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<sup>98</sup> Available at <https://ncua.gov/regulation-supervision/letters-credit-unions-other-guidance>.

information provided by a third party without independent review by the FCU's board and management could result in unsafe and unsound practices.

The proposed rule allows FCUs the flexibility to determine the level and depth of due diligence reviews that are necessary based on the level of risk posed by the loans being purchased and the third-party relationships. Several factors may be considered when determining the appropriate nature of due diligence for third-party loan purchases and programs, including:

- the transaction's complexity;
- the purchasing FCU's internal lending policies and procedures;
- the transaction's size relative to the FCU's existing loan portfolio, concentrations, and net worth level; and
- the purchasing FCU's management and staff expertise regarding the types of loans being purchased.

Additionally, FCUs can take a tiered approach when establishing their due diligence processes in their loan purchase policies. For example, when conducting background checks the FCU can determine how best to assess a third party's business reputation, potential conflicts of interest, experience, and compliance with federal and state laws, rules, and regulations based on the type of relationship with the third party and its risk exposure.

Accordingly, proposed § 701.23(b)(6)(i) would provide that the purchasing FCU's written purchase policy must require that the purchasing FCU conduct due diligence on the seller of the loans and other counterparties to the transaction prior to the purchase.

*New 701.23(b)(6)(ii)*

Proposed new § 701.23(b)(6)(ii) would require FCUs to establish risk assessment and risk management processes for purchase activities. Conducting risk assessments and implementing risk management processes reflect the NCUA's long-standing expectation that credit unions incorporate these activities in relationships with third parties as outlined in [NCUA LCU 07-CU-13](#) (April 2008), Evaluating Third-Party Relationships; [NCUA LCU 22-CU-05](#) (March 2022), CAMELS Rating System; and [NCUA Letter to FCUs 02-FCU-09](#) (March 2002), Risk-Focused Examination Program.<sup>99</sup> The purchase of loans can provide an FCU with a wide range of benefits, including achieving strategic loan growth, managing liquidity, adjusting risk exposures, and enhancing the services provided to members. However, an FCU that starts a new lending program, including the purchase or sale of loans, or engages with third parties without fully understanding the associated risks, may expose itself to credit, interest rate, liquidity, transaction, compliance, strategic, or reputation risk. Risk assessments allow credit unions to better understand the risk involved in new products and services to ensure the board has effective processes in place to control the risk. Not understanding these associated risks may result in the FCU operating outside of the board's risk appetite and can result in elevated risk to the Share

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<sup>99</sup> Available at <https://ncua.gov/regulation-supervision/letters-credit-unions-other-guidance>.

Insurance Fund. FCUs are ultimately responsible for safeguarding member assets and ensuring sound operations.

Adequate risk management processes include ongoing monitoring and oversight of the loan purchase program. This includes formal reporting to the board of directors and the FCU's senior management, which will ensure the board is able to fulfill its duties. An FCU's management reporting should be timely and commensurate with the size, complexity, and risk exposure of the FCU. For example, the board of directors should be informed when targets are met or exceeded, or limits breached. Reports should also consist of appropriate information that the board of directors and management could use to make informed decisions and take timely corrective action when warranted. For effective governance, an FCU's board of directors and management must understand the nature and level of risk associated with the FCU's purchased loan portfolio and program and receive periodic updates and reports on the performance of the purchased loan portfolio.

The proposed rule provides FCUs the flexibility to tailor their risk assessment and management processes to fit within their governance framework and other operations, while providing a basic framework to follow when developing their initial and ongoing risk assessment and management processes. Accordingly, proposed § 701.23(b)(6)(ii) would provide that the purchasing FCU's internal written purchase policies must 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.

*New 701.23(b)(6)(iii)*

Proposed new § 701.23(b)(6)(iii) would require FCUs to establish certain internal underwriting and ongoing monitoring standards for eligible obligation purchase activities. Underwriting is the foundation of lending. Without ensuring that underwriting standards are in place that adequately address how to analyze a borrower's ability to repay their debt, the board will not be able to fulfill its responsibilities for the safety and soundness of the FCU's lending activities. By this same logic, the board must also monitor the level of credit risk within the credit union's loan portfolio. Changing economic conditions at the local, regional, or national level can materially impact the likelihood that the credit union's outstanding loans are repaid. For example, the closure of a local business that is a large employer of the credit union's members could significantly change the risk profile of the credit union's loan portfolio. Changing levels of credit risk within the FCU's existing loan portfolio (including eligible obligations) may necessitate strategic changes or mitigating actions. If the level of credit risk begins to exceed the board's risk appetite, then risk exposures may need to be adjusted. Depending on the circumstances, this could include, but is not limited to, restricting the purchase of new eligible obligations, implementing more conservative underwriting standards, or potentially divesting parts of the existing loan portfolio.

The FCU's internal policies must address the level of underwriting to be performed for the purchase of loans. Underwriting should identify all risks that could materially influence the purchasing FCU's decision to proceed with a loan purchase. Appropriate underwriting standards that adequately address how to analyze a borrower's ability to repay their loan and the support



provided by collateral are a basic tenet of lending and help ensure that the FCU will be repaid, which protects its members and the Share Insurance Fund. Without appropriate underwriting standards, an FCU will not be able to accurately assess its risk of credit loss. Originating or purchasing loans to high credit risk borrowers without appropriately understanding and planning for that risk can result in unexpectedly high loss rates that negatively impact earnings and net worth, which may impair the viability of the credit union and pose a risk to the Share Insurance Fund. A lack of adequate underwriting standards can also result in adverse risk selection, whereby high credit risk borrowers are only able to obtain loans from institutions with lax underwriting, resulting in the FCU attracting borrowers with a much higher risk of default.

An FCU engaging in loan purchases should conduct an independent credit analysis and assessment of the borrower's creditworthiness and ability-to-repay, the support provided by collateral if relied on as part of the credit decision, and changes to the risk profile of the purchased loans. A purchasing FCU should not rely on the underwriting and analysis performed by the seller, or work performed by other third-party underwriters on behalf of a seller. To do so is an unsafe and unsound practice.

An FCU can leverage its current internal underwriting policies for similar loan types when developing its loan purchase policies. Performing credit and collateral analysis as if it were the originator should result in purchased loans that are consistent with the board of director's overall business strategy, risk tolerances, and credit quality standards. To the extent a purchasing FCU relies on a third party's credit models for credit decisions, the purchasing FCU should perform due diligence on the credit model. An FCU is not prohibited from relying on a

qualified and independent third party to perform model validation. However, the purchasing FCU should review the model validation to determine if it is sufficient.

The purchasing FCU's internal loan purchase policies should outline and identify the loan types that are acceptable for purchase. For example, acceptable loan types could include residential real estate (1–4 family or multi-family first lien and/or junior lien), solar loans, automobile loans, student loans, unsecured loans, out-of-territory loans, commercial loans, or government guaranteed loans (guaranteed and/or unguaranteed portion).

The loan purchase policy should address the level and depth of the underwriting and analysis that is required for each loan type permitted to be purchased based on the specific loan category, type, size, complexity, and risk profile of the borrower. The proposed rule allows flexibility to establish those parameters, while providing a basic framework for FCUs to follow when developing their policies.

Accordingly, proposed § 701.23(b)(6)(iii) would provide that the purchasing FCU's internal written purchase policies must 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. Proposed paragraph (b)(6)(iii) would provide further that 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.

*New 701.23(b)(6)(iv)*

Proposed new § 701.23(b)(6)(iv) would provide that the purchasing FCU's internal written purchase policy must require that the written purchase agreements include certain language. A well-written loan purchase agreement can minimize conflicts between the FCU and other parties to the agreement. The Board believes that any written loan purchase agreement must clearly delineate the roles, duties, and obligations of the seller, the purchasing FCU, servicer, and any other parties associated with the agreement, as applicable. The proposed rule establishes minimum provisions that any well-written loan purchase agreement must address.

The written loan purchase agreement is a critical component of any third-party relationship. In addition to establishing the rights and obligations of each party to the loan agreement, it should clearly address how the relationship operates. The written loan purchase agreement should fully describe the roles and responsibilities of all parties to the agreement, including any subcontractors. A well-written loan purchase agreement should address dispute resolution, requirements for any ongoing credit information if necessary for the loan type, remedies upon loan default and bankruptcy, identify which party bears the costs of collateral disposition, whether there are recourse arrangements for early pay-off, and if there is an obligation for the purchasing FCU to make any additional purchases or credit advances.

The purchasing FCU's board of directors and management should understand that it may have limited control over credit decisions for loans purchased in part, including limitations on the ability of the purchasing FCU to participate in loan modifications, act on defaulted loans, or

decline to make additional advances if the purchasing FCU deems such advances are not prudent in relation to the loan quality. The written loan agreement must address these circumstances, and other conditions under which the parties to the agreement may replace the servicer if services are not performed in accordance with the terms of the written loan purchase agreement. The purchasing FCU must also know the location and custodian for the original loan documents if the original loan documents are not required to be transferred to the purchasing FCU as part of the loan purchase transaction. The purchasing FCU could be required to provide the original loan documents to various parties involved in the administration and collection of the purchased loans. The purchasing FCU would therefore need to know where the original documents were located and which party to contact should the purchasing FCU need to obtain the original loan documents.

The written loan purchase agreement must, prior to the loan purchase transaction, identify the specific loan or loans being purchased, and the interest being purchased. A loan purchase transaction may involve a single loan or multiple loans, purchased in whole or in part. The documentation, for example, can be as simple as an addendum or schedule identifying each loan, provided the addendum or schedule is incorporated by reference into the loan purchase agreement. This provision clarifies in the existing rule that the loan purchase transaction involves the purchase of individual loans, and it is not the purchase of an investment interest in a pool of loans. Accordingly, for all the reasons outlined above, proposed § 701.23(b)(6)(iv) would provide that the purchasing FCU's internal written purchase policy must require that the written purchase agreement include: the specific loans being purchased (either directly in the agreement or through a document that is incorporated by reference into the agreement); the

location and custodian for the original loan documents; 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, if applicable; and 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, if applicable.

*New 701.23(b)(6)(v)*

Proposed new § 701.23(b)(6)(v) would require that FCUs establish certain portfolio concentration limits. Excessive concentration risk can severely impact the financial condition of an FCU. High concentrations in areas experiencing economic distress could result in significant losses exceeding an FCU's net worth. An FCU's board of directors and management have the responsibility to identify, manage, monitor, and control the risks facing the FCU, including concentration risk. FCU management must know what their concentration risks are and be able to demonstrate appropriate risk management and mitigation practices to minimize the risk of significant financial condition decline. Accordingly, proposed § 701.23(b)(6)(v) would provide that a purchasing FCU's internal written purchase policies must 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. Paragraph (b)(6)(v) would provide further that 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.

An FCU's loan purchase policy should establish credit underwriting and administration requirements that address the risks and characteristics unique to the loan types permitted for purchase. An FCU's loan purchase policy concentration limits should be considered for the aggregate amount of total purchased loans, for each loan type, risk factor, or category permitted. For example, concentration limits can be set by loan or collateral type but may also be set by associated borrower, origination channel, geographic area, or other risk category as applicable.

An FCU's board of directors should establish concentration risk limits commensurate with its net worth levels and consider how the limits fit into the overall strategic plan of the FCU. When credit union loan portfolios are concentrated in a small number of loan products that are significantly exposed to similar or correlated risk factors, a single event can impact a large portion of the loan portfolio and result in elevated losses that, if not managed appropriately, can lead to the credit union's failure. Since the year 2000, more than 50 percent of the NCUA's postmortems and material loss reviews have cited concentration risk as a central component of credit union failures. An FCU's board of directors should use a comprehensive perspective when developing loan purchase concentration policy limits, including identifying outside forces (such as economic or housing price uncertainty) that would affect the ability to manage concentration risk. The parameters set by the board of directors should be specific to each portfolio and should include limits on loan types and third-party relationship exposure, at a minimum. The concentration risk limits should correlate to the FCU's overall growth objectives, financial targets, and net worth plan. The concentration risk limits set forth in the FCU's policy should be closely linked to those codified in related policies, including, but not limited to, real estate loans, member business loans, asset/liability management (ALM), and investment policies.

Concentrations that exceed net worth must be monitored carefully, and the board of directors should document an adequate rationale for undertaking that level of risk.<sup>100</sup>

*New 701.23(b)(6)(vi)*

Proposed new § 701.23(b)(6)(vi) would address when a legal review of agreements or contracts would be required. The written loan purchase agreement is a critical component of any third-party relationship and, as such, the requirement for a legal review is a key element in the overall risk mitigation and management process. By obtaining legal advice regarding third-party contracts, an FCU can ensure its legal and business interests are appropriately protected, and the board of directors and management understand the risks, rights, and responsibilities of each party to the written loan purchase agreement. Accordingly, proposed § 701.23(b)(6)(vi) would provide that an FCU's internal written purchase policy must 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.

A legal review of the written loan purchase agreements and contracts will help an FCU ensure that the board of directors and management understand the rights and responsibilities of each party. For example, the review could identify which party bears the costs of collateral disposition, whether there are recourse arrangements, or whether the agreement includes a commitment for the purchasing FCU to make additional loan purchases and describe the interest

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<sup>100</sup> See attachment to NCUA Letter to FICUs 10-CU-03 (March 2010) available at <https://www.ncua.gov/files/letters-credit-unions/LCU2010-03Encl.pdf>.

being purchased. A legal review may also reduce a credit union's legal, compliance, or reputation risk by ensuring that the written loan purchase agreement complies with all applicable state and federal laws.

Further, an FCU should understand what actions it may take if the contract is breached, or services are not performed as expected. For example, the legal review could determine if the written loan purchase agreements include recourse language that requires a seller to buy back loans with missing documents, made outside of policy, or otherwise not in conformance with representations and warranties. The written loan purchase agreement is a critical component of any third-party relationship and, as such, a legal review is a key element in the overall risk mitigation and management process.

#### *701.23(c) Sale*

The proposal would make a non-substantive conforming change to current § 701.23(c)(1). In addition, the proposal would make certain substantive changes to paragraph (c)(2) and add new paragraphs (c)(3) and (c)(4), which are discussed in more detail in the following paragraphs. No changes would be made in the introductory sentence to current § 701.23(c).

#### *701.23(c)(1)*



As required by the changes discussed below, proposed § 701.23(c)(1) would make a conforming amendment to current § 701.23(c)(1). The conforming amendment would remove the “and” at the end of the provision to allow for an additional provision to be added under § 701.23(c)(2). No substantive change to this provision is intended.

#### *701.23(c)(2)*

The proposal would amend current § 701.23(c)(2) to change the retention requirements for the written agreement and schedule of eligible obligations sold by an FCU. The Board believes that this would result in only a minor technical change to current §701.23(c)(2). Under the proposed rule, the FCU selling the eligible obligations would still be required to retain the written loan sales agreement and a schedule of the eligible obligations covered by the agreement. The Board acknowledges the requirement for the FCU to retain the written loan sales agreement and schedule of the eligible obligations in the seller’s office could imply that the written loan sales agreement and schedule be retained in a hard-copy format, which is outdated given the current digital environment. An FCU might choose to store its records in electronic format, in the cloud, or housed in off-site servers or databases.

This proposed change would align this requirement with the NCUA’s regulations and guidelines for FICUs on records preservation programs. Under part 749, the NCUA does not require or recommend a particular format for record retention. If the credit union stores records on microfilm, microfiche, or in an electronic format, the stored records must be accurate,

reproducible, and accessible to an NCUA examiner.<sup>101</sup> If records are stored on the credit union premises, they should be immediately accessible upon the examiner's request; if records are stored by a third party or off site, then they should be made available to the examiner within a reasonable time after the examiner's request. The credit union must maintain the necessary equipment or software to permit an examiner to review and reproduce stored records upon request. The credit union should also ensure that the reproduction is acceptable for submission as evidence in a legal proceeding.<sup>102</sup> Accordingly, proposed § 701.23(c)(2) would provide that a written agreement, and a schedule of the eligible obligations covered by the agreement, is retained by the selling credit union that identifies the specific loans being sold either directly in the agreement or through a document that is incorporated by reference into the agreement.

*New 701.23(c)(3)*

The proposal would add new paragraph (c)(3) to § 701.23 to require a legal review of the written agreement to protect the legal and business interests of the selling FCU. 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. For example, the legal review would make clear which party bears the costs of collateral disposition, whether there are recourse arrangements, whether the agreement includes a commitment for the purchasing credit union to make additional loan purchases, and whether it describes the interest

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<sup>101</sup> See 12 CFR 749.5.

<sup>102</sup> See generally part 749; and NCUA Legal Op. 07-0812 (Jan. 2008), available at <https://www.ncua.gov/regulation-supervision/legal-opinions/2008/electronic-retention-records>.

being purchased. 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. The legal review should address loan and collateral documentation and information that the selling party is required to share with the purchasing party, status reports on payments and interest accrual, exit strategies, procedures for modifying loan terms, notification of adverse loan events, and collection procedures if servicing rights are retained by the seller. Further, an FCU should understand what actions it may take if the contract is breached or services are not performed as expected. The written loan sales agreement is a critical component of any third-party relationship and, as such, the requirement for a legal review is a key element in the overall risk mitigation and management process.

Accordingly, proposed § 701.23(c)(3) 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.

#### *701.23(d) Pledge*

The proposed rule would amend current § 701.23(d)(1)(iii) to amend the retention requirements for agreements covering eligible obligations pledged by an FCU. The Board believes that this would result in only a minor technical change to current §701.23(d)(1)(iii). Under the proposed rule, the FCU pledging the eligible obligations would still be required to retain the written agreement covering the pledging arrangement. The Board acknowledges the

requirement for the FCU that pledges the eligible obligations to retain the written agreement in the office could imply that the written agreement should be retained in a hard-copy format, which is outdated given the current digital environment. An FCU might choose to store its records in electronic format, in the cloud, or housed in off-site servers or databases. The Board's intent is that the FCU that pledges the eligible obligations make the written agreement covering the pledging arrangement available upon request.<sup>103</sup>

This proposed change would align this requirement with the NCUA's regulations and guidelines for FICUs on records preservation programs. Under part 749, the NCUA does not require or recommend a particular format for record retention. If the credit union stores records on microfilm, microfiche, or in an electronic format, the stored records must be accurate, reproducible, and accessible to an NCUA examiner.<sup>104</sup> If records are stored on the credit union premises, they should be immediately accessible upon the examiner's request; if records are stored by a third party or off site, then they should be made available to the examiner within a reasonable time after the examiner's request. The credit union must maintain the necessary equipment or software to permit an examiner to review and reproduce stored records upon request. The credit union should also ensure that the reproduction is acceptable for submission as evidence in a legal proceeding.<sup>105</sup>

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<sup>103</sup> See § 749.2.

<sup>104</sup> See 12 CFR 749.5.

<sup>105</sup> See generally part 749; and NCUA Legal Op. 07-0812 (Jan. 2008), available at <https://www.ncua.gov/regulation-supervision/legal-opinions/2008/electronic-retention-records>.

Accordingly, proposed § 701.23(d)(1)(iii) would require that a written agreement covering the pledging arrangement is retained by the credit union that pledges the eligible obligations.

#### *701.23(g) Payments and Compensation*

The proposed rule would amend current § 701.23(g) by adding a paragraph heading. The Board believes that this would result in only a minor technical change to paragraph (g). The amended rule would add the three-word descriptive heading “payments and compensation” for this section of the rule, but does not add any additional requirements or make any other changes to this section of this rule. Accordingly, proposed § 701.23(g) would have the paragraph heading “payments and compensation.”

#### *701.23(i) Temporary Regulatory Relief in Response to COVID-19*

The proposed rule would not extend the regulatory relief in § 701.23(i) that the Board approved in April of 2020 in response to COVID-19. This temporary relief is set to sunset on December 31, 2022. Current paragraph (i) provides as follows:

Notwithstanding § 701.23(b), during the period commencing on April 21, 2020, and concluding on December 31, 2022, an FCU may:

(1) Purchase, in whole or in part, and within the limitations of the board of directors’ written purchase policies, any eligible obligations pursuant to paragraph (b)(1)(i)

and (b)(2)(i) of this section 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

(2) Purchase and hold the obligations described in § 701.23(b)(2)(i) through (iv) if the FCU's CAMELS composite rating is "1," "2," or "3".<sup>106</sup>

As provided in current paragraph (i), the temporary regulatory relief provided under the paragraph expires on December 31, 2022. The Board temporarily modified certain regulatory requirements to help ensure that FICUs remained operational and liquid during the COVID-19 pandemic. The Board concluded, at the time, that the amendments would provide FICUs with the necessary flexibility in a manner consistent with the NCUA's responsibility to maintain the safety and soundness of the credit union system. The Board provided this temporary regulatory relief to assist credit unions in navigating the national emergency resulting from the COVID-19 pandemic.<sup>107</sup> Since the implementation of temporary regulatory relief, many credit unions have generally resumed normal, pre-pandemic operations. The majority of the COVID-19 pandemic health mitigation efforts imposed by states as well as the federal government have been lifted (non-essential business closures, social distancing requirements, and mask mandates).

The expiration date of the temporary final rule was initially extended through the close of December 31, 2021, by publishing the extension in the *Federal Register* on December 22,

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<sup>106</sup> (emphasis added).

<sup>107</sup> See 85 FR 22010 (April 21, 2020).

2020.<sup>108</sup> Due to the continued impact of COVID-19, the Board decided it was necessary to further extend the effective period of these temporary modifications until December 31, 2022, by publishing the extension in the *Federal Register* on December 22, 2021.<sup>109</sup> The Board is proposing to remove current paragraph (i) from § 701.23 as part of any final rule issued after December 31, 2022.

*B. Part 714—Leasing*

*Section 714.9 [Removed and Reserved]*

Current § 714.9 provides that the indirect leasing arrangements of an FCU are not subject to the eligible obligation limit if they satisfy the provisions of § 701.23(b)(3)(iv) that require that FCUs make the final underwriting decision and that the lease contract is assigned to the FCU very soon after it is signed by the member and the dealer or leasing company. The reference in current § 714.9 cites to § 701.23(b)(3)(iv), but there is no paragraph (b)(3)(iv) in that section. It is clear from the “eligible obligations limit” language in current § 714.9, however, that the cross citation is intended to reference the exclusion from the 5-percent limitation in current § 701.23(b)(4)(iv). Because this proposal would amend § 701.23(b)(4) to remove paragraph (b)(4)(iv) and would no longer apply the 5-percent limitation to any purchases of eligible obligations, as explained earlier in the preamble, current § 714.9 would be rendered moot by this

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<sup>108</sup> *See Id.*

<sup>109</sup> 85 FR 22010.

proposal. Accordingly, this proposal would remove the language in current § 714.9 and reserve the blank section for future use.

The Board seeks comments specifically on the placement of the definition of indirect leasing arrangement in the NCUA's regulations. The proposed definition would apply throughout the NCUA's regulations and is being proposed for inclusion in § 701.21 alongside the related definition of indirect lending arrangement that the Board is proposing to add to new § 701.21(c)(9)(i). The Board requests comments on whether stakeholders would find it clearer or more user-friendly to codify this definition in part 714.

#### **IV. Regulatory Procedures**

##### *Regulatory Flexibility Act*

The Regulatory Flexibility Act (RFA) generally requires that, in connection with a notice of proposed rulemaking, an agency prepare and make available for public comment an initial regulatory flexibility analysis that describes the impact of a proposed rule on small entities. A regulatory flexibility analysis is not required, however, if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities (defined for purposes of the RFA to include credit unions with assets less than \$100 million)<sup>110</sup> and publishes its certification and a short, explanatory statement in the *Federal Register* together with the rule.

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<sup>110</sup> See 80 FR 57512 (Sept. 24, 2015).



The Board fully considered the potential economic impact of the proposed changes during the development of the proposed rule. As noted in the preamble, the proposed rules would clarify the NCUA's current regulations and provide additional flexibilities to FICUs, making it easier to take advantage of advanced technologies and opportunities offered by the fintech sector.

The proposed rule would not impose any new significant burden on FICUs and may ease some existing requirements. Small FICUs are not obligated to buy and sell eligible obligations and loan participations. Additionally, while the proposed rule introduces risk management and due diligence policy expectations, FICUs have the flexibility to tailor required processes and policies to fit within their existing governance framework and commensurate with their size and complexity. Accordingly, the NCUA certifies that it would not have a significant economic impact on a substantial number of small FICUs.

#### *Paperwork Reduction Act*

The Paperwork Reduction Act of 1995 (PRA) applies to rulemakings in which an agency by rule creates a new paperwork burden on regulated entities or modifies an existing burden.<sup>111</sup>

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<sup>111</sup> 44 U.S.C. 3507(d).

For purposes of the PRA, a paperwork burden may take the form of a reporting, disclosure, or recordkeeping requirement, each referred to as an information collection. The NCUA may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number.

The rule as previously published contains an information collection in the form of a written policy requirement and a transaction documentation requirement, covered by OMB control numbers 3133-0127 and 3133-0141. The proposed changes to Part 701 would not result in a change in burden, and there are no new information collection requirements associated with this proposed rule.

#### *Executive Order 13132*

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. The NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the principles of the executive order to adhere to fundamental federalism principles. This proposed rule would reduce regulatory burdens on, and expand the authority of, federally insured credit unions, including federally insured, state-chartered natural-person credit unions to purchase certain loans and loan participations. It may have, to some degree, a direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. It does not, however, rise to the level of material impact for purposes of Executive Order 13132.

*Assessment of Federal Regulations and Policies on Families*

The NCUA has determined that this proposed rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

**List of Subjects**

**12 CFR Part 701**

Advertising, Aged, Civil rights, Credit, Credit unions, Fair housing, Individuals with disabilities, Insurance, Marital status discrimination, Mortgages, Religious discrimination, Reporting and recordkeeping requirements, Sex discrimination, Signs and symbols, Surety bonds.

**12 CFR Part 714**

Credit unions, Leasing, Reporting and recording keeping requirements.

By the National Credit Union Administration Board on December 15, 2022.

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Melane Conyers-Ausbrooks,  
Secretary of the Board.

For the reasons discussed above, the Board proposes to amend 12 CFR Parts 701 and 714 as follows:

**PART 701—ORGANIZATION AND OPERATION OF FEDERAL CREDIT UNIONS**

1. The authority citation for part 701 continues to read as follows:

**Authority:** 12 U.S.C. 1752(5), 1755, 1756, 1757, 1758, 1759, 1761a, 1761b, 1766, 1767, 1782, 1784, 1785, 1786, 1787, 1788, 1789. Section 701.6 is also authorized by 15 U.S.C. 3717. Section 701.31 is also authorized by 15 U.S.C. 1601 et seq.; 42 U.S.C. 1981 and 3601–3610. Section 701.35 is also authorized by 42 U.S.C. 4311–4312.

2. Amend §701.21 by adding paragraph (c)(9) to read as follows:

**§ 701.21 Loans to members and lines of credit to members**

\* \* \* \* \*

(c) \* \* \*

(9) *Indirect lending and indirect leasing arrangements.*

(i) *Definitions.* For purposes of this chapter VII, the following definitions apply:

*Indirect leasing arrangement* means 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* means 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.

(ii) *Indirect lending.* A loan acquired pursuant to an indirect lending arrangement, and that meets the requirements of this section, is classified as a loan and not the purchase of a loan for purposes of this chapter.

(iii) *Indirect leasing.* A lease acquired pursuant to an indirect leasing arrangement, and that meets the requirements of part 714 of this chapter, is classified as a lease and not the purchase of a lease for purposes of this chapter.

\* \* \* \* \*

3. Amend § 701.22 by:
  - a. Revising the introductory paragraph;
  - b. Revising the definition of “originating lender” in paragraph (a); and
  - c. Removing paragraph (e).

The revisions read as follows:

**§ 701.22 Loan participations.**

This section applies only to loan participations as defined in paragraph (a) of this section. It does not apply to the purchase of an investment interest in a pool of loans. This section establishes the requirements a federally insured credit union must satisfy to purchase a participation in a loan. Federally insured state-chartered credit unions are required by § 741.225 of this chapter to comply with the loan participation requirements of this section. This section does not apply to corporate credit unions, as that term is defined in § 704.2 of this chapter.

(a) \* \* \*

*Originating lender* means the participant with which the borrower initially or originally contracts for a loan and who, thereafter or concurrently with the funding of the loan, sells participations to other lenders. Originating lender includes a participant that acquires a loan through an indirect lending arrangement as defined under § 701.21(c)(9).

\* \* \* \* \*

4. Amend § 701.23 by:
- a. Revising the first paragraph;
  - b. Revising paragraph (a);
  - c. Adding the words “of loans” after the word “purchase” in the heading to paragraph (b);
  - d. Revising paragraph (b)(1)(ii);
  - e. Removing the word “mortgage” from the introductory sentence in paragraph (b)(1)(iv) and adding in its place the word “mortgage”;
  - f. Revising paragraphs (b)(2) and (b)(2)(ii), (b)(3)(ii), (b)(4) and (b)(5);
  - g. Adding new paragraph (b)(6);
  - h. Revising paragraphs (c)(1) and (c)(2);
  - i. Adding new paragraph (c)(3);
  - j. Revising paragraph (d)(1)(iii);
  - k. Adding the paragraph heading “Payments and compensation.” to paragraph (g); and
  - l. Removing paragraph (i).

The revisions and additions read as follows:

**§ 701.23 Purchase, sale, and pledge of loans.**

This section governs a federal credit union’s purchase, sale, or pledge of all or part of a loan to one of its own members, subject to certain exceptions. For purchases of eligible obligations, except as otherwise described under paragraph (b) of this section, the borrower must be a member of the purchasing federal credit union before the purchase is made.

(a) *Definitions.* For purposes of this section:

*Eligible obligation* means 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 § 701.22(a).

*Liquidating credit union* means:

(1) In the case of a voluntary liquidation, a credit union is a liquidating credit union as of the date the members vote to approve liquidation.

(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.

*Student loan* means a loan granted to finance the borrower's attendance at an institution of higher education or at a vocational school, which is secured by and on which payment of the outstanding principal and interest has been deferred in accordance with the insurance or guarantee of the Federal Government, of a state government, or any agency of either.

(b) *Purchase of loans.*

(1) \* \* \*

(ii) Notes of a liquidating credit union's individual members, from the liquidating credit union;

\* \* \* \* \*

(2) *Purchases of obligations from a FICU.* A federal credit union may purchase and hold the following obligations, provided that it would be empowered to grant them:

\* \* \* \* \*



(ii) *Notes of a liquidating credit union.* Notes of a liquidating credit union, without regard to whether they are notes of the liquidating credit union's members.

\* \* \* \* \*

(3) \* \* \*

(ii) A written agreement and a schedule of the eligible obligations covered by the agreement are retained by the purchaser; and

\* \* \* \* \*

(4) The aggregate of the unpaid balance of notes purchased under paragraphs (b)(1)(ii) and (b)(2)(ii) of this section shall not exceed 5 percent of the unimpaired capital and surplus of the purchaser.

(5) *Grandfathered purchases.* Subject to safety and soundness considerations, a federal credit union may hold any of the loans described in paragraph (b) of this section that were acquired before [INSERT EFFECTIVE DATE OF THE FINAL RULE]; provided the transaction was in compliance with § 701.23 at the time the transaction was executed.

(6) Purchases of eligible obligations and notes of liquidating credit unions must comply with the purchasing federal credit union's internal written purchase policies, which must:

(i) Require that the purchasing federal credit union 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 (either directly in the agreement or through a document that is incorporated by reference into the agreement);

(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, if applicable; 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, if applicable.

(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.

(c) \* \* \*

(1) The board of directors or investment committee approves the sale;

(2) A written agreement, and a schedule of the eligible obligations covered by the agreement, is retained by the selling credit union that identifies the specific loans being sold either directly in the agreement or through a document that is incorporated by reference into the agreement; and

(3) 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 federal credit union's legal and business interests are protected from undue risks.

(d) \* \* \*

(1) \* \* \*

(iii) A written agreement covering the pledging arrangement is retained by the credit union that pledges the eligible obligations.

\* \* \* \* \*

(g) *Payments and compensation.*

\* \* \* \* \*

## **Part 714—Leasing**

5. The authority citation for part 714 continues to read as follows:

**Authority:** 12 U.S.C. 1756, 1757, 1766, 1785, 1789.

### **§ 714.9 [Removed and Reserved]**

6. Remove and reserve § 714.9.