



February 21, 2006

Mary F. Rupp  
Secretary of the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314

RE: Comments on Notice of Proposed Rulemaking (Specialized Lending Activities)

Dear Ms. Rupp:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions (FCUs), I am responding to the National Credit Union Administration's (NCUA) proposed rule and request for comment regarding amendments to 12 C.F.R. Parts 701 and 741. In particular, NCUA has requested comment on issues related to purchases by federally insured credit unions of indirect vehicle loans serviced by third-parties.

In light of the agency's concerns regarding the significant risks inherent in certain specialized lending activities, the proposed rule would limit the aggregate amount of indirect vehicle loans serviced by any single third-party to 50 percent of the credit union's net worth for the first 30 months of the relationship with the vendor. After 30 months, this concentration limit would increase to 100 percent.

NAFCU believes credit unions should use sound business practices and exercise adequate due diligence when participating in high risk lending activities. While NAFCU appreciates the agency's efforts to provide credit unions with guidance on specialized lending activities, we are not certain that regulation of indirect, outsourced lending activities is necessary at this time. NAFCU is concerned that the proposal is not sufficiently well-defined and may have unintended consequences for credit unions that are operating safe and sound indirect lending programs. Specifically, NAFCU offers the following comments as outlined below.

## **Coverage and Definitions**

### *Indirect Outsourced Programs*

NCUA has stated that the proposed rule is narrowly tailored and intended to cover indirect vehicle loans serviced by third-parties. A great variety of product innovations populate today's complex marketplace. Certain lending programs outsource some, but not all, servicing to a third-party vendor, while other programs provide for far greater vendor involvement.

Section 701.21(h)(3) of the proposed rule defines a "third-party servicer" as any entity "that receives any scheduled periodic payments from a borrower pursuant to the terms of a loan and distributes the payments of principal and interest and such other payments with respect to the amounts received from the borrower as may be required pursuant to the terms of the loan." Accordingly, the proposed rule applies to all credit unions that rely on vendors to accept payments from borrowers of indirect vehicle loans (and distributes these payments to the credit union).

In comparison, the preamble to the proposal refers to loans as "indirect, outsourced programs," and appears to be narrower in scope. The preamble describes an indirect, outsourced lending program as one where a "vendor manages the credit union's relationship with the automobile dealer and, through loan servicing conducted by the vendor or a related business entity, the credit union's relationship with the member." *Third-Party Servicing of Indirect Vehicle Loans*, 70 Fed. Reg. 244, 75754 (December 21, 2005). The preamble also discusses indirect, outsourced programs in which "the third-party also controls the quality of the loan receivables because it dictates the underwriting criteria and processes the loan applications." *Id.* at 75755. Further, the credit risks associated with indirect, outsourced vehicle loans referred to in the preamble are attributed to both "underwriting" and "post-underwriting" factors. *Id.* at 75754 ("Credit loss experience may be worse if the indirect, outsourced loan program uses more permissive underwriting criteria than the credit union uses for its direct lending."). Thus, reading the preamble it is unclear, for example, whether coverage would extend to an indirect lending arrangement where the credit union retains substantive control over the lending relationship but uses some minimal third-party servicing for underwriting and loan processing.

NAFCU recommends that the agency clearly define the types of lending programs covered by the rule so that credit unions may have greater certainty about whether compliance with the new rule is necessary or whether the credit union will have to seek a waiver.

*Wholly-Owned Subsidiaries*

Under section 701.21(h)(3) of the proposed rule, a “wholly-owned subsidiary of a federally-insured depository institution” is not a “third-party servicer” for the purposes of the regulation. Thus, an indirect vehicle loan serviced by a credit union service organization (CUSO) that is *wholly*-owned by a credit union would not come within the scope of the proposed rule. It is unclear, however, whether a CUSO that is *jointly*-owned by two or more credit unions would also be excluded from the definition of a third-party servicer.

Since many CUSOs are jointly owned by numerous credit unions, NAFCU suggests that the proposed rule’s definition of “wholly-owned subsidiary” be revised to include subsidiaries that are majority owned by two or more financial institutions.

*Net Worth*

The proposed rule defines the term “net worth” as “the retained earnings balance of the credit union at quarter end as determined under generally accepted accounting principles.” NAFCU is concerned that accounting principles regarding the merger of credit unions may change in the near future. As part of this change, the net worth of a credit union may not be accurately reflected. To avoid unintended consequences of this proposed accounting rule change, NAFCU supports the passage of the Net Worth Amendment for Credit Unions Act. However, should the law change, and if the proposed regulation is implemented as drafted, the definition of net worth for the purposes of indirect vehicle lending will become narrower in scope in the regulation than in the Federal Credit Union Act. Accordingly, NAFCU recommends that the definition in the regulation reference the Federal Credit Union Act.

NAFCU commends the agency’s continued efforts to ensure the safety and soundness of all credit unions and would like to thank you for this opportunity to share its views on this proposed rule. Should you have any questions or require additional information please call me or Pamela Yu, NAFCU’s Associate Director of Regulatory Affairs, at (703) 522-4770 or (800) 336-4644 ext. 218.

Sincerely,



Fred R. Becker, Jr.  
President/CEO

FRB/pwy