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## Key Differences in the NCUA's Updated Loan Participation and Eligible Obligations Rule

The new, [final rule](#) recently issued by the National Credit Union Administration (NCUA) is now effective as of October 30, 2023. LoanStreet previously provided an overview of the final rule's amendments to Rules 701.22 (Loan Participations) and 701.23 (Eligible Obligations).

The final rule's most extensive changes reorient the requirements for purchasing and selling Eligible Obligations in a more "principles-based" direction. The updated rule opts for guidelines and credit union discretion instead of the specific conditions and limits present in the Loan Participations rule.

To help our clients evaluate whether to structure a transaction as a Loan Participation or an Eligible Obligation under this updated regulatory scheme, LoanStreet prepared the following summary of the key substantive differences between the two rules.

As a reminder, all federally insured credit unions (FICUs) are subject to the Loan Participation regulation, while only federal credit unions (FCUs) are directly subject to the Eligible Obligations regulation. Some state-chartered credit unions may nonetheless avail themselves of the Eligible Obligation rule if their local state rules have regulatory parity provisions or other similar features.

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## Risk Retention

Critically, there is no risk retention requirement under the Eligible Obligation rule, while for Loan Participations the originator must retain either 10% or 5% of each loan (depending whether the originator is an FCU).<sup>1</sup>

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## Caps

Under the Eligible Obligation rule there is no explicit cap on the aggregate amount of loans a FCU can purchase from a single originator. In contrast, the Loan Participation rule continues to maintain the following limits:

- The aggregate amount of participations purchased from a single originator is limited to either \$5 million or 100% of the purchaser's net worth (701.22(b)(5)(ii)).
- The aggregate amount of participations purchased with respect to a single borrower (or group of associated borrowers) is limited to 15% of the purchaser's net worth (701.22(b)(5)(iv)).

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## Banks

State-chartered credit unions may still purchase Loan Participations from banks, depending on their local state rules. FCUs remain unable to make purchases under either rule unless the borrower becomes a member of at least one of the participating credit unions.

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<sup>1</sup>FCUs and federally insured state-chartered credit unions (FISCUs) may still only purchase loans under either provision if the loans are ones the FICU is empowered to grant.

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## Expanded Guidelines for Internal Policies on Eligible Obligations

The rule's new provisions addressing the required internal policies for purchasing Eligible Obligations continue to follow the "principles-based" approach. Some of the updates bring the requirements for Eligible Obligations and Loan Participations in line with each other. For example:

- Both must establish underwriting standards (701.22(b)(5)(i) and 701.23(b)(6)(iii)); and
- Agreements for both must explain the duties and responsibilities of the seller, servicer, and other participants with respect to the transaction (701.22(d)(4)(v) and 701.23(b)(6)(iv)(C)).

At the same time, the expanded internal policy requirements for Eligible Obligations include provisions not present in the Loan Participation regulation. These new requirements do not impose prescriptive caps, but rather invite FCUs to determine their own limits and risk tolerance when purchasing Eligible Obligations. Of note:

- Purchasers must conduct due diligence on the seller and other counterparties prior to the purchase, establish risk assessment and risk management process requirements, and establish ongoing monitoring standards (701.23(b)(6)).
- Policies must establish portfolio concentration limits by loan type and risk category (701.23(b)(6)(v)).
- Policies must address when legal review of the purchase agreement will be performed depending on level of risk (701.23(b)(6)(vi)). For *sales* of Eligible Obligations, a review (not necessarily by legal) of the transaction agreement must be completed (701.23(c)(3)).

While these required internal policy changes may not result in any significant changes to how credit unions actually conduct their Eligible Obligation or Loan Participation transactions (particularly if their internal policies already conform in substance to the rules' prescriptions), we nevertheless advise all our credit union clients to be mindful of the different provisions as they make the determination to structure a transaction as one or the other, and ensure that all of these policies are, in fact, in place before conducting any transaction under these rules.

**As a follow-up to this overview of the key differences between the Loan Participation and Eligible Obligation regulations in light of the NCUA's new rule, LoanStreet will provide further insights into how we anticipate the updated regulations will shape credit unions' incentives and the credit union lending market more generally.**

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