Open Board Meeting June 18, 2015

NCUA Vice Chairman Rick Metsger
Statement on the Proposed Rule on Member Business Loans

I support this effort to modernize federal rules on member business loans and commercial lending and I look forward to the input we will receive during the upcoming comment period.

Federal MBL and commercial lending rules have not been significantly revised since 2003. The market, and our nation's credit unions, have changed dramatically over the intervening years, and these rules are overdue for revision.

Most importantly, this proposed set of revisions continues the devolution of decision-making from the NCUA to the boards and management of credit unions.

The proposed rule will get the NCUA out of the waiver business, and will, within the limits of statutory restrictions imposed by the Congress, give credit unions greater latitude in determining who to lend to and under what conditions. Credit unions will no longer have to ask for permission before they make commercial loans.

The most common complaints I receive about our current member business loan rules are:

- They are too restrictive; and
- It takes too long to get a waiver and thus credit unions lose the business to competitors who are not subject to similar constraints.

This last point is particularly important because the loans a credit union doesn't make may be more valuable than the loans they do make. Many credit unions have given up on serving their members' commercial lending needs because existing limits and the waiver process prevent them being competitive and meeting their members' needs in a timely fashion.

This rule tackles these problems head-on.

Among the host of prescriptive limits, definitions, and waivers removed or modified by this rule are:

- The requirement for a personal guarantee
- The 80 percent limit on Loan-to-Value ratios
- The limit on unsecured MBLs
- The requirement that staff have 2 years of direct experience
- Detailed limits on construction and development loans
- The restrictive definition of "associated borrower"

- The 15 percent of net worth limit on loans to one borrower, which will now increase to 25 percent if the additional 10 percent is supported by readily marketable collateral

Instead of trying to prescriptively micromanage credit unions' actions in these areas the new rule will give credit union boards and management greater authority and latitude, but will also hold them accountable for their decisions, and require them to document their policies and decisions. As our former president was fond of saying, we will, "Trust but verify."

This rule is part of a larger agency-wide trend of devolution and more flexible regulation which includes the NCUA's new streamlined exam system for small credit unions, as well as new rules or proposed rules on management of fixed assets, securitization, and adding associations to credit unions' fields of membership.

This proposed rule will empower boards of directors to set overall policies including:

- The institution's appetite for risk,
- The types of loans it will grant,
- Its trade area,
- Its underwriting standards,
- Its collateral requirements, and
- Its risk rating system.

Credit unions will have to employ staff with appropriate commercial lending experience and expertise, but will have greater latitude in determining what constitutes appropriate experience and expertise. Management will be responsible for implementation of these policies, for developing processes and procedures to carry them out, and for hiring staff with requisite experience.

The proposed rule carefully delineates the responsibilities of boards of directors and management. Boards will set policy limits and monitor their execution, while management will establish procedures and processes and to hire staff with appropriate experience to carry-out the policies.

It is important to note that most credit unions which are engaged in business lending already comply with these requirements because it is good business to do so. More than 90 percent of the credit unions that make business loans, for example, already have a risk rating system. The relatively small number, approximately 142 who do not have a risk rating system can either develop the expertise in-house or contract with a third party vendor. Either way, the decisions they make will be better in the long run for these credit unions and their members.

In return for requiring credit unions which make commercial loans to set policies and document their decisions, we will be empowering those credit unions to make a host of decisions that they now have to ask for permission to make.

As Peter Parker's Uncle Ben reminded him, "With great power comes great responsibility." This proposed rule grants great power, but requires responsibility in exercising that authority.

The rule creates a new definition of "commercial loan" which is similar, but not identical to the definition of "member business loan." In general, the term "commercial loan" encompasses a broader range of loans, but in a couple of areas it is narrower. The new definition was created for two reasons: First, because there are controls and policies that should be applied to the broader range of commercial loans, and not just to member business loans, and second because Congress was very prescriptive in defining member business loans.

The proposed rule also contains important de Minimis exceptions to the definition of what constitutes commercial lending. As with member business loans, loans under $50,000 do not count, nor do loans made by corporate credit unions, loans made to CUSOs, and loans made to other credit unions. In addition, all loans secured by vehicles manufactured for personal use, and loans secured by a non-owner-occupied 1-to-4 family residence do not count as commercial loans. These last two exceptions are areas where the definition of "commercial loan" is narrower than the definition of a "member business loan."

In accordance with the Regulatory Flexibility Act, and to provide even more relief to credit unions under $250 million in assets, they will be able to benefit from all of the additional flexibility the rule provides, and will also be exempt from portions of the new rule unless they have more than 15 percent of their net worth in commercial loans, and as long as they are not avoiding this cap by originating and then selling-off their commercial loans to stay under the cap.

As a result of this action, not only will all credit unions benefit from the new flexibility the rule allows, but 93 percent of all credit unions under $50 million in assets (the current threshold for "small entities" under the Regulatory Flexibility Act) will receive additional regulatory relief, yet at the same time 98.7 percent of all member business loans will be covered by the new rules.

In addition, more than 40 percent of the credit unions between $50 and $250 million in assets that make member business loans will also receive additional regulatory relief. The percentages of credit unions that receive additional regulatory relief are probably understated because of categories of loans that count as MBL but which will not count as commercial loans.

Let me reiterate that all credit unions, regardless of size, and their field of membership, will benefit from the elimination of prescriptive limits, definitions, and waiver requirements.

The key takeaway is that we have struck the right balance by eliminating many limits and waivers, and by exempting many loans and providing additional regulatory relief to small credit unions, while still covering nearly 99 percent of all MBLs.

I also want to note that, as permitted under the statute, the rule provides that if the agency adopts a final risk based capital rule which imposes a Risk Based Net Worth requirement on a credit union to be well capitalized that is higher than the 7 percent leverage requirement, then that credit union could have an MBL cap greater than 12.25 percent of its assets if it actually has that much capital on hand.

This is because the statutory MBL cap is actually the lower of 1.75 times its actual net worth or 1.75 times its Risk-Based Net Worth requirement, and 1.75 times its RBNW could be more than 12.25 percent.

While I doubt that there will be many credit unions who meet these criteria, there may be some. We said when we first proposed the RBC rule, and again when we proposed a second rule, that our intent was for credit unions to hold capital commensurate with their risk. Accordingly, credit unions which have a lot of capital, and who also have a Risk-Based Net Worth requirement that is higher than their 7 percent leverage ratio, should be permitted the higher MBL cap authorized under the law. This rule will grant them the higher cap permitted by the statute.

Finally, I want to note that while this proposed rule may require a one-time review of existing policies and procedures, it will then provide credit unions a lifetime of relief from waiver requests. I would further note that the incremental cost of this rule is only slightly over $800,000 for examiner training on the revised rule. Additional training will be provided during already scheduled and budgeted training that examiners regularly receive.

Accordingly, I am happy to support issuing this proposed rule for public comment and I look forward to reviewing those comments.