

Summary of Key Proposed Changes to NCUA’s Member Business Loan Rule

Federally insured credit unions have generally conducted business lending safely, and NCUA’s supervision of business lending has largely been successful. Over the past ten years, business loan portfolios at credit unions have nearly quadrupled in size to over \$51 billion today. As part of NCUA’s ongoing Regulatory Modernization Initiative, the NCUA Board is now proposing to modernize its member business lending (MBL) rule. The proposed re-write of the rule incorporates input from credit unions engaged in business lending that requested further clarity on aspects of NCUA’s MBL rules. It also addresses several issues NCUA identified as often problematic, such as the MBL waiver process and prescriptive lending limits, to allow credit unions to better serve their members’ individualized business lending needs. The rule also distinguishes the policy and program responsibilities for commercial loans from the statutory limit on MBLs.

The proposed MBL rule will provide federally insured credit unions making business loans with greater flexibility and more autonomy, shifting the rule’s focus from the current prescriptive approach to a more principle-based methodology that emphasizes sound risk management practices for commercial lending.

This document is a brief summary of key changes being proposed. It should not be solely relied upon as a comprehensive discussion for each section or item. Please consult the proposed rule’s preamble and text for more comprehensive detail about all the proposed changes to the MBL rule. NCUA remains committed to rigorous and prudential supervision of credit union commercial lending activities to ensure they remain safe and sound.

Table 1 – List of Waivers That Are No Longer Required

1. Aggregate Construction & Development (C&D) Loan Limit
2. Minimum Borrower’s Equity for C&D Loans
3. LTV Requirement
4. Personal Guarantee Requirement
5. Maximum Unsecured MBL to One Member or Group of Associated Members
6. Maximum Aggregate Unsecured MBL Loan Limit
7. Maximum Aggregate Net MBL to One Member or Group of Associated Members

Table 2 - Comparison of Member Business Loan and Commercial Loan Definitions

Type of Loan	MBL	Commercial Loan
Loan fully secured by a 1- to 4- family residential property (borrower's primary residence)	No	No
Member business loan secured by a 1- to 4- family residential property (<u>not</u> the borrower's primary residence)	Yes ¹	No
Member business loan secured by a vehicle manufactured for household use	Yes ²	No
Business loan with aggregate net member business loan balance less than \$50,000	No	No
Commercial loan fully secured by shares in the credit union making the extension of credit or deposits in other financial institutions	No	No
Commercial loan in which a federal or state agency (or its political subdivision) fully insures repayment, fully guarantees repayment, or provides an advance commitment to purchase the loan in full	No	Yes ³
Non-member commercial loan or non-member participation interest in a commercial loan made by another lender	No	Yes ⁴

¹ If the outstanding aggregate net member business loan balance is greater than \$50,000.

² If the outstanding aggregate net member business loan balance is greater than \$50,000.

³ If the outstanding aggregate net member business loan balance is greater than \$50,000.

⁴ If the outstanding aggregate net member business loan balance is greater than \$50,000.

Table 3 – Summary of Proposed MBL Rule Change

Proposed MBL Rule Section	Summary of Proposed MBL Rule Change	Reason for Proposed Change and Effect
723.1	PURPOSE AND SCOPE	
723.1(b)	<p><i>Allows smaller credit unions with limited commercial loan exposures more flexibility in complying with the regulation.</i> A credit union is exempt from the commercial loan policy and the board and management requirements sections of the proposed rule if the credit union:</p> <ul style="list-style-type: none"> • is less than \$250 million in assets, • has a commercial loan portfolio less than 15 percent of its total net worth, and • is not regularly making and selling or participating commercial loans. 	<p>The section provides explicit regulatory relief to qualifying credit unions with small commercial loan exposures that are not regularly originating and selling or participating commercial loans. An estimated 685 credit unions (31 percent of all credit unions with MBLs) would receive this exemption, based on 12/31/14 Call Report data. However, the proposed rule’s requirements would still cover over 99 percent of total outstanding commercial loans.</p>
723.1(c)(2)	<p><i>Government business lending programs.</i> The proposed rule broadens the provision that allows loans made under SBA-guaranteed loan programs to follow those provisions if less restrictive than the MBL rule for any federal or state guaranteed loan programs.</p>	<p>This change allows for parallel treatment and greater flexibility to include other federal or state-guaranteed business lending programs available to credit unions.</p>
723.2	DEFINITIONS	
723.2, 701.22	<p><i>Associated borrower.</i> The proposed rule revises the definition of <i>associated borrower</i> to generally encompass only associated persons or entities with common control or substantial financial interdependence. This definition also utilizes the new definitions included in the rule of <i>common enterprise, control, and direct benefit</i> to achieve this.</p>	<p>Suggested by credit union business lenders, this change generally reduces how far the <i>associated borrower</i> definition extends and more closely aligns the definition with the other banking agency standards. This change also benefits all loan participations (not just MBLs) with the proposed conforming change to 701.22.</p>

Proposed MBL Rule Section	Summary of Proposed MBL Rule Change	Reason for Proposed Change and Effect
723.2	DEFINITIONS (cont.)	
723.2	<i>Commercial loan.</i> Added a definition to distinguish between loans that by law are defined as MBLs for purposes of the statutory MBL cap and commercial loans that invoke the safety and soundness provisions of the proposed rule. This definition utilizes the new definitions for <i>loans secured by a 1- to 4-family residential property, residential property, and vehicle manufactured for household use</i> to achieve this.	The <i>commercial loan</i> definition excludes loans secured by non-owner-occupied, 1- to 4-family residential properties and those secured by vehicles manufactured for household use from triggering the requirements in sections 721.3 through 721.7 of the proposed rule. The definition is generally consistent with the related proposed risk-based capital definition and provides relief to credit unions making loans secured by non-owner-occupied, 1- to 4-family residential properties and vehicles manufactured for household use.
723.2	<i>Commercial loan.</i> The definition also encompasses business loans fully guaranteed by a federal or state agency.	Business loans fully guaranteed by a federal or state agency are not defined as MBLs in the current rule, but are considered commercial loans in the proposed rule for purposes of the safety and soundness provisions. The guarantees for these programs are customarily contingent on the credit union meeting prudent underwriting and servicing standards.
723.2, 723.4(g)(3)	<i>Credit-risk rating system.</i> The new definition addresses the requirement for a credit union's use of a credit-risk rating system if it makes commercial loans. The credit union's commercial loan policy must provide for use of a credit-risk rating system.	This definition, and related provision to incorporate a risk rating system into the credit union's commercial loan policy, was added to reinforce existing supervisory guidance and accounting standards. ⁵ Over 90 percent of credit unions that would be subject to this provision already have credit-risk rating systems for their commercial loans.

⁵ See NCUA Letter to Credit Unions 10-CU-02, *Current Risks in Business Lending and Sound Risk Management Practices*, January 2010, citing *The Office of Comptroller of the Currency, Comptroller's Handbook, Rating Credit Risk*, April 2001. Also see NCUA Accounting Bulletin 06-01, Attachment 1, Dec. 2006.

Proposed MBL Rule Section	Summary of Proposed MBL Rule Change	Reason for Proposed Change and Effect
723.2	DEFINITIONS (cont.)	
723.2	<i>Loan-to-value ratio.</i> Revises the current definition to exclude junior debt from other lenders in calculating loan-to-value ratios and clarify the valuation basis for the collateral.	This change and clarification was suggested by credit union MBL lenders. It better reflects how loan-to-value ratios are customarily calculated for commercial loans.
723.2, 723.4(c)	<i>Readily marketable collateral.</i> The proposed rule adds a definition to support flexibility for credit unions in exceeding the 15 percent of net worth single obligor limit.	The term was added to support the flexibility to exceed the single obligor limit.
723.3	BOARD OF DIRECTORS AND MANAGEMENT RESPONSIBILITIES	
723.3(a)(1)	<i>Board of director's oversight.</i> The proposed rule clarifies the credit union's board needs to review and update the commercial loan policy if there is a material change in circumstances.	The clarification aligns with current supervisory expectations and customary risk management practices.
723.3(a)(2), 723.3(a)(3), 723.3(b)	<i>MBL program management oversight responsibilities and required MBL experience.</i> The proposed rule adds more discrete provisions for the roles and responsibilities of the board of directors, senior management, and commercial lending staff. It also clarifies that the credit union must provide oversight for third parties used to conduct the credit union's commercial lending related work.	Replaces the explicit two-year experience requirement in favor of a more flexible principles-based approach that considers the overall experience of the staff involved in the credit union's commercial lending program. These proposed provisions align with current supervisory expectations and customary governance roles for institutions involved in commercial lending.

Proposed MBL Rule Section	Summary of Proposed MBL Rule Change	Reason for Proposed Change and Effect
723.4	COMMERCIAL LOAN POLICY	
723.4(c)	<p><i>Limit on single obligor loans.</i> The proposed rule moves the current rule’s single obligor limit of 15 percent of net worth into the policy requirement, and removes the related waiver provision. The proposal provides for the limit to be as high as 25 percent of net worth if supported by readily marketable collateral.</p>	<p>The change supports the elimination of regulatory waivers in the commercial lending process, but maintains a critical prudential limit on concentrations of credit to a single borrower. Without the need for a waiver, credit unions could choose to go up to 25 percent of net worth for a single obligor if the amount above 15 percent of net worth is collateralized by readily marketable collateral. This change parallels how the regulatory limit is applied by the other banking agencies.</p>
723.4(e)	<p><i>NCUA expectations for commercial loan policy underwriting.</i> The proposed rule specifies the policy must address delegated lending authority and the loan approval process.</p>	<p>This minor clarification aligns with current supervisory expectations and customary risk management practices.</p>
723.4(f)	<p>The proposed rule adds additional details on how the policy needs to address underwriting standards.</p>	<p>The change provides clarification on how credit unions must address underwriting standards. It is consistent with current supervisory expectations and customary risk management practices.</p>
723.4(g)	<p>The proposed rule adds additional details on how the policy needs to address risk management processes for commercial lending.</p>	<p>The change provides clarification on how credit unions must address commercial lending risk management processes. It is consistent with current supervisory expectations and customary risk management practices.</p>

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723.5	COLLATERAL AND SECURITY	
723.5(a)	<i>Loan-to-value requirements.</i> The proposed rule replaces the current rules' prescriptive loan-to-value requirements, and unsecured lending limit, with the principle that sufficient collateral is obtained when warranted and in relation to the risk.	The change provides credit unions with flexibility in setting their own unsecured portfolio limits and loan-to-value requirements. It also eliminates the need for regulatory waivers under the current rule.
723.5(b)	<i>Personal loan guarantees.</i> The proposed rule replaces the requirement for a personal guarantee or waiver with the requirement the credit union document for commercial loans without a personal guarantee that mitigating factors offset the risk of not having the personal guarantee.	The change provides credit unions with flexibility in setting their own underwriting criteria related to personal guarantees. It also eliminates the need for regulatory waivers under the current rule.
723.6	CONSTRUCTION AND DEVELOPMENT (C&D) LOANS	
723.6	<i>Removes C&D limit.</i> The proposed rule eliminates the prescriptive portfolio limit of 15 percent of net worth for construction and development loans in the current rule.	The change provides credit unions with flexibility in setting their own prudent limit for their C&D portfolio. It also eliminates the need for regulatory waivers, and the related waiver provisions in the current rule.

Proposed MBL Rule Section	Summary of Proposed MBL Rule Change	Reason for Proposed Change and Effect
723.6	CONSTRUCTION AND DEVELOPMENT (C&D) LOANS (Cont.)	
723.6(a) and (b)	<i>Definition of C&D loan, and determination of collateral values.</i> The proposed rule clarifies the definition of a C&D loan. It also clarifies how collateral values for C&D loans are determined.	The definition was changed for clarification. It also addresses questions received from credit unions and examination staff and better reflects how collateral values are customarily calculated for C&D loans.
723.6(c)	<i>C&D Loan Disbursement Process.</i> The proposed rule provides more detail to the current rule's requirement related to the disbursement of funds for C&D loans.	The change provides more specificity on the minimum requirement for disbursement of funds for construction and development loans, consistent with current supervisory expectations and customary construction and development lending practices.
723.7	PROHIBITED ACTIVITIES	
723.7	The proposed rule reorganizes existing prohibitions into one section.	The reorganization imposes no substantive change.
723.8	AGGREGATE MEMBER BUSINESS LENDING LIMIT; EXCLUSIONS AND EXCEPTIONS	
723.8(a)	<i>MBL cap expressed as multiple of net worth, not percentage of assets.</i> The proposed rule modifies the regulation to better conform to the statutory language for the MBL cap.	Credit unions with a higher net worth requirement under the risk-based standard than the net worth ratio requirement would have a higher MBL cap. The change is consistent with the Federal Credit Union Act.

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723.8	AGGREGATE MEMBER BUSINESS LENDING LIMIT; EXCLUSIONS AND EXCEPTIONS (cont.)	
723.8(b), 723.8(c)	<i>Defines a MBL for purposes of the statutory cap.</i>	The change clarifies non-member business loans and participations in non-member business loans made by another lender would not be subject to the MBL cap. It also eliminates the need for a regulatory waiver of such loans from the MBL cap.
723.8(d)	<i>Statutory MBL cap exemptions.</i> The proposed rule deletes from the current rule obsolete provisions related to the evidentiary documentation necessary to demonstrate qualification for the exemption for credit unions that had a history of primarily making member business loans.	The change eliminates an obsolete provision.
723.9	TRANSITIONAL PROVISIONS	
723.9	<i>Existing enforcement constraints or waivers.</i> The proposed rule specifies how any outstanding commercial lending waivers or supervisory enforcement actions would be affected upon implementation of the proposed rule.	The change provides added clarification on how the proposal would affect existing enforcement constraints and waivers.

Table 4 - Summary of Sections Deleted from Current Rule

Current Rule Section	Requirement	Why section was deleted
723.10	<i>What waivers are available?</i>	The change to a principles-based rule eliminates the need for waiver provisions.
723.11	<i>How do you obtain a waiver?</i>	The change to a principles-based rule eliminates the need for waiver provisions.
723.12	<i>What will NCUA do with my waiver request?</i>	The change to a principles-based rule eliminates the need for waiver provisions.
723.13	<i>What options are available if the NCUA Regional Director denies my waiver request, or a portion of it?</i>	The change to a principles-based rule eliminates the need for waiver provisions.
723.19	<i>What are the recordkeeping requirements?</i>	Policy and recordkeeping requirements are consolidated into new sections under the proposed rule.
723.20	<i>How can a state supervisory authority develop and enforce a member business loan regulation?</i>	The change to a principles-based rule may preclude the need for separate state MBL regulations. The Board is seeking comments on this issue as part of the proposed rulemaking. See the proposed rule's preamble.