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**Date:** June 28, 2021

**Re:** Proposed Revisions to Oregon Member Business Loan Rules, OAR 441-720-0300 to 441-720-0380

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## **441-720-0300, Definitions**

(1) “Associated borrower” means any other person or entity with a shared ownership, investment, or other pecuniary interest in a business or commercial endeavor with the borrower. This means any person or entity named as a borrower or debtor in a loan or extension of credit, or any other person or entity, such as a drawer, endorser, or guarantor, engaged in a common enterprise with the borrower, or deriving a direct benefit from the loan to the borrower.

(2) “Commercial loan” means:

(a) any loan, line of credit, or letter of credit, and any interest a credit union obtains in such loans made by another lender, to individuals, sole proprietorships, partnerships, corporations, or other business enterprises for commercial, industrial, agricultural, or professional purposes, but not for personal expenditure purposes.

(b) Excluded from this definition are loans made by a corporate credit union; loans made by a federally insured credit union to another federally insured credit union; loans made by a credit union to a credit union service organization; loans fully secured by shares, including deposits, in the credit union making the extension of credit or in other financial institutions; loans secured by a one-to-four (1-4) family residential property (whether or not it is the borrower’s primary residence); loans secured by a vehicle manufactured for household use that will be used for a commercial, corporate, other business investment property or venture, or agricultural purpose (unless a fleet of six or more vehicles); and loans that would otherwise meet the definition of commercial loan and which, when the aggregate outstanding balances and unfunded commitments to a borrower or an associated borrower, less any loans fully secured by shares, including deposits, are equal to less than \$50,000. The definition of “commercial loan” also excludes covered loans issued under the Small Business Administration’s Paycheck Protection Program.

(3) “Common enterprise” means:

(a) The expected source of repayment for each loan or extension of credit is the same for each borrower and no individual borrower has another source of income from which the loan (together with the borrower's other obligations) may be fully repaid. An employer will not be treated as a source of repayment because of wages and salaries paid to an employee, unless the standards described in paragraph (b) of this definition are met;

(b) Loans or extensions of credit are made:

(A) To borrowers who are related directly or indirectly through common control, including where one borrower is directly or indirectly controlled by another borrower; and

(B) Substantial financial interdependence exists between or among the borrowers. Substantial financial interdependence means 50 percent or more of one borrower's gross receipts or gross expenditures (on an annual basis) are derived from transactions with another borrower. Gross receipts and expenditures include gross revenues or expenses, intercompany loans, dividends, capital contributions, and similar receipts or payments; or

(c) Separate borrowers obtain loans or extensions of credit to acquire a business enterprise of which those borrowers will own more than 50 percent of the voting securities or voting interests.

(4) “Community development financial institution” means a financial institution, with a primary mission of community development that provides credit and financial services to underserved markets and population and is certified by an entity recognized by the director.

(5) “Construction or development loan” means a financing arrangement for acquiring property or rights to property, including land or structures, with the intent to construct or renovate an income-producing property such as residential housing for rental or sale; or a commercial building for industrial use; or similar uses. It also means a financing arrangement for the construction, major expansion, or renovation of the property types referenced in this section.

(6) “Control” means a person or entity directly or indirectly, or acting through or together with one or more persons or entities:

(a) Owns, controls, or has the power to vote 25 percent or more of any class of voting securities of another person or entity;

(b) Controls, in any manner, the election of a majority of the directors, trustees, or other persons exercising similar functions of another person or entity; or

(c) Has the power to exercise a controlling influence over the management or policies of another person or entity.

(7) “Credit risk rating system” means a formal process that identifies and assigns a relative credit risk score to each commercial loan in a credit union's portfolio, using ordinal ratings to represent the degree of risk. The credit risk score is determined through an evaluation of quantitative factors based on financial performance and qualitative factors based on management, operational, market, and business environmental factors.

(8) “Direct benefit” means the proceeds of a loan or extension of credit to a borrower, or assets purchased with those proceeds, that are transferred to another person or entity,

other than in a bona fide arm's-length transaction where the proceeds are used to acquire property, goods, or services.

(9) “Director” means the Director of the Department of Consumer and Business Services.

(10) “Immediate family member,” for the application of this rule, means a spouse or other family member living in the same household.

(11) “Loan secured by a 1- to 4-family residential property” means a loan that, at origination, is secured wholly or substantially by a lien on a 1- to 4-family residential property for which the lien is central to the extension of the credit; that is, the borrower would not have been extended credit in the same amount or on terms as favorable without the lien. A loan is wholly or substantially secured by a lien on a 1- to 4-family residential property if the estimated value of the real estate collateral at origination (after deducting any senior liens held by others) is greater than 50 percent of the principal amount of the loan.

(12) “Loan-to-value ratio or LTV ratio” means the aggregate amount of all sums borrowed, including senior liens, outstanding balances, and any unfunded commitments secured by the collateral, divided by the market value of the collateral. The current collateral value must be established by prudent and accepted commercial lending practices and comply with all regulatory requirements. For a construction and development loan, the collateral value is the lesser of cost to complete or prospective market value, as determined in accordance with applicable subsection of OAR 441-720-0355.

(13) “Low-Income Designation” means a credit union that has received the designation from the NCUA or the Director because of the income thresholds of the members or field of membership.

(14) “Member business loan” means any commercial loan as defined in 441-720-0300(2) of this part, and any loan secured by a vehicle manufactured for household use that will be used for a commercial, corporate, other business investment property or venture, or agricultural purpose if the aggregate member business loan balance and unfunded commitments to a member and associated borrowers is \$50,000 or greater.

(15) “Net member business loan” means the amount of the outstanding balances and unfunded commitments of the member business loans, reduced by any 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 or any loan that is fully secured by a lien on a 1- to 4- family dwelling; or any portion of a loan sold as a participation interest without recourse and qualifying for true sales accounting under Generally Accepted Accounting Principles.

(16) “Net Worth” means retained earnings of the credit union at quarter-end as determined under Generally Accepted Accounting Principles (GAAP). Retained earnings normally includes undivided earnings, regular reserves and any other appropriations designated by management or regulatory authorities. It does not include the Allowance for Loan and Lease Losses account.

(17) “NCUA” means the National Credit Union Administration.

(18) “Residential property” means a house, condominium unit, cooperative unit, manufactured home (whether completed or under construction), or unimproved land zoned for 1- to 4-family residential use. A boat or motor home, even if used as a primary residence, or timeshare property is not residential property.

***(441-720-0305, Member Business Loan Deleted)***

***(441-720-0310, Implementation of Commercial Loan Program Deleted)***

#### **441-720-0310, Board of Directors and Management Responsibilities**

Prior to engaging in commercial lending, a credit union must address the following board responsibilities and operational requirements:

(1) Board of directors. A credit union’s board of directors, at a minimum, must:

(a) Approve a commercial loan policy that complies with OAR 441-720-0315. The board must review its policy on an annual basis, prior to any material change in the credit union's commercial lending program or related organizational structure, and in response to any material change in portfolio performance or economic conditions, and update it when warranted.

(b) Ensure the credit union appropriately staffs its commercial lending program in compliance with paragraph (2)(b) of this section.

(c) Understand and remain informed, through periodic briefings from responsible staff and other methods, about the nature and level of risk in the credit union’s commercial loan portfolio, including its potential impact on the credit union’s earnings and net worth.

(2) Required expertise and experience. A credit union making, purchasing, or holding any commercial loan must internally possess the following experience and competencies:

(a) Senior executive officers. A credit union’s senior executive officers overseeing the commercial lending function must understand the credit union’s commercial lending activities. At a minimum, senior executive officers must have a

comprehensive understanding of the role of commercial lending in the credit union's overall business model and establish risk management processes and controls necessary to safely conduct commercial lending.

(b) Qualified lending personnel. A credit union must employ qualified staff with experience in the following areas:

(A) Underwriting and processing for the type(s) of commercial lending in which the credit union is engaged;

(B) Overseeing and evaluating the performance of a commercial loan portfolio, including rating and quantifying risk through a credit risk rating system; and

(C) Conducting collection and loss mitigation activities for the type(s) of commercial lending in which the credit union is engaged.

(c) Options to meet the required experience. A credit union may meet the experience requirements in paragraphs (2)(a) and (b) of this section by conducting internal training and development, hiring qualified individuals, or using a third-party, such as an independent contractor or a credit union service organization; however, with respect to the qualified lending personnel requirements in paragraph (2)(b) of this section, use of a third-party is permissible only if the following conditions are met:

(A) The third-party has no affiliation or contractual relationship with the borrower or any associated borrowers;

(B) The actual decision to grant a loan must reside with the credit union;

(C) Qualified credit union staff exercises ongoing oversight over the third party by regularly evaluating the quality of any work the third party performs for the credit union; and

(D) The third-party arrangement must otherwise comply with OAR 441-720-0370.

#### **441-720-0315, Commercial Loan Policies and Procedures**

Prior to engaging in commercial lending, a credit union board must approve policies, and management must prepare procedures, for the types of loans the credit union is originating (or plans to originate). At a minimum, the policies and procedures should address the following:

(1) Types of loans to be made;

(2) Identification of trade area to be served;

- (3) The maximum amount of net worth that will be invested in commercial loans;
- (4) The maximum amount of net worth that will be invested in a given category or type of commercial loan;
- (5) The maximum amount of net worth that will be loaned to any one member (including those loans that the member guarantees) and group of associated borrowers, subject to OAR 441-720-0330;
- (6) Qualifications and experience requirements for personnel involved in underwriting, processing, approving, administering, and collecting commercial loans.
- (7) Initial and ongoing analysis and documentation of the ability of the borrower to repay the loan;
- (8) Periodic receipt and analysis of the financial statements and other documents, including tax returns, of the borrower(s) and guarantor(s);
- (9) Considerations governing the quality and complexity of the financial statements;
- (10) Documentation sufficient to support each request for an extension of credit, or an increase in an existing loan or line of credit, except where the credit union finds that the required documentation is generally not available for a particular type of loan and states the reasons for those findings in the credit union's written policies. The documentation is expected to include the following:
  - (a) Understanding and history of the borrower(s) and guarantor(s) and the business operation and ownership;
  - (b) Balance sheet, income statement, and tax returns;
  - (c) Analysis of financial statements, cash flow, and leverage position; debt service coverage ratio guidelines including, but not limited to, the lessees of non-owner occupied property; and the global financial ability to repay;
  - (d) Comparison with industry average or similar analysis.
  - (e) Explanation of the related debt with the credit union;
  - (f) A detailed explanation of the complexity of the loan purpose, repayment, collateral, loan structure, conditions, capacity, relationship, strengths and weaknesses, and associated risks; and



(g) Borrower documentation such as loan agreement and covenants, note, security agreement, borrowing authority, and commitment letter.

(11) Collateral requirements must include all of the following:

(a) Steps to be taken to secure various types of collateral;

(b) Determination of ownership;

(c) Determination of value, source, and marketability, including a real estate appraisal policy;

(d) Maximum loan-to-value ratio guidelines;

(e) Frequency of reevaluation of the value and marketability of the collateral;  
and

(f) Insurance, if applicable.

(12) General underwriting guidelines such as cash-out purpose and maximum financing; expectations for due diligence of loan brokers and their loans and borrowers; and expectations for stress-testing.

(13) General credit risk management and administration procedures which include:

(a) Loan approval authorities and limits;

(b) Credit risk rating system;

(c) Servicing and follow-up;

(d) Collection process;

(e) Frequency and type of loan monitoring, which may include financial analysis, documented collateral inspection, loan agreement and covenant compliance, and credit risk rating system review;

(f) Review of concentrations and limits, loan losses, delinquencies, and underwriting standards and practices; and

(g) Internal controls and audit processes.

(14) Interest rates and maturities of loan type; pricing and risk philosophy;

(15) Procedures for adequate safeguards to minimize potential environmental liability.



(16) Identification of individuals prohibited from receiving commercial loans under OAR 441-720-0370.

(17) Approval of policy exceptions and reporting process, noting distinctions between the process for routine exceptions and significant exceptions and, to control risk, how to avoid frequent exceptions.

(18) If, however, a credit union makes a commercial loan through a program in which a federal or state agency (or its political subdivision) insures repayment, guarantees repayment, or provides an advance commitment to purchase the loan in full, and that program has requirements that are less restrictive than those required by this rule, then the credit union may follow the loan requirements of the relevant guaranteed loan program.

#### **441-720-0320, Collateral and Security Requirements**

(1) A credit union must require collateral commensurate with the level of risk associated with the size and type of any commercial loan. Collateral must be sufficient to ensure adequate loan balance protection along with appropriate risk sharing with the borrower and principal(s). A credit union making an unsecured loan must document in the loan file the mitigating factors that sufficiently offset the relevant risk.

(2) A credit union that does not require the full and unconditional personal guarantee from the principal or principals of the borrower, who have a controlling interest in the borrower, must document in the loan file the mitigating factors that sufficiently offset the relevant risk.

(3) Collateral is not required when the loan is guaranteed or insured by a private insurer that the credit union has determined has the financial capacity and willingness to perform under the terms of the guaranty or insurance agreement.

#### **441-720-0325, Recordkeeping Requirements**

The credit union must separately identify member business and commercial loans in its records and in the aggregate on its regulatory financial reports.

#### **441-720-0330, Aggregate Lending Limit to a Member and Associated Borrowers**

The aggregate amount of the credit union's outstanding loans and any unfunded commitments to a member (including those loans guaranteed by the member) and a group of associated borrowers may not exceed the greater of 15% of the credit union's net worth; or \$100,000.

#### **441-720-0335, Calculation of the Aggregate 15% Lending Limit**

For purposes of complying with the provisions of OAR 441-720-0330, a credit union must:

- (1) Calculate the numerator by adding together the credit union's total outstanding balance(s) of loans and any unfunded commitments to any one member (including those loans that the member guarantees) and groups of associated borrowers. From this amount, subtract any loans fully secured by shares, including deposits, in the credit union or in another financial institution; and
- (2) Divide the numerator by the net worth of the credit union.

#### **441-720-0340, Aggregate (Net) Member Business Loan Limit.**

(1) For purposes of this rule, "net member business loans" means the amount of outstanding balances and any unfunded commitments of the member business loans, reduced by any loan in which a federal or state agency (or its political subdivision) fully insures repayment, fully guarantees repayment, provides an advance commitment to purchase the loan in full, or any loan that is fully secured by a lien on a 1- to 4- family dwelling; or any portion of a loan sold as a participation interest without recourse and qualifying for true sales accounting under Generally Accepted Accounting Principles.

(2) The aggregate limit on the amount of a credit union's net member business loan balances and any unfunded commitments, is the lesser of:

- (a) 1.75 times the credit union's actual net worth; or
- (b) 1.75 times the minimum net worth required under section 1790d(c)(1)(A) of the Federal Credit Union Act (12 USC 1790d(c)(1)(A), as of 2018).

(3) Purchases of non-member commercial loans or non-member participation interests are excluded from the aggregate member business loan limit provided the credit union acquired the non-member loans or participation interests in compliance with all relevant laws and regulations and it is not, with one or more credit unions, trading member business loans to circumvent the aggregate limit.

#### **441-720-0345, Exemptions to the Aggregate (Net) Member Business Loan Limit**

A credit union that has a low-income designation, or participates in a community development financial institutions program, or was chartered for the purpose of making member business loans, or which as of the date of enactment of the Credit Union Membership Access Act of 1998 had a history of primarily making commercial loans, is exempt from compliance with the aggregate member business loan limits in this section.

*(441-720-0350, Exception Procedure Deleted)*

#### **441-720-0355, Construction and Development Lending**

In addition to the foregoing, the following requirements apply to a construction and development loan made by a credit union.

(1) For the purposes of this section, a construction or development loan means any financing arrangement to enable the borrower to acquire property or rights to property, including land or structures, with the intent to construct or renovate an income producing property, such as residential housing for rental or sale, or a commercial building, such as may be used for commercial, agricultural, industrial, or other similar purposes. It also means a financing arrangement for the construction, major expansion or renovation of the property types referenced in this section. The collateral valuation for securing a construction or development loan depends on the satisfactory completion of the proposed construction or renovation where the loan proceeds are disbursed in increments as the work is completed. A loan to finance maintenance, repairs, or improvements to an existing income producing property that does not change its use or materially impact the property is not a construction or development loan.

(2) A credit union that elects to make a construction or development loan must ensure that its commercial loan policy includes adequate provisions by which the collateral value associated with the project is properly determined and established. For a construction or development loan, collateral value is the lesser of the project's cost to complete or its prospective market value.

(a) For the purposes of this section, cost to complete means the sum of all qualifying costs necessary to complete a construction project and documented in an approved construction budget. Qualifying costs generally include on- or off-site improvements, building construction, other reasonable and customary costs paid to construct or improve a project, including general contractor's fees, and other expenses normally included in a construction contract such as bonding and contractor insurance. Qualifying costs include the value of the land, determined as the lesser of appraised market value or purchase price plus the cost of any improvements.

- (i) For land that has been held for an extended period, generally more than 12 months, by a borrower or principal, the credit union may use the market value of the land, as documented by a current appraisal.
- (ii) Any appreciation represented in the real estate valuation must be realistic and well-supported by current market conditions in an appraisal.

Qualifying costs also include interest, a contingency account to fund unanticipated overruns, and other development costs such as fees and related pre-development expenses. Interest expense is a qualifying cost only to the extent it is included in the construction budget and is calculated based on the projected changes in the loan balance up to the expected “as-complete” date for owner-occupied non-income producing commercial real estate or the “as-stabilized” date for income producing real estate. Project costs for related parties, such as developer fees, leasing expenses, brokerage commissions, and management fees, are included in qualifying costs only if reasonable in comparison to the cost of similar services from a third party. Qualifying costs exclude interest or preferred returns payable to equity partners or subordinated debt holders, the developer's general corporate overhead, and selling costs to be funded out of sales proceeds such as brokerage commissions and other closing costs.

(b) For the purposes of this section, prospective market value means the market value opinion determined by an independent appraiser in compliance with the relevant standards set forth in the Uniform Standards of Professional Appraisal Practice. Prospective value opinions are intended to reflect the current expectations and perceptions of market participants, based on available data. Two prospective value opinions may be required to reflect the time frame during which development, construction, and occupancy occur. The prospective market value “as-completed” reflects the property's market value as of the time that development is to be completed. The prospective market value “as-stabilized” reflects the property's market value as of the time the property is projected to achieve stabilized occupancy. For an income producing property, stabilized occupancy is the occupancy level that a property is expected to achieve after the property is exposed to the market for lease over a reasonable period of time and at comparable terms and conditions to other similar properties.

(3) A credit union that elects to make a construction and development loan must also ensure that its commercial loan policy meets the following conditions:

- (a) Qualified personnel representing the interests of the credit union must conduct a review and approval of any line item construction budget prior to closing the loan;
- (b) A credit union approved requisition and loan disbursement process is established;
- (c) Release or disbursement of loan funds occurs only after on-site inspections, documented in a written report by qualified personnel representing the interests of the credit union, certifying that the work requisitioned for payment has been satisfactorily completed, and the remaining funds available to be disbursed from the construction and development loan is sufficient to complete the project; and
- (d) Each loan disbursement is subject to confirmation that no intervening liens have been filed.

#### **441-720-0360, Commercial Loan Risk Classifications**

Commercial loans must be classified (graded) as to risk, based upon factors established by the credit union. Such factors should include the analysis of the credit and supporting documentation for the risk classification (grade) given, based upon the financial strength of the borrower. The credit risk rating system should include, but not be limited to, these categories:

- (1) **SPECIAL MENTION.** A special mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the credit union's credit position at some future date.
- (2) **SUBSTANDARD.** A substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. The loan classified has a well-defined weakness or weaknesses that jeopardize the liquidation of debt. The loan is characterized by the distinct possibility that the credit union will sustain some loss if the deficiencies are not corrected.
- (3) **DOUBTFUL.** A loan classified doubtful has all the weaknesses inherent in one classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include:

proposed merger, acquisition, or liquidation actions; capital injection; perfecting liens on collateral; and refinancing plans.

(4) LOSS. A loan classified loss is considered uncollectible and of such little value that its continuance as a loan is not warranted. This classification does not necessarily mean that the loan has absolutely no recovery or salvage value, but rather, it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may occur in the future.

***(441-720-0365, Minimum Reserves for Potential Loan Losses Deleted)***

**441-720-0370, Prohibited Commercial Loans**

(1) A credit union may not grant a commercial loan to the credit union's senior management, which shall include all chief officers, vice presidents and staff directors, as well as any credit union staff directly involved in commercial lending management, underwriting, servicing, or collecting; or any associated borrower or the immediate family member of anyone listed in this section.

(2) Equity agreement/Joint Ventures. The credit union may not grant a commercial loan if any additional income received by the credit union or senior management employees is tied to the profit or sale of the business or commercial endeavor for which the loan is made.

(3) Loans to Members of the Board of Directors. A credit union may not grant a commercial loan to a director who is a member of the credit union board of directors unless the board of directors approves in advance granting the loan and the director is recused from the decision making process.

(4) Conflicts of Interest. Any third party used by a credit union to meet the requirements of this part must be independent from the commercial loan transaction and may not have a participation interest in a loan or an interest in any collateral securing a loan that the third party is responsible for reviewing, or an expectation of receiving compensation of any sort that is contingent on the closing of the loan, with the following exceptions:

(a) A third party may provide a service to the credit union that is related to the transaction, such as loan servicing.

(b) The third party may provide the requisite experience to a credit union and purchase a loan or a participation interest in a loan originated by the federally insured credit union that the third party reviewed.

(c) A credit union may use the services of a credit union service organization that otherwise meets the requirements of OAR 441-720-0310(2)(c) of this part even if the credit union service organization is not independent from the transaction, provided the credit union has a controlling financial interest in the credit union service organization as determined under GAAP.

*(441-720-0375, Available Waivers for Specific Loan Types Deleted)*

*(441-720-0380, Waiver Procedure Deleted)*