

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

Federally insured credit unions generally have conducted business lending safely, and NCUA’s supervision of business lending has largely been successful. As part of NCUA’s ongoing Regulatory Modernization Initiative, in June 2015 the NCUA Board proposed changes to the member business lending rule for comment. Overall the comments received indicated the credit union industry was in general agreement with the proposed changes. The final rule approved by the NCUA Board at its February 18, 2016, meeting incorporates various suggestions received on the proposed rule.

The final 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 principles-based methodology that emphasizes sound risk management practices for business lending. Specifically, the final rule eliminates most prescriptive lending limits and the corresponding waiver provisions. The rule also distinguishes the policy and program responsibilities for commercial loans from the statutory limit on MBLs and complies with the Federal Credit Union Act in all respects.

This document is a brief summary of key changes. It should not be solely relied upon as a comprehensive discussion for each section or item. Please consult the final rule’s preamble and rule text for comprehensive detail about all the 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, Effective January 1, 2017

1.	Aggregate Construction & Development Loan Limit
2.	Minimum Borrower’s Equity for C&D Loans
3.	LTV Requirement
4.	Personal Guarantee Requirement (Effective 60 days after publication in the <i>Federal Register</i>)
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 (a member's primary residence)	No	No
Member business loan fully secured by a 1- to 4-family residential property (<u>not</u> a member'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 aggregate outstanding balances plus unfunded commitments less any portion secured by shares in the credit union is greater than \$50,000.

⁴ If the aggregate outstanding balances plus unfunded commitments less any portion secured by shares in the credit union is greater than \$50,000.

Table 3 – Summary of Final Rule Changes to Current Rule

Final MBL Rule Section	Summary of Final MBL Rule Change	Reason for Change and Effect
723	The final rule becomes effective January 1, 2017. However, 723.5(b) - Personal Guarantees becomes effective 60 days after publication in the <i>Federal Register</i>.	
723.1	PURPOSE AND SCOPE	
723.1(b)	<p><i>Allows smaller credit unions with limited commercial loan exposures and that infrequently originate and sell commercial loan participations more flexibility in complying with the regulation. A credit union is exempt from the commercial loan policy and the board and management requirements sections of the final rule if the credit union:</i></p> <ul style="list-style-type: none"> • has less than \$250 million in assets, • has a commercial loan portfolio plus commercial loans sold but serviced less than 15 percent of its total net worth, and • in any given calendar year has originated and sold and no longer services commercial loans that in aggregate are less than 15 percent of its net worth. 	<p>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. This exempts an estimated 660 smaller credit unions (30 percent of all credit unions with MBLs), based on 9/30/15 Call Report data. The final rule would still cover over 99 percent of total outstanding commercial loans. The final rule adds specificity to the exemption criteria compared to the proposed rule for clarity.</p>
723.1(c)(2)	<p><i>Government business lending programs.</i> The final 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>Allows for parallel treatment and greater flexibility to include other federal or state-guaranteed business lending programs available to credit unions.</p>

Final MBL Rule Section	Summary of Final MBL Rule Change	Reason for Change and Effect
723.2	DEFINITIONS	
723.2, 701.22	<p><i>Associated borrower.</i> The final 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</i>, <i>control</i>, and <i>direct benefit</i> to achieve this. As suggested by the commenters, the final rule addresses specific treatment for partnerships.</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. Change also benefits all loan participations, not just MBLs.</p>
723.2	<p><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 rule. This definition utilizes the new definitions for <i>loans secured by a 1- to 4-family residential property</i>, <i>residential property</i>, and <i>vehicle manufactured for household use</i> to achieve this.</p>	<p>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 final rule. The definition is generally consistent with the related 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.</p>
723.2	<p><i>Commercial loan.</i> The definition also encompasses business loans fully guaranteed by a federal or state agency.</p>	<p>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 final 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.</p>

Final MBL Rule Section	Summary of Final MBL Rule Change	Reason for Change and Effect
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 More than 90 percent of credit unions that would be subject to this provision are estimated to have credit-risk rating systems for their commercial loans.
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.	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 rule adds a definition to support flexibility for credit unions in exceeding the 15 percent of net worth single obligor limit.	Term added to support the flexibility to exceed the single obligor limit. In response to the comments made on the proposed rule, the preamble for the final rule adds additional explanation to determine readily marketable collateral.
723.3	BOARD OF DIRECTORS AND MANAGEMENT RESPONSIBILITIES	
723.3(a)(1)	<i>Board of director's oversight.</i> The rule clarifies the credit union's board needs to review and update the commercial loan policy if there is a material change in circumstances. It clarifies the board must have qualified personnel to manage the commercial risk and adequate reporting to understand the level of commercial loan risk.	Clarification aligns with current supervisory expectations and customary risk management practices.

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, December 2006.

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723.3(a)(2), 723.3(a)(3), 723.3(b)	<i>MBL program management oversight responsibilities and required MBL experience.</i> The 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 provisions align with current supervisory expectations and customary governance roles for institutions involved in commercial lending.
723.4	COMMERCIAL LOAN POLICY	
723.4(c)	<i>Limit on single obligor loans.</i> The final 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. In response to the comments received, the final rule also excludes the government-guaranteed portions of loans from the limit.	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. The change parallels how the regulatory limit is applied by the other banking agencies.
723.4(e)	<i>NCUA expectations for commercial loan policy underwriting.</i> The final rule specifies the policy must address delegated lending authority and the loan approval process.	Minor clarification that aligns with current supervisory expectations and customary risk management practices.
723.4(f)	The final rule adds additional details on how the policy needs to address underwriting standards.	Provides clarification on how credit unions must address underwriting standards. It is consistent with current supervisory expectations and customary risk management practices.

Final MBL Rule Section	Summary of Final MBL Rule Change	Reason for Change and Effect
723.4(g)	The final rule adds additional details on how the policy needs to address risk management processes for commercial lending.	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.
723.5	COLLATERAL AND SECURITY	
723.5(a)	<i>Loan-to-value requirements.</i> The final 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.	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 final 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 additional risk of not having the personal guarantee. This provision will go into effect 60 days after the final rule is published in the <i>Federal Register</i> .	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 final rule eliminates the prescriptive portfolio limit of 15 percent of net worth for construction and development loans in the current rule.	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.
723.6(a), 723.6(b)	<i>Definition of C&D loan, and determination of collateral values.</i> The final rule clarifies the definition of a C&D loan. It also clarifies how collateral values for C&D loans are determined.	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.

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723.6(c)	<i>C&D Loan Disbursement Process.</i> The final rule provides more detail to the current rule's requirement related to loan administration and the disbursement of funds for C&D loans.	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 final rule reorganizes existing prohibitions into one section.	Reorganization imposes no substantive change.
723.7(a)(1)	The final rule provides greater flexibility and allows senior managers not involved in or having influence over the commercial loan process the ability to obtain commercial loans from the credit union.	Less restrictive than the current rule and allows employees that cannot influence the loan approval, servicing, and collection processes to receive a commercial loan from the credit union.
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 final 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.
723.8(b), 723.8(c)	<i>Defines a MBL for purposes of the statutory cap.</i>	Eliminates the need for non-member business loans and participations in non-member business loans made by another lender to get a waiver of such loans from the regulatory MBL cap. The change preserves the statutory cap on loans meeting the Federal Credit Union Act's definition of a member business loan.

Final MBL Rule Section	Summary of Final MBL Rule Change	Reason for Change and Effect
723.8(d)	<i>Statutory MBL cap exemptions.</i> The final 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.	Eliminates an obsolete provision.
723.9	TRANSITIONAL PROVISIONS	
723.9	<i>Existing enforcement constraints or waivers.</i> The final rule specifies how any outstanding commercial lending waivers or supervisory enforcement actions would be affected upon implementation of the final rule.	Provides added clarification on how the final rule will affect existing enforcement constraints and waivers.
723.10	STATE REGULATION OF BUSINESS LENDING	
723.10(a)	The final rule allows federally insured, state-chartered credit unions to be exempt from NCUA's rule if their state has a MBL rule that is at least as stringent as Part 723 and complies with the requirements of the Federal Credit Union Act, as determined by NCUA.	Preserves a state's ability to exempt federally-insured state chartered credit unions from Part 723 by putting in place a state rule that complies with the requirements of the Federal Credit Union Act and ensures business lending is conducted safely and soundly by the state-chartered credit unions it regulates.
723.10(b)	The final rule grandfathers the seven state rules NCUA has previously approved.	

Table 4 - Sections Deleted from Current Rule

Current Rule Section	Requirement	Reason for Deletion
723.10	<i>What waivers are available?</i>	Change to a principles-based rule eliminates the need for waiver provisions.
723.11	<i>How do you obtain a waiver?</i>	
723.12	<i>What will NCUA do with my waiver request?</i>	
723.13	<i>What options are available if the NCUA Regional Director denies my waiver request, or a portion of it?</i>	
723.19	<i>What are the recordkeeping requirements?</i>	Policy and recordkeeping requirements are consolidated into new sections under the final rule.

Table 5 - Changes Incorporated into Final Rule based on Comments on Proposed Rule

Final MBL Rule Section	Description of the Change
723.1(b)(1) - Credit Unions Qualifying for Exemptions	Clarifies the qualifying criteria.
723.2 - Associated Borrower Definition	Includes exceptions for certain partnerships, joint ventures and associations.
723.2 - Commercial Loan Definition	Clarifies how “less than \$50,000” is determined.
723.2 - Loan-to-value Definition	Replaces “the lesser of purchase price or market value for collateral held 12 months or less, and market value for collateral held longer than 12 months” with “current collateral value.”
723.4(c) - Single Obligor Limit	Excludes the government guaranteed portion of a commercial loan from the limit.
723.5(b)(1) - Transitional Provision for Personal Guarantees	Personal guarantee provision effective 60 days after publication in the <i>Federal Register</i> .
723.7(a) – Ineligible Borrowers	Allows employees that cannot influence the loan approval, servicing, and collection processes to receive a commercial loan from the credit union.
723.10 - State Regulation of Business Lending	Preserves option for state rules to supersede Part 723 and grandfathers the seven existing NCUA-approved state rules.