



TEMPORARY RULE-MAKING FINDINGS OF NEED

[Authority G.S. 150B-21.1]

OAH USE ONLY

VOLUME:

ISSUE:

1. Rule-Making Agency:

North Carolina Credit Union Division

2. Rule citation & name:

04 NCAC 06C .0407 Commercial Lending and Member Business Loans

3. Action:

☐ Adoption

☒ Amendment

☐ Repeal

4. Was this an Emergency Rule:

☐ Yes

Effective date:

☒ No

5. Provide dates for the following actions as applicable:

a. Proposed Temporary Rule submitted to OAH: September 22, 2016

b. Proposed Temporary Rule published on the OAH website: September 29, 2016

c. Public Hearing date: October 12, 2016

d. Comment Period: September 29, 2016 to October 29, 2016

e. Notice pursuant to G.S. 150B-21.1(a3)(2): September 26, 2016

f. Adoption by agency on: November 8, 2016

g. Proposed effective date of temporary rule [if other than effective date established by G.S. 150B- 21.1(b) and G.S. 150B-21.3]: January 1, 2017

h. Rule approved by RRC as a permanent rule [See G.S. 150B-21.3(b2)]:

OFFICE OF ADMIN HEARINGS

2016 DEC -2 AM 11:40

FILED

6. Reason for Temporary Action. Attach a copy of any cited law, regulation, or document necessary for the review.

- ☐ A serious and unforeseen threat to the public health, safety or welfare.
- ☐ The effective date of a recent act of the General Assembly or of the U.S. Congress.
Cite:
Effective date:
- ☐ A recent change in federal or state budgetary policy.
Effective date of change:
- ☒ A recent federal regulation.
Cite: 12 C.F.R. Part 723
Effective date: January 1, 2017
- ☐ A recent court order.
Cite order:
- ☐ State Medical Facilities Plan.
- ☐ Other:

Explain:

The National Credit Union Administration has modified the Member Business Loans rule with changes that become effective January 1, 2017. State chartered credit unions will be disadvantaged without the opportunity to follow similar or the same rule. The modifications in the Rule will allow more access to commercial and business lending for consumers.

7. Why is adherence to notice and hearing requirements contrary to the public interest and the immediate adoption of the rule is required?

There has been a recent change in a Federal Regulation that will become effective January 1, 2017. 12 C.F.R. Part 723. The National Credit Union Administration has modified the rule, and state chartered credit unions will be disadvantaged without the opportunity to follow similar or the same rules. All state charters should have the ability to offer commercial and business lending as it will provide more access to capital for consumers. If state charters are not permitted to start at the same time, it may impact the ability to remain competitive within their perspective markets. A negative impact on the credit union financially, could cause a negative impact on the consumers that make up the field of membership of the credit union, as well as potential members.

There was a 30 day comment period offered from September 29, 2016 to October 29, 2016. There were no comments received.

The Credit Union Division also hosted a hearing on October 12, 2016. The North Carolina Credit Union League did attend the hearing in support of the temporary rule change, as well as Frank Drake, a local attorney that represents credit unions and is a well known speaker and trainer at credit union conferences.

It is very important for state chartered credit unions to have the opportunity to move into the commercial and business loan market on January 1, 2017

8. Rule establishes or increases a fee? (See G.S. 12-3.1)

☐ Yes

Agency submitted request for consultation on:

Consultation not required. Cite authority:

☒ No

9. Rule-making Coordinator:

Tony Knox, Deputy Administrator

Phone:

919-571-4888 ext. 204

E-Mail:

tknox@nccud.org

Agency contact, if any:

Rose Conner, Administrator

Phone:

919-571-4888 ext 203

E-Mail: rconner@nccud.org

10. Signature of Agency Head*:



*** If this function has been delegated (reassigned) pursuant to G.S. 143B-10(a), submit a copy of the delegation with this form.**

Typed Name:

Title:

E-Mail:

RULES REVIEW COMMISSION USE ONLY

Action taken:

Submitted for RRC Review:

☐ Date returned to agency:

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ELECTRONIC CODE OF FEDERAL REGULATIONS

e-CFR data is current as of August 25, 2016

Amendment

12 CFR--PART 723

View Printed Federal Register page 81 FR 13554 in PDF format.

Amendment(s) published March 14, 2016, in 81 FR 13554

EFFECTIVE DATES: January 1, 2017

5. Revise part 723 to read as follows:

PART 723—MEMBER BUSINESS LOANS; COMMERCIAL LENDING**Sec.**

- 723.1 Purpose and scope.
- 723.2 Definitions.
- 723.3 Board of directors and management responsibilities.
- 723.4 Commercial loan policy.
- 723.5 Collateral and security.
- 723.6 Construction and development loans.
- 723.7 Prohibited activities.
- 723.8 Aggregate member business loan limit; exclusions and exceptions.
- 723.9 Transitional provisions.
- 723.10 State regulation of business lending.

AUTHORITY: 12 U.S.C. 1756, 1757, 1757A, 1766, 1785, 1789.

§723.1 Purpose and scope.

(a) *Purpose.* This part is intended to accomplish two broad objectives. First, it sets out policy and program responsibilities that a federally insured credit union must adopt and implement as part of a safe and sound commercial lending program. Second, it incorporates the statutory limit on the aggregate amount of member business loans that a federally insured credit union may make pursuant to Section 107A of the Federal Credit Union Act. The rule distinguishes between these two distinct objectives.

(b) *Credit unions and loans covered by this part.* (1) This part applies to federally insured natural person credit unions. However, a federally insured natural person credit union is not subject to §723.3 and §723.4 of this part if it meets all of the following conditions:

- (i) The credit union's total assets are less than \$250 million.
 - (ii) The credit union's aggregate amount of outstanding commercial loan balances and unfunded commitments, plus any outstanding commercial loan balances and unfunded commitments of participations sold, plus any outstanding commercial loan balances and unfunded commitments sold and serviced by the credit union total less than 15 percent of the credit union's net worth.
 - (iii) In a given calendar year the amount of originated and sold commercial loans the credit union does not continue to service total less than 15 percent of the credit union's net worth.
- (2) This part does not apply to loans:
- (i) Made by a corporate credit union, as defined in part 704 of this chapter;
 - (ii) Made by a federally insured credit union to another federally insured credit union;
 - (iii) Made by a federally insured credit union to a credit union service organization, as defined in part 712 and §741.222 of this chapter; or

(iv) Fully secured by a lien on a 1- to 4-family residential property that is a member's primary residence.

(c) *Other regulations that apply.* (1) For federal credit unions, the requirements of §701.21(a) through (g) of this chapter apply to commercial loans granted by a federal credit union to the extent they are consistent with this part. As required by §741.203 of this chapter, a federally insured, state-chartered credit union must comply with §701.21(c)(8) of this chapter concerning prohibited fees, and §701.21(d)(5) of this chapter concerning non-preferential loans.

(2) If a Federal 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 Federal credit union may follow the loan requirements of the relevant guaranteed loan program. A federally insured, state-chartered credit union that is subject to this part and that makes a commercial loan as part of a loan 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 federally insured, state-chartered credit union may follow the loan requirements of the relevant guaranteed loan program, provided that its state supervisory authority has determined that it has authority to do so under state law.

(3) The requirements of §701.23 of this chapter apply to a Federal credit union's purchase, sale, or pledge of a commercial loan as an eligible obligation.

(4) The requirements of §701.22 of this chapter apply to a federally insured credit union's purchase of a participation interest in a commercial loan.

§723.2 Definitions.

For purposes of this part, the following definitions apply:

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. Exceptions to this definition for partnerships, joint ventures and associations are as follows:

(1) If the borrower is a partnership, joint venture or association, and the other person with a shared ownership, investment, or other pecuniary interest in a business or commercial endeavor with the borrower is a member or partner of the borrower, and neither a direct benefit nor a common enterprise exists, such other person is not an associated borrower.

(2) If the borrower is a member or partner of a partnership, joint venture, or association, and the other entity with a shared ownership, investment, or other pecuniary interest in a business or commercial endeavor with the borrower is the partnership, joint venture, or association and the borrower is a limited partner of that other entity, and by the terms of a partnership or membership agreement valid under applicable law, the borrower is not held generally liable for the debts or actions of that other entity, such other entity is not an associated borrower.

(3) If the borrower is a member or partner of a partnership, joint venture, or association, and the other person with a shared ownership, investment, or other pecuniary interest in a business or commercial endeavor with the borrower is another member or partner of the partnership, joint venture, or association, and neither a direct benefit nor a common enterprise exists, such other person is not an associated borrower.

Commercial loan means any loan, line of credit, or letter of credit (including any unfunded commitments), 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. 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 federally insured credit union to a credit union service organization; loans secured by a 1- to 4-family residential property (whether or not it is the borrower's primary residence); loans fully secured by shares in the credit union making the extension of credit or deposits in other financial institutions; loans secured by a vehicle manufactured for household use; and loans that would otherwise meet the definition of commercial loan and which, when the aggregate outstanding balances plus unfunded commitments less any portion secured by shares in the credit union to a borrower or an associated borrower, are equal to less than \$50,000.

Common enterprise means:

(1) 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 (2) of this definition are met;

(2) Loans or extensions of credit are made:

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

(ii) 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

(3) 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.

Control means a person or entity directly or indirectly, or acting through or together with one or more persons or entities:

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

(2) 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

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

Credit risk rating system means a formal process that identifies and assigns a relative credit risk score to each commercial loan in a federally insured 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.

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.

Immediate family member means a spouse or other family member living in the same household.

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.

Loan secured by a vehicle manufactured for household use means a loan that, at origination, is secured wholly or substantially by a lien on a new and used passenger car and other vehicle such as a minivan, sport-utility vehicle, pickup truck, and similar light truck or heavy-duty truck generally manufactured for personal, family, or household use and not used as a fleet vehicle or to carry fare-paying passengers, for which the lien is central to the extension of credit. A lien is central to the extension of credit if 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 vehicle manufactured for household use if the estimated value of the collateral at origination (after deducting any senior liens held by others) is greater than 50 percent of the principal amount of the loan.

Loan-to-value ratio means, with respect to any item of collateral, the aggregate amount of all sums borrowed and secured by that collateral, including outstanding balances plus any unfunded commitment or line of credit from another lender that is senior to the federally insured credit union's lien position, divided by the current collateral value. 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 §723.6 of this part.

Net worth means a federally insured credit union's net worth, as defined in part 702 of this chapter.

Readily marketable collateral means a financial instrument or bullion that is salable under ordinary market conditions with reasonable promptness at a fair market value determined by quotations based upon actual transactions on an auction or similarly available daily bid and ask price market.

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.

§723.3 Board of directors and management responsibilities.

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

(a) *Board of directors.* A federally insured credit union's board of directors, at a minimum, must:

(1) Approve a commercial loan policy that complies with §723.4 of this part. The board must review its policy on an annual basis, prior to any material change in the federally insured 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.

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

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

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

(1) *Senior executive officers.* A federally insured credit union's senior executive officers overseeing the commercial lending function must understand the federally insured 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 federally insured credit union's overall business model and establish risk management processes and controls necessary to safely conduct commercial lending.

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

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

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

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

(3) *Options to meet the required experience.* A federally insured credit union may meet the experience requirements in paragraphs (b)(1) and (2) 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 (b)(2) of this section, use of a third-party is permissible only if the following conditions are met:

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

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

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

(iv) The third-party arrangement must otherwise comply with §723.7 of this part.

§723.4 Commercial loan policy.

Prior to engaging in commercial lending, a federally insured credit union must adopt and implement a comprehensive written commercial loan policy and establish procedures for commercial lending. The board-approved policy must ensure the federally insured credit union's commercial lending activities are performed in a safe and sound manner by providing for ongoing control, measurement, and management of the federally insured credit union's commercial lending activities. At a minimum, a federally insured credit union's commercial loan policy must address each of the following:

(a) Type(s) of commercial loans permitted.

(b) Trade area.

(c) Maximum amount of assets, in relation to net worth, allowed in secured, unsecured, and unguaranteed commercial loans and in any given category or type of commercial loan and to any one borrower or group of associated borrowers. The policy must specify that the aggregate dollar amount of commercial loans to any one borrower or group of associated borrowers may not exceed the greater of 15 percent of the federally insured credit union's net worth or \$100,000, plus an additional 10 percent of the credit union's net worth if the amount that exceeds the credit union's 15 percent general limit is fully secured at all times with a perfected security interest by readily marketable collateral as defined in §723.2 of this part. Any insured or guaranteed portion of a commercial loan made 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, is excluded from this limit.

(d) Qualifications and experience requirements for personnel involved in underwriting, processing, approving, administering, and collecting commercial loans.

(e) Loan approval processes, including establishing levels of loan approval authority commensurate with the individual's or committee's proficiency in evaluating and understanding commercial loan risk, when considered in terms of the level of risk the borrowing relationship poses to the federally insured credit union.

(f) Underwriting standards commensurate with the size, scope and complexity of the commercial lending activities and borrowing relationships contemplated. The standards must, at a minimum, address the following:

(1) The level and depth of financial analysis necessary to evaluate the financial trends and condition of the borrower and the ability of the borrower to meet debt service requirements;

(2) Thorough due diligence of the principal(s) to determine whether any related interests of the principal(s) might have a negative impact or place an undue burden on the borrower and related interests with regard to meeting the debt obligations with the credit union;

(3) Requirements of a borrower-prepared projection when historic performance does not support projected debt payments. The projection must be supported by reasonable rationale and, at a minimum, must include a projected balance sheet and income and expense statement;

(4) The financial statement quality and the degree of verification sufficient to support an accurate financial analysis and risk assessment;

(5) The methods to be used in collateral evaluation, for all types of collateral authorized, including loan-to-value ratio limits. Such methods must be appropriate for the particular type of collateral. The means to secure various types of collateral, and the measures taken for environmental due diligence must also be appropriate for all authorized collateral, and

(6) Other appropriate risk assessment including analysis of the impact of current market conditions on the borrower and associated borrowers.

(g) Risk management processes commensurate with the size, scope and complexity of the federally insured credit union's commercial lending activities and borrowing relationships. These processes must, at a minimum, address the following:

(1) Use of loan covenants, if appropriate, including frequency of borrower and guarantor financial reporting;

(2) Periodic loan review, consistent with loan covenants and sufficient to conduct portfolio risk management. This review must include a periodic reevaluation of the value and marketability of any collateral;

(3) A credit risk rating system. Credit risk ratings must be assigned to commercial loans at inception and reviewed as frequently as necessary to satisfy the federally insured credit union's risk monitoring and reporting policies, and to ensure adequate reserves as required by generally accepted accounting principles (GAAP); and

(4) A process to identify, report, and monitor loans approved as exceptions to the credit union's loan policy.

§723.5 Collateral and security.

(a) A federally insured 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 federally insured credit union making an unsecured loan must determine and document in the loan file that mitigating factors sufficiently offset the relevant risk.

(b) A federally insured credit union that does not require the full and unconditional personal guarantee from the principal(s) of the borrower who has a controlling interest in the borrower must determine and document in the loan file that mitigating factors sufficiently offset the relevant risk.

(1) *Transitional provision.* A federally insured credit union that, between May 13, 2016 and January 1, 2017, makes a member business loan and does not require the full and unconditional personal guarantee from the principal(s) of the borrower who has a controlling interest in the borrower is not required to seek a waiver from the requirement for personal guarantee, but it must determine and document in the loan file that mitigating factors sufficiently offset the relevant risk.

(2) [Reserved].

§723.6 Construction and development loans.

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

(a) 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.

(b) A federally insured 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.

(1) 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. 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.

(2) 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.

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

(1) Qualified personnel representing the interests of the federally insured credit union must conduct a review and approval of any line item construction budget prior to closing the loan;

(2) A credit union approved requisition and loan disbursement process is established;

(3) 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 federally insured 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

(4) Each loan disbursement is subject to confirmation that no intervening liens have been filed.

§723.7 Prohibited activities.

(a) *Ineligible borrowers.* A federally insured credit union may not grant a commercial loan to the following:

(1) Any senior management employee directly or indirectly involved in the credit union's commercial loan underwriting, servicing, and collection process, and any of their immediate family members;

(2) Any person meeting the definition of an associated borrower with respect to persons identified in paragraph (a)(1) of this section; or

(3) Any compensated director, unless the federally insured credit union's board of directors approves granting the loan and the compensated director was recused from the board's decision making process.

(b) *Equity agreements/joint ventures.* A federally insured credit union may not grant a commercial loan if any additional income received by the federally insured credit union or its senior management employees is tied to the profit or sale of any business or commercial endeavor that benefits from the proceeds of the loan.

(c) *Conflicts of interest.* Any third party used by a federally insured 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:

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

(2) The third party may provide the requisite experience to a federally insured 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.

(3) A federally insured credit union may use the services of a credit union service organization that otherwise meets the requirements of §723.3(b)(3) of this part even if the credit union service organization is not independent from the transaction, provided the federally insured credit union has a controlling financial interest in the credit union service organization as determined under GAAP.

§723.8 Aggregate member business loan limit; exclusions and exceptions.

This section incorporates the statutory limits on the aggregate amount of member business loans that may be held by a federally insured credit union and establishes the method for calculating a federally insured credit union's net member business loan balance for purposes of the statutory limits and NCUA form 5300 reporting.

(a) *Statutory limits.* The aggregate limit on a federally insured credit union's net member business loan balances is the lesser of 1.75 times the actual net worth of the credit union, or 1.75 times the minimum net worth required under section 1790d(c)(1)(A) of the Federal Credit Union Act.

(b) *Definition.* For the purposes of this section, member business loan means any commercial loan as defined in 723.2 of this part, except that the following commercial loans are not member business loans and are not counted toward the aggregate limit on a federally insured credit union's member business loans:

(1) 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; and

(2) Any non-member commercial loan or non-member participation interest in a commercial loan made by another lender, provided the federally insured credit union acquired the non-member loans and participation interests in compliance with all relevant laws and regulations and it is not, in conjunction with one or more other credit unions, trading member business loans to circumvent the aggregate limit.

(c) *Exceptions.* Any loan secured by a lien on a 1- to 4-family residential property that is not a member's primary residence, and any loan secured by a vehicle manufactured for household use that will be used for a commercial, corporate, or other business investment property or venture, or agricultural purpose, is not a commercial loan but it is a member business loan (if the outstanding aggregate net member business loan balance is \$50,000 or greater) and must be counted toward the aggregate limit on a federally insured credit union's member business loans.

(d) *Statutory exemptions.* A federally insured credit union that has a low-income designation, or participates in the 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.

(e) *Method of calculation for net member business loan balance.* For the purposes of NCUA form 5300 reporting, a federally insured credit union's net member business loan balance is determined by calculating the outstanding loan balance plus any unfunded commitments, reduced by any portion of the loan that is secured by shares in the credit union, or by shares or deposits in other financial institutions, or by a lien on a member's primary residence, or insured or guaranteed by any agency of the federal government, a state or any political subdivision of such state, or subject to an advance commitment to purchase by any agency of the Federal Government, a state or any political subdivision of such state, or sold as a participation interest without recourse and qualifying for true sales accounting under generally accepted accounting principles.

§723.9 Transitional provisions.

This section governs circumstances in which, as of January 1, 2017, a federally insured credit union is operating in accordance with an approved waiver from NCUA or is subject to any enforcement constraint relative to its commercial lending activities.

(a) *Waivers.* As of January 1, 2017, any waiver approved by NCUA concerning a federally insured credit union's commercial lending activity is rendered moot except for waivers granted for borrowing relationship limits. Borrowing relationships granted a waiver will be grandfathered however the debt associated with those relationships may not be increased.

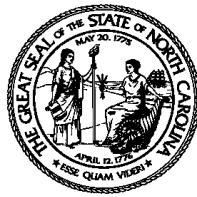
(b) *Enforcement constraints.* Limitations or other conditions imposed on a federally insured credit union in any written directive from NCUA, including but not limited to items specified in any Document of Resolution, any published or unpublished Letter of Understanding and Agreement, Regional Director Letter, Preliminary Warning Letter, or formal enforcement action, are unaffected by the adoption of this part. Included within this paragraph are any constraints or conditions embedded within any waiver issued by NCUA. As of January 1, 2017, all such limitations or other conditions remain in place until such time as they are modified by NCUA.

§723.10 State regulation of business lending.

(a) *State rules.* Federally insured state chartered credit unions in a given state are exempted from compliance with this part if the state supervisory authority administers a state commercial and member business loan rule for use by federally insured credit unions chartered in that state, provided the state rule at least covers all the provisions in this part and is no less restrictive, upon determination by NCUA.

(b) *Grandfathering of NCUA-approved state rules.* A state supervisory authority that administers a state commercial and member business loan rule previously approved by NCUA may continue to administer that rule in its current NCUA-approved format. Any modification of that rule must be consistent with this rule, but modification of one part of an existing NCUA-approved state rule will not cause other parts of that rule to lose their grandfathered status.

Need assistance?



State of North Carolina Credit Union Division

Patrick L. McCrory
Governor

Rose Heston Conner
Administrator

December 1, 2016

Rules Review Commission
1711 New Hope Church Rd
Raleigh NC 27609

Authority Cited for promulgation of the temporary rule;

The North Carolina Credit Union Division is submitting a proposal for a temporary rule, 04 NCAC 06C .0407, Commercial Lending and Member Business Loans. The proposed effective date is to be January 1, 2017. We are following the process as set forth in 150B-21.1 and 150B-21.19 for temporary rules. The Authority to propose temporary rules is granted to the Credit Union Division in NC Credit Union Laws 54-109.12. Please see the attached.

Please call if you have questions upon receipt.

Regards,

Tony Knox
Deputy Administrator

§ 54-109.12. Corporations organized hereunder subject to Administrator of Credit Unions; rules and regulations.

In addition to any and all other powers, duties and functions vested in the Administrator of Credit Unions under the provisions of this Article, the Administrator of Credit Unions shall have general control, management and supervision over all corporations organized under the provisions of Article 14A. All corporations organized under the provisions of Article 14A shall be subject to the management, control and supervision of the Administrator of Credit Unions as to their conduct, organization, management, business practices and their financial and fiscal matters. The Administrator of Credit Unions may prescribe rules and regulations for the administration of this Article, as well as rules and regulations relating to financial records, business practices and the conduct and management of credit unions, and it shall be the duty of the board of directors and of the various officers of the credit union to put into effect and to carry out such regulations. (1915, c. 115, s. 7; C.S., s. 5237; 1925, c. 73, s. 3; 1935, c. 87; 1957, c. 989, s. 6; 1965, c. 956, ss. 1, 22; 1975, c. 538, s. 1; 1979, c. 198.)

04 NCAC 06C .0407 is amended as a temporary rule as follows:

04 NCAC 06C .0407 ~~BUSINESS LOANS~~ Commercial Lending and Member Business Loans

(a) ~~Prohibited fees. A North Carolina credit union shall not make any loan or extend any line of credit if, either directly or indirectly, any commission, fee or other compensation is to be received by the Credit Union's directors, committee members, senior management employees, loan officers, or any immediate family members of such individuals, in connection with underwriting, insuring, servicing or collecting the loan or line of credit. However, salary (except commissions) for employees is not prohibited by this Section. For purposes of this Section, "senior management employees" means the Credit Union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President or Assistant Treasurer/Manager), and the chief financial officer (Comptroller), and "immediate family member" means a spouse or other family member living in the same household.~~

~~(b) Member Business Loans.~~

~~(1) Definitions:~~

~~(A) Member business loans mean any loan, line of credit, or letter of credit, the proceeds of which will be used for commercial, corporate, business, investment property or venture, or agriculture purpose, except that the following shall not be considered member business loans for purposes of this Section:~~

~~(i) A loan or loans fully secured by a lien on a one to four family dwelling that is the member's primary residence.~~

~~(ii) A loan that is fully secured by shares in the credit union or deposits in other financial institutions.~~

~~(iii) A loan meeting the general definition of member business loans under Part (b)(1)(A) of this Rule, and, made to a borrower or an associated member, which, when added to other such loans to the borrower or associated member, is less than fifty thousand dollars (\$50,000).~~

~~(iv) A loan, the repayment of which is fully insured or fully guaranteed by, or where there is an advance commitment to purchase in full by, any agency of the federal government or of a state or any of its political subdivisions.~~

~~(v) A loan granted by a corporate credit union operating under the provisions of the North Carolina General Statutes to another credit union.~~

~~(B) Reserves means reserve fund, undivided earnings, current earnings, and excludes the Allowance for Loan Losses.~~

~~(C) Associated Member means any member with a shared ownership, investment or other pecuniary interest in a business or commercial endeavor with the borrower.~~

~~(D) Immediate Family Member means a spouse, or other family member living in the same household.~~

~~(E) Loan to Value (LTV) ratio means the quotient of the aggregate amount of all sums borrowed from all sources on an item of collateral divided by the market value of the collateral used to secure the loan.~~

~~(F) Construction or development loan means a financing arrangement for the purpose of acquisition of property or rights to property or rights to property including land or structures with the intent of conversion into income-producing property including residential housing for rental or sale, commercial or industrial use, or a similar use.~~

(2) Requirements. Member business loans, as defined in Part (b)(1)(A) of this Rule may be made by credit unions only in accordance with the applicable provisions of Rule .0409 and .0205(d) and the following additional requirements:

(A) Written loan policies. The Board of Directors must adopt specific business loan policies and review them at least annually. The policies shall, at a minimum, address the following:

- (i) Types of business loans that will be made;
- (ii) The credit union's trade area for business loans;
- (iii) Maximum amount of credit union assets, in relation to reserves, that will be invested in business loans;
- (iv) Maximum amount of credit union assets, in relation to reserves, that will be invested in a given category or type of business loan;
- (v) Maximum amount of credit union assets, in relation to reserves, that will be loaned to any one member or group of associated members, subject to Subpart (b)(2)(C)(i) of this Rule;
- (vi) Qualifications and experience of personnel involved in making and administering business loans with a minimum of two years direct experience with this type of lending;
- (vii) Analysis of the ability of the borrower to repay the loan;
- (viii) Documentation supporting each request for an extension of credit or an increase in an existing loan or line of credit shall (except where the Board of Directors finds that such documentation requirements are not generally available for a particular type of business loan and states the reasons for those findings in the credit union's written policies) include the following: balance sheet, cash flow analysis, income statement, tax data, leveraging; comparison with industry averages; receipt and periodic updating of financial statements and other documentation; including tax returns;
- (ix) Collateral requirements, including loan to value ratios; appraisal, title search and insurance requirements; steps to be taken to secure various types of collateral; and how often the value and marketability of collateral is reevaluated;
- (x) Appropriate interest rates and maturities of business loans;
- (xi) Loan monitoring, servicing and follow up procedures, including collection procedures;
- (xii) Provision for periodic disclosure to the credit union's members of the number and aggregate dollar amount of member business loans;
- (xiii) Identification, by position, of those senior management employees prohibited by Rule .0205(d) of this Chapter from receiving member business loans.

(B) Other policies. The following minimum limits and policies shall also be established in writing and reviewed at least annually for loans granted under this Section:

- (i) Loans shall be granted on a fully secured basis by collateral as follows:
 - (I) Second lien for LTV ratios of up to 70 percent;
 - (II) First lien for LTV ratios of up to 80 percent;
 - (III) First lien with a LTV ratio in excess of 80 percent shall be granted only where the value in excess of 80 percent is covered through acquisition of private mortgage, or equivalent type insurance provided by an insurer acceptable to

1 the credit union or insurance or guarantees by or subject to advance commitment to purchase by, an agency of the
2 federal government or of a state or any of its political subdivisions, and in no event shall the LTV ratio exceed 95
3 percent;

4 (ii) Loans shall not be granted without the personal liability and guarantees of the principals (natural person
5 members) except where the borrower is a not for profit organization as defined by the Internal Revenue Service
6 Code (26 U.S.C. 501);

7 (iii) All loans to non-natural persons, except to other credit unions, must be secured as required in Chapter 54-
8 109.27 of the North Carolina General Statutes.

9 ~~(C) Loan Limits.~~

10 (i) Unless a greater amount is approved by the Administrator based on the factors set out in Subpart (b)(2)(C)(ii) of
11 this Rule with the concurrence of the Regional Director of the National Credit Union Administration, the aggregate
12 amount of outstanding member business loans to any one member or group of associated members shall not exceed
13 15 percent of the credit union's reserves (less the Allowance for Loan Losses account), or seventy five thousand
14 dollars (\$75,000) whichever is higher. If any portion of a member business loan is secured by shares in the credit
15 union, or deposits in another financial institution, or fully or partially insured or guaranteed by, or subject to an
16 advance commitment to purchase by, any agency of the federal government or of a state or any of its political
17 subdivisions, such portion shall not be calculated in determining the 15 percent limit.

18 (ii) Exceptions. Credit unions seeking an exception from the limits of Subpart (b)(2)(C)(i) or Subparagraph (b)(3) of
19 this Rule must present the Administrator of Credit Unions and the Regional Director of the National Credit Union
20 Administration with, at a minimum; the higher limit sought; an explanation of the need by the members to raise the
21 limit and ability of the credit union to manage this activity; an analysis of the credit union's prior experience making
22 member business loans; and a copy of its business lending policy. The analysis of credit union experience in making
23 member business loans shall document the history of loan losses, loan delinquency, volume and cyclical or seasonal
24 patterns, diversification, concentrations of credit to one borrower or group of associated borrowers in excess of 15
25 percent of reserves (less the Allowance for Loan Losses account), underwriting standards and practices, types of
26 loans grouped by purpose and collateral and qualifications of personnel responsible for underwriting and
27 administering member business loans. The credit union must have written approval of the Administrator of Credit
28 Unions and the Regional Director of the National Credit Union Administration to exceed the limitations contained in
29 this Rule.

30 (iii) Maturity. Member business loans shall be granted for periods consistent with the purpose, security,
31 creditworthiness of the borrower and sound lending policies.

32 (iv) Monitoring requirement. Credit unions with member business loans in excess of 100 percent of reserves (less
33 the Allowance for Loan Losses account) shall submit the following information regarding member business loans to
34 the Administrator on a quarterly basis: the aggregate total of loans outstanding; the amount of loans delinquent in
35 excess of 30 days; the balance of the allowance for member business loan losses; the aggregate total of all
36 concentrations of credit to one borrower or group of associated borrowers in excess of 15 percent of reserves (less
37 the Allowance for Loan Losses account); the total number and amount of all construction, development or

speculative loans; and any other information pertinent to the safe and sound condition of the member business loan portfolio.

(D) Allowance for loan losses.

(i) The determination whether a member business loan will be classified as substandard, doubtful, or loss, for purposes of the valuation allowance for loan losses, will rely on factors not limited to the delinquency of the loan. Non delinquent loans may be classified depending on an evaluation of factors, including but not limited to, the adequacy of analysis and documentation.

(ii) Loans classified shall be reserved as follows:

(I) Substandard loans at ten percent of outstanding amount unless other factors (e.g. history of such loans at the Credit Union) indicate a greater or lesser amount is appropriate. Loans classified as substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified must have a well defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Credit Union will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans classified substandard.

(II) Doubtful loans at 50 percent of outstanding amount. Loans classified as doubtful loans have all the weaknesses inherent in ones 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 is determined. Pending factors include: proposed merger, acquisition, or liquidation actions, capital injection, perfecting liens on additional collateral, and refinancing plans.

(III) Loss loans at 100 percent of outstanding amount. Loans classified as loss loans are considered uncollectible and of such little value that their continuance as loans 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.

(3) Construction and development lending. Loans granted under this Section to finance the construction or development of commercial or residential property shall be subject to the following additional provisions:

(A) The aggregate of all such loans, excluding any portion of a loan secured by shares in the credit union, or deposits in another financial institution, or fully or partially insured or guaranteed by, or subject to an advance commitment to purchase by, any agency of the Federal Government or of a State or any of its political subdivisions, shall not exceed 15 percent of reserves (less the Allowance for Loan Losses account);

(B) The borrower shall have a minimum of 35 percent equity interest in the project being financed;

(C) Funds for such projects shall be released following on-site inspections by independent credit union personnel, qualified as in Subpart (b)(2)(A)(vi) of this Rule in accordance with a draw schedule preapproved by the credit union.

(4) Prohibitions.

~~(A) Senior management employees. A credit union may not make member business loans to the following:~~

- ~~(i) Any member of the Board of Directors who is compensated as such;~~
- ~~(ii) The credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager);~~
- ~~(iii) Any assistant chief executive officers (e.g. Assistant President, Vice President or Assistant Treasurer/Manager);~~
- ~~(iv) The chief financial officer (Comptroller);~~
- ~~(v) Any associated member or immediate family member of the senior management employees listed in Subparagraphs (b)(4)(A)(i) thru (iv) of this Rule.~~

~~(B) Equity kickers/joint ventures. A credit union shall not grant a member business loan where a portion of the amount of income to be received by the credit union in conjunction with such loan is tied to the profit or sale of the business or commercial endeavor for which the loan is made.~~

~~(5) Recordkeeping. All loans, lines of credit, or letters of credit, the proceeds of which will be used for a commercial, corporate, business, investment property or venture, or agriculture purpose, shall be separately identified in the records of the credit union and reported as such in financial and statistical reports required by the Administrator in Subpart (b)(2)(C)(iv) of this Rule or the Regional Director of the National Credit Union Administration.~~

(a) Commercial lending and member business loans. State chartered federally insured credit unions shall adhere to the federal regulations prescribed by the National Credit Union Administration relating to commercial lending and member business loan program pursuant to 12 C.F.R. Part 723, and this Rule.

(b) Written loan policies. The Board of Directors shall give notification to the Administrator of Credit Unions prior to initiating a commercial lending and member business loan program and adopt specific commercial lending and member business loan policies and review them at least annually. The Board of Directors shall review its commercial lending and member business loan policies prior to any material change in the credit union's commercial lending and member business loan program or related organizational structure, and in response to any material change in portfolio performance or change in economic conditions. Credit unions with an asset size of \$250, 000,000 or below shall have commercial lending and member business loan policies submitted to the Administrator of Credit Unions 30 days prior to initiating a commercial lending and member business loan program.

History Note: Authority G.S. 54-109.12; 54-109.21(25); 54-109.78; Federal Regulation 12 C.F.R. Part 741.3; 12 C.F.R. Part 723 and 12 C.F.R. Part 741.203

Eff. January 1, 1988;

Amended Eff. August 1, 1998; March 2, 1992.

Temporary Amendment Eff. January 1, 2017