

Proposed Rules

Federal Register

Vol. 62, No. 148

Friday, August 1, 1997

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 701, 722 and 723

Organization and Operations of Federal Credit Unions; Appraisals; and Member Business Loans

AGENCY: National Credit Union Administration (NCUA).

ACTION: Notice of proposed rulemaking.

SUMMARY: The NCUA is proposing to update, clarify and streamline its existing rules concerning member business loans and appraisals for federally insured credit unions. The intended effect of the proposal is to reduce regulatory burden, maintain safety and soundness, and expand the number and type of business loans a federal credit union may grant their members.

DATES: Comments must be received on or before September 30, 1997.

ADDRESSES: Direct comments to Becky Baker, Secretary of the Board. Mail or hand-deliver comments to: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428. Fax comments to (703) 518-6319. *Please send comments by one method only.*

FOR FURTHER INFORMATION CONTACT: Michael J. McKenna, Staff Attorney, Division of Operations, Office of General Counsel, at the above address or telephone: (703) 518-6540; or Roger Blake, Program Officer, Division of Supervision, Office of Examination and Insurance, at the above address or telephone: (703) 518-6360.

SUPPLEMENTARY INFORMATION:

A. Background

The NCUA Board adopted its first member business loan rule in April 1987 due to increased amount of credit union losses and failures attributed to business lending activity. In response to continued losses to credit unions and the National Credit Union Share Insurance Fund (NCUSIF) due to

member business loans, the NCUA Board adopted a more restrictive member business loan rule in September 1991. In general, the results of the 1991 revision have been very positive. Nonetheless, experience with the regulation indicates that there may be a need for simplification, clarification, and improvement. In addition, NCUA is conducting a review of its regulations pursuant to the Regulatory Reinvention Initiative of the Vice President's National Performance Review and the NCUA Board's Regulatory Relief Project.

In particular, NCUA is aware that certain business and legal developments make this a good time to review and update the member business loan rule. NCUA staff has over 5 years of experience with implementing and interpreting the regulation and believes it can be improved. The purpose of this notice of proposed rulemaking is to identify, and request public comment on reducing regulatory burden while ensuring the safety and soundness of federal credit unions and the NCUSIF.

In providing comments upon the proposed rule, commentators should keep in mind the needs of small credit unions, especially community development and low-income designated credit unions, and their members. In some cases, member business loans provide an ideal means for smaller credit unions to expand the types of products and services offered to their memberships and enhance their members' lives. For these types of credit unions, member business loans may be the best method to help the credit union accommodate membership needs and improve the community.

B. Section-by-Section Analysis

The most noticeable change in the proposed revision is the use of a plain English question and answer format. The federal government is promoting plain English to increase regulatory comprehension and improve compliance for users of regulations. An intended consequence of this format, other than anticipated compliance, is a lessening of misunderstandings caused by unclear standard regulatory language. NCUA requests comments regarding the new format and numbering system as well as moving the rule from Part 701 to Part 723 of NCUA's Regulations.

Proposed Section 723.1—What is a Member Business Loan?

This section provides a definition of a member business loan. A member business loan is any loan, line of credit, or letter of credit where the borrower uses the proceeds for the following purposes: commercial, corporate, investment property, business venture, or agricultural. This definition is slightly different from the current rule in that the proposal deletes the term "business" from "business investment property". Investment property, whether business related or other, represents additional risk (beyond that of standard consumer lending) that credit unions must recognize and control through adequate underwriting standards and monitoring.

NCUA proposes to move all other definitions to Section 723.19.

Proposed Section 723.1(b)—Exceptions to the General Rule

This section sets forth the exceptions to the definition of a member business loan. NCUA is proposing to retain the exceptions in the current rule and add one new exception to the definition. The proposed exception is for one other loan fully secured by a lien on 1 to 4 family dwelling where the borrower does not rely upon rental or business income derived from that property to repay the loan. This exception would allow credit unions to make more than one real estate loan to one borrower, subject to the 15% limitation, without triggering the member business rule requirements. However, NCUA still believes that, given the risks associated with business lending, the source of repayment should be proven and stable and not related to any income produced by the collateral of that loan.

To avoid any misunderstanding, the Board is once again reiterating that a federal credit union may finance a future retirement home under the long-term mortgage authority. If at the time the loan is made, the member's intent is to establish a new principal residence, either immediately or some time in the future, the federal credit union may grant a long-term mortgage loan secured by the second home. Under this analysis, since the member intends to occupy this residence as his or her primary residence, the credit union may grant a second home loan under the long-term mortgage authority and the

loan is exempt from the definition of a member business loan.

The Board is requesting comments on whether a loan fully secured by a lien on a one to six family dwelling, that is the borrower's primary residence, should be exempt from the definition of a member business loan. It is the Board's understanding, that in some urban locations, there are few, if any, one to four family dwellings whereas one to six family dwellings are more common. The Board is considering this change to provide an opportunity for credit unions to help members renovate properties and increase home ownership by residents in low income areas. The Board requests that commentors address any additional risk associated with such properties and why this type of property should not be considered a member business loan. NCUA currently views this as a member business loan since five of the six units are likely to be rental units. Also, commentors should keep in mind that such loans would statutorily be limited to twelve years.

The current rule exempts loans fully secured by shares in the credit union or deposits in other financial institutions. NCUA believes the current regulation may not be clear regarding the term "financial institutions" since the rule does not define the term. Therefore, NCUA proposes to clarify the term to read "federally insured financial institutions" since deposits in non-federally insured institutions may represent a greater risk of loss.

NCUA proposes to increase the dollar threshold at which the rule applies from \$50,000 to \$100,000. NCUA has received many comments from credit unions regarding vehicle loans and vacation home loans that currently bump up against the threshold and have to be classified as business loans. NCUA has also received many comments regarding a situation where a member had a loan that was exempted because it was under the \$50,000 threshold. Subsequently, the member desired to purchase an automobile for their business and in the business's name for tax purposes. If the credit union made the loan and the aggregate total of such loans exceeded the \$50,000 threshold, then under the current regulation, the second loan is considered to be a member business loan. In essence, many credit unions have avoided making a good automobile loan because they are not structured to make member business loans. The increase in the exception threshold should alleviate these types of problems. Moreover, staff believes that most credit unions can handle the increased risk safely. However, NCUA

continues to expect that a credit union will test "business related loans" against sound underwriting standards and the borrower's ability to repay, regardless of whether an exception applies.

Proposed Section 723.2—What Are the Prohibited Activities?

NCUA is proposing no substantive changes from the current rule except for adding senior management employees and officials to the provision prohibiting equity agreements/joint ventures.

Proposed Section 723.3—What Are the Requirements for Construction and Development Lending?

This section sets forth the requirements for construction and development lending. NCUA is proposing no substantive changes to this section from the current rule. However, NCUA wishes to clarify that member construction and development loans that are below the dollar limits (individually and/or in the aggregate) are not considered to be member business loans for the purpose of this rule. Thus, if a member has a construction loan for \$40,000, and no other outstanding business type loans (including unfunded business type lines of credit), then the construction loan is not a member business loan. Nevertheless, given the increased risk associated with these types of loans, NCUA expects credit unions to have adequate policies, procedures, and monitoring systems in place to address this type of lending.

Proposed Section 723.4—What Are the Other Applicable Regulations?

This section merely describes the other lending rules credit unions must follow when granting member business loans. NCUA is proposing no substantive changes from the current rule.

Proposed Section 723.5—How Do I Implement a Member Business Loan Program?

Many credit unions have informed NCUA staff that they have not instituted a member business loan program because they could not meet the requirement to have a person on staff with two years of direct experience with business lending. Credit unions stated that they could not make certain vehicle loans to small businesses because their employees did not have experience in making business loans. NCUA has never required experience with business loans in general but rather experience with making loans the credit union intends to grant. Hence, if a loan officer has

experience making vehicle loans to consumers, he or she would also have the requisite experience to make vehicle loans for a business purpose. To clarify the experience requirement, NCUA is proposing to change the terminology in the rule to " * * * at least two years direct experience with the type of lending the credit union will be engaging in." NCUA believes that if a credit union has adequate policies, controls, and monitoring in place, employees with experience in the type of lending for which the credit union proposes to make business loans, it should be able to make those loans. Though a business automobile loan represents more risk than a consumer automobile loan, the credit union can manage that risk through policies, controls, and monitoring.

Credit unions do not have to hire staff to meet the requirements of this section; however, credit unions must ensure that the expertise is available. They can meet the experience requirement through various approaches. For example, a credit union can utilize the services of a CUSO, an employee of another credit union, an independent contractor, or other third parties. However, the actual decision to grant a loan must reside with the credit union.

Proposed Section 723.6—What Must Our Member Business Loan Policies Address?

This section sets forth those items that credit unions must address in their written business loan policies. The proposal retains many of the requirements contained in the current regulation but they are now located in two sections, 723.6 and 723.7. The proposal adds a new requirement for credit unions to review financial statements. NCUA believes that, just periodically updating financial statements, is not sufficient. The benefits of updating this information come from the process of reviewing and analyzing this information.

The proposal also changes the term "appraisals" to "determination of value." The current wording implies, or emphasizes, that member business loans center around real estate lending. The proposed wording clarifies that, whether a member business loan is for real estate or non-real estate, credit unions must meet the collateral requirements. The proposal also changes the term "title search" to "determination of ownership" for the same reason.

The proposal also clarifies that maturity of a member business loan may not exceed 12 years. Several credit unions have inquired about the

permissibility of structuring member business loans as 12-year-or less balloon notes, with the idea of refinancing the balloon for another 12 years. It is permissible to use a balloon payment method to finance business loans provided that this type of financing is not being used to circumvent the 12 year maturity restriction imposed by the Federal Credit Union Act.

Proposed Section 723.7—What Other Items Must the Member Business Loan Policy Address?

This section sets forth the remaining issues that written loan policies must address, including loan-to-value ratios and the requirement for the personal liability and guarantee of the member. The current rule states that “[u]nless a credit union loan program was in existence prior to January 1, 1992, and is granted an exemption by the regional director, loans shall be granted on a fully secured basis by collateral.” Section 701.21(h)(2)(ii)(A). NCUA is proposing to expand the waiver for this section by eliminating the requirement that the member business loan program be in existence prior to January 1, 1992. This would permit credit unions that recently initiated member business loan programs to seek an exemption from the loan-to-value ratios.

The NCUA Board is also proposing to increase the second lien limitation from 70% to 80% for collateral loan-to-value ratios. The 70% limit is not competitive in today’s market. NCUA believes the increase represents little additional risk but does provide added flexibility for credit unions. The proposal also clarifies that private mortgage insurance for first liens with a loan-to-value ratio exceeding 80% applies only to real estate loans.

Proposed Section 723.8—How Much May One Member, or a Group of Associated Members, Borrow?

This section sets forth the aggregate amount of outstanding member business loans that credit unions may grant to one member, or a group of associated members. Unless NCUA grants a waiver, the current rule limits the aggregate amount of outstanding business loans to any one member or group of associated members to 15% of the credit union’s reserves (less the Allowance for Loan Losses account) or \$75,000, whichever is higher. With the increase of the general exception dollar limit to \$100,000, there must be a corresponding increase to \$100,000 for the aggregate limit.

NCUA has received inquiries about loan participations in regard to business loan limits. In those situations where

the credit union sold the participation without recourse, the amount sold would not be included when calculating the 15% limit to one borrower. However, if the credit union sold the participation with recourse (that is, the selling credit union essentially retains a contingent liability), it would include the amount sold when calculating the 15% limit.

Proposed Section 723.9—How Do I Calculate the Aggregate 15% Limit?

The current rule states that if any portion of a member business loan is secured by shares in the credit union, or a deposit 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, such portion is not used in calculating the 15% limit. NCUA is proposing no substantive change to the current rule on the calculation of the 15% limit. Some credit unions have asked NCUA staff whether the partial guarantee by a federal agency includes loans guaranteed by the Small Business Administration. The amount of the loan guaranteed by the Small Business Administration is not used in calculating the 15% limit. Credit unions must continue to meet its due diligence requirements regarding the underlying Small Business Administration loan.

For consistency with proposed section 723.1(b), NCUA is proposing to change the term “financial institution” in this section to “federally insured financial institution”.

Proposed Section 723.10—What Loan Limit Waivers Are Available?

The current rule provides for a waiver from: (1) the maximum loan amount to one borrower or associated group of members; (2) loan-to-value ratios; and (3) construction and development lending. Except for the previously discussed expansion of the waiver on loan-to-value ratios, NCUA is proposing no substantive change to the current rule on what loan limit exceptions are available.

Proposed Section 723.11—How Do I Obtain an Available Waiver?

This section describes the information that credit unions must submit to the Regional Director with their waiver request. NCUA is proposing no substantive changes to what the current rule requires.

Proposed Section 723.12—What Will NCUA Do With My Waiver Request?

This section addresses what the Regional Director considers in reviewing the waiver request and how the waiver is processed. Many regional directors typically consider not only the credit union’s historical CAMEL rating, but also that rating’s components. Such a review is a prudent practice and provides more information than simply the CAMEL rating. The proposal would require that the Regional Director consider the composites to the CAMEL rating and not simply the overall CAMEL rating. In assessing risk, the Regional Director will determine if any safety and soundness concerns are raised due to granting the waiver.

The proposal increases the number of days from 30 to 60 that a Regional Director has to act on a waiver request. It also eliminates the automatic waiver approval if a region does not take action on a request within the specified time frame. NCUA believes, that with the increase in the types of waivers available in the proposal, regions will have more requests to process. Hence, the regions will need more time to process the requests adequately.

Proposed Section 723.13—What Options Are Available to Us if the Regional Director Denies Our Waiver Request, or a Portion of it?

Under the current rule, a credit union can appeal the denial of its request to the NCUA Board. NCUA proposes no substantive changes to this area.

Proposed Section 723.14—How Do I Reserve for Potential Losses?

Consistent with the current rule, this section addresses the criteria for determining the classification of loans. NCUA proposes no substantive change to the loan classification. However, NCUA proposes to move the current Appendix of Section 701.21(h) to this proposed section.

Proposed Section 723.15—How Much Must I Reserve for Potential Losses?

This section provides a schedule a credit union must use to reserve for classified loans. NCUA proposes no substantive changes to this schedule from the current rule. However, NCUA is proposing to clarify the meaning of this section by stating that this is the minimum amount when establishing the reserve percentage. This is simply a clarification so that a credit union will not misinterpret the stated percentages as an absolute.

Proposed Section 723.16—What Are The Recordkeeping Requirements?

Consistent with the current rule, a credit union must separately identify member business loans in its records and financial reports. NCUA proposes no substantive change to this requirement from the current rule.

Proposed Section 723.17—What Additional Steps do Federally Insured State Chartered Credit Unions Have to Perform?

NCUA believes it is important for state supervisory authorities to remain aware of, and involved in, member business loan activity in federally insured state chartered credit unions. Therefore, this new section would require federally insured state chartered credit unions to obtain written approval for a waiver from their state supervisory authority prior to submitting the waiver request to NCUA.

Proposed Section 723.18—How Can a State Supervisory Authority Develop and Implement a Member Business Loan Regulation?

In the current rule, a federally insured state charter credit union may be exempt from NCUA's member business rule if the state had adopted a substantially equivalent regulation as determined by the NCUA board. The Board believes that this process has been effective. However, in order to provide better guidance to the states, the regulation identifies the minimum requirements that they must address for a rule to be deemed substantially equivalent.

Proposed Section 723.19—Definitions

NCUA is proposing a general definition section at the end of the rule. NCUA is proposing to clarify the Loan-to-Value ratio by including terminology that requires the inclusion of unfunded commitments and/or lines of credit when determining the aggregate sum.

C. Other Proposed Revisions—Reducing Regulatory Burden

Under the current rule, all loans, lines of credit, or letters of credit that meet the definition of a member business loan must be separately identified in the records of the credit union and be reported as such in financial and statistical reports required by the NCUA. NCUA believes that this information is already collected, and readily available, through the 5300 Call Report. The current requirement imposes an unnecessary burden on credit unions and, therefore, the NCUA Board is proposing to delete this monitoring requirement.

The current rule requires credit unions to provide periodic disclosure to credit union members of the number and aggregate dollar amount of member business loans. NCUA believes the language is ambiguous and does not serve any true safety or soundness issue or concern. Therefore, the NCUA Board proposes to delete this requirement.

The current Section 701.21(c)(5) of NCUA's Regulations references the member business loan section. Due to the proposed change to the member business loan rule numbering system, NCUA proposes to update 701.21(c)(5) to reference the appropriate sections of the proposed rule.

D. Part 722—Appraisals

A number of credit unions have suggested that a credit union should be able to obtain a waiver from the appraisal requirement for member business loans. They argue that, since the appraisal requirement for business loans is significantly lower for credit unions (threshold is \$50,000) than for banks (threshold is \$250,000) that credit unions are at a severe competitive disadvantage in making business loans to people of modest means. Furthermore, they suggest that in some instances an appraisal is practically meaningless. One example they have provided is the requirement for an appraisal on a business loan to construct a church. Another example where an appraisal may be unnecessary is where the loan-to-value ratio is extremely low due to property ownership interests such as borrowing a small amount to improve property that is already completely owned by the member.

The NCUA Board continues to believe that, for credit unions engaging in business lending that involves real estate, their greatest single risk protection is a licensed or certified appraisal to support the loan-to-value ratio. However, the Board is willing to provide for a waiver from the appraisal requirement because there may be a small number of loans that credit unions may grant where the appraisal requirement is an unnecessary burden. The church loan scenario is a good example of where an appraisal may not be necessary.

When reviewing the waiver request, the Regional Director will consider: (1) the reason for the waiver of the appraisal requirement; (2) the credit union's written business loan policies; (3) an analysis of the credit union's prior experience making member business loans; and (4) written documentation provided by the credit union which may indicate present value

(such as tax assessments, market analysis, etc.).

E. Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact any proposed regulation may have on a substantial number of small entities (primarily those under \$1 million in assets). The proposed member business loan rule would reduce existing regulatory burdens. In addition, most small credit unions do not grant member business loans. Therefore, the NCUA Board has determined and certifies that the proposed amendment, if adopted, will not have a significant economic impact on a substantial number of small credit unions. Accordingly, the Board has determined that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

NCUA has determined that several requirements of this proposal constitute collections of information under the Paperwork Reduction Act. The requirements are that FICUs: (1) develop written loan policies; (2) provide waiver requests in writing. These sections are necessary to ensure the safety and soundness of credit unions involved in business lending as well as process requests for waivers. Other aspects of this proposal reduce the paperwork requirements in the current rule.

It is NCUA's view that the time it takes a credit union to develop written loan policies is not a burden created by this regulation but is the usual and customary practice in the normal operations of a business entity. The paperwork burdens created by this rule is the written request for a waiver.

NCUA estimates that it should take a credit union an average of 2 hours to develop a written waiver request. NCUA estimates that it will receive 50 waiver requests in any given year. The annual reporting burden would be 100 hours to comply with this requirement. The total annual burden hours imposed by the proposed rule is 100 hours.

The Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget (OMB) require that the public be provided an opportunity to comment on information collection requirements, including an agency's estimate of the burden of the collection of information.

The NCUA Board invites comment on: (1) whether the collection of the information is necessary for the proper performance of the functions of NCUA,

including whether the information will have practical utility; (2) the accuracy of NCUA's estimate of the burden of the collection of information, including the validity of the methodology and assumptions used; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) ways to minimize the burden of collection of information on those who are to respond, including through the use of appropriate automated electronic, mechanical, or other technological collection techniques or other forms of information technology; e.g., permitting electronic submission of responses.

OMB is required to make a decision concerning the collection of information contained in these proposed regulations between 30 and 60 days after publication of this document in the **Federal Register**. Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. This does not affect the deadline for the public to comment to the NCUA Board on the proposed regulation.

Organizations and individuals desiring to submit comments on the information collection requirements should direct them to the Office of Information and Regulatory Affairs, OMB, Room 10235, New Executive Officer Building, Washington, D.C. 20503; Attention: Alex Hunt, Desk Officer for NCUA. Comments must also be sent to NCUA, 1775 Duke Street, Alexandria, VA 22314-3428; Attention: Betty May, Paperwork Reduction Act Coordinator, Telephone No. (703) 518-6410; Fax No. (703) 518-6433; E-Mail Address: BETTYM@NCUA.GOV. Comments should be postmarked by September 30, 1997. All comments submitted in response to these proposed regulations will be available for public inspection, during and after the comment period, at NCUA's Central Office, 6th Floor, Law Library, 1775 Duke Street, Alexandria, VA between the hours of 9 a.m. and 1 p.m., Monday through Friday of each week except federal holidays, and by appointment through the Law Librarian at telephone no. (703) 518-6540.

Executive Order 12612

Executive Order 12612 requires NCUA to consider the effect of its actions on state interests. The proposed rule would, as does the current rule, apply to all federally insured credit unions, including federally insured state-chartered credit unions. However, since the proposed rule reduces regulatory burdens, NCUA has determined that the proposed rule does not constitute a "significant regulatory

action" for purposes of the Executive Order. NCUA welcomes comment on means and methods to coordinate with the state credit union supervisors regarding achievement of shared goals involving viability, flexibility, parity, conformity, and safety and soundness regarding member business loans.

List of Subjects

12 CFR Part 701

Credit, Credit unions, Insurance, Reporting and recordkeeping requirements, Surety bonds.

12 CFR Part 722

Appraisals, Credit, Credit unions, Mortgages, Reporting and recordkeeping requirements, State-certified and State-licensed appraisers.

12 CFR Part 723

Credit, Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on July 23, 1997.

Becky Baker,

Secretary of the Board.

For the reasons set forth in the preamble, it is proposed that 12 CFR chapter VII be amended as follows:

PART 701—ORGANIZATION AND OPERATION OF FEDERAL CREDIT UNIONS

1. The authority citation for Part 701 continues to read as follows:

Authority: 12 U.S.C. 1752(5), 1755, 1756, 1757, 1759, 1761a, 1761b, 1766, 1767, 1782, 1784, 1787, 1789. Section 701.6 is also authorized by 31 U.S.C. 3717. Section 701.31 is also authorized by 15 U.S.C. 1601 *et seq.*; 42 U.S.C. 1861 and 3601-3610. Section 701.35 is also authorized by 42 U.S.C. 4311-4312.

2. Section 701.21 is amended in paragraph (c)(5) by revising "§ 701.21(h)(1)(i)" to read "§ 723.1 of this chapter" and "§ 701.21(h)(2)(ii)" to read "§§ 723.8 and 723.9 of this chapter".

§ 701.21 [Amended]

3. Section 701.21(h) is removed and reserved.

PART 722—APPRAISALS

4. The authority citation for part 722 continues to read as follows:

Authority: 12 U.S.C. 1766, 1789 and 3339.

5. Section 722.3 is amended by removing "or" at the end of paragraph (a)(7), by removing the period at the end of paragraph (a)(8)(ii) and adding "; or" in its place, and by adding a new paragraph (a)(9) to read as follows:

§ 722.3 Appraisals required; transactions requiring a State certified or licensed appraiser.

(a) * * *

(9) The regional director has granted a waiver from the appraisal requirement for a loan meeting the definition of a member business loan.

* * * * *

6. Part 723 is added to read as follows:

PART 723—MEMBER BUSINESS LOANS

Sec.

- 723.1 What is a member business loan?
- 723.2 What are the prohibited activities?
- 723.3 What are the requirements for construction and development lending?
- 723.4 What are the other applicable regulations?
- 723.5 How do you implement a member business loan program?
- 723.6 What must your member business loan policy address?
- 723.7 What are the collateral and security requirements?
- 723.8 How much may one member, or a group of associated members, borrow?
- 723.9 How do you calculate the aggregate 15% limit?
- 723.10 What loan limit waivers are available?
- 723.11 How do you obtain a waiver?
- 723.12 What will NCUA do with my waiver request?
- 723.13 What options are available to us if the Regional Director denies our waiver request, or a portion of it?
- 723.14 How do I reserve for potential losses?
- 723.15 How much must I reserve for potential losses?
- 723.16 What are the recordkeeping requirements?
- 723.17 What additional steps do federally insured state chartered credit unions have to perform?
- 723.18 How can a State Supervisory Authority develop and enforce a Member Business Loan Regulation?
- 723.19 Definitions.

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

§ 723.1 What is a member business loan?

(a) *General rule.* A member business loan includes any loan, line of credit, or letter of credit where the borrower uses the proceeds for the following purposes:

- (1) Commercial;
- (2) Corporate;
- (3) Investment property;
- (4) Business venture; or
- (5) Agricultural.

(b) *Exceptions to the general rule.* The following are not member business loans:

- (1) Loan(s) fully secured by a lien on a 1 to 4 family dwelling that is the member's primary residence;
- (2) One other loan fully secured by a lien on a 1 to 4 family dwelling that does not rely upon rental or business

income derived from that property for repayment;

(3) Loan(s) fully secured by shares in the credit union or deposits in other federally insured financial institutions;

(4) Loan(s) to a member or an associated member which, when added together, are less than \$100,000;

(5) Loan(s) where a federal or state agency (or its political subdivision): fully insures repayment; or fully guarantees repayment; or provides an advance commitment to purchase in full;

nd

(6) Loan(s) granted by a corporate credit union to another credit union under part 704 of this chapter.

§ 723.2 What are the prohibited activities?

(a) *Senior management employees.* You must not make a member business loan to the following:

(1) Any member of the board of directors who is compensated as such;

(2) Your chief executive officer (typically this individual holds the title of President or Treasurer/Manager);

(3) Any assistant chief executive officers (e.g., Assistant President, Vice President, or Assistant Treasurer/Manager);

(4) Your chief financial officer (Comptroller); or

(5) Any associated member or immediate family member of anyone listed in paragraphs (a)(1) through (4) of this section.

(b) *Equity agreements/joint ventures.* You may not grant a member business loan where a portion of the amount of income received by the credit union, senior management employees, or officials in conjunction with the loan is tied to the profit or sale of the business or commercial endeavor for which the loan is made.

§ 723.3 What are the requirements for construction and development lending?

Unless the Regional Director grants an exemption, loans granted for the construction or development of commercial or residential property are subject to the following additional requirements:

(a) The aggregate of all construction and development loans must not exceed 15 percent of reserves, (excluding the Allowance for Loan Losses account). To determine the aggregate, you may exclude any portion of a loan:

(1) Secured by shares in the credit union;

(2) Secured by deposits in another federally insured financial institution;

(3) Fully or partially insured or guaranteed by any agency of the federal government, state, or its political subdivisions; or

(4) Subject to an advance commitment to purchase by any agency of the federal government, state, or its political subdivisions;

(b) The borrower must have a minimum of 35 percent equity interest in the project being financed; and

(c) The funds for these projects may be released only after on-site, written inspections by independent, qualified personnel and according to a preapproved draw schedule and any other conditions as set forth in the loan documentation.

§ 723.4 What are the other applicable regulations?

The provisions of § 701.21(a) through (g) of this chapter apply to member business loans to the extent they are consistent with this part.

§ 723.5 How do you implement a member business loan program?

The board of directors must adopt specific business loan policies and review them at least annually. The board must also utilize the services of an individual with at least two years direct experience with the type of lending the credit union will be engaging in.

§ 723.6 What must your member business loan policy address?

At a minimum, your policy must address the following:

(a) The types of business loans you will make;

(b) Your trade area;

(c) The maximum amount of your assets, in relation to reserves, that you will invest in business loans;

(d) The maximum amount of your assets, in relation to reserves, that you will invest in a given category or type of business loan;

(e) The maximum amount of your assets, in relation to reserves, that you will loan to any one member or group of associated members, subject to § 723.8;

(f) The qualifications and experience of personnel (minimum of 2 years) involved in making and administering business loans;

(g) A requirement to analyze and document the ability of the borrower to repay the loan;

(h) Receipt, periodic updating, and review of financial statements and other documentation, including tax returns;

(i) A requirement for sufficient documentation supporting each request to extend credit, or increase an existing loan or line of credit (except where the board of directors finds that the 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). At a minimum, your documentation must include the following:

(1) Balance sheet;

(2) Cash flow analysis;

(3) Income statement;

(4) Tax data;

(5) Leveraging; and

(6) Comparison with industry average or similar analysis;

(j) The collateral requirements, including, but not limited to:

(1) Loan-to-value ratios;

(2) Determination of value;

(3) Determination of ownership;

(4) Steps to secure various types of collateral; and

(5) How often the credit union will reevaluate the value and marketability of collateral;

(k) The interest rates and maturities of business loans (maturity may not exceed 12 years);

(l) General loan procedures which include:

(1) Loan monitoring;

(2) Servicing and follow-up; and

(3) Collection;

(m) Identification of those individuals prohibited from receiving member business loans.

§ 723.7 What are the collateral and security requirements?

(a) Unless your NCUA Regional Director grants a waiver, all member business loans must be secured by collateral as follows:

Lien	Minimum loan to value requirements
All	LTV ratios cannot exceed 95%.
First	You may grant a LTV ratio in excess of 80 percent only where the value in excess of 80 percent is covered through: in regards to real estate member business loans, acquisition of private mortgage or equivalent type insurance provided by an insurer acceptable to the credit union (where available); insurance or guarantees by, or subject to advance commitment to purchase by, an agency of the Federal government; or insurance or guarantees by, or subject to advance commitment to purchase by, an agency of a state or any of its political subdivisions.
First	LTV ratios up to 80%.
Second	LTV ratios up to 80%.

(b) Borrowers, other than a not for profit organization as defined by the Internal Revenue Service Code (26 U.S.C. 501) or those where the regional director grants a waiver; must provide their personal liability and guarantee.

(c) Federally insured credit unions are exempt from the provisions of paragraphs (a) and (b) of this section with respect to credit card line of credit programs offered to nonnatural person members that are limited to routine purposes normally made available under those programs.

§ 723.8 How much may one member, or a group of associated members, borrow?

The aggregate amount of outstanding member business loans to any one member or group of associated members must not exceed the greater of:

- (a) 15% of the credit union's reserves (excluding the Allowance for Loan Losses account); or
- (b) \$100,000; or
- (c) An amount approved by the credit union's NCUA Regional Director.

§ 723.9 How do I calculate the aggregate 15% limit?

(a) *Step 1.* Calculate the numerator by adding together the total outstanding balance of member business loans to any one member, or group of associated members. From this amount, subtract any portion:

- (1) Secured by shares in the credit union;
- (2) Secured by deposits in another federally insured financial institution;
- (3) Fully or partially insured or guaranteed by any agency of the Federal government, state, or its political subdivisions;
- (4) Subject to an advance commitment to purchase by any agency of the Federal government, state, or its political subdivisions.

(b) *Step 2.* Divide the numerator by all reserves, excluding the Allowance for Loan Losses account.

§ 723.10 What loan limit waivers are available?

You may seek a waiver in the following areas:

- (a) Loan-to-value ratios;
- (b) Maximum loan amount to one borrower or associated group of borrowers; and
- (c) Construction and development loan limits.

§ 723.11 How do I obtain a waiver?

To obtain a waiver, you must provide your NCUA Regional Director:

- (a) A copy of your business lending policy;
- (b) The higher limit sought;
- (c) An explanation of the need to raise the limit;
- (d) Documentation supporting your ability to manage this activity; and
- (e) An analysis of the credit union's prior experience making member business loans, including as a minimum:

(1) The history of loan losses and loan delinquency;

(2) Volume and cyclical or seasonal patterns;

(3) Diversification;

(4) Concentrations of credit to one borrower or group of associated borrowers in excess of 15 percent of reserves (excluding the Allowance for Loan Losses account);

(5) Underwriting standards and practices;

(6) Types of loans grouped by purpose and collateral; and

(7) The qualifications of personnel responsible for underwriting and administering member business loans.

§ 723.12 What will NCUA do with my waiver request?

Your Regional Director will:

- (a) Review the information you provided in your request;
- (b) Evaluate the level of risk to your credit union;
- (c) Consider your credit union's historical CAMEL composite and component ratings when evaluating your request; and
- (d) Notify you of the action taken within 60 calendar days of receiving your request.

§ 723.13 What options are available to us if the Regional Director denies our waiver request, or a portion of it?

You may appeal the Regional Director's decision in writing to the NCUA Board. Your appeal must include all information requested in § 723.11 and why you disagree with your Regional Director's decision.

§ 723.14 How do I reserve for potential losses?

Non-delinquent loans may be classified based on factors such as the adequacy of analysis and supporting documentation. You must classify potential loss loans as either substandard, doubtful, or loss. The criteria for determining the classification of loans are:

(a) *Substandard.* Loan is 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 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.

(b) *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.

(c) *Loss.* Loans classified loss 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.

§ 723.15 How much must I reserve for potential losses?

The following schedule sets the minimum amount you must reserve for classified loans:

Classification	Amount required
Substandard	10% of outstanding amount unless other factors (e.g., history of such loans at the credit union) indicate a greater or lesser amount is appropriate.
Doubtful	50% of the outstanding amount.
Loss	100% of the outstanding amount.

§ 723.16 What are the recordkeeping requirements?

You must separately identify member business loans in your records and in the aggregate on your financial reports.

§ 723.17 What additional steps do federally insured state chartered credit unions have to perform?

When requesting a waiver from your Regional Director, federally insured state chartered credit unions must first submit their request to their state supervisory authority. If the state supervisory authority approves the request, the credit union must forward its request, with the state supervisory authority's written approval, to its Regional Director.

§ 723.18 How can a State Supervisory Authority develop and enforce a Member Business Loan Regulation?

(a) The NCUA Board may exempt a federally insured state chartered credit union from NCUA's Member Business Rule in this part if the state has adopted a rule substantially equivalent to NCUA's rule in this part. In a substantially equivalent determination, the Board reviews whether the state regulation minimizes the risk and accomplishes the overall objectives of NCUA's member business rule in this part. Specifically, the Board will focus its equivalency review on the definition of:

- (1) A member business loan;
- (2) Loan to one borrower limits;
- (3) Written loan policies;
- (4) Collateral and security requirements;
- (5) Construction and development lending; and
- (6) Loans to senior management.

(b) To receive a substantially equivalent determination, the State Supervisory Authority must submit their rule to the NCUA regional office. After reviewing the rule, the region will forward the request to the NCUA Board for final determination.

§ 723.19 Definitions.

For purposes of this part, the following definitions apply:

Associated member is any member with a shared ownership, investment, or other pecuniary interest in a business or commercial endeavor with the borrower.

Construction or development loan is a financing arrangement for acquiring property or rights to property, including land or structures, with the intent to convert it to income-producing property such as: residential housing for rental or sale; commercial use; industrial use; or similar uses.

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

Loan-to-value ratio is the aggregate amount of all sums borrowed (outstanding balances plus any unfunded commitment/line of credit) from all sources on an item of collateral divided by the market value of the collateral used to secure the loan.

Reserves are all reserves, including the Allowance for Loan Losses and Undivided Earnings or surplus.

[FR Doc. 97-19936 Filed 7-31-97; 8:45 am]

BILLING CODE 7535-01-P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. 97-ANE-16]

RIN 2120-AA64

Airworthiness Directives; Precision Airmotive Corporation Carburetors

AGENCY: Federal Aviation Administration, DOT.

ACTION: Notice of proposed rulemaking (NPRM).

SUMMARY: This document proposes the superseding of an existing airworthiness directive (AD), applicable to Precision Airmotive Corporation carburetors, that currently requires the inspection of those carburetors equipped with a two-piece venturi at each annual inspection to determine if the primary venturi is loose or missing, and requires the replacement of a two-piece venturi with a one-piece venturi within 48 months after the effective date of the existing AD. This action would eliminate the requirement to install a one-piece venturi, and allows the installation of a one-piece venturi on affected carburetors as an optional terminating action; or, requires repetitive inspections of a two-piece venturi on affected carburetors. This AD would also add an additional carburetor model, and requires the installation of a new fuel nozzle on certain carburetors when a one-piece venturi is installed. This proposal is prompted by service difficulty reports describing engines that fail to attain rated power, run rough, or experience power loss after installation of a one-piece venturi in accordance with the existing AD, and by incidents of forced landings of aircraft powered by engines modified to comply with the existing AD. The actions specified by the proposed AD are intended to prevent disruption of fuel flow to the engine resulting in failure to attain rated power, power loss in flight, and forced landings.

DATES: Comments must be received by September 30, 1997.

ADDRESSES: Submit comments in triplicate to the Federal Aviation Administration (FAA), New England Region, Office of the Assistant Chief Counsel, Attention: Rules Docket No. 97-ANE-16, 12 New England Executive Park, Burlington, MA 01803-5299.

Comments may also be sent via the Internet using the following address: "9-ad-engineprop@faa.dot.gov". Comments sent via the Internet must contain the docket number in the subject line.

Comments may be inspected at this location between 8:00 a.m. and 4:30 p.m., Monday through Friday, except Federal holidays.

The service information referenced in the proposed rule may be obtained from Precision Airmotive Corporation, 3220 100th Street SW., Building E, Everett, WA 98204; telephone (206) 353-8181, fax (206) 348-3545. This information may be examined at the FAA, New England Region, Office of the Assistant Chief Counsel, 12 New England Executive Park, Burlington, MA.

FOR FURTHER INFORMATION CONTACT: Richard Simonson, Aerospace Engineer, Seattle Aircraft Certification Office, FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW, Renton, WA 98055-4056; telephone (425) 227-2597, fax (425) 227-1181.

SUPPLEMENTARY INFORMATION:

Comments Invited

Interested persons are invited to participate in the making of the proposed rule by submitting such written data, views, or arguments as they may desire. Communications should identify the rules docket number and be submitted in triplicate to the address specified above. All communications received on or before the closing date for comments, specified above, will be considered before taking action on the proposed rule. The proposals contained in this notice may be changed in light of the comments received.

Comments are specifically invited on the overall regulatory, economic, environmental, and energy aspects of the proposed rule. All comments submitted will be available, both before and after the closing date for comments, in the Rules Docket for examination by interested persons. A report summarizing each FAA-public contact concerned with the substance of this proposal will be filed in the Rules Docket.

Commenters wishing the FAA to acknowledge receipt of their comments submitted in response to this notice must submit a self-addressed, stamped postcard on which the following statement is made: "Comments to Docket Number 97-ANE-16." The postcard will be date stamped and returned to the commenter.

Availability of NPRMs

Any person may obtain a copy of this NPRM by submitting a request to the FAA, New England Region, Office of the Assistant Chief Counsel, Attention: Rules Docket No. 97-ANE-16, 12 New