§ 713.6 What is the permissible deductible?

(a)(1) The maximum amount of allowable deductible is computed based on a Federal credit union's asset size, as follows:

Assets	Maximum deductible
$0–$100,000	No deductibles allowed.
$100,001–$250,000	$1,000.
$250,001–$1,000,000	$2,000.
Over $1,000,001	$2,000 plus 1/1000 of total assets up to a maximum deductible of $200,000.

(2) The deductibles may apply to one or more insurance clauses in a policy. Any deductibles in excess of the above amounts must receive the prior written permission of the NCUA Board.

(b) A deductible may not exceed 10 percent of a credit union's Regular Reserve unless a separate Contingency Reserve is set up for the excess. In computing the maximum deductible, valuation accounts such as the allowance for loan losses cannot be considered.

§ 713.7 May the NCUA Board require a credit union to secure additional insurance coverage?

The NCUA Board may require additional coverage when the Board determines that a credit union's current coverage is inadequate. The credit union must purchase this additional coverage within 30 days.

PART 741—REQUIREMENTS FOR INSURANCE

4. The authority citation for part 741 continues to read as follows:

Authority: 12 U.S.C. 1757, 1766 and 1781–1790. Section 741.4 is also authorized by 31 U.S.C. 3717.

5. Section 741.201(a) and (b) are amended by removing ''§ 701.20'' and adding ''Part 713'' in its place.

[FR Doc. 99–13309 Filed 5–26–99; 8:45 am]

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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 701, 722, 723 and 741

RIN 3133–AB91

Organization and Operation of Federal Credit Unions; Appraisals; Member Business Loans; and Requirements for Insurance

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The NCUA is updating, clarifying and streamlining its existing rules concerning member business loans and appraisals for federally insured credit unions, as well as implementing recent statutory limitations regarding member business loans.

The intended effect of this rule is to reduce regulatory burden, maintain safety and soundness, implement statutory limits and provide guidance on the statutory exception for qualifying credit unions from the statutory aggregate limit on a credit union's outstanding member business loans.

DATES: This rule is effective June 28, 1999.

ADDRESSES: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.

FOR FURTHER INFORMATION CONTACT: Michael J. McKenna, Senior Staff Attorney, Division of Operations, Office of General Counsel, at the above address or telephone: (703) 518–6540; or David M. Marquis, Director, Office of Examination and Insurance, at the above address or telephone: (703) 518–6360.

SUPPLEMENTARY INFORMATION:

A. Background

On July 23, 1997, the Board issued proposed amendments to the regulation governing member business loans (Previous Section 701.21(h) and Proposed Part 723 of NCUA's Regulations) and appraisals (Part 722 of NCUA's Regulations) with a sixty-day comment period. 62 FR 41313 (August 1, 1997). The Credit Union Membership Access Act (the Act) was enacted into law on August 7, 1998. Public Law 105–219, 112 Stat. 913 (1998). Among other things, the Act imposed a new aggregate limit on a federally-insured credit union's outstanding member business loans. However, the Act also provided for three circumstances where a credit union could qualify for an exception from the aggregate limit. On September 23, 1998, the NCUA Board issued an interim final member business loan rule with a sixty-day comment period. 63 FR 51793 (September 29, 1998). The comment period was extended November 19, 1998, for an additional sixty days. 63 FR 65532 (November 27, 1998).

B. Comments

Eighty-seven comments were received. Comments were received from twenty-five federal credit unions, ten state-chartered credit unions, eleven state leagues, three national credit union trade associations, one association of state supervisors, one appraisal trade association, fifteen banks, eighteen bank trade associations, two law firms, and one government agency. Except for the bank and bank trade associations, the commenters were generally supportive of the interim final rule, although most commenters suggested ways they would modify the final rule. The bank and bank trade association comments are summarized in a separate section.

Section-by-Section Analysis and NCUA Board Decisions

Section 723.1(a)—What is a Member Business Loan?

This section provides a definition of a member business loan. The Act sets forth the definition of a member business loan, so NCUA can no longer define the term.

Therefore, a member business loan means any loan, line of credit, or letter of credit, the proceeds of which will be used for a commercial, corporate or other business investment property or venture, or agricultural purposes. Section 107A(c)(1)(a) of the Act. The final rule clarifies that unfunded commitments are included in determining whether a loan is a member business loan.

Three commenters requested that loans made to churches or other religious organizations be exempt from the definition of a member business loan. These commenters stated that while churches may be organized as corporations, any loan to such a corporation would not be for a ''commercial'' purpose. These commenters stated that the term ''business'' implies for-profit activity. The NCUA Board disagrees with these commenters. In general, a loan to a non-

natural person will qualify as a member business loan. Although a loan to a church is not for a profit making purpose, it does have a ''corporate'' purpose as that term is generally understood. If the purpose of the loan is to benefit the institution, even a non-profit unincorporated association, then it has a corporate purpose. For example, a loan to build a new church has the same corporate purpose as a loan to a non-profit association to acquire a new headquarters building. Even though the purpose (functions) of the institutions differ, the purpose for the loan does not.

Section 723.1(b)—Exceptions to the General Rule

This section sets forth five exceptions to the general definition of a member business loan. The exceptions are established by the Act and are virtually identical to the exceptions in the previous member business loan rule. The following loans are excepted from the member business loan definition: (1) an extension of credit fully secured by a lien on a 1-to-4 family dwelling that is the primary residence of a member; (2) an extension of credit fully secured by shares in the credit union making the extension of credit or deposits in financial institutions; (3) an extension of credit that meets the member business loan definition made to a borrower or an associated member that has a total of all such extensions of credit in an amount equal to or less than $50,000; (4) an extension of credit where the repayment is fully insured or fully guaranteed by, or where there is an advance commitment to purchase in full by, an agency of the federal government or of a state, or any political subdivision thereof; or (5) an extension of credit that is granted by a corporate credit union (as that term is defined by the Board) to another credit union.

Three commenters requested that the $50,000 limit be increased to $100,000. Another commenter also suggested an increase in the limit. The NCUA Board cannot increase the dollar threshold because the Act sets the dollar limit.

Two commenters recognized that NCUA does not have the authority to adopt a definition of a member business loan that is different from the one provided by the Act, but encouraged the agency to provide some guidance on the meaning of ''commercial'' loan or ''investment property.'' The NCUA Board believes that the interpretation given to these terms will depend on the facts of a particular case. However, in general, the NCUA Board interprets ''commercial'' as any loan that does not fit in the standard category of consumer lending. The NCUA Board interprets ''investment property'' as a property that is intended to produce income.

Two commenters stated that NCUA should specifically exclude vacation homes and other residences related to a member's professional mobility that are not for investment purposes from the definition of ''commercial.'' One commenter requested that a loan fully secured by a lien on a dwelling that is the member's secondary or vacation home should be added to the loans specifically excluded from the definition of member business loans. Two commenters requested that a second 1-to-4 family home should also be excluded from the definition. The NCUA Board believes that since Congress used the term ''primary residence,'' the exemption cannot be expanded to include other types of homes a member may use as collateral in obtaining a loan. However, a loan to purchase or refinance a vacation home or other residence that is not generally used for investment purposes does not meet the definition of a member business loan.

One commenter suggested that NCUA exempt retirement homes from the member business loan definition because such homes will eventually be a primary residence. This commenter also suggested defining ''primary residence'' in the definition section. Although the Board does not believe the term ''primary residence'' needs to be defined, 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 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 as long as the source of repayment is not dependent on rental income involving the residence.

One commenter suggested that the final rule clarify that an advance commitment to purchase a loan by a federally chartered financial institution would be considered a commitment from a federal agency and be excluded from the definition of a business loan. The NCUA Board does not believe such an exemption is permissible under the Act and thus is not adopting this commenter's suggestion in the final rule. Of course, loans to credit unions by a corporate credit union are exempt from the definition of a member business loan.

One commenter requested that NCUA clarify that the amount of any loan fully guaranteed by the federal, state or local government is not included in determining whether the $50,000 threshold has been reached. The reason is that small business administration loan programs do not guarantee full repayment, only the amount of the loan that is not guaranteed should be considered in determining whether the threshold has been reached. The NCUA Board agrees and a credit union need not include that portion of a loan that is guaranteed toward the $50,000 threshold.

One commenter questioned whether the final rule applies to corporate credit unions, and specifically to corporate credit union loans to non-credit union members. The Act does not distinguish between corporate and natural person credit unions. Since the NCUA Board has not been provided any compelling reason on why this rule should not apply to corporate credit unions granting member business loans to entities other than credit unions, the final rule applies to all types of federally insured credit unions.

Section 723.2—What Are the Prohibited Activities?

This section sets forth who is ineligible to receive a member business loan. The interim final rule identified as ineligible the following persons: (1) Any member of the board of directors who is compensated as such; (2) the chief executive officer; (3) any assistant chief executive officers; (4) the chief financial officer; or (5) any associated member or immediate family member of anyone listed in 1–4. The interim final rule also added senior management employees to the provision prohibiting equity agreements or joint ventures.

Four commenters supported the prohibition on member business loans as set forth in this section. Six commenters requested that senior management officials, compensated directors, and immediate family members thereof, be able to receive member business loans. One commenter stated that associated members or immediate family members of anyone specifically prohibited should be eligible to receive a member business loan. One commenter stated that ten states allow compensation for the board of directors and the prohibition on compensated directors obtaining member business loans should not apply to state chartered credit unions.

The agency has historically included compensated directors as persons who were prohibited from receiving member business loans. In the past, the agency has believed that the compensated director might unduly influence the other directors to have the credit union grant questionable and/or risky member business loans to the compensated director and/or their family members. Recent agency experience in other lending areas has led the NCUA Board to believe that such influence would probably be minimal or non existent. Therefore, the NCUA Board is eliminating the prohibition on member business loans to the compensated director. However, to maintain proper internal controls, the board of directors must approve the loan to the compensated director and the compensated director must be recused from the decision to grant or deny the loan.

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

This section sets forth the requirements for construction and development lending. NCUA clarified in the preamble to the interim final rule that construction and development loans 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. No substantive comments were received on this section. The Board is adopting this section in final as set forth in the interim final rule, except the term ''reserves'' has been replaced by the term ''net worth'' and the word ''independent'' has been eliminated from paragraph (c) since most financial institutions use qualified employees to conduct draw inspections.

Section 723.4—What Are the Other Applicable Regulations?

This section merely describes the other NCUA lending rules credit unions must follow when granting member business loans to the extent they are consistent with this regulation. One commenter supported this section. Six commenters opposed applying these standards to federally insured credit unions. These commenters requested that NCUA, instead, clearly state that this section does not apply to federally insured state chartered credit unions except as may be specified in Part 741 of NCUA's Regulations. The NCUA Board agrees and the final rule incorporates this change.

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

This section sets forth the requirement that the board of directors adopt business loan policies and review them at least annually. This section also requires the board to use the services of an individual with at least two years direct experience in the type of lending in which the credit union will be engaging. The preamble to the interim final rule also clarified that NCUA does not necessarily require experience with business loans in general but, rather, the experience could also be with the type of loans the credit union intends to grant. The preamble also clarified that credit unions need not hire staff to meet the requirements of this section; however, credit unions must ensure that the expertise is available. Credit unions can meet the experience requirement through various approaches. For example, a credit union can use the services of a CUSO, an employee of another credit union or other financial institution, an independent contractor, or other third parties. However, the actual decision to grant a loan must reside with the credit union.

Nine commenters believe the two-year experience requirement is reasonable. Three commenters objected to the two-year experience requirement. One commenter stated that the employee should only be required to have general business lending experience and not direct experience with a certain type of loan or collateral. One commenter believed this section should be clarified to state that a credit union need only have at least two years experience in making loans secured by a particular class of collateral and not necessarily two years experience in making business loans.

The NCUA Board believes it crucial for a credit union to have experienced personnel involved in making decisions regarding business lending. Member business loans require special expertise in virtually all phases of origination and administration. The experience requirement can be met by either general business lending experience or experience with granting loans for a particular purpose or secured by a particular collateral. Therefore, the NCUA Board is adopting this section in the final rule as set forth in the interim final rule.

Section 723.6—What Must Your Member Business Loan Policy Address?

This section set forth those items that credit unions must address in their written business loan policies. The interim final rule used the term ''determination of value'' instead of ''appraisal'' in the discussion of written loan policies. One commenter stated that NCUA should use the term ''appraisal.'' The Board believes that the term ''determination of value'' is more appropriate since the term ''appraisal'' unduly emphasizes member business loans as real estate loans. The term ''determination of value'' clarifies that, whether a member business loan is collateralized by real estate or other types of collateral, credit unions must address the value of the collateral.

Two commenters requested that NCUA state that the maturity limit for member business loans applies only to federal credit unions and not state chartered credit unions. As stated in the preamble to the interim final rule, federally insured state-chartered credit unions can grant business loans with a maturity limit consistent with state law. The final rule does not impose any maturity limits for state-chartered credit unions.

One commenter stated that all the documentation listed in this section is not necessary for every member business loan. The NCUA Board agrees. The interim final rule, as well as the final rule, provides the board of directors with significant discretion to determine the documentation necessary to make the decision whether a member business loan should be granted.

One commenter stated that credit unions should be required to conduct a periodic review of financial statements. Agency experience has demonstrated that, in most cases, a credit union will ordinarily review the financial statements of its open-end business loans. The NCUA Board is not requiring in the final rule, a review of financial statements on all member business loans.

The NCUA Board is adopting this section in final as set forth in the interim final rule except the term ''reserves'' has been replaced by the term ''net worth.''

Section 723.7—What Are the Collateral and Security Requirements?

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. As is the current practice, loan-to-value ratios apply to the entire loan that is in excess of $50,000.

Questions have been raised on loan-to-value ratios for multiple member business loans to the same borrower. If multiple loans are on the same

collateral, the loan-to-value limitation will apply to any loan where the aggregate amount of the loans exceed $50,000. For example, if a credit union makes a loan on a piece of real estate for $40,000 and subsequently makes another $40,000 loan on the same collateral, the loan-to-value limitation applies to the second loan. The NCUA will not allow a credit union to circumvent the loan-to-value ratios simply be making numerous loans for less than $50,000 on the same collateral. If the first member business loan to a borrower is unsecured and the second loan is secured the loan-to-value ratios apply to the second loan if the aggregate amount of both loans exceeds $50,000.

Three commenters supported including unfunded commitments when calculating the loan-to-value ratios. Two commenters objected to including unfunded commitments. The NCUA Board believes it is reasonable to include unfunded commitments when calculating the loan-to-value ratios because, if they were excluded, the loan-to-value ratios could be exceeded when the entire loan is funded.

Four commenters supported the second lien limitation at 80%. One commenter requested the number be raised. One commenter requested NCUA eliminate regulatory loan-to-value ratio requirements. One commenter stated that the regulation should allow for selected loans to exceed the proposed loan-to value ratios and/or occassionally be undersecured or unsecured. Five commenters stated that NCUA should be more flexible with respect to loan-to-value ratios for loans on personal property, vehicles and equipment. One commenter requested that the loan-to-value limitation be increased to 95%. The NCUA Board believes the specified loan-to-value ratios are appropriate for member business loans and although the exact wording has been modified, the same loan-to-value ratios are incorporated into the final rule. However, the NCUA Board is reiterating that, if there is a category of loans that a credit union believes should be allowed to exceed these ratios, the credit union can request a waiver from the appropriate Regional Director. For example, if a credit union regularly grants vehicle loans in excess of $50,000 that meet the definition of member business loans, the credit union would likely be a good candidate to receive a waiver from the loan-to-value ratio requirements for that category of loans.

One commenter requested that NCUA allow borrowers that are corporations and other business entities, such as limited liability companies, to borrow in the name of the corporation whereby the guarantor is the corporation. The NCUA Board does not agree with such a change because it would allow a corporation to be liable instead of the individual. Past experience with credit union losses with this type of loan structure indicates that such a change would not be in the best interest of credit unions or the National Credit Union Share Insurance Fund (NCUSIF).

One commenter recommended NCUA use the term ''principals'' instead of ''borrowers'' to avoid confusion when addressing the requirement for a personal guarantee since a borrower could be a non-natural person. The NCUA Board agrees this change would provide greater clarity and has incorporated it into the final rule.

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 credit unions may grant to one member or a group of associated members. Unless NCUA grants a waiver, the interim final rule limited 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 $100,000, whichever is higher. The NCUA Board, in the final rule, is replacing the term ''reserves'' with the term ''net worth.'' This change will not make the 15% limit more restrictive in gross dollar terms.

In the preamble to the interim final rule, the Board clarified how loan participations are treated 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 for a single borrower. However, if the credit union sold the participation with recourse (that is, the selling credit union retains a contingent liability), it would include the amount sold when calculating the 15% limit.

Four commenters specifically approved of the aggregate loan limit to one member or group of associated members. One commenter stated that the restrictions on loan to one borrower should be deleted. One commenter supported the 15% limit but would eliminate the $100,000 limitation. One commenter stated that unfunded commitments should be included in the aggregate loan limit. One commenter stated that unfunded commitments should not be included in the aggregate loan limit. The NCUA Board has not been provided with a convincing rationale for changing the loan limits to one borrower or for excluding unfunded commitments from the loan limits. Therefore, the NCUA Board is adopting the limitations in the interim final rule in the final rule.

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

This section sets forth how a credit union calculates the aggregate 15% limit. The interim final rule stated 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. No substantive comments were received on this section. Except for inserting the term ''net worth'' for the term ''reserves'' the NCUA Board is adopting in final this section as it was set forth in the interim final rule.

Section 723.10—What Loan Limit Waivers Are Available?

The interim final rule provided 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. The interim final rule stated that the waiver is for a category of loans. Two commenters supported the loan limit waiver provisions. In the interest of making this section more informative, the NCUA Board is also referencing the waivers that are available for appraisals under Part 722 and the requirement for the personal liability in Section 723.7. Hence, this section is now retitled: ''What waivers are available?'' The NCUA Board has not made any other substantive changes to this section from the interim final rule.

Section 723.11—How Do You Obtain an Available Waiver?

This section described the information that a federal credit union must submit to the Regional Director with a waiver request. This section also provided a mechanism for state chartered federally insured credit unions to have the waiver request processed through the state supervisory authority. If the state supervisory authority approves the request, the state regulator forwards the request to the Regional Director. A waiver is not effective until it is approved by the Regional Director.

One commenter requested that NCUA specify that the state supervisory authority makes the decision whether or not to grant a waiver for a federally insured state chartered credit union and that state regulators may allow self-implementing waivers for categories of loans. The NCUA Board has not been provided any convincing rationale for not being part of the waiver process. Being part of the process allows NCUA, as the insurer of credit unions, to ensure that all waiver requests are properly reviewed.

Furthermore, permitting self-implementing waivers would result in NCUA abdicating its regulatory responsibility and potentially threatening the NCUSIF. Except for some minor editing changes, including a reference for corporate federal credit unions, the NCUA Board has not made any substantive changes to this section from the interim final rule.

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

This section sets forth what the Regional Director must consider in reviewing the waiver request and how the waiver is processed. The interim final rule stated that a Regional Director must act on a waiver request within 45 days (from receipt from the federal credit union or the state supervisory authority) and set forth an automatic waiver approval if a region does not take action on a request within the specified time frame.

Any waiver is revocable at NCUA's sole discretion. If a waiver is revoked, loans granted under the waiver authority are grandfathered.

Two commenters stated that NCUA should make the decision in 30 days. One commenter stated that NCUA should make a decision in less than 45 days if the waiver was processed first through the state regulator. The NCUA Board is maintaining 45 days as the time frame the agency has to approve or deny the waiver because of the increase in the number of available waivers for credit unions.

Section 723.13—What Options Are Available if the Regional Director Denies My Waiver Request or a Portion of It?

This section describes how a credit union may appeal the denial of its waiver request by the Regional Director to the NCUA Board. No substantive comments were received on this section. The NCUA Board is adopting this section in final as it was set forth in the interim final rule.

Section 723.14—How Do I Reserve for Potential Losses?

This section addresses the criteria for determining the classification of loans. One commenter stated that the title of this section should be modified to address the classification of loans. The NCUA Board agrees with this commenter and has changed the title of this section accordingly.

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 clarified the meaning of this section by stating that this is the minimum amount when establishing the reserve percentage. No substantive comments were received on this section. Except for a minor editing change, the Board is adopting this section in final as it was set forth in the interim final rule.

Section 723.16—What is the Aggregate Member Business Loan Limit for a Credit Union?

The Act imposes a new aggregate limit on a credit union's outstanding member business loans (including any unfunded commitments) of the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets. Net worth is all of the credit union's retained earnings. The definition of net worth should be determined under Generally Accepted Accounting Principles which includes retained earnings. Retained earnings normally includes undivided earnings, regular reserves and any other appropriations designated by management or regulatory authority. The final rule has been modified to reflect this definition accurately.

If a credit union currently has business loans exceeding the aggregate loan limit and does not qualify for an exception, it has until August 7, 2001, to reduce the total amount of outstanding member business loans to below the aggregate loan limit. Furthermore, once the prompt corrective action provisions are implemented in a final regulation, an insured credit union that is undercapitalized may not make any increase in the total amount of member business loans until such time as the credit union becomes adequately capitalized as required by the prompt corrective action provisions of the Act. 12 U.S.C. 216(g)(2).

Four commenters opposed the statutory limitation. Two commenters objected to including unfunded commitments in determining the aggregate loan limit. Unfunded commitments are included in calculating the aggregate loan limit because to do otherwise could inadvertently place a credit union over the aggregate loan limit when the loan was fully funded. Such a result would violate the Act.

One commenter requested guidance on how loan participations are treated for purpose of the aggregate loan limit. Unless otherwise exempt, loan participations that are made without recourse are not part of the loan limit for the originating credit union. However, such loans are to be counted against the aggregate loan limit for the participating credit union, unless otherwise exempt.

Section 723.17—Are There Any Exceptions to the Aggregate Loan Limit?

The interim final rule set forth three exceptions to the aggregate loan limit: (1) credit unions that have a low-income designation or participate in the Community Development Financial Institutions program; (2) credit unions that have a ''a history of primarily making member business loans;'' or (3) credit unions that were chartered for the purpose of primarily making member business loans. A credit union that does not qualify for an exception must immediately stop making business loans that will exceed the aggregate loan limit.

Five commenters stated that the exceptions for credit unions should be self-certifying and the examiners could review whether the exception is justified during the examination. The NCUA Board believes it would be abandoning its regulatory responsibility if it were to allow credit unions to self-certify. This could result in a credit union making member business loans in excess of the amount permitted under the Act. The NCUA Board believes that the process has worked properly since it was adopted in September, and therefore, it is retained in the final rule. In fact, of the eighty-three credit unions that exceeded the aggregate loan limit as of August 7, 1998, sixty-five have been granted exceptions, six requests were denied, and twelve have not sought an exception. If a credit union is eligible for an exception but chooses not to seek one, the credit union has until August 7, 2001 to reduce the total amount of business loans to below the aggregate loan limit. If an exception is revoked, current loans are grandfathered but the credit union cannot make any new member business loan until the credit union's total amount of business loans is below the aggregate loan limit.

History of Primarily Making Member Business Loans

The NCUA Board defined ''a history of primarily making member business loans'' as either: (1) member business loans comprise at least 25% of the credit union's outstanding loans; or (2) member business loans comprise the largest portion of the credit union's loan portfolio.

Six commenters supported NCUA's definition of ''a history of primarily making member business loans.'' Two commenters stated that the 25% level was too high. One commenter recommended a percentage between 18–20% for determining whether a credit union has ''a history of primarily making member business loans.'' Another commenter suggested 17.5%. Four commenters suggested 15%. Two commenters stated that any credit union currently above the aggregate loan limit should be able to receive an exception. Two commenters requested a third category under this exception. These commenters believe an exception should also be granted to credit unions whose business loans have averaged 20% of total loans over a ten-year period. One commenter stated that NCUA should permit an exception if member business loans are the second largest category in the credit union's portfolio. One commenter stated that the Board should add a third criterion where loans are an integral part of the credit union's loan portfolio.

The language of the statute is ambiguous and leaves to NCUA's discretion the responsibility for defining when a credit union has a ''history of primarily making member business loan[s].'' The Board recognizes that only a limited number of credit unions will be eligible for this exception because the aggregate loan limit will prevent credit unions in the future from exceeding the cap. While the legislative history provides no definitive guidance, it does make clear that Congress intended that exceptions be crafted in a way that would allow those credit unions with a history of beneficial business lending to continue that practice. The Senate Report stated that the NCUA Board should

> interpret the exceptions under new section 107A(b), to permit worthy projects access to affordable credit union financing. Loans for such purposes as agriculture, self-employment, small business establishment, large up-front investments or maintenance of equipment such as fishing or shrimp boats, taxi cab medallions, tractor trailers, or church construction should not be unduly constricted as a result of the Board's actions.

S. Rep. No. 105–193, p. 9 (1998). Report of the Committee on Banking, Housing, and Urban Affairs.

The NCUA Board, believes that establishing the level at 25% of assets is consistent with congressional intent and permits credit unions with history and experience with member business loans to continue to engage in that activity. NCUA arrived at this number after reviewing the legislative history and other federal regulations and interpretations, including the ''principally engaged'' language in the Revenue Limit on Bank-Ineligible Activities of Subsidiaries of Bank Holding Companies Engaged in Underwriting and Dealing in Securities. 61 FR 68750 (December 30, 1996).

The second part of the Board's exception would apply when member business loans comprise the largest portion of a credit unions loan portfolio. For example, a credit union would meet this standard if it makes 23% member business loans, 22% first mortgage loans, 22% new automobile loans, 20% credit card loans and 13% other real estate loans.

This approach is consistent with the definition of primarily as ''being or standing first in a list [or] series.'' *See* Webster's II, New Riverside University Dictionary, 1994 Houghton Mifflin Company. It recognizes the primacy or state of being first when business loans form the largest type of lending in a credit union's portfolio. *See Id.* (Primacy defined as the state of being first or foremost) The Board also believes it is faithful to the intent of the legislative history, e.g., that those credit unions with a history of beneficial member business lending may continue that practice.

The NCUA Board is requiring that, for determining the categories of loans, a credit union must use loan categories that are similar to those set forth in the call report such as: unsecured credit card loans/lines of credit; all other unsecured loans/lines of credit; new vehicle loans; used vehicle loans; total first mortgage loans; total other real estate loans; and total member business loans. In no case could a credit union have more than seven categories of loans for the purpose of qualifying for this exception. The NCUA Board believes that the largest book exception is consistent with congressional intent and is not subject to manipulation since only seven categories of loans can be used to calculate the largest book of loans.

The NCUA Board believes that the two definitions of a ''history of primarily making member business loans'' are limited and carefully crafted. In fact, this exception is so narrowly tailored that less than ninety credit unions are even eligible for the exception.

The NCUA Board is also clarifying in the final rule what is acceptable evidence to demonstrate a ''history of primarily making member business loans.'' Call reports and financial statements from January 1995 to September 1998 are acceptable evidence to demonstrate the primacy of business lending in a credit union's portfolio. Three commenters stated that credit union should be able to use call report data after September 1998 to demonstrate that the credit union has a ''history of primarily making member business loans.'' The NCUA Board disagrees with these commenters. Under the Act, if a credit union exceeded the aggregate loan limit on September 30, 1998, and did not receive an exception, the credit union should not have granted any new member business loans, unless the credit union was pursuing an appeal.

Some have suggested that reliance on the call report is not a history of lending but simply a snapshot in time. The NCUA Board disagrees. Credit union loan portfolios fluctuate over time based on such things as economic cycles, changes in membership and the needs and desires of members. By allowing call reports and financial statements from 1995 to September 1998 to support qualification for an exception, the NCUA Board has adopted an approach which addresses these issues by establishing a reasonable time period during which a credit union may establish it qualifies for an exception. The period is in the recent past and is of limited duration. This will assure that the exception is available only to those credit unions with a demonstrated recent history of primacy in the area of business lending.

One commenter stated that NCUA should include unfunded commitments for purposes of calculating the amount of loans for the exception just as NCUA counts unfunded commitments in determining the number for the aggregate loan limit. The NCUA Board agrees and, therefore, unfunded commitments are included in calculating whether the credit union has a ''history of primarily making member business loans.''

Three commenters stated that credit unions should be allowed to count loans less than $50,000, as well as otherwise exempt loans, for purposes of qualifying for the ''history of primarily making member business loans'' exception. The NCUA Board disagrees. By definition, these loans are not member business

loans under the Act and therefore are not counted for either the aggregate loan limit or the exception from the limit. The final rule incorporates this interpretation in Sections 723.16 and 723.17.

Loan Participations

Six commenters stated that loan participations should be excluded from the calculation of a credit union's aggregate member business loan limit, except for the originating credit union. Most of these commenters stated that the Act refers to loans ''made'' by federally insured credit unions and since the originating credit union ''makes'' the loan, purchasing credit unions would not be ''making'' the loan, and therefore, it should not count toward the statutory limits. The NCUA Board is not adopting this recommendation since it would promote form over substance and result in a large block of member business loans suddenly vanishing from the books of credit unions for purposes of calculating the aggregate loan limit.

Eight commenters stated that NCUA should permit a credit union participating in a member business loan to classify the participation as an investment, rather than a member business loan. The NCUA Board disagrees since the authority for loan participations is located in the Federal Credit Union Act under the lending powers of credit unions and not the investment powers. 12 U.S.C. 1757(5) and 1757(7). In addition, NCUA, as well as credit unions, historically have classified loan participations as loans and not as investments. In certain limited circumstances the NCUA Board recognizes that a credit union can purchase a loan participation that is properly structured as a security. However, this does not mean that credit unions participating in a member business loan can classify the transaction as an investment.

Seven commenters recommended that NCUA should permit a credit union participating in a loan to exclude it from its total member business loan amount if it was originated by a credit union that is exempt under the Act from the member business loan regulation limits. The exception would, in effect, travel with the loan. The NCUA Board is not adopting this recommendation. The Act exempts credit unions and not loans from the aggregate loan limit. If NCUA adopted this recommendation, it could lead to absurd results. For example, a credit union could have half of its assets in member business loan participations without falling within the aggregate loan limit and without receiving an exception. Clearly, such a result was not intended by Congress and does not make sense within the statutory scheme.

One commenter stated that only the amount of the loan held by the originating credit union should be counted against the aggregate loan limit. The NCUA Board agrees as long as the loan participations are without recourse. One commenter stated that NCUA should exclude all loans to non-profits purchased through participation agreements, the proceeds of which are not used for commercial purpose. The NCUA Board does not believe there is any statutory authority to support such a position. Two commenters stated that a credit union that originates sufficient loans to meet NCUA's threshold requirements should qualify for the exception even if the credit union does not hold onto the loans. The NCUA Board is not sure that such an expansion of the exception is consistent with congressional intent.

Chartered for the Purpose of Making Member Business Loans

The NCUA Board also stated that an exception may also be granted for credit unions that were chartered for the purpose of primarily making member business loans. It is up to the credit union to provide sufficient documentation to demonstrate it meets this exception. Due to the nature of federal chartering, the NCUA Board believed it would be unlikely that many federal credit unions would qualify for this type of exception. However, the NCUA Board sought comment on how it could more fully define credit unions that were ''chartered for the purpose of primarily making member business loans'' for the purpose of this exception.

Four commenters stated that the interim final rule is more restrictive than the legislation by adding the word ''primarily'' to this exception. These commenters stated that the fact that Congress did not include the word ''primarily'' in the exception based on a credit union's charter but did add it to the exception regarding member business loan history is a strong indication that Congress did not intend for the NCUA Board to include the additional standard. After further review, the NCUA Board agrees with these commenters and the final rule has been changed accordingly.

One commenter stated that, for this exception, NCUA should define the exception as a product of the credit union's field of membership and its lending history. For example, this commenter stated that this would allow NCUA to exempt credit unions that serve farm cooperatives or groups of self-employed individuals, such as taxi drivers; or community credit unions with a history or providing small business loans, and others. The NCUA Board generally agrees with this commenter and has incorporated this suggestion into the final rule.

Two commenters stated that federal credit unions should be afforded the opportunity to prove, if they can, that they were chartered for the purpose of making member business loans. Two commenters suggested NCUA allow a broad range of evidence including historical documents such as original bylaws, articles of incorporation and the credit union's mission statement. One commenter recommended that NCUA state what the agency will consider as acceptable documentation to support such a showing. NCUA will consider any documentation from original charters, original bylaws, early business plans, mission statements, board minutes, original field of membership, early loan portfolios and any other appropriate evidence a credit union may submit to demonstrate that the credit union was chartered for the purpose of making a member business loan. The list of documentation that NCUA will consider in making this determination has been incorporated into the final rule.

One commenter stated that NCUA should review a credit union's service area and, if the service area is rural or agricultural, the credit union should qualify for the exception. Simply because a credit union is located in a rural or agricultural area does not demonstrate that a credit union was chartered for the purpose of making member business loans. Additional evidence would be necessary to permit a credit union to obtain this exception.

Nine commenters stated that this exception should be broadened so that an existing credit union can amend its charter to state that it is chartered for the purpose of making member business loans and thus qualify for the exception. The NCUA Board believes such a change would not generally be consistent with congressional intent. If any credit union simply could update its charter to state its purpose was to make business loans, and thereby be exempt, from the statutory limits, the result would be inconsistent with the entire statutory scheme. However, there may be certain circumstances, including safety and soundness reasons, that would require NCUA or the state supervisory authority to recommend to the credit union to amend its charter.

Section 723.18—How Do I Obtain an Exception?

To obtain the exception, a federal credit union must submit documentation to the Regional Director, demonstrating that it meets the criteria of one of the exceptions. A state chartered federally insured credit union must submit documentation to its state regulator to receive the exception. Although effective when granted by the state regulator, the state regulator should forward its decision to NCUA. The exception does not expire unless revoked by the Regional Director for a federal credit union or by the state regulator for a federally insured state chartered credit union. If an exception is revoked, loans granted under the exception authority are grandfathered.

One commenter stated that the preamble to the final rule should clarify that if a state regulator has approved an exception, NCUA cannot overturn the state regulator's decision. NCUA has no intention of overturning a state regulator's decision regarding the exception. The process simply requires the state regulator to notify NCUA that the exception has been granted.

Section 723.19—What Are the Recordkeeping Requirements?

This section required a credit union to identify member business loans separately in its records and financial reports. No substantive comments were received on this section. The Board is adopting this section in final as it was set forth in the interim final rule.

Section 723.20—How Can a State Supervisory Authority Develop and Implement a Member Business Loan Regulation?

The interim final rule allowed a federally-insured state-chartered credit union to obtain an exemption from NCUA's member business loan rule so that a state supervisory authority can enforce the state's rule instead of NCUA's rule. The NCUA Board must approve the state's rule before a federally-insured state-chartered credit union is exempt from NCUA's member business loan rule. The interim final rule identified the minimum requirements that a state regulation must address for a rule to be approved by the NCUA Board. Because of the new statutory requirements of the Act, no state rule is currently approved for use by federally-insured state-chartered credit unions. Therefore, states must seek a new determination from NCUA. In addition, the NCUA Board is reemphasizing that any state's rule must follow the new definitions and the statutory limits in the Act. That is, the definition of a member business loan, the exemptions from the definition of a member business loan, the aggregate loan limit, and the state's interpretation of the exceptions from the aggregate loan limit must mirror NCUA's Regulation.

One commenter specifically approved of this section. Three commenters requested that NCUA eliminate the words ''substantial equivalency determination'' from this section. Two commenters did not agree in eliminating the words ''substantial equivalency determination'' from this section. The final rule does not contain the term ''substantial equivalency'' because of the continuing objections expressed by some state supervisory authorities. The Board acknowledges the concerns of the state supervisory authorities, and the final rule recognizes that, in deciding whether to allow a state to implement its own rule, the NCUA Board is concerned, as insurer, with safety and soundness issues and not whether the language of the rule is virtually identical to NCUA's rule.

One commenter requested that the rule specify the time frame NCUA has to render a determination on a state's rule. Although no time frame is specified in the final rule, the NCUA Board has a goal of making a decision within 90 days of receiving a complete request for a determination.

Section 723.21—Definitions

NCUA proposed a general definition section at the end of the rule. One commenter did not object to NCUA's definition of ''associated member'' but did question how NCUA applies it. This commenter specifically requested that, in cases where there are related parties, loans will be aggregated only when assets of the related parties provide the income for the repayment of the loan. This commenter states that the proper test for determining the status of an associated member is the existence of a nexus between the success of the endeavor and the ability to repay the loan. The NCUA Board agrees and the agency will apply the definition accordingly.

In an attempt to make the regulation easier to understand, the NCUA Board has slightly modified the definition of ''construction or development loan'' and ''loan-to-value ratio'' and added a definition for ''net worth'' and deleted the definition of ''reserves.''

Miscellaneous

Six commenters requested that NCUA develop two distinct classes of member business loans—one for real estate and one for other types of member business loans. At this time, the NCUA Board believes it is not necessary to have separate rules because this final rule provides sufficient flexibility and guidance.

The interim final rule was written in a plain English, question and answer format. Two commenters approved of the plain English, question and answer format. Two commenters preferred the traditional regulatory style. The NCUA Board has not noted any problems with the plain English, question and answer format and believes the question and answer format is comprehensive and easy to understand. Therefore, the final rule is written in the plain English, question and answer format.

A few commenters requested that NCUA's Chartering Manual be amended to describe how a credit union can be chartered for the purpose of making member business loans. The NCUA Board will review this issue the next time it amends the Chartering Manual. In the meantime, a new charter can simply incorporate into its charter or bylaws a statement that its purpose is to make member business loans. Obviously, the credit union must incorporate this statement in good faith and the credit union's business plan will be reviewed to ensure that it reflects this stated purpose.

Part 722—Appraisals

Certain loans as specified in Section 722.3(a) do not require an appraisal. In addition, the interim final rule contains a waiver process from the appraisal requirement where the appraisal requirement is an unnecessary burden. Three commenters specifically approved of the waiver provision for appraisals. Two commenters requested more guidance on when a waiver would be granted for a category of loans. The NCUA Board believes a waiver on a category of loans should be granted whenever an appraisal would be virtually meaningless. For example, an appraisal on loans to construct churches is often unnecessary. Another example where an appraisal may be unnecessary is when 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.

C. Other Reductions In Regulatory Burden

Under the previous member business loan rule, all loans, lines of credit, or letters of credit that met the definition of a member business loan had to 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 previous requirement imposed an unnecessary burden on credit unions and, therefore, the NCUA Board deleted this monitoring requirement in the interim final rule.

The previous member business loan rule required credit unions to provide periodic disclosures to credit union members on the number and aggregate dollar amount of member business loans. NCUA believed the language was ambiguous and did not serve any true safety or soundness issue purpose. Therefore, the NCUA Board deleted this requirement in the interim final rule.

Two commenters supported the elimination of these reporting requirements. The Board has not been provided any convincing rationale for reimposing these reporting requirements on credit unions, therefore, the final rule, like the interim rule, does not contain these reporting requirements.

D. Comments From Banks and Bank Trade Organizations

Briefly summarized, the bank commenters argued that NCUA did not interpret CUMAA correctly and some stated that federal credit unions should be subject to taxation like banks. In general, these commenters opposed: (1) NCUA's definition of a ''history of primarily making member business loans'' exception; (2) NCUA's addition of the word ''primarily'' to the exception regarding the chartering of the credit union for the purpose of making business loans; (3) NCUA's attempt to reduce regulatory burden, including revisions regarding loans-to-one borrower, employee lending experience, loan-to-value ratios, appraisal rules, review of financial statements, and state waiver authority; and (4) NCUA's elimination of some burdensome reporting requirements.

The Board has considered all issues raised by these commenters and has previously addressed the major issues in this preamble since other commenters also addressed many of the same provisions. As to the question of taxation, this issue was legislatively addressed in CUMAA at Section 2.(4), which states that ''[c]redit unions, unlike many other participants in the financial services market, are exempt from Federal and most State taxes because they are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer board of directors and because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means.''

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). Aside from provisions mandated by the Act, the final 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 final rule will not have a significant economic impact on a substantial number of small credit unions.

Accordingly, the NCUA Board has determined that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

The reporting requirements in part 723 have been submitted to and approved by the Office of Management and Budget under OMB control number 3133–0101. Under the Paperwork Reduction Act of 1995, no persons are required to respond to a collection of information unless it displays a valid OMB control number. The control number will be displayed in the table at 12 CFR part 795.

Executive Order 12612

Executive Order 12612 requires NCUA to consider the effect of its actions on state interests. The final rule, as does the current rule, applies to all federally insured credit unions, including federally insured state chartered credit unions. However, since the final rule reduces regulatory burden, NCUA has determined that the final rule does not constitute a ''significant regulatory action'' for purposes of the Executive Order.

Congressional Review

The Small Business Regulatory Enforcement Fairness Regulatory Enforcement Fairness Act of 1996 (Public Law 104–221) provides for Congressional review of agency rules.

The reporting requirements is triggered in instances where NCUA issues a final rule as defined by section 551 of the Administrative Procedures Act, 5 U.S.C. 551.

The Office of Management and Budget has determined this is not a major rule. A major rule is defined as being any final rule that the Office of Management and Budget finds has resulted in or is likely to result in: (1) an annual effect on the economy of $100 million or more; (2) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or (3) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States based enterprises to compete with foreign-based enterprises in domestic and export markets.

List of Subjects

12 CFR Part 701

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

12 CFR Part 722

Appraisals, Credit, Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 723

Credit, Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 741

Bank deposit insurance, Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on May 19, 1999.

Becky Baker,

Secretary of the Board.

Accordingly, the interim rule amending 12 CFR parts 701, 722, 723 and 741 which was published at 63 FR 51793, September 29, 1998, is adopted as a final rule with the following changes:

1. Part 723 is revised to read as follows:

PART 723—MEMBER BUSINESS LOANS

Sec.

Authority: 12 U.S.C. 1756, 1757, 1757A, 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 (including any unfunded commitments) where the borrower uses the proceeds for the following purposes:

(1) Commercial;

(2) Corporate;

(3) Other business investment property or venture; or

(4) Agricultural.

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

(1) A loan fully secured by a lien on a 1 to 4 family dwelling that is the member's primary residence;

(2) A loan fully secured by shares in the credit union making the extension of credit or deposits in other financial institutions;

(3) Loan(s) to a member or an associated member which, when added together, are equal to or less than $50,000;

(4) A loan 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; or

(5) A loan granted by a corporate credit union to another credit union.

§ 723.2 What are the prohibited activities?

(a) *Who is ineligible to receive a member business loan?* You may not grant a member business loan to the following:

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

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

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

(4) Any associated member or immediate family member of anyone listed in paragraphs (a) (1) through (3) of this section.

(b) *Equity agreements/joint ventures.* You may not grant a member business loan if any additional income received by the credit union or senior management employees is tied to the profit or sale of the business or commercial endeavor for which the loan is made.

(c) *Loans to compensated directors.* A credit union may not grant a member business loan to a compensated director unless the board of directors approves granting the loan and the compensated director is recused from the decision making process.

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

Unless the Regional Director grants a waiver, 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% of net worth. 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 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% equity interest in the project being financed; and

(c) The funds may be released only after on-site, written inspections by 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 granted by federal credit unions to the extent they are consistent with this part. Except as required by part 741 of NCUA's regulations, federally insured credit unions are not required to comply with the provisions of § 701.21(a) through (g).

§ 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.

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. A credit union can meet the experience requirement through various approaches. For example, a credit union can use the services of a credit union service organization, 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.

§ 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 net worth, that you will invest in business loans;

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

(e) The maximum amount of your assets, in relation to net worth, 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 and periodic updating 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) Analysis of leveraging; and

(6) Comparison with industry average or similar analysis;

(j) The collateral requirements must include:

(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;
(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 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 for all liens cannot exceed 80% unless the value in excess of 80% is covered through private mortgage or equivalent insurance but in no case can it exceed 95%.
First with PMI or similar type of insurer.	You may grant a LTV ratio in excess of 80% only where the value in excess of 80% is covered through: 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) Principals, 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?

Unless your Regional Director grants a waiver for a higher amount the aggregate amount of outstanding member business loans (including any unfunded commitments) to any one member or group of associated members must not exceed the greater of:
(a) 15% of the credit union's net worth; or
(b) $100,000.

§ 723.9 How do you 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 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 net worth.

§ 723.10 What waivers are available?

You may seek a waiver for a category of loans in the following areas:
(a) Loan-to-value ratios under § 723.7;
(b) Maximum loan amount to one borrower or associated group of borrowers under § 723.8;
(c) Construction and development loan limits under § 723.3;
(d) Requirement for personal liability and guarantee under § 723.7; and
(e) Appraisal requirements under § 722.3.

§ 723.11 How do you obtain a waiver?

To obtain a waiver, a federal credit union must submit a request to the Regional Director (a corporate federal credit union submits the waiver request to the Director of the Office of Corporate Credit Unions). A state chartered federally insured credit union must submit the request to its state supervisory authority. If the state supervisory authority approves the request, the state regulator will forward the request to the Regional Director (or if appropriate the Director of the Office of Corporate Credit Unions). A waiver is not effective until it is approved by the Regional Director (or in the case of a corporate federal credit union the Director of the Office of Corporate Credit Unions). The waiver request must contain the following:
(a) A copy of your business lending policy;
(b) The higher limit sought (if applicable);
(c) An explanation of the need to raise the limit (if applicable);
(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% of net worth;
(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 (or the Director of the Office of Corporate Credit Unions) 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 whenever your waiver request is deemed complete. Notify you of the action taken within 45 calendar days of receiving a complete request from the federal credit union or the state supervisory authority. If you do not receive notification within 45 calendar days of the date the complete request was received by the regional office, the credit union may assume approval of the waiver request.

§ 723.13 What options are available if the NCUA Regional Director denies my waiver request or a portion of it?

You may appeal the Regional Director's (or the Director of the Office

of Corporate Credit Unions) 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 (or the Office of Corporate Credit Union Director's) decision.

§ 723.14 How do I classify loans so as to reserve for potential losses?

Non-delinquent member business 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 (for example, 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 is the aggregate member business loan limit for a credit union?

The aggregate limit on a credit union's outstanding member business loans (including any unfunded commitments) is the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets. Net worth is all of the credit union's retained earnings. Retained earnings normally includes undivided earnings, regular reserves and any other appropriations designated by management or regulatory authorities. Loans that are exempt from the definition of member business loans are not counted for the purpose of the aggregate loan limit.

§ 723.17 Are there any exceptions to the aggregate loan limit?

There are three circumstances where a credit union qualifies for an exception from the aggregate limit. Loans that are excepted from the definition of member business loans are not counted for the purpose of the exceptions. The three exceptions are:

(a) Credit unions that have a low-income designation or participate in the Community Development Financial Institutions program;

(b) Credit unions that were chartered for the purpose of making member business loans and can provide documentary evidence (such evidence includes but is not limited to the original charter, original bylaws, original business plan, original field of membership, board minutes and loan portfolio);

(c) Credit unions that have a history of primarily making member business loans, meaning that either member business loans comprise at least 25% of the credit union's outstanding loans (as evidenced in any call report filed between January 1995 and September 1998 or any equivalent documentation including financial statements) or member business loans comprise the largest portion of the credit union's loan portfolio (as evidenced in any call report filed between January 1995 and September 1998 or any equivalent documentation including financial statements). For example, if a credit union makes 23% member business loans, 22% first mortgage loans, 22% new automobile loans, 20% credit card loans, and 13% total other real estate loans, then the credit union meets this exception.

§ 723.18 How do I obtain an exception?

To obtain the exception, a federal credit union must submit documentation to the Regional Director, demonstrating that it meets the criteria of one of the exceptions. A state chartered federally insured credit union must submit documentation to its state supervisory authority. The state supervisory authority will forward its decision to NCUA. The exception does not expire unless revoked by the state supervisory authority for a state chartered federally insured credit union or the Regional Director for a federal credit union. If an exception request is denied for a federal credit union, it may be appealed to the NCUA Board within 60 days of the denial by the Regional Director. Until the NCUA Board acts on the appeal, the credit union can continue to make new member business loans.

§ 723.19 What are the recordkeeping requirements?

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

§ 723.20 How can a state supervisory authority develop and enforce a member business loan regulation?

(a) The NCUA Board may exempt federally insured state chartered credit unions in a given state from NCUA's member business loan rule if NCUA approves the state's rule for use for state chartered federally insured credit unions. In making this determination, the Board is guided by safety and soundness considerations and reviews whether the state regulation minimizes the risk and accomplishes the overall objectives of NCUA's member business loan rule in this part. Specifically, the Board will focus its review on:

(1) The definition of 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 NCUA's approval of a state's members business loan rule, the state supervisory authority must submit its rule to the NCUA regional office. After reviewing the rule, the region will

forward the request to the NCUA Board for a final determination.

§ 723.21 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 including outstanding balances plus any unfunded commitment or line of credit from all sources on an item of collateral divided by the market value of the collateral used to secure the loan.

Net worth is retained earnings as defined under Generally Accepted Accounting Principles. Retained earnings normally includes undivided earnings, regular reserves and any other appropriations designated by management or regulatory authorities.

PART 741—REQUIREMENTS FOR INSURANCE

2. The authority citation for part 741 continues to read as follows:

Authority: 12 U.S.C. 1757, 1766 and 1781–1790. Section 741.4 is also authorized by 31 U.S.C. 3717.

§ 741.203 [Amended]

3. Section 741.203 is amended in paragraph (a) by removing the second sentence and adding in its place a new sentence to read as follows: ''State-chartered, NCUSIF-insured credit unions in a given state are exempt from these requirements if the state supervisory authority for that state adopts substantially equivalent regulations as determined by the NCUA Board or, in the case of the member business loan requirements, if the state supervisory authority adopts member business loan regulations that are approved by the NCUA Board pursuant to § 723.20.''

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NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 708a

Conversion of Insured Credit Unions to Mutual Savings Banks

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The NCUA is issuing a final rule that revises its rules governing the conversion of insured credit unions to mutual savings banks or mutual savings associations. These revisions simplify the charter conversion process and reduce regulatory burden for insured credit unions that choose to convert. NCUA is making these revisions in compliance with federal legislation that mandates such revisions.

DATES: This rule is effective June 28, 1999.

FOR FURTHER INFORMATION CONTACT: Frank S. Kressman, Staff Attorney, Division of Operations, Office of General Counsel, (703) 518–6540.

SUPPLEMENTARY INFORMATION:

Background

The Credit Union Membership Access Act (CUMAA) was enacted into law on August 7, 1998. Public Law 105–21. Section 202 of CUMAA amends the provisions of the Federal Credit Union (FCU) Act concerning conversion of insured credit unions to mutual savings banks or mutual savings associations. 12 U.S.C. 1785(b). CUMAA requires the NCUA to promulgate final rules regarding charter conversions within six months of that date that are: (1) consistent with CUMAA; (2) consistent with the charter conversion rules promulgated by other financial regulators; and (3) no more or less restrictive than rules applicable to charter conversions of other financial institutions. Accordingly, NCUA issued an interim final rule with request for comments that was effective November 27, 1998. 63 FR 65532 (November 27, 1998).

Final Rule

With the benefit of having considered public comments on part 708a, NCUA issues this final rule and amends the interim final rule. As discussed more fully below, the changes from the interim final rule to the final rule consist of providing more flexibility to credit unions in choosing methods for delivering member notices, correcting an inadvertent, inconsistent use of language in the notice provision in § 708a.5(c), and clarifying the purpose and scope of the certification provision in § 708a.9(b). These amendments further reduce regulatory burden on converting credit unions, simplify the conversion process and provide continued consistent treatment of proposals to convert. NCUA finds it appropriate to allow credit unions to act immediately under this revised, less restrictive rule. Accordingly, pursuant to 5 U.S.C. 553(d)(1) and (3), the rule will be effective immediately and without 30 days advance notice of publication.

Summary of Comments

The NCUA Board received eleven comment letters regarding the interim final rule: three from banking trade associations, three from credit union trade associations, one from an association of state credit union supervisors, three from FCUs and one from a law firm. They offered the following comments.

General Comments

Three commenters approve of the interim rule as written and believe the rule is consistent with the provisions of CUMAA. As of the date of preparation of this final rule, three converting FCUs have opted to request NCUA review of their notice and other materials they intend to send to members in advance of the time frame required by part 708a. NCUA has reviewed these materials, had minor revisions, and the review has not delayed or unduly burdened the conversion process. The revisions incorporated into this final rule will further enhance part 708a.

One commenter contended generally that the rule is inconsistent with the charter conversion rules of other financial regulators. NCUA has reviewed the charter conversion rules of other financial regulators and has drafted this rule to be consistent with them. In contrast to the statutory and regulatory provisions governing conversions under the jurisdiction of other financial regulators, CUMAA imposes specific time frames and particular responsibilities on NCUA in the conversion process. Accordingly, because of this significant difference, this rule is not identical to those of the other financial regulators, but is nonetheless consistent with them.

One commenter noted that in the preamble to the interim final rule, NCUA stated that it ''does not interpret the [Credit Union] Membership Access Act to preclude state regulatory authorities from imposing more restrictive charter conversion rules on federally insured state-chartered credit unions.'' That commenter suggested the