NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

November 4, 1991

Alan B. Decker
1841 Broadway
New York, N.Y. 10023

Re: Member Business Loans (Your August 30, 1991, Letter)

Dear Mr. Decker:

You have asked whether a loan of $25,000 or less, that is used for a commercial purpose, is counted against the limit of loans to one borrower under the member business loan rule. In general such loans are not counted when calculating the loans to one borrower limit as long as the aggregate of all such loans to the same borrower is less than $25,000.

ANALYSIS

NCUA has issued a new member business loan rule (see enclosed) which becomes effective on January 1, 1992. The answer to whether a loan under $25,000, granted for a commercial purpose, is exempt from the loans to one borrower limits, remains unchanged. It is important to note, however, that under the new regulation the loans to one borrower limit has been reduced from 20% to 15% of reserves and the definition of reserves has also been modified. This letter discusses the new regulation.

Section 701.21(h)(1)(i)(C) of NCUA's Rules and Regulations exempts from the business loan regulation a "loan meeting the general definition of member business loans . . . which when added to other such loans to the borrower or associated member, is less than $25,000." Section 701.21(h)(2)(iii)(A) of NCUA's Rules and Regulations, states in part that:

> the aggregate amount of outstanding member business loans to any one member

FCUA VCI I C, 3C Commercial Loans

> or group of associated members shall not exceed 15% of the credit union's reserves (less the Allowance for Loan Losses account), or $75,000, whichever is higher.

If the aggregate of business purpose loans is less than $25,000, they are not counted toward the 15% loan to one borrower limit because they are not classified as business loans for purposes of the regulation. Therefore, it is possible for a credit union to make a business purpose loan(s) of less than $25,000 to a member that exceeds 15% of its reserves without violating the regulation. The regional office may however, have safety and soundness concerns with that situation.

Sincerely,

Hattie M. Ulan

Hattie M. Ulan
Associate General Counsel

Attachment

cc: Doug Verner, Region I
Director of Supervision

GC/MM:sg
SSIC 3501
91-0912

Rules and Regulations

Federal Register
Vol. 56, No. 186
Wednesday, September 25, 1991

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

Organization and Operation of Federal Credit Unions

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The National Credit Union Administration Board (Board) has amended its rules concerning member business loans, which were initially adopted by the Board in 1987. These amendments follow two separate requests for comment. The first request was issued on January 17, 1991, (See 56 FR 2723, 1/24/91). The comment period closed on March 25, 1991, with a total of 744 comments. On April 4, 1991, the Board approved a second request for comments which, based on the earlier comments, reflected a number of changes and amendments (See FR 15053, 4/15/91). That comment period ended on June 14, 1991, with 403 comments. Numerous problems relating to member business loans have been revealed during the examination and supervision process. Business lending has resulted in high losses to credit unions, their members and the National Credit Union Share Insurance Fund. The existing rule and increased examination and supervision efforts have not been sufficient to stem losses due to problems associated with member business loans. Changes to the existing rule are necessary in order to limit certain high risk activities and are intended to reduce losses to the credit union system.

EFFECTIVE DATE: January 1, 1992.

ADDRESSES: National Credit Union Administration, 1776 G Street, NW., Washington, DC 20456.

FOR FURTHER INFORMATION CONTACT: D. Michael Riley, Director, David M. Marquis, Deputy Director, or Timothy P. Hornbrook, Director, Department of Supervision, Office of Examination and Insurance, NCUA, at the above address, or telephone: (202) 682-9640.

SUPPLEMENTARY INFORMATION:

A. Background

The Board adopted rules and regulations addressing member business loans in 1987 (See 52 FR 12365, 4/16/87). At that time, the Board expressed its intent to evaluate the effectiveness of the rule over a 3-year period. Over that period, specialized examination methods and training have been developed in order to increase overall examiner awareness and skills in this area. In addition, data has been collected from the semiannual call reports and from examination and supervision contacts.

The proposed changes to the existing rule are intended to reduce losses to the credit union system. These changes will require greater diversification, revised collateral requirements and overall limits on certain types of lending. In addition, the changes adopted will improve the ability of the Agency to identify and monitor business lending activity.

Numerous problems relating to member business loans have been revealed during the examination and supervision process. These problems have contributed to overall weaknesses in asset quality, earnings and capital which have led to liquidations, mergers and special assistance to avoid liquidation. Business lending, when not properly carried out, has invariably caused heavy expenses to individual credit unions, their members and the National Credit Union Share Insurance Fund (NCUSIF).

Examination and supervision findings have documented the often complex and potentially high risk nature inherent in loans for business purposes. Traditionally, other industries recognize this increased risk in the form of a risk premium, e.g., higher rates charged to business borrowers. Data from the Federal Deposit Insurance Corporation, for example, indicates that even experienced commercial banks average a loss ratio related to business lending that is nearly three times higher than the average loss ratio for credit unions. Finally, NCUA experience indicates that problems related to member business loans have an extremely high correlation with problem credit unions and losses to the NCUSIF.

Call report data from June 1991 indicates that federally insured credit unions now hold a total of $1.9 billion in member business loans. This is 1.4 percent of total loans or .8 percent of total assets. Member business loans have increased $924 million/99 percent since 1987 and $212 million/13 percent over the past 6 months. The data indicate further that only 1,360 of 13,007 or about 10 percent of total federally insured credit unions are holding member business loans.

At the same time, problem credit unions (CAMEL code 3, 4, or 5), share a disproportionately higher level of member business loans than other credit unions. In addition, poorly reserved credit unions hold a larger amount of member business loans in proportion to other, better reserved credit unions. In summary, credit unions with the poorest overall condition and poorest ability to withstand losses tend to have the greatest involvement with member business loans.

The Board recognizes that loans for business purposes have been an integral part of some credit union's lending programs. Accordingly, the Board wishes to reaffirm that it does not intend to preclude well-operated credit unions from offering business-purpose loans to their members. Nevertheless, consistent with its fiduciary duty to protect the interests of all federally insured credit unions, and the NCUSIF, the Board is taking certain steps in an effort to reduce losses. These steps are intended to place reasonable limits on some of the riskiest activities, require the board of directors to establish prudent lending policies and to improve the ability of NCUA to monitor its exposure. At the same time, examination procedures will continue to emphasize safe and sound lending policies and practices in an effort to minimize operating losses. Finally, training programs will provide continuing education to agency staff in order to ensure that staff is sufficiently qualified and experienced to evaluate and provide guidance to credit union officials when appropriate. Although several commenters continue to encourage the Board to limit its regulatory changes in favor of increased supervision and monitoring, the Board is not convinced that these efforts alone

will produce the changes needed to reduce losses to an acceptable level.

B. Comments

A total of 403 comments were received as a result of the request for comments which ended on June 14, 1991. Eighty comments were received from Federal credit unions and 133 comments came from State-chartered credit unions. Seventy-five comments were received from credit union members (including 48 comments from a single credit union). Six comments were from national credit union organizations and 21 were from State credit union leagues. Four comments were from state regulators and two comments were received from other state agencies. Seventy-six comments were received from religious organizations and their affiliates. Two comments were received from law firms. Comments were also received from two State senators, an insurance group, and a city mayor.

Although nine commenters approve of the proposed rule in its entirety, most comments recommended additional changes. Numerous meetings and discussions with various individuals and groups and, as a result of this additional information, a number of changes to the April proposed rule are incorporated herein. While these amendments will cause certain changes to policies and practices, these changes are considered a reasonable accommodation in consideration of the increased risk exposure resulting from lending for business purposes.

C. Discussion

Definitions—Section 701.21(h)(1)

Section 701.21(h)(1)(i) contains the definition of member business loans. The definition of member business loans was expanded to include loans for the purpose of "investment property or venture". Several commenters requested additional clarification of this term. Such loans are characterized by a dependence on future appreciation in the value of the property or future income derived from the property in order to repay the loan in whole or in part.

Fifty-five commenters requested a separate rule for agricultural lending. At this time, the Board is convinced that agricultural and other types of business lending share common characteristics and behavioral patterns and accordingly, fall into the same general category. A separate rule has not been incorporated.

The existing rule contains four exclusions from the general definition of member business loans. Several modifications have been made. It is not the Board's intent to include within the context of this revised rule, loans already granted under the authority of the deleted exclusions. Similarly, recordkeeping provisions of this rule are not intended to apply to loans previously exempted from reporting requirements. Accordingly, credit unions are not required to reclassify existing loans or take any other actions with respect to loans previously granted under existing authority. All new loans granted subsequent to the effective date of the rule are covered under the revised provisions of this rule.

Section 701.21(h)(1)(i)(A) of the final rule removes the exemptions for business loans secured by a member's secondary residence or one other such dwelling. Thirty-eight commenters favored the exemptions contained in the existing rule. Loans secured by a member's primary residence are considered a lesser overall risk than loans secured by other residences. In determining whether an exemption is allowable, the credit union must determine whether the subject property is or will be the principal residence of the member-borrower. If so, the loan is not within the purview of § 701.21(h) but may be subject to rules concerning long-term mortgage lending. § 701.21(g).

Section 701.21(h)(1)(i)(C) excludes business loans of less than $25,000 from the definition of member business loans. The language contained in this section has been amended slightly for clarification purposes. Although several commenters requested an increase in the amount of the exclusion, the Board has heard no clear or compelling reasons why such an increase should be considered. By way of example, commenters pointed out that a loan for $25,000 for an automobile would be considered a consumer loan to an individual, yet the same loan would be subject to the provisions of this section if granted for a business purpose. Although true, the additional underwriting, recordkeeping and other provisions of this section is related to the risk inherent in business loans rather than the character or value of the collateral securing such a loan. In short, risks associated with consumer credit are less than those associated with business credit. In any event, the Board is excluding loans of less than $25,000 in the interest of eliminating unnecessary burdens for smaller credits. Nevertheless, regardless of amount, loans for business purposes should be underwritten as business loans and any additional risks associated with such lending should be considered by the credit union in its evaluation criteria, collateral requirements, pricing and monitoring mechanisms.

Section 701.21(h)(1)(i)(E) was added to clarify that loans granted by a corporate credit union to another credit union are not included within the scope of this rule. Several commenters indicated that while this point was clear with respect to federally chartered corporates, the issue with respect to State-chartered corporates was unclear. It was not the Board's intent to include corporate credit union transactions within the context of this rule.

Section 701.21(h)(1)(ii) defines the term "reserves" as used in this section. The proposed rule excluded the balance of the Allowance for Loan Losses account from the definition of reserves. Several commenters pointed out that this revised definition differed from the definition of reserves used elsewhere in these regulations and in other Agency references and would lead to unnecessary confusion. The Board agrees and retains the definition as used in the existing rule. At the same time, the Board reaffirms the exclusion of the Allowance for Loan Losses as a factor in the computation of various limits found elsewhere in this section. Since the Allowance for Loan Losses account is considered a provision for known and potential losses in the existing loan portfolio, these are not considered free, unallocated reserves available for use in deferring risk in other assets. Accordingly, the Allowance for Loan Losses is not considered a viable factor to be used to leverage the amount of available credit. Accordingly, §§ 701.21(h)(2)(iii) (A), (B) and (D) have been revised to exclude the Allowance for Loan Losses account from total reserves. This change accommodates the concerns of those who believe the proposed definition will be unnecessarily confusing while also providing for the concerns of the Board that allowance accounts not be leveraged.

Section 701.21(h)(1)(iii) defines the term "associated member". Several commenters requested clarification that the term be limited to shared interests with this credit union. Although no change is being made to the final rule, it is noted that the Board intends for this term to be limited to shared interests, investments or other pecuniary interests associated with the credit union where the loan has been requested. Similarly, § 701.21(2)(iii)(A) is intended to apply to member business loans to this credit union. For example, in determining the limit of loans to one borrower, this construction applies to the individual credit union to which the member

applies for a member business loan and does not require each credit union to determine the aggregate member business loans made collectively by all credit unions or other financial institutions.

Section 701.21(h)(1)(v) defines the term "loan-to-value" as used elsewhere in this section. This amendment to the existing regulation received no comment or discussion and is being left as proposed.

Section 701.21(h)(1)(vi) defines the term "construction or development loan" as used elsewhere in this section. Commenters requested additional clarification in order to ensure that such loans are distinctly identified. Construction or development loans are for the acquisition of land or property upon which improvements are planned. Examples of these types of loans included: (1) The purchase of raw land to be developed for resale as building lots; (2) the purchase of raw or developed land for the purpose of constructing housing or a commercial building; and (3) the purchase of an existing structure for rehabilitation in order to improve the economic value for resale or to improve income-producing potential. This term does not include loans for the construction of a member's residence. Loans for construction of a member's residence are normally consumer loans granted under other provisions of these rules and regulations.

Requirements—Section 701.21(h)(2)

Section 701.21(h)(2)(i) establishes a requirement that the board of directors adopt written business loan policies. Section 701.21(h)(2)(i)(F) requires that the board of directors establish qualification requirements for personnel. This section has been revised to require at least 2 years direct experience of personnel involved in making and administering business loans. Although 14 commenters objected to this requirement, the Board remains convinced that minimum experience requirements are necessary. The responsibility of determining the criteria to be used to establish the minimum qualifications rests with the board of directors.

The intent of this section is to ensure that each type of credit offered is properly underwritten and administered. For example, the lending process involved with commercial real estate differs significantly from that of lending for business inventory or equipment. In this example, a credit union involved in both types of business lending would be required to establish qualified personnel for each type credit. In some cases, this may require that more than one individual be used. Credit unions are not required to hire staff but must ensure that the expertise is available, as necessary, to meet the requirements of this section. This could be met, for example, by hiring contract assistance on a case-by-case basis.

Section 701.21(h)(2)(ii)(H) clarifies the documentation requirements needed to support extensions of credit for business purposes. This section has been amended to clarify that documentation is necessary except when it is not generally available. This reduces somewhat, the discretion of the board of directors to determine that documentation is not necessary. The Board will normally expect that each business loan is well-documented as noted in the regulation.

Section 701.21(h)(2)(ii)(A) establishes new requirements that business loans be secured and establishes loan-to-value (LTV) ratios. Six commenters approved of these provisions, while 33 commenters objected. Those objecting did so on the basis that such limits are unrealistic and that creditworthiness should be the primary concern as opposed to collateral requirements. The Board agrees and notes that lending criteria should place primary emphasis on the borrower's creditworthiness, secondary emphasis on viability of the enterprise and lastly, on the collateral value securing the loan.

As recent events in New England have demonstrated, material declines in regional economies impact creditworthiness and collateral adequacy simultaneously. Collateral requirements are imposed as a hedge against the potential for borrower default. Additionally, LTV ratios implicitly produce powerful incentives to encourage borrowers to repay, e.g., to protect the borrower's equity interest in the property. These incentives do not exist with high LTV ratios where the borrower has little, if any, equity at risk. Accordingly, it is critical that sufficient equity be available to protect the lender's interest. For these reasons, LTV ratios consistent with generally accepted industry standards have been established as a part of this rule.

Section 701.21(h)(2)(ii)(B) adds a requirement that member business loans include the personal liability and guarantee of principals. The final rule exempts loans to not-for-profit organizations such as churches, cooperatives, charitable organizations and similar groups from the signature requirement of this provision. Comments to the rule proposed in January 1991, argued that, given the low level of losses with such groups, the provision requiring the signature of the principal should not be imposed where the borrower is organized or incorporated as a nonprofit corporation. The Board recognizes that the structure of such organizations normally does not provide for a principal.

Section 701.21(h)(2)(ii)(C) has been added to the rule to exempt state-chartered credit unions from the general prohibition against unsecured credit with respect to corporate credit card accounts. Several comments pointed out that such credit is normally short-term, entails strong underwriting criteria and is generally made available only to the most creditworthy applicants. Although State-chartered credit unions are not prohibited from offering such unsecured credit by these regulations, State law provisions must also be followed, if applicable. In any event, this exemption is intended to apply only with respect to traditional credit card uses. Such uses may include employee travel reimbursement and similar credit arrangements. Further, examiners will be closely reviewing such credit extensions and will expect sound underwriting criteria including careful documentation with collateral required when appropriate. Examiners will also review policies and procedures to ensure adequate administration and monitoring. This exemption does not affect federal credit unions since the standard Federal Credit Union Bylaws generally limit credit to nonnatural persons to the extent of shares on deposit as the credit union.

Section 701.21(h)(2)(iii)(A) establishes a limit on the amount of loans that may be made to one borrower. Sixty commenters objected to this provision. A number of these comments indicated that they believe that reducing the limit to 10 percent of reserves will have a substantially negative impact on agricultural credit unions. Consistent with the intent expressed by the Board to increase the diversification of member business loan portfolios, the rule has been amended to a loans to one borrower limit of 15 percent of reserves (less the Allowance for Loan Losses account) or $75,000, whichever is the higher. At the same time, the Board acknowledges that circumstances have been demonstrated to indicate that loans in excess of this amount are sometimes clearly warranted. Exceptions to the loans to one borrower limitation may be obtained through the regional director serving the area where the credit union is located. Clarification of the information required to be submitted in support of an exception are discussed elsewhere. As indicated

earlier, it is not the Board's intent to curtail sound lending programs but rather, to improve upon weak programs. Although credit unions may apply for a loan-by-loan exception, an application for a higher overall limit will oftentimes prove a more practical alternative.

This section has been amended to eliminate the exclusion of an interest in the borrower's residence(s) from calculation of the loans to one borrower limit. This exclusion had no practical effect in the existing rule, since such loans were already excluded from the rule by definition. Eliminating these exclusions from this final rule maintains consistency between the definition of member business loans and the loans which, when added together, establish the loans to one borrower limit.

Section 701.21(h)(2)(iii)(A) has also been modified slightly to clarify that the Board intends to exclude from the calculation of the loans to one borrower limit, any portion of a member business loan secured by shares in the credit union or by deposits in another financial institution, or fully or partially insured or guaranteed by, or subject to, an advance commitment to purchase by any agency of the federal government or of a state or any of its political subdivisions. This has been accomplished by changing the term "fully secured" in the second sentence of this section to "secured".

Several comments expressed concern regarding loans which presently exceed the revised loans to one borrower limit. This would include loans which have been fully funded, binding commitments, letters of credit or lines of credit issued. As with other provisions contained in this section, the effective date applies to loans which are granted or committed on or after the effective date. Loans granted, committed or funded prior to the effective date of this rule are not affected by these provisions.

The proposed rules each contained an aggregate limit on member business loans. This issue created considerable comment and debate regarding the merits and problems related to an aggregate cap. At this time, the Board has determined that an aggregate cap shall not be established by regulation. Although cognizant that a cap alone will not reduce losses, it is important to note, however, that each board of directors is required by this rule to establish its own aggregate member business loan limit. Such limits shall be reviewed during regular supervisory examinations. Additionally, the Board will monitor the activity of credit unions through the reporting requirements of this rule. The need to readdress this issue will be reviewed periodically to ensure that aggregate limits established by each credit union are meaningful and provide for the safe and sound operation of the credit union.

Section 701.21(h)(2)(iii)(B) establishes criteria for credit unions seeking exceptions to the loans to one borrower limit or those contained in the construction, development and speculative lending section of these rules. Thirty-seven comments opposed the involvement of the regional director in the process. Previous comments expressed concern regarding the impartiality of the regional directors' views concerning member business loans and requested clarification of the criteria to be used to evaluate requests for exceptions. The Board believes that it is necessary that an exception process be available to credit unions who wish to avail themselves of limits in excess of those established by regulation, whatever that limit should be. Further, the regional directors clearly have the best resources to investigate and act on requests in the most timely manner. Finally, as indicated previously, the Board has made it clear that member business loans are a necessary service for many credit unions and regional directors support these views as well.

This section clarifies, in specific detail, those items which shall be included in the requests for exception. The Board intends that requests which are well-supported by sound financial condition, experience, and thorough analysis shall be favorably viewed. Further, the final rule provides that credit unions may assume approval has been granted if notification has not been provided within 30 days of receipt of the request in the regional office. In any event, regional directors will make every reasonable effort to act on each request as expeditiously as possible. As with other actions, appeal of the decision of the regional directors may be directed to the NCUA Board. The Board will monitor this process to assure that applications for exception are processed timely and effectively in conformance with the intent of the Board.

Section 701.21(h)(2)(iii)(C) requires that member business loans be granted for periods consistent with the purpose, security, creditworthiness of the borrower and sound lending policies. Additionally, it is noted that the board of directors is responsible for establishing maturity limits on these loans. Although the proposed rules established maximum maturity limits, these are deleted from this final rule. In the case of federal credit unions, member business loans may not be granted for periods in excess of 12 years. This limit is established by the Federal Credit Union Act. State-chartered credit unions are limited to the maturity established under state law.

Section 701.21(h)(2)(iii)(D) establishes monitoring requirements for credit unions which have member business loans outstanding in excess of 100 percent of reserves (less the Allowance for Loan Losses account). Forty-six comments objected to this monitoring requirement. Experience with problem credit unions has indicated that, frequently, losses or liquidations could have been avoided or minimized if poor underwriting and similar problems were detected earlier and corrective action taken. Short of imposing a mandatory cap on such lending, the Board believes that requiring credit unions to provide a monitoring report, once a substantial commitment of credit union equity is at risk, is a reasonable method of detecting such problems at an earlier stage.

Although the proposed rule required a monthly report, this requirement has been modified slightly to require such reports on a quarterly basis. In addition, information regarding delinquent member business loans is modified from 10 days delinquent to 30 days delinquent. Monitoring requirements may be modified or amended through separate request or agreement with the regional director.

Section 701.21(h)(2)(iv) has been amended slightly in order to reference the Appendix to § 701.21(h). No change in intent or meaning to derived from this modification.

Construction and Development Lending—Section 701.21(h)(3)

Section 701.21(h)(3) establishes additional rules concerning construction and development lending. The Board has determined that this particular segment of the member business lending market contains the largest overall risks. The final rule establishes an aggregate portfolio cap on such loans, requires a minimum 35 percent equity in the project by the borrower, and requires on-site inspection prior to release of funds.

In general, most comments and discussions support the provisions of this section. Several individuals suggested that NCUA prohibit such lending by federally insured credit unions. Lending for speculative purposes is not appropriate for federally insured credit unions. Speculation, in general, is purchasing something (land, a building) in hopes of future returns or appreciation. Speculative construction means construction that begins without signed contract(s) for the ultimate

purchase of the building or lease of space.

A number of comments, although not objecting to the provision, suggested increasing the portfolio cap above the proposed 15 percent of reserves level. A number of comments recommended excluding any portion of a loan secured by shares or guaranteed by a government agency. This final recommendation has been adopted in the final rule while maintaining the proposed aggregate cap on such lending of 15 percent of reserves, less the Allowance for Loan Losses account. This exclusion language should provide some relief to credit unions such as community development credit unions which offer government guaranteed or assisted loans to low income groups and others. Rehab of existing structures for low income housing would often fall into this same category of exclusion.

A number of comments requested clarification concerning whether this rule is intended to apply to loans for the construction of a member's residence. It is not the intent of the Board that this rule apply to loans for the purpose of constructing a member's personal residence. Such loans would not generally meet the definition of member business loans since the purpose is for a residence and not for business, commercial, investment or similar purpose.

Section 701.21(5) establishes recordkeeping requirements. The final rule requires that loans which meet the general definition of a member loan, regardless of exclusions or exemptions, be identified as such in the records of the credit union and reported on the financial and statistical reports required by NCUA. In view of the record of losses and high risk involved with such lending, the Board has determined that accurate recordkeeping and reporting rules are necessary.

This requirement adds a recordkeeping burden to credit unions which grant loans for business purposes that are excluded from the underwriting and other requirements of these rules due to one or more exclusion to the general definition. This added burden is necessary to determine the extent of business lending by credit unions, associated losses and the effect of regulation in limiting such losses. Further, this new requirement only affects loans made prospectively and does not apply to loans existing within the portfolio prior to the effective date of this rule. Periodic review of the need for such a recordkeeping burden will be performed as required by the Office of Management and Budget.

Section 701.21(h)(6) establishes an effective date of January 1, 1992. This rule was proposed in January, 1991 and affected parties have had a significant period of time to determine the potential effect of any regulatory changes. The Board is confident that the effective date should provide adequate time for credit unions to make any changes necessary to comply with this revised rule.

As indicated earlier, this rule applies only to loans granted or committed after the effective date of the rule. Loans granted or committed prior to the effective date are not required to comply with the revised provisions of this rule.

Requirements of Insurance—Section 741.3

No change is being made to this section. State regulatory authorities and federally insured state-chartered credit unions are advised, however, that exemptions previously obtained by states under the existing regulations are no longer valid to the extent that existing state regulations are not substantially equivalent to these final regulations. Such states must reapply for exemption as provided in this section.

D. Regulatory Procedures

Regulatory Flexibility Act

The Board certifies that the proposed rule will not have a significant impact on a substantial number of small credit unions because the rule applies only to the federally insured credit unions which make member business loans. Approximately 78 federally insured credit unions with assets less than $1 million grant member business loans. In addition, loans of less than $25,000 are exempt from most provisions of this rule. Accordingly, the Board has determined that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

This rule will increase the collection and recordkeeping requirements of the Paperwork Reduction Act. A separate request is being submitted to the Office of Management and Budget for approval prior to the effective date of this regulation.

Executive Order 12612

Executive Order 12612 requires NCUA to consider the effect of its actions on state interests. It states that "Federal action limiting the policy making discretion of the States should be taken only where constitutional authority for the action is clear and certain and the national activity is necessitated by the presence of a problem of national scope." The issue of member business loans and their risks to federally insured credit unions are concerns of national scope. This regulation is enacted in order to enable NCUA and the NCUSIF to have an operable mechanism in place to ensure the safety and soundness of federally insured credit unions. This regulation will apply to all federally insured credit unions. The NCUA Board believes that the protection of the NCUSIF warrants these new restrictions and that the increased restrictions in the amendments will not unduly burden federally insured state-chartered credit unions. The NCUA Board, pursuant to Executive Order 12612, has determined that this rule may have an occasional direct effect on the states, on the relationship between the states, or on the distribution of power and responsibilities among the various levels of government. Further the amendments may supersede provisions of state law or regulations concerning member business loans which do not substantially meet the requirements of § 701.21(h).

List of Subjects in 12 CFR Part 701

Civil rights, Conflict of interests, Credit, Credit unions, Fair housing, Insurance, Mortgages, Reporting and recordkeeping requirements, Signs and symbols, Surety bonds.

By the National Credit Union Administration Board on September 13, 1991.

Becky Baker,

Secretary of the Board.

For the reasons set forth in the preamble, 12 CFR part 701 is 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 and 1789 and P.L. 101-73.

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. 1981 and 42 U.S.C. 3601-3610.

2. In § 701.21, paragraph (h) is revised to read as follows:

§ 701.21 Loans to members and lines of credit to members.

* * * * *

(h) *Member business loans*—(1) *Definitions.* (i) *Member business loans* mean any loan, line of credit, or letter of credit, the proceeds of which will be used for a commercial, corporate, business, investment property or

venture, or agricultural purpose, except that the following shall not be considered member business loans for the purposes of this section:

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

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

(C) A loan meeting the general definition of *member business loans* under this paragraph (h)(1)(i), and, made to a borrower or an associated member (as defined in paragraph (h)(1)(iii) of this section), which, when added to other such loans to the borrower or associated member, is less than $25,000.

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

(E) A loan granted by a corporate credit union operating under the provisions of part 704 of this chapter, to another credit union.

(ii) *Reserves* mean all reserves, including the Allowance for Loan Losses and undivided earnings or surplus.

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

(iv) *Immediate Family Member* means a spouse or other family member living in the same household.

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

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

(2) *Requirements.* Member business loans, as defined in § 701.21(h)(1)(i), may be made by federal credit unions only in accordance with the applicable provisions of § 701.21 (a) through (g), to the extent that they are not inconsistent with this section, and the following additional requirements:

(i) *Written loan policies.* The board of directors must adopt specific business loan policies and review them at least annually. The policies shall, at a minimum, address the following:

(A) Types of business loans that will be made;

(B) The credit union's trade area for business loans;

(C) Maximum amount of credit union assets, in relation to reserves, that will be invested in business loans;

(D) Maximum amount of credit union assets, in relation to reserves, that will be invested in a given category or type of business loan;

(E) Maximum amount of credit union assets, in relation to reserves, that will be loaned to any one member or group of associated members, subject to § 701.21(h)(2)(iii)(A);

(F) Qualifications and experience of personnel involved in making and administering business loans with a minimum of 2 years direct experience with this type of lending;

(G) Analysis of the ability of the borrower to repay the loan;

(H) Documentation supporting each request for an extension of credit or an increase in an existing loan or line of credit shall (except where the board of directors finds that such documentation requirements are not generally available for a particular type of business loan and states the reasons for those findings in the credit union's written policies) include the following: balance sheet, cash flow analysis, income statement, tax data; leveraging; comparison with industry averages; receipt and periodic updating of financial statements and other documentation; including tax returns;

(I) Collateral requirements, including loan-to-value ratios; appraisal, title search and insurance requirements; steps to be taken to secure various types of collateral; and how often the value and marketability of collateral is reevaluated;

(J) Appropriate interest rates and maturities of business loans;

(K) Loan monitoring, servicing and follow-up procedures, including collection procedures;

(L) Provision for periodic disclosure to the credit union's members of the number and aggregate dollar amount of member business loans;

(M) Identification, by position, of those senior management employees prohibited by paragraph (h)(3) of this section from receiving member business loans.

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

(A) Loans shall be granted on a fully secured basis by collateral as follows:

(*1*) Second lien for LTV ratios of up to 70 percent;

(*2*) First lien for LTV ratios of up to 80 percent;

(*3*) First lien with an LTV ratio in excess of 80 percent shall be granted only where the value in excess of 80 percent is covered through acquisition of private mortgage, or equivalent type, insurance provided by an insurer acceptable to the credit union or insurance or guarantees by or subject to advance commitment to purchase by, an agency of the federal government or of a state or any of its political subdivisions, and in no event shall the LTV ratio exceed 95 percent;

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

(C) Federally insured, state-chartered credit unions are exempt from the provisions of § 701.21(h)(2)(ii)(A) with respect to credit card line of credit programs offered to nonnatural person members which are limited to routine purposes normally made available under such programs.

(iii) *Loan limits.*—(A) *Loans to one borrower.* Unless a greater amount is approved by the NCUA regional director, the aggregate amount of outstanding member business loans to any one member or group of associated members shall not exceed 15% of the credit union's reserves (less the Allowance for Loan Losses account), or $75,000, whichever is higher. If any portion of a member business loan is secured by shares in the credit union, or deposits in another financial institution, or fully or partially insured or guaranteed by, or subject to an advance commitment to purchase by, any agency of the federal government or of a state or any of its political subdivisions, such portion shall not be calculated in determining the 15% limit.

(B) *Exceptions.* Credit unions seeking an exception from the limits of § 701.21(h)(2)(iii)(A) or § 701.21(h)(3) must present the regional director with, at a minimum: the higher limit sought; an explanation of the need by the members to raise the limit and ability of the credit union to manage this activity; an analysis of the credit union's prior experience making member business loans; and a copy of its business lending policy. The analysis of credit union experience in making member business loans shall document the history of loan losses, loan delinquency, volume and cyclical or seasonal patterns, diversification, concentrations of credit to one borrower or group of associated borrowers in excess of 15 percent of reserves (less the Allowance for Loan

Losses account), underwriting standards and practices, types of loans grouped by purpose and collateral and qualifications of personnel responsible for underwriting and administering member business loans. Regional directors shall consider, in addition to the information submitted by the credit union, the historical CAMEL ratings. If the credit union does not receive notification of the action taken within 30 calendar days of the date the request was received by the regional office, the credit union may assume approval of the request to exceed the limit.

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

(D) *Monitoring requirement.* Credit unions with member business loans in excess of 100 percent of reserves (less the Allowance for Loan Losses account) shall submit the following information regarding member business loans to their respective regional director on a quarterly basis: the aggregate total of loans outstanding; the amount of loans delinquent in excess of 30 days; the balance of the allowance for member business loan losses; the aggregate total of all concentrations of credit to one borrower or group of associated borrowers in excess of 15 percent of reserves (less the Allowance for Loan Losses account); the total number and amount of all construction, development or speculative loans; and any other information pertinent to the safe and sound condition of the member business loan portfolio.

(iv) *Allowance for loan losses.* (A) The determination whether a member business loan will be classified as substandard, doubtful, or loss, for purposes of the valuation allowance for loan losses, will rely on factors not limited to the delinquency of the loan. Nondelinquent loans may be classified, depending on an evaluation of factors, including, but not limited to, the adequacy of analysis and documentation. The criteria for determining the classification of loans is contained in the appendix to § 701.21(h)—Classifications.

(B) Loans classified shall be reserved as follows:

(1) Loss loans at 100% of outstanding amount;

(2) Doubtful loans at 50% of outstanding amounts; and

(3) Substandard loans at 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.

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

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

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

(iii) Funds for such projects shall be released following on-site inspections by independent, qualified personnel in accordance with a preapproved draw schedule.

(4) *Prohibitions.*—(i) *Senior management employees.* A federal credit union may not make member business loans to the following:

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

(B) The credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager);

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

(D) The chief financial officer (Comptroller);

(E) Any associated member or immediate family member of the senior management employees listed in paragraphs (h)(4)(i) (A) through (D) of this section.

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

(5) *Recordkeeping.* All loans, lines of credit, or letters of credit, the proceeds of which will be used for a commercial, corporate, business, investment property or venture, or agricultural purpose, shall be separately identified in the records of the credit union and reported as such in financial and statistical reports required by the National Credit Union Administration.

(6) *Effective date.* Section 701.21(h) is effective January 1, 1992. All member business loans granted on or after that date must be in full compliance with § 701.21(h).

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DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 71

[Airspace Docket No. 90-ANM-15]

Amendment, Aspen Transition Area, Aspen, CO

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final rule.

SUMMARY: This action amends the Aspen, Colorado, 1200 foot Transition Area. The increase in aeronautical operations at Colorado "Ski Country" airports, and the attendant development of Instrument Flight Rules (IFR) procedures, necessitates the establishment of this additional controlled airspace. This change will facilitate further procedure development and provide point-to-point air navigation routings within controlled airspace where none presently exists.

EFFECTIVE DATE: 0901 u.t.c., November 14, 1991.

FOR FURTHER INFORMATION CONTACT: Ted Melland, ANM-536, Federal Aviation Administration, Docket No. 90-ANM-15, 1601 Lind Avenue SW, Renton, WA 98055-4056, Telephone: (206) 227-2536.

SUPPLEMENTARY INFORMATION:

History

On January 29, 1991, the FAA proposed to amend part 71 of the Federal Aviation Regulations (14 CFR part 71) to amend the Transition Area at Aspen, Colorado (56 FR 3231). Interested parties were invited to participate in this rulemaking proceeding by submitting written comments on the proposal to the FAA. No comments objecting to the proposal were received. The proposed coordinates have been changed to (1) exclude the eastern portion of the proposal that is part of the Denver Transition Area, (2) exclude a southwest portion of the proposal which is part of controlled airspace at Grand Junction, Colorado, and (3) include airspace west of the proposal which is currently part of the Meeker, Colorado, Transition Area. These changes to the proposal do not result in an increase in the volume of existing controlled airspace. Accordingly, the rule is adopted as