



DCU BULLETIN

Division of Credit Unions

Washington State Department of Financial Institutions

Phone: (360) 902-8718

FAX: (360) 704-6991

February 23, 2001

No. B-01-05

Division Schedules Hearing on Proposed Rule On Member Business Loans; Comments Invited on Proposed Rule

The Division recently filed a CR-102 form to schedule the hearing on and publish the Division's proposed rule on member business loans (MBL). Enclosed is a copy of the CR-102 and the small business economic impact statement in regard to the rule. The proposed MBL rule will constitute a new chapter in our rules: Chapter 208-460 WAC.

Hearing time and location

The hearing on the proposed MBL rule will be held on March 27, 2001, beginning at 2:00 p.m., at the Department of Financial Institutions, located at 210 11th St. S.W., Room 300, Olympia, WA. Please contact Diane Moyer at the Division, at (360) 902-8791, if you would like a map to the hearing site.

Comments on the proposed MBL rule

Persons wishing to comment on the proposed rule may present their comments at the hearing or submit their comments in writing prior to the close of business on March 27, 2001.

We are particularly interested if you have comments on how the proposed rule could be made less burdensome for small credit unions. We are also interested in

comments in response to the seven questions posed in Executive Order 97-02. The questions are listed in the enclosed CR-102 form.

Please submit your comments to:

Parker Cann
Director of Credit Unions
Division of Credit Unions
PO Box 41200
Olympia, WA 98504-1200

Phone: (360) 902-8778
Fax: (360) 704-6978
E-mail: pcann@dfi.wa.gov

NCUA approval of proposed MBL rule

The proposed rule has been approved by the NCUA Board and will supersede the NCUA's MBL rule (12 C.F.R. Part 723), upon adoption of the final MBL rule by the Division. Enclosed is a summary of the differences between the two rules.



**PROPOSED RULE MAKING
(RCW 34.05.320)**

**CR-102 (7/10/97)
Do NOT use for expedited
adoption**

Agency: Department of Financial Institutions		<input checked="" type="checkbox"/> Original Notice												
<input checked="" type="checkbox"/> Preproposal Statement of Inquiry was filed as WSR 00-16-028 <input type="checkbox"/> Expedited Adoption -- Proposed Rule Making notice was filed as WSR _____; or <input type="checkbox"/> Proposal is exempt under RCW 34.05.310(4).		<input type="checkbox"/> Supplemental Notice to WSR _____ <input type="checkbox"/> Continuance of WSR _____												
(a) Title of rule: (Describe Subject) Member Business Loans Purpose: See attachment A Other identifying information:														
(b) Statutory authority for adoption: RCW 31.12.426(1), RCW 31.12.516(2); RCW 43.320.040		Statute being implemented: Chapter 31.12 RCW												
(c) Summary: The proposed MBL rule: <ul style="list-style-type: none"> • Defines "member business loan" and other relevant terms • Specifies what MBL are prohibited • Specifies requirements for development and construction MBL • Specifies requirements for implementing a MBL program • Requires that MBL be collateralized, with certain exceptions • Limits MBL to one borrower or associated borrowers • Allows for regulatory waiver of certain restrictions, upon application by a credit union • Provides for classification of and reserving for MBL • Limits aggregate MBL, with certain exceptions • Requires certain record keeping in regard to MBL. Reasons supporting proposal: To regulate member business lending by credit unions to protect their safety and soundness.														
<table style="width:100%; border-collapse: collapse;"> <tr> <td style="width:35%;">(d) Name of Agency Personnel Responsible for:</td> <td style="width:35%;">Office Location</td> <td style="width:30%;">Telephone</td> </tr> <tr> <td>1. Drafting.....</td> <td>Parker Cann</td> <td>210 11th St. SW Room 300, Olympia, WA 98504</td> </tr> <tr> <td>2. Implementation....</td> <td>Same</td> <td>Same</td> </tr> <tr> <td>3. Enforcement.....</td> <td>Same</td> <td>Same</td> </tr> </table>			(d) Name of Agency Personnel Responsible for:	Office Location	Telephone	1. Drafting.....	Parker Cann	210 11 th St. SW Room 300, Olympia, WA 98504	2. Implementation....	Same	Same	3. Enforcement.....	Same	Same
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2. Implementation....	Same	Same												
3. Enforcement.....	Same	Same												
(e) Name of proponent (person or organization): Department of Financial Institutions, Division of Credit Unions <div style="float: right;"> <input type="checkbox"/> Private <input type="checkbox"/> Public <input checked="" type="checkbox"/> Governmental </div>														
(f) Agency comments or recommendations, if any, as to statutory language, implementation, enforcement and fiscal matters:														
(g) Is rule necessary because of: <table style="width:100%; border-collapse: collapse;"> <tr> <td style="width:30%;">Federal Law?</td> <td style="width:15%;"><input type="checkbox"/> Yes</td> <td style="width:15%;"><input checked="" type="checkbox"/> No</td> <td style="width:40%;">If yes, ATTACH COPY OF TEXT</td> </tr> <tr> <td>Federal Court Decision?</td> <td><input type="checkbox"/> Yes</td> <td><input checked="" type="checkbox"/> No</td> <td>Citation:</td> </tr> <tr> <td>State Court Decision?</td> <td><input type="checkbox"/> Yes</td> <td><input checked="" type="checkbox"/> No</td> <td></td> </tr> </table>			Federal Law?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	If yes, ATTACH COPY OF TEXT	Federal Court Decision?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	Citation:	State Court Decision?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	
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Federal Court Decision?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No	Citation:											
State Court Decision?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No												
(h) HEARING LOCATION: Department of Financial Institutions 210 11th Street SW Room 300 Olympia, WA 98504 Date: March 27, 2001 Time: 2:00 p.m. Assistance for persons with disabilities: Contact Tina Philippsen by March 9, 2001 TDD (360) 664-8126 or (360) 902-8718		Submit written comments to: Parker Cann Division of Credit Unions PO Box 41200 Olympia, WA 98504-1200 FAX (360) 704-6978 By (date) March 27, 2001 DATE OF INTENDED ADOPTION: May 1, 2001 <div style="background-color: #cccccc; padding: 5px; text-align: center;">CODE REVISER USE ONLY</div>												
NAME (TYPE OR PRINT) John L. Bley														
SIGNATURE														
TITLE Director	DATE													

(j) Short explanation of rule, its purpose, and anticipated effects:

All Washington state-chartered credit unions are federally insured by the National Credit Union Share Insurance Fund (NCUSIF), administered by the National Credit Union Administration (NCUA). RCW 31.12.408. Among other requirements, the NCUA requires all insured credit unions to comply with its MBL rule. 12 C.F.R. Section 741.203; 12 C.F.R. Part 723 (MBL rules.)

The NCUA's MBL rule preempts the application of any less restrictive state laws to federally insured, state credit unions, including DFI's former MBL rule, Chapter 208-464 WAC. Consequently, the DFI repealed Chapter 208-464 WAC. WSR 99-03-009. To a large degree, the prior Washington MBL rule mirrored the NCUA's MBL rule.

However, a state's MBL rule may, upon a determination by the NCUA Board, supersede the NCUA's MBL rule. Although in the past the NCUA would not reach such a determination unless the state MBL rules were virtually identical to the NCUA's, the NCUA has relaxed its standards for approval. 12 C.F.R. Section 741.203(a).

The DFI submitted the proposed MBL rule to the NCUA Board for approval and the rule was approved by the NCUA Board at its January 18, 2001 meeting. The proposed MBL rule is more flexible and less restrictive than the NCUA's MBL rule. A more flexible rule will allow credit unions to better serve the MBL needs of their members.

For a short summary or explanation of the rule, see (c) above. For a brief explanation of the purpose of the rule and reasons supporting the proposal, see (c) above.

Does proposal change existing YES NO If yes, describe changes:

(k) Has a small business economic impact statement been prepared under chapter 19.85 RCW?

- Yes. Attach copy of small business economic impact statement.
A copy of the statement may be obtained by writing to:

Parker Cann
Division of Credit Unions
PO Box 41200
Olympia, WA 98504-1200

telephoning: (360) 902-8718

faxing: (360) 704-6978

- No. Explain why no statement was prepared

(l) Does section 201, chapter 403, Laws of 1995, apply to this rule adoption? Yes No
Please explain: *DFI is not a listed agency in section 201.*

CR 102 - Proposed Rule Making

Attachment A:

1. Adopt a new rule on member business loans (MBL) made by Washington State-chartered credit unions.

2. Review the proposed rule under the criteria described in Executive Order 97-02:

A. Need. Is the rule necessary to comply with the statutes that authorize it? Is the rule obsolete, duplicative, or ambiguous to a degree that warrants repeal or revision? Have laws or other circumstances changed so that the rule should be amended or repealed? Is the rule necessary to protect or safeguard the health, welfare, or safety of Washington's citizens?

B. Effectiveness and Efficiency. Is the rule providing the results that it was originally designed to achieve in a reasonable manner? Are there regulatory alternatives or new technologies that could more effectively or efficiently achieve the same objectives?

C. Clarity. Is the rule written and organized in a clear and concise manner so that it can be readily understood by those to whom it applies?

D. Intent and Statutory Authority. Is the rule consistent with the legislative intent of the statutes that authorize it? Is the rule based upon sufficient statutory authority? Is there a need to develop a more specific legislative authorization in order to protect the health, safety, and welfare of Washington's citizens?

E. Coordination. Could additional consultation and coordination with other governmental jurisdictions and state agencies with similar regulatory authority eliminate or reduce duplication and inconsistency?

F. Cost. Have qualitative and quantitative benefits of the rule been considered in relation to its cost?

G. Fairness. Does the rule result in equitable treatment of those required to comply with it? Should it be modified to eliminate or minimize any disproportionate impacts on the regulated community? Should it be strengthened to provide additional protection?

The agency is interested in your comments on the proposed rule in light of these criteria.

Chapter 208-460 WAC

MEMBER BUSINESS LOANS

NEW SECTION

WAC 208-460-010 What is a member business loan? (1) **Definition of MBL.** "Member business loan" or "MBL" includes any loan, line of credit, letter of credit, or any unfunded commitment to make a loan, where the borrower intends to use the proceeds for any of the following purposes:

- (a) Commercial;
- (b) Corporate;
- (c) Investment property;
- (d) Business venture; or
- (e) Agricultural.

(2) **Exemptions.** The following are not member business loans:

(a) A business purpose loan fully secured by a lien on a one to four family dwelling that is the member's primary residence;

(b) A business purpose loan fully secured by shares or deposits in the credit union making the extension of credit or in other credit unions, or by deposits in other financial institutions;

(c) One or more business purpose loans to a member or any associated member which in the aggregate do not exceed the amount of 49,999 dollars. The entire amount of such a loan that exceeds this figure, or that causes the aggregate to exceed this figure, is a MBL;

(d) A business purpose loan where a federal or state agency (or any political subdivision of a state) fully insures repayment, or fully guarantees repayment, or provides an advance commitment to purchase in full; or

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

(3) **Other definitions.** Certain other terms used in this chapter are defined in WAC 208-460-170.

NEW SECTION

WAC 208-460-020 What member business loans are prohibited? (1) **Who is ineligible to receive a member business loan?** You may not grant a member business loan to the following:

(a) Your chief executive officer (typically this individual holds the title of president or treasurer/manager);

(b) Any assistant chief executive officers (e.g., assistant president, vice-president, or assistant treasurer/manager);

(c) Your chief financial officer (comptroller); or

(d) Any associated member or immediate family member of anyone listed in (a) through (c) of this subsection.

(2) **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.

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

NEW SECTION

WAC 208-460-030 What are the requirements for MBL development and construction lending? Unless the director grants a waiver, a credit union that makes MBL development or construction loans is subject to the following requirements:

(1) The aggregate of all such loans may not exceed fifteen percent of net worth. To determine the aggregate, you may exclude any portion of a loan that is:

(a) Secured by shares or deposits in the credit union making the extension of credit or in other credit unions, and by deposits in other financial institutions; or

(b) Insured or guaranteed, or subject to an advance commitment to purchase, by any federal or state agency (or any political subdivision of a state);

(2) The borrower on such loans must have a minimum of:

(a) Thirty percent equity interest in the project being financed if the loan is for land development; and

(b) Twenty-five percent equity interest in the project being financed if the loan is for construction or for a combination of development and construction;

(3) The funds for such loans may be released only after on-site inspections, documented in writing, by qualified personnel and according to a preapproved draw schedule and any other conditions as set forth in the loan documentation; and

(4) The credit union may not make such loans unless it utilizes the services of an individual with at least five years direct experience in development and construction lending.

NEW SECTION

WAC 208-460-040 How do you implement a member business loan program? The board of directors must adopt specific member business loan policies and review them at least annually. The credit union must 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, except as required by WAC 208-460-030(4).

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.

NEW SECTION

WAC 208-460-050 What must your member business loan policy address?

At a minimum, your member business loan policy must address the following:

- (1) The types of MBL you will make;
- (2) Your trade area;
- (3) The maximum amount of your assets, in relation to net worth, that you will invest in MBL;
- (4) The maximum amount of your assets, in relation to net worth, that you will invest in a given type of MBL;
- (5) The maximum amount of your assets, in relation to net worth, that you will loan to a member or associated members, subject to WAC 208-460-070;
- (6) The qualifications and experience of personnel (minimum of two years) involved in making and administering the loans;
- (7) A requirement for analysis and documentation of the ability of the borrower to repay the loan;
- (8) Receipt and periodic updating of financial statements and other documentation, including tax returns;
- (9) Documentation sufficient to support each request to extend credit, or increase an existing loan or line of credit, except where the board of directors finds that the required documentation is not generally available for a particular type of loan and states the reasons for those findings in the credit union's written policy. At a minimum, the documentation must include the following:
 - (a) Balance sheet;
 - (b) Cash flow analysis;
 - (c) Income statement;
 - (d) Tax data;
 - (e) Analysis of leveraging; and
 - (f) Comparison with industry average or similar analysis;
- (10) Collateral requirements, including:
 - (a) Loan-to-value ratios;
 - (b) Determination of value;
 - (c) Determination of ownership;
 - (d) Steps to secure various types of collateral; and
 - (e) How often the credit union will reevaluate the value and marketability of collateral;
- (11) The interest rates and maturities of the loans;
- (12) General MBL procedures which include:
 - (a) Loan monitoring;
 - (b) Servicing and follow-up; and
 - (c) Collection;
- (13) Identification of those individuals prohibited from receiving member business loans; and
- (14) Guidelines for purchase and sale of member business loans and loan participations, if the credit union engages in that activity.

The division recognizes that all of the provisions of the policy may not apply to every MBL.

NEW SECTION

WAC 208-460-060 What are the collateral and security requirements?

Unless the director grants a waiver:

(1) All member business loans must be secured by collateral in accordance with this section, except the following:

(a) A credit card line of credit granted to nonnatural persons that is limited to routine purposes normally made available under such lines of credit; and

(b) A loan made by a credit union where the loan and the credit union meet each of the following criteria:

(i) The amount of the loan does not exceed one hundred thousand dollars;

(ii) The aggregate of unsecured MBL under (b) of this subsection does not exceed ten percent of the credit union's net worth;

(iii) The credit union has a net worth of at least seven percent; and

(iv) The credit union submits reports to the division of credit unions with its NCUA 5300 reports, providing figures and other detail as may be requested by the director to demonstrate compliance with (b) of this subsection.

(2) In the case of a member business loan secured by collateral on which the credit union will have a first lien, you may grant the loan with a LTV ratio in excess of eighty percent only where the value in excess of eighty percent is:

(a) Covered through acquisition of private mortgage or equivalent type insurance provided by an insurer acceptable to the credit union; or

(b) Insured or guaranteed, or subject to advance commitment to purchase, by any federal or state agency (or any political subdivision of a state);

In no case may the LTV ratio exceed ninety-five percent;

(3) In the case of a member business loan secured by collateral on which the credit union will have a second or lesser priority lien, you may not grant the loan with a LTV ratio in excess of eighty percent; and

(4) In the case of member business loans secured by the same collateral:

(a) On which the credit union will have a first lien as well as other lesser priority liens, you may grant the loans with a LTV ratio in excess of eighty percent only if subsection (2)(a) or (b) of this section is satisfied. In no case may the LTV ratio exceed ninety-five percent; and

(b) On which the credit union will have lesser priority liens but no first lien, you may not grant the loans with a LTV ratio in excess of eighty percent.

NEW SECTION

WAC 208-460-070 How much may a member or associated members borrow?

Unless the director grants a waiver for a higher amount, the aggregate amount of member business loans to a member or associated members may not exceed the greater of:

- (1) Fifteen percent of the credit union's net worth; or
- (2) One hundred thousand dollars.

NEW SECTION

WAC 208-460-080 How do you calculate the aggregate fifteen percent limit? (1) Step 1. Calculate the numerator by adding together the amount of the member business loans to the member and associated members (if any). From this amount, subtract any portion:

(a) Secured by shares or deposits in the credit union making the extension of credit or in other credit unions, or by deposits in other financial institutions; or

(b) Insured or guaranteed, or subject to an advance commitment to purchase, by any federal or state agency (or any political subdivision of a state).

- (2) Step 2. Divide the numerator by net worth.

NEW SECTION

WAC 208-460-090 What waivers are available? You may seek a waiver for a type of member business loan in the following areas:

- (1) Development and construction loan requirements under WAC 208-460-030;
- (2) Loan-to-value ratios under WAC 208-460-060;
- (3) Maximum loan amount to a member or associated members under WAC 208-460-070; and
- (4) Appraisal requirements under Section 722.3 of NCUA rules.

NEW SECTION

WAC 208-460-100 How do you obtain a waiver? (1) To obtain a waiver under WAC 208-460-090, a credit union must submit its request to the director. The waiver request must contain the following:

- (a) A copy of your member business loan 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:
 - (i) The history of loan losses and loan delinquency;
 - (ii) Volume and cyclical or seasonal patterns;
 - (iii) Diversification;
 - (iv) Concentrations of credit to a member and associated members in excess of fifteen percent of net worth;
 - (v) Underwriting standards and practices;
 - (vi) Types of loans grouped by purpose and collateral; and

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

(2) The director will:

(a) Review the information you provided in your request;

(b) Evaluate the level of risk to your credit union;

(c) Consider your credit union's historical CAMEL composite and component ratings;

(d) Notify you whenever your waiver request is deemed complete; and

(e) Notify you of the action taken within forty-five calendar days of receiving a complete request.

(3) In connection with a waiver request under WAC 208-460-090 (1) through (3):

(a) The director will provide a copy of the waiver request to Region VI of the NCUA and will consult and seek to work cooperatively with Region VI in making his or her decision on the request;

(b) The waiver is not effective until the director approves it;

(c) If you do not receive notification within forty-five calendar days after the date the complete request was received by the director, the waiver request is deemed approved by the director; and

(d) The director will promptly notify Region VI of the NCUA of his or her decision on the request.

(4) In connection with a waiver request under WAC 208-460-090(4):

(a) If the director approves the request, the director will promptly forward the request to Region VI of the NCUA for decision under NCUA rules at 12 C.F.R. 723.12;

(b) The waiver is not effective until the regional director of the NCUA approves it in accordance with NCUA rules at 12 C.F.R. 723.12; and

(c) The credit union may appeal the regional director's decision in accordance with NCUA rules at 12 C.F.R. 723.13.

NEW SECTION

WAC 208-460-110 How do I classify member business loans so as to reserve for potential losses? Nondelinquent 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:

(1) **Substandard.** A substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. The loan must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. It is characterized by the distinct possibility that the credit union will sustain some loss if the deficiency is not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans classified substandard;

(2) **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; and

(3) **Loss.** A loan classified loss is considered uncollectible and of such little value that its continuance as a loan 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.

NEW SECTION

WAC 208-460-120 How much must I reserve for potential losses? The following schedule sets the minimum amount you must reserve for classified member business loans:

Classification	Amount Required
Substandard	10% of outstanding balance 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 balance.
Loss	100% of the outstanding balance.

NEW SECTION

WAC 208-460-130 What is the aggregate member business loan limit? The aggregate limit on the amount of a credit union's member business loans is the lesser of:

- (1) One and three quarters times the credit union's net worth; or
- (2) Twelve and one quarter percent of the credit union's total assets.

NEW SECTION

WAC 208-460-140 Are there any exceptions to the aggregate MBL limit?
(1) Credit unions that meet any one of the following four criteria qualify for an exception from the aggregate member business loan limit in WAC 208-460-130:

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

(c) Credit unions that are chartered for the purpose of making member business loans, as supported by documentary evidence, such as the credit union's charter, bylaws, business plan, field of membership, board minutes and loan portfolio; and

(d) Credit unions that have a recent history of primarily making member business loans, established by the fact that the outstanding balance of member business loans comprises:

(i) At least twenty-five percent of the outstanding balance of the credit union's loans; or

(ii) The largest portion of the outstanding balance of the credit union's loans.

Such facts must be evidenced in an NCUA call report or any equivalent documentation, such as financial statements, for a period within two years before the date of application. For example, a credit union qualifies for the exception under (d)(ii) of this subsection if, based on the outstanding balance of a credit union's loans, the credit union's loan portfolio is comprised of twenty-three percent member business loans, twenty-two percent first mortgage loans, twenty-two percent new automobile loans, twenty percent credit card loans, and thirteen percent total other real estate loans.

(2) Unless the director gives his or her prior consent, a credit union granted an exception from the aggregate MBL limit may not make MBL in excess of the greater of:

(a) Twelve and one quarter percent of the credit union's total assets;
or

(b) Three times the credit union's net worth.

NEW SECTION

WAC 208-460-150 How do I obtain an exception? (1) The exception under WAC 208-460-140 (1)(a) and (b) is effective upon written notice to the director of such designation or participation.

(2) To obtain an exception under WAC 208-460-140 (1)(c) or (d), a credit union must submit its request to the director. An exception is not effective until it is approved by the director. The exception request must include documentation demonstrating that the credit union meets the criteria for one of the exceptions. The exception does not expire unless revoked for safety and soundness reasons by the director.

(3) The director will promptly notify Region VI of the NCUA of his or her decision on the request.

NEW SECTION

WAC 208-460-160 What are the recordkeeping requirements? You must separately identify member business loans in your records and in the aggregate on your financial reports.

NEW SECTION

WAC 208-460-170 Definitions. For purposes of this chapter, the following definitions apply:

- (1) The "amount" of a MBL includes:
 - (a) Any unfunded commitment to make the loan;
 - (b) The outstanding balance of the loan; and
 - (c) Any undisbursed proceeds of the loan.
- (2) A person is "associated" with another if they have a shared ownership, investment, or other pecuniary interest in a business or commercial endeavor.
- (3) A "business purpose" loan means a loan where the borrower intends to use the proceeds for any of the purposes listed in WAC 208-460-010(1).
- (4) "Development or construction loan" is a financing arrangement for acquiring real property or rights to real property, including land or structures, with the intent to develop or improve it for:
 - (a) Residential housing for sale;
 - (b) Income property;
 - (c) Commercial use;
 - (d) Industrial use; or
 - (e) Similar uses.
- (3) "Immediate family member" is a spouse or other family member living in the same household.
- (4) "Loan-to-value ratio" or "LTV ratio" is derived by dividing:
 - (a) The amount of all member business loans by the credit union and loans by other lenders secured by an item of collateral, by
 - (b) The market value of the item of collateral.
- (5) "Member business loan" or "MBL" is defined in WAC 208-460-010.
- (6) "NCUA" means the National Credit Union Administration.
- (7) "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. Net worth does not include the allowance for loan and lease losses.

SMALL BUSINESS ECONOMIC IMPACT STATEMENT (“SBEIS”)

Member Business Loan Rule: Chapter 208-460 RCW

Subject: Rule proposed by the Division of Credit Unions (“Division”) of the Washington State Department of Financial Institutions (DFI) to add a new Chapter 208-460 to the Washington Administrative Code (WAC). Chapter 208-460 WAC is entitled “Member Business Loans.”

By: Parker Cann, Director of Credit Unions

Date: February 15, 2001

Introduction

The Division has prepared this SBEIS in compliance with Chapter 19.85 of the Revised Code of Washington (RCW), the Regulatory Fairness Act (RFA). The Preproposal Statement of Inquiry (form CR-101) in connection with the proposed rule was filed at WSR 00-16-028.

Background For Proposed Rule

All Washington state-chartered credit unions are federally insured by the National Credit Union Share Insurance Fund (NCUSIF), administered by the National Credit Union Administration (NCUA). RCW 31.12.408. Among other requirements, the NCUA requires all insured credit unions to comply with its MBL rule. 12 C.F.R. Section 741.203; 12 C.F.R. Part 723 (MBL rules.)

The NCUA's MBL rule preempts the application of any less restrictive state laws to federally insured, state credit unions, including DFI's former MBL rule, Chapter 208-464 WAC. Consequently, the DFI repealed Chapter 208-464 WAC. WSR 99-03-009. To a large degree, the prior Washington MBL rule mirrored the NCUA's MBL rule.

However, a state's MBL rule may, upon a determination by the NCUA Board, supersede the NCUA's MBL rule. Although in the past the NCUA would not reach such a determination unless the state MBL rules were virtually identical to the NCUA's, the NCUA has relaxed its standards for approval. 12 C.F.R. Section 741.203(a).

The DFI submitted the proposed MBL rule to the NCUA Board for approval and the rule was approved by the NCUA Board at its January 18, 2001 meeting. The proposed MBL rule is more flexible and less restrictive than the NCUA's MBL rule. A more flexible rule will allow credit unions to better serve the MBL needs of their members.

Description Of Proposed Rule

The proposed MBL rule:

- Defines “member business loan” and other relevant terms
- Specifies what MBL are prohibited
- Specifies requirements for development and construction MBL

- Specifies requirements for implementing a MBL program
- Requires that MBL be collateralized, with certain exceptions
- Limits MBL to one borrower or associated borrowers
- Allows for regulatory waiver of certain restrictions, upon application by a credit union
- Provides for classification of and reserving for MBL
- Limits aggregate MBL, with certain exceptions
- Requires certain records in regard to MBL.

REQUIRED ELEMENTS OF SBEIS

The elements of the SBEIS required by the RFA are set forth below.

ELEMENT 1. A brief description of the reporting, recordkeeping, and other compliance requirements of the proposed rule and the kinds of professional services that a small business is likely to need in order to comply with the requirements.

RESPONSE:

See “Description of Proposed Rules” above for a brief description of the requirements of the proposed rule. As noted above, the rule is overall more flexible and less restrictive than the NCUA’s MBL rule. Consequently, the rule does not add new compliance requirements that need to be addressed.

ELEMENT 2. An analysis of the costs of compliance for identified industries, including costs of equipment, supplies, labor and increased administrative costs.

RESPONSE:

As noted above, the rule is overall more flexible and less restrictive than the NCUA’s MBL rule. Consequently, the rule does not add new compliance requirements that need to be addressed.

Moreover, it is difficult to assess the costs of compliance for several reasons:

- Many credit unions may not wish to make MBL. They would therefore not incur costs for compliance with the proposed rule.
- For those credit unions that currently have a MBL program, the rule does not add new compliance requirements. For those credit unions that wish to implement a MBL program, the cost of compliance will vary extensively depending on the exact nature and extent of the MBL program.

Because of this uncertainty, we have assumed that the cost of compliance would be more than minor.

ELEMENT 3. Whether compliance with the proposed rule will cause business to lose sales or revenue.

RESPONSE: Relative to the existing NCUA rule on MBL, the proposed rule will be more flexible and less restrictive, enabling credit unions to better serve their members’ MBL needs. It is unlikely

that credit unions would lose sales or revenue because of the proposed rule, as compared to the NCUA's existing MBL rule that they are subject to.

ELEMENT 4. A comparison of the compliance costs for the small business segment and large business segment of the affected industry(ies), and whether the impact on the small business segment is disproportionate.

RESPONSE: Because the cost of compliance, as uncertain as it may be, would probably be the same in regard to a given MBL program, whether the credit union is large or small, we have assumed that the cost of compliance for the small business segment of credit unions would be higher per unit, whether the unit is an employee, hour of labor to comply, or one hundred dollars of sales. Consequently, the cost to small credit unions may be considered disproportionate.

ELEMENT 5. Steps taken by the agency under RCW 19.85.030(3) to reduce the costs of the proposed rule on small businesses, or reasonable justification for not doing so, addressing the specified mitigation steps.

RESPONSE: We have reviewed the six steps under RCW 19.85.030(3)(a) through (f). Our analysis is as follows:

(a) Reducing, modifying, or eliminating substantive regulatory requirements

We believe that the proposed rule is necessary to ensure the safety and soundness of credit unions, regardless of size, and that the compliance requirements in this area should not be reduced for small credit unions.

(b) Simplifying, reducing, or eliminating recordkeeping and reporting requirements

We believe that the proposed rule is necessary to ensure the safety and soundness of credit unions, regardless of size, and that the compliance requirements in this area should not be diminished for small credit unions. However, one inherent advantage for small credit unions is that their MBL programs tend to be simpler and more narrow, allowing them to avoid some of the complexities of the rule.

(c) Reducing the frequency of inspections

This step is not applicable, because the proposed rule does not provide for inspections.

(d) Delaying compliance timetables

Considering that the proposed rule actually relaxes existing restrictions, we do not feel it is appropriate to delay compliance.

(e) Reducing or modifying fine schedules for noncompliance

This step is not applicable, because the Division does not have fining authority.

(f) Any other mitigation techniques.

We are not aware of other mitigation techniques. However, we have encouraged comments from small credit unions on how to make the proposed rule less onerous for them and we will consider comments received. To date we have not received any such comments.

Consequently, as discussed above, we do not believe that it is legal or feasible to reduce the costs of the proposed rule on small businesses, beyond what the rule already provides.

ELEMENT 6. A description of how the agency will involve small business in the development of the proposed rule.

RESPONSE: All credit unions, including smaller credit unions, will be provided with a copy of the proposed rule and an opportunity to provide comment on the proposal. Credit unions are encouraged to contact the Division to comment on the rule. Small credit unions in particular are encouraged to provide comments on how the rule could be made less onerous for them.

ELEMENT 7. A list of the industry (ies) affected by the proposed rule.

RESPONSE: The industry affected by the proposed rule is state credit unions, Standard Industrial Classification 6062.

Summary of Major Differences
Between Washington's Proposed MBL Rule
and
NCUA's MBL Rule

To: Washington Credit Unions
From: Parker Cann, Director of Credit Unions
Date: February 22, 2001

1. Definition of MBL clarified

Section 208-460-010(1)

One of the key components of an MBL has been slightly changed here - from how the borrower "uses" the proceeds for specified purposes to how the borrower "intends to use" the proceeds for such purposes. I expect that this more closely reflects reality - that most credit unions actually look at what the borrower says he/she/it intends to do with the proceeds rather than monitoring the use of proceeds to determine after the fact whether they were actually used for business purposes.

2. Exemption from MBL definition clarified

Section 208-460-010(2)

The exemptions here should apply only to loans for commercial, corporate, etc. purposes (what the rule refers to as "business purpose" loans). Otherwise the loans would not need an exemption. Wording has been added to (2) to clarify this issue. "Business purpose" is defined in the definitional section at the end.

In addition, the changes make it clearer that a credit union must aggregate all business purpose loans to member A with any individual business purpose loans to other members who are associated with member A in order to determine if the business purpose loans exceed the \$49,999 threshold.

In some places, the NCUA MBL rule refers to the "outstanding balance" of an MBL and in some places it refers to the "outstanding balance including unfunded commitments." In order to clarify this issue, the rule identifies the outstanding balance and unfunded commitments as the "amount" of an MBL, to distinguish it from the "outstanding balance" of an MBL. A definition has been added in the

definitional section for the “amount” of an MBL. In the context of this section - exemptions from the definition of MBL – it is appropriate to use the “amount” concept, and the changes so provide.

The sentence added at the end of paragraph (2)(c) incorporates an NCUA interpretation.

3. Restrictions on MBL to directors expanded

Section 208-460-020(3)

It is more appropriate for these requirements to apply to MBL to all directors, not just MBL to compensated directors, and the changes reflect this. Consequently, the Washington rule is more restrictive in this respect than the NCUA rule.

4. Regulatory decision-maker on waivers changed

Section 208-460-030(1)

DFI’s Director is named in the rule as the decision-making regulator on MBL waivers, instead of NCUA’s Regional Director. (As you know, the DFI Director has delegated such authority to the Director of Credit Unions.) The one exception here is on waivers of the NCUA’s appraisal requirements in 722.3 – the decision-maker remains NCUA’s Regional Director. Consequently, except for an appraisal waiver request, all requests will be approved/disapproved by the Director of Credit Unions after consulting with NCUA’s Region VI on the request. See also 208-460-100.

5. Required equity on development/construction loans decreased; required experience increased

Section 208-460-030(2), (4)

The rule reduces the minimum required equity from 35% to 30% for land development loans and from 35% to 25% for construction or combination development/construction loans.

As an offset to these changes, the rule increases the experience requirement from 2 to 5 years of direct experience with development/construction lending, for credit unions that do this type of lending. Consequently, the Washington rule is more restrictive in this respect than the NCUA rule.

6. Requirement for individual with direct experience on MBL clarified

Section 208-460-040

The rule has been changed to reflect that the MBL-experienced person is working for the credit union, not necessarily the Board of Directors.

The exception added at the end of the second sentence refers to the requirement in the prior section that if the credit union does development and construction lending, it must utilize a person with more than 5 years direct experience in this type of lending.

7. Reference to “category or type” of MBL clarified

Section 208-460-050

In some places the NCUA rule uses “category or type” and in some places it uses one word, either “category” or “type.” To avoid confusion, the rule uses “type” in these situations throughout the rule.

8. Requirement for MBL policies clarified

Section 208-460-050(14)

This subsection was added to require credit unions to adopt policies on MBL participations if they engage in that activity. In addition, a sentence was added at the end of the section as a regulatory recognition that every provision of the policy may not apply to every MBL.

9. New type of unsecured MBL allowed

Section 208-460-060(1)

A new exception was added in paragraph (1)(b) to allow unsecured loans which individually do not exceed \$100,000 and which in the aggregate do not exceed 10% of net worth. The credit union cannot make such loans if its net worth is below 7%. Credit unions making this type of MBL must file additional reports with their 5300s concerning this type of lending.

The first exception in paragraph (1)(a) is merely a restatement of the existing exception in subsection (c) of the NCUA rule for credit card LOCs.

10. Minimum LTV ratios clarified

Section 208-460-060(2), (3), (4)

The NCUA rule uses a matrix to set forth loan-to-value requirements. I felt that the matrix was confusing and have restated the LTV requirements of the matrix in the narrative in subsections (2), (3) and (4). I did not intend to change the effect of these LTV requirements – only to restate them in more understandable form.

Subsection (2) deals with a first lien only situation; (3) deals with a second (or lesser) priority lien only situation; (4) deals with multiple priority liens on the same collateral.

11. Personal guarantee requirement eliminated

Section 208-460-060

The personal guarantee requirement has been deleted in its entirety.

12. The term “associated members” clarified

Section 208-460-070

Use of the term “group of associated members” was somewhat confusing in the NCUA’s MBL rule. It appears that the purpose of the NCUA provision is to apply the MBL-to-one-borrower limit to the aggregate of a member’s MBL and any MBL to individuals who are associated with the member. I believe it is clearer to refer to MBL to “associated members” rather than MBL to a “group of associated members” in this respect and the rule has been so changed. The latter wording implies that only MBL to the group or entity of associated members would be aggregated with the member’s MBL.

13. Aggregate state MBL limit added

Section 208-460-140(2)

Wording was added to establish a state MBL limit - 3 times net worth - for those credit unions excepted from CUMAA’s aggregate MBL limits. Such a restriction does not exist in the NCUA’s MBL rule. Consequently, the Washington MBL rule is more restrictive in this respect than the NCUA rule.

14. Aggregate limit exception for LICUs and CDCUs made automatic

Section 208-460-150(1)

The exception for LICUs and Community Development Credit Unions is automatic with notice to DFI’s Director.

15. Definitions added, clarified

Section 208-460-170

New definitions were added to:

- Clarify the “amount” of an MBL
- Define “business purpose”
- Clarify “development or construction loan”
- Clarify “loan-to-value ratio”
- Clarify when one person is “associated” with another