

Handout for Rule-making meeting on May 20, 2016

Compare sections of Chapter 208-460 to 12 CFR 723 (2016).

Section of Existing State Rule – WAC 208-460-040	Section of applicable federal rule (2016) § 723.3	Proposed Amended Section to WAC 208-460-040
<p>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.</p>	<p>§ 723.3 Board of directors and management responsibilities. Prior to engaging in commercial lending, a federally insured credit union must address the following board responsibilities and operational requirements: (a) Board of directors. A federally insured credit union’s board of directors, at a minimum, must: (1) Approve a commercial loan policy that complies with § 723.4 of this part. The board must review its policy on an annual basis, prior to any material change in the federally insured credit union’s commercial lending program or related organizational structure, and in response to any material change in portfolio performance or economic conditions, and update it when warranted. (2) Ensure the federally insured credit union appropriately staffs its commercial lending program in compliance with paragraph (b) of this section. (3) Understand and remain informed, through periodic briefings from responsible staff and other methods, about the nature and level of risk in the federally insured credit union’s commercial loan</p>	<p>WAC 208-460-040 How do you implement a commercial loan program? (a) Prior to engaging in commercial loans, the board of directors must: (1) adopt specific commercial loan policies and review them at least annually as described in WAC 208-460-050. Policies must ensure the commercial loan program is performed in a safe and sound manner by providing for ongoing control, measurement, and management of the commercial loan activities. (2) ensure its appropriate staff for its commercial loan program in compliance with (b). (3) understand and remain informed, through periodic briefings from responsible staff and other methods, about the nature and level of risk in the commercial loan portfolio, including its</p>

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	<p>portfolio, including its potential impact on the federally insured credit union’s earnings and net worth.</p> <p>(b) Required expertise and experience. A federally insured credit union making, purchasing, or holding any commercial loan must internally possess the following experience and competencies:</p> <p>(1) Senior executive officers. A federally insured credit union’s senior executive officers overseeing the commercial lending function must understand the federally insured credit union’s commercial lending activities. At a minimum, senior executive officers must have a comprehensive understanding of the role of commercial lending in the federally insured credit union’s overall business model and establish risk management processes and controls necessary to safely conduct commercial lending.</p> <p>(2) Qualified lending personnel. A federally insured credit union must employ qualified staff with experience in the following areas:</p> <p>(i) Underwriting and processing for the type(s) of commercial lending in which the federally insured credit union is engaged;</p> <p>(ii) Overseeing and evaluating the performance of a commercial loan portfolio, including rating and quantifying</p>	<p>potential impact on its earnings and net worth.</p> <p>(b) A credit union making, purchasing, or holding any commercial loans must internally possess the following experience and competencies:</p> <p>(1) <i>Senior executive officers.</i> A credit union’s senior executive officers overseeing the commercial loan program must understand the credit union’s commercial loan activities. At a minimum, senior executive officers must have a comprehensive understanding of the role of commercial loans in the credit union’s overall business model and establish risk management processes and controls necessary to safely conduct commercial lending.</p> <p>(2) <i>Qualified lending personnel.</i> A credit union must employ qualified staff with experience in the following areas:</p> <p>(i) Underwriting and processing for the type(s) of commercial lending in which the credit union is engaged;</p> <p>(ii) Overseeing and evaluating the performance of a commercial loan portfolio, including rating and quantifying</p>

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	<p>risk through a credit risk rating system; and</p> <p>(iii) Conducting collection and loss mitigation activities for the type(s) of commercial lending in which the federally insured credit union is engaged.</p> <p>(3) Options to meet the required experience.</p> <p>A federally insured credit union may meet the experience requirements in paragraphs (b)(1) and (2) of this section by conducting internal training and development, hiring qualified individuals, or using a third-party, such as an independent contractor or a credit union service organization.</p> <p>However, with respect to the qualified lending personnel requirements in paragraph (b)(2) of this section, use of a third-party is permissible only if the following conditions are met:</p> <p>(i) The third-party has no affiliation or contractual relationship with the borrower or any associated borrowers;</p> <p>(ii) The actual decision to grant a loan must reside with the federally insured credit union;</p> <p>(iii) Qualified federally insured credit union staff exercises ongoing oversight over the third party by regularly evaluating the quality of any work the third party performs for the federally insured credit</p>	<p>risk through a credit risk rating system; and</p> <p>(iii) Conducting collection and loss mitigation activities for the type(s) of commercial loans in which the credit union is engaged.</p> <p>(3) <i>Options to meet the required experience.</i> A credit union may meet the experience requirements in paragraphs (b)(1) and (2) of this section by conducting internal training and development, hiring qualified individuals, or using a third party, such as an independent contractor or a credit union service organization.</p> <p>However, with respect to the qualified lending personnel requirements in paragraph (b)(2) of this section, use of a third-party is permissible only if the following conditions are met:</p> <p>(i) The third-party has no affiliation or contractual relationship with the borrower or any associated borrowers;</p> <p>(ii) The actual decision to grant a loan must reside with the credit union;</p> <p>(iii) Qualified credit union staff exercises ongoing oversight over the third party by</p>

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	union; and (iv) The third-party arrangement must otherwise comply with § 723.7 of this part.	regularly evaluating the quality of any work the third party performs for the credit union; and (iv) The third-party arrangement must otherwise comply with WAC 208-460-xx of this part.

Section of Existing State Rule – WAC 208-460-050	Section of applicable federal rule (2016) § 723.4	Proposed Amended Section to WAC 208-460-050
<p>At a minimum, your member business loan policy must address the following:</p> <ul style="list-style-type: none"> (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 	<p>§ 723.4 Commercial loan policy. Prior to engaging in commercial lending, a federally insured credit union must adopt and implement a comprehensive written commercial loan policy and establish procedures for commercial lending. The board- approved policy must ensure the federally insured credit union’s commercial lending activities are performed in a safe and sound manner by providing for ongoing control, measurement, and management of the federally insured credit union’s commercial lending activities. At a minimum, a federally insured credit union’s commercial loan policy must address each of the following:</p> <ul style="list-style-type: none"> (a) Type(s) of commercial loans permitted. (b) Trade area. 	<p>WAC 208-460-050 What must your commercial loan policy and procedures address? At a minimum, your commercial loan policy must address the following:</p> <ul style="list-style-type: none"> (1) The categories or types of commercial loans you will make, including the maximum amount given in any category or type of commercial loans to any one borrower or group of associated borrowers in compliance with WAC 208-460-070; (2) Your trade area; (3) The maximum amount of your assets, in relation to net worth, allowed in secured, unsecured, and unguaranteed

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<p>documentation of the ability of the borrower to repay the loan;</p> <p>(8) Receipt and periodic updating of financial statements and other documentation, including tax returns;</p> <p>(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:</p> <p>(a) Balance sheet;</p> <p>(b) Cash flow analysis;</p> <p>(c) Income statement;</p> <p>(d) Tax data;</p> <p>(e) Analysis of leveraging; and</p> <p>(f) Comparison with industry average or similar analysis;</p> <p>(10) Collateral requirements, including:</p> <p>(a) Loan-to-value ratios;</p> <p>(b) Determination of value;</p> <p>(c) Determination of ownership;</p> <p>(d) Steps to secure various types of collateral; and</p> <p>(e) How often the credit union will reevaluate the value and marketability of collateral;</p>	<p>(c) Maximum amount of assets, in relation to net worth, allowed in secured, unsecured, and unguaranteed commercial loans and in any given category or type of commercial loan and to any one borrower or group of associated borrowers. The policy must specify that the aggregate dollar amount of commercial loans to any one borrower or group of associated borrowers may not exceed the greater of 15 percent of the federally insured credit union's net worth or \$100,00 plus an additional 10 percent of the credit union's net worth if the amount that exceeds the credit union's 15 percent general limit is fully secured at all times with a perfected security interest by readily marketable collateral as defined in § 723.2 of this part. Any insured or guaranteed portion of a commercial loan made through a program in which a federal or state agency (or its political subdivision) insures repayment, guarantees repayment, or provides an advance commitment to purchase the loan in full, is excluded from this limit.</p> <p>(d) Qualifications and experience requirements for personnel involved in underwriting, processing, approving, administering, and collecting commercial loans.</p> <p>(e) Loan approval processes, including</p>	<p>commercial loans that you will invest in commercial loans;</p> <p>(4) The maximum amount of your assets, in relation to net worth, that you will invest in a given type of commercial loan;</p> <p>(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;</p> <p>(6) The qualifications and experience of personnel involved in underwriting, processing, approving, administering, and collecting the loans;</p> <p>(7) Loan approval processes, including establishing levels of loan approval authority commensurate with the individual's or committee's proficiency in evaluation and underwriting commercial loan risk, when considered in terms of the level of risk the borrowing relationship poses to the credit union.</p>

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<p>(11) The interest rates and maturities of the loans;</p> <p>(12) General MBL procedures which include:</p> <p>(a) Loan monitoring;</p> <p>(b) Servicing and follow-up; and (c) Collection;</p> <p>(13) Identification of those individuals prohibited from receiving member business loans; and</p> <p>(14) Guidelines for purchase and sale of member business loans and loan participations, if the credit union engages in that activity.</p> <p>The division recognizes that all of the provisions of the policy may not apply to every MBL.</p>	<p>establishing levels of loan approval authority commensurate with the individual’s or committee’s proficiency in evaluating and understanding commercial loan risk, when considered in terms of the level of risk the borrowing relationship poses to the federally insured credit union.</p> <p>(f) Underwriting standards commensurate with the size, scope and complexity of the commercial lending activities and borrowing relationships contemplated. The standards must, at a minimum, address the following:</p> <p>(1) The level and depth of financial analysis necessary to evaluate the financial trends and condition of the borrower and the ability of the borrower to meet debt service requirements;</p> <p>(2) Thorough due diligence of the principal(s) to determine whether any related interests of the principal(s) might have a negative impact or place an undue burden on the borrower and related interests with regard to meeting the debt obligations with the credit union;</p> <p>(3) Requirements of a borrower- prepared projection when historic performance does not support projected debt payments. The projection must be supported by reasonable rationale and, at a minimum, must include a projected balance sheet and</p>	<p>(8) The underwriting standards commensurate with the size, scope, and complexity of the commercial loan activities and borrowing relationship contemplated. Policy must provide standards that must, at a minimum, address the following:</p> <p>(i) The level and depth of financial analysis necessary to evaluate the financial trends and condition of the borrower to meet debt service requirements.</p> <p>(ii) Thorough due diligence of the principal(s) to determine whether any related interests of the principal(s) might have a negative impact or place an undue burden on the borrower and related interests with regard to meeting the debt obligations with the credit union;</p> <p>(iii) Requirements of a borrower prepared projection when historic performance does not support projected debt payments. The projection must be supported by reasonable rationale and, at a minimum, must include a projected balance sheet and income and expense statement;</p>

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	<p>income and expense statement;</p> <p>(4) The financial statement quality and the degree of verification sufficient to support an accurate financial analysis and risk assessment;</p> <p>(5) The methods to be used in collateral evaluation, for all types of collateral authorized, including loan-to- value ratio limits. Such methods must be appropriate for the particular type of collateral. The means to secure various types of collateral, and the measures taken for environmental due diligence must also be appropriate for all authorized collateral; and</p> <p>(6) Other appropriate risk assessment including analysis of the impact of current market conditions on the borrower and associated borrowers.</p> <p>(g) Risk management processes commensurate with the size, scope and complexity of the federally insured credit union’s commercial lending activities and borrowing relationships. These processes must, at a minimum, address the following:</p> <p>(1) Use of loan covenants, if appropriate, including frequency of borrower and guarantor financial reporting;</p> <p>(2) Periodic loan review, consistent with loan covenants and sufficient to conduct portfolio risk management. This review must include a periodic reevaluation of the</p>	<p>(iv) The financial statement quality and the degree of verification sufficient to support an accurate financial analysis and risk assessment;</p> <p>(v) The methods to be used in collateral evaluation, for all types of collateral authorized, including loan-to value ratio limits. Such methods must be appropriate for the particular type of collateral. The means to secure various types of collateral, and the measures taken for environmental due diligence must also be appropriate for all authorized collateral; and</p> <p>(vi) Other appropriate risk assessment including analysis of the impact of current market conditions on the borrower and associated borrowers.</p> <p>(9) Risk management processes commensurate with the size, scope and complexity of the credit union’s commercial lending activities and borrowing relationships. Processes must, at a minimum, address the following:</p> <p>(i) Use of loan covenants, if appropriate, including frequency of borrower and guarantor financial reporting;</p>

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	<p>value and marketability of any collateral;</p> <p>(3) A credit risk rating system. Credit risk ratings must be assigned to commercial loans at inception and reviewed as frequently as necessary to satisfy the federally insured credit union’s risk monitoring and reporting policies, and to ensure adequate reserves as required by generally accepted accounting principles (GAAP); and</p> <p>(4) A process to identify, report, and monitor loans approved as exceptions to the credit union’s loan policy.</p>	<p>(ii) Periodic loan review, consistent with loan covenants and sufficient to conduct portfolio risk management. This review must include a periodic reevaluation of the value and marketability of any collateral;</p> <p>(ii) A credit risk rating system. Credit risk ratings must be assigned to commercial loans at inception and reviewed as frequently as necessary to satisfy the federally insured credit union’s risk monitoring and reporting policies, and to ensure adequate reserves as required by generally accepted accounting principles (GAAP); and</p> <p>(iv) A process to identify, report, and monitor loans approved as exceptions to the credit union’s loan policy.</p> <p>(10) Identification of those individuals prohibited from receiving commercial loans at a minimum in compliance with WAC 208-460-020; and</p> <p>(11) Requirements for purchase and sale of commercial s loans and loan participations, if the credit union engages in that activity.</p> <p>(12) Identification of those individuals</p>

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		<p>who are prohibited from receiving commercial loans.</p> <p>The division recognizes that all of the provisions of the policy may not apply to every commercial loan.</p> <p>(13) General commercial loan procedures which include:</p> <ul style="list-style-type: none"> (a) Loan monitoring; (b) Servicing and follow-up; and (c) Collection.