

 Office of Credit Unions Policies and Procedures	POLICY NUMBER
	10345
LENDING	EFFECTIVE DATE
	11/01/2018
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I. PURPOSE

Examiners must evaluate the levels of credit, concentration, and interest rate risk in the business loan portfolio. Management must have appropriate controls in place to monitor and mitigate risk(s) and ensure the level of risk remains acceptable for the credit union. Examiners must ensure the credit union complies with state and federal regulations regarding business lending, loan workouts/modifications, and appraisals. Management and the Board of Directors must understand the risks of business lending. Management and staff must have appropriate experience, expertise and resources to ensure compliance with policy, procedure, and regulation. Risk management systems must be comprehensive and ongoing, and review of business loans must be completed on a regular basis

II. PRIMARY REFERENCES / RELATED REGULATIONS

1. NCUA Rules & Regulations:
 - a. [Section 701.22](#) – Loan Participations
 - b. [Section 722](#) – Appraisals
 - c. [Section 723](#) – Member Business Loans
 - d. [Section 741, Appendix C](#) – Extensions, Workout Loans, and Modifications; Restoring loans to accrual status
2. Accounting Standards Codifications:
 - a. [ASC 310-10](#) – Loan Impairment/Individual Reserves
 - b. ASC 450-2 – Loan Reserve Pool(s)

III. COMMERCIAL LOANS VS BUSINESS LOANS

Type of Loan	MBL	Commercial Loan
Loan fully secured by a 1 to 4 family residential property (member's primary residence)	No	No



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Type of Loan	MBL	Commercial Loan
Business loan fully secured by a 1- to 4-unit family residential property (not a member's primary residence)	Yes, if the aggregate net member business loan balance is equal to or greater than \$50,000	No
Business loan secured by a vehicle manufactured for household use	Yes, if the aggregate net member business loan balance is equal to or greater than \$50,000	No
Business loan secured by a vehicle used in a fleet or to carry fare-paying passengers	Yes, if the aggregate net member business loan balance is equal to or greater than \$50,000	Yes, if the aggregate outstanding balances plus unfunded commitments less any portion secured by shares in the credit union is equal to or greater than \$50,000
Business loan with aggregate net member business loan balance less than \$50,000	No	No
Business loan fully secured by shares in the credit union making the extension of credit or deposits in other financial institutions	No	No
Business loan in which a federal or state agency (or its political subdivision) fully insures repayment, fully guarantees repayment, or provides an advance commitment to	No	Yes, if the aggregate outstanding balances plus unfunded commitments less any portion secured by shares in the credit union is equal to or greater

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Type of Loan	MBL	Commercial Loan
purchase the loan in full		than \$50,000
Non-member business loan or non-member participation interest in a commercial loan made by another lender	No	Yes, if the aggregate outstanding balances plus unfunded commitments less any portion secured by shares in the credit union is equal to or greater than \$50,000

IV. EXEMPTION FOR SMALL CREDIT UNIONS

1. [Part 723](#) of NCUA Rules and Regulations applies to all federally insured credit unions; however, a small credit union that holds a relatively small amount of commercial loans compared to its net worth and infrequently originates and sells commercial loans is exempt from [§723.3](#) and [§723.4](#) of the rule. In order to qualify for the exemption, a credit union must satisfy all of the following conditions as established in [§723.1\(b\)\(1\)](#):
 - a. Less than \$250 million in total assets.
 - b. Aggregate amount of outstanding commercial loan balances and unfunded commitments, plus any outstanding commercial loan balances and unfunded commitments of participations sold, plus any outstanding commercial loan balances and unfunded commitments sold and serviced by the credit union total less than 15 percent of the credit union's net worth. The aggregate amount of outstanding commercial loan balances and unfunded commitments includes any such balances outstanding, including those originated and purchased by the credit union.
 - i. This threshold is measured against all commercial loans in a credit union's portfolio, as well as whole commercial loans or commercial loan participations a credit union has sold but continues to service. For example, a credit union has \$20 million in commercial loans including unfunded commitments. In addition, the credit union has sold \$10 million commercial loan participations, including unfunded commitments, and \$5 million whole commercial loans, including unfunded commitments with servicing retained. In this example, the aggregate amount of commercial loans that need to be

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measured against the 15 percent of net worth threshold would be \$35 million.

2. Amount of commercial loans originated and sold (which the credit union does not continue to service) total less than 15 percent of the credit union’s net worth in a given calendar year. All credit unions must have a board-approved loan policy covering their lending activity in general, including those credit unions that qualify for the exemption. A credit union that meets the criteria outlined above is only exempt from the specific policy and infrastructure requirements of [§723.3](#) and [§723.4](#). Exempt credit unions must ensure their general loan policy (required by Part 701) covers the types of commercial loans the institution makes, including satisfying all other applicable commercial lending requirements in the rule.

V. MINIMUM PROCEDURES

1. Business Lending Policy:

- a. Determine whether the policy complies with the requirements of Part [723.4](#) of the NCUA Rules & Regulations. **Refer to the Commercial Loan Policy Guidelines for detailed requirements.**
- b. Policy must address, at minimum, the following:
 - i. Types of commercial loans permitted
 - ii. Trade area
 - iii. Portfolio concentration limits
 - iv. Single borrower limits
 - v. Qualifications and experience requirements for lending staff
 - vi. Loan approval processes
 - vii. Underwriting standards
 - viii. Risk management processes

2. Underwriting & Controls:

- a. Determine whether lending personnel meet qualifications specified in NCUA Rules and Regulations Part [723.3](#), including experience in
 - i. Underwriting and processing types of commercial loans offered;
 - ii. Overseeing and evaluating performance of commercial portfolio (including rating systems); and
 - iii. Conducting collection activities for types of commercial loans offered.
- b. Review the business portfolio to determine compliance with policy concentration limits, as well as compliance with individual and portfolio limits established in NCUA Rules and Regulations Part [723.4](#) and [723.8](#).

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- c. Review policy to ensure underwriting standards are sufficient for the credit union’s risk profile.
 - d. Review monitoring practices for property taxes, lien placement and insurance policies. Review tracking reports from internal or third-party monitoring.
- 3. Loan Review:** Review a sample of loans.
- a. Review the credit analysis of the business. Review the financial statements of the business, personal guarantees, corporate resolution, and assignment of rents, if applicable.
 - b. Review the collateral.
 - i. Determine whether the credit union has obtained sufficient information to determine the value of the collateral.
 - ii. Determine whether the loan-to-value ratios comply with the limitations of Part [723.7](#) of the NCUA Rules & Regulations.
 - iii. Review the appraisal. Determine whether the appraisal complies with the requirements of [Part 722](#) of the NCUA Rules & Regulations.
 - c. Review the servicing of the loan. Determine whether an annual analysis is being performed.
- 4. Portfolio Risk Management:**
- a. Classify business and commercial loans as satisfactory, substandard, doubtful, or loss. Review internal watch list and individually impaired loans to ensure appropriate reserves are maintained for potential/probable losses if necessary.
 - b. Evaluate the risk associated with concentrations (i.e. geographic area, industry), and the portfolio as a whole. Evaluate the potential risk to the credit union’s overall financial condition.
 - c. Review the credit risk rating system, and compliance with [723.4\(g\)](#) of the NCUA Rules & Regulations. Review the ratings of a sample of loans and determine reasonableness when compared to recent financial analysis, credit memo, and/or annual review. Review monitoring practices for high risk rated loans, and the frequency at which monitoring takes place.
 - d. Review loan covenants for requirements for risk management tools such as required financial reporting and regular site visits. Review practice of monitoring and reviewing periodic review of financial data and site visits.

IV. ATTACHMENTS / FORMS

1. [10345-A: Commercial Loan Policy Guidelines](#)