

ORDER OF THE
STATE OF WISCONSIN
OFFICE OF CREDIT UNIONS

The State of Wisconsin, Office of Credit Unions proposes an order to create ch. DFI—CU 72 relating to member business loans.

Analysis Prepared by the Office of Credit Unions:

An order to create ch. DFI—CU 72 relating to member business loans. Analysis: Statutory authority: ss. 186.115(1) and (2), 186.235(8) and 227.11(2), Stats. Statutes interpreted: ss. 186.115(1) and (2), 186.235(8), Stats. Summary: The rule provides certain criteria, exemptions, prohibitions and waivers; establishes procedures for programs and criteria for policies; sets forth collateral, security and record keeping requirements; and sets forth limitations, calculations and classifications relating to member business loans. The rule would be the implementing provision under state law authorizing credit unions to make loans to their members. The promulgation of this rule has been approved by the Credit Union Review Board. Agency person to be contacted for substantive questions and responsible for the agency's internal processing: Ginger Larson, Director, Office of Credit Unions, tel. (608) 261-9543. Pursuant to the statutory authority referenced above, the Office of Credit Unions adopts the following:

SECTION 1: CHAPTER DFI—CU 72 is created to read:

CHAPTER DFI—CU 72

MEMBER BUSINESS LOANS

DFI-CU 72.01 Definitions. In this chapter:

(1) “Amount” of a business loan includes all the following:

- (a) Any unfunded commitment to make the loan.
- (b) The outstanding balance of the loan.
- (c) Any undisbursed proceeds of the loan.

(2) “Associated member” means a person who is associated with another by means of a shared ownership, investment or other pecuniary interest in a business or commercial endeavor.

(3) “Business purpose loan” means a loan where the borrower intends to use the proceeds for any of the purposes listed in s. DFI-CU 72.02(1).

(4) “Construction or development loan” means 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 any of the following:

(a) Residential housing for sale.

(b) Income property.

(c) Commercial use.

(d) Industrial use.

(e) Any similar uses.

(5) “Director” means the director of the office of credit unions or an authorized representative of the director.

(6) “Loan-to-value ratio” or “LTV ratio” means the amount of all loans by the credit union secured by an item of collateral added to the amount of all outstanding loans by other lenders secured by that item of collateral, that total amount then being divided by the market value of that item of collateral.

(7) “Member business loan” has the meaning set forth in s. DFI—CU 72.02.

(8) “NCUA” means the National Credit Union Administration.

(9) “Net worth” means the retained earnings as defined under Generally Accepted Accounting Principles. Retained earnings include undivided earnings, regular reserves and any other appropriations designated by management or regulatory authorities.

DFI-CU 72.02 Member business loan. (1) “Member business loan” means 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.

(e) Agricultural.

(2) “Member business loan” shall not include any of the following:

(a) A business purpose loan fully secured by a lien on a 1 to 4 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 an associated member that, in the aggregate, are less than \$50,000. The entire amount of such a loan or loans that equals or exceeds this amount, or that causes the aggregate to exceed this amount is a business loan.

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

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

DFI-CU 72.03 Prohibited member business loans. (1) OFFICERS. A credit union shall not grant a member business loan to any of its following:

(a) Chief executive officer.

Example: President, Treasurer or Manager.

(b) Assistant chief executive officers.

Example: Assistant President, Vice President, Assistant Treasurer or Assistant Manager.

(c) Chief financial officer.

Example: Comptroller.

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

(2) EQUITY AGREEMENTS OR JOINT VENTURES. A credit union shall not grant a member business loan if any additional income received by the credit union or its senior management employees is tied to the profit or sale of the business or commercial endeavor for which the loan is made.

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

DFI-CU 72.04 Construction and development loans. Unless the director grants a waiver, a credit union that makes construction or development loans shall be subject to all of the following:

(1) The aggregate of all construction and development loans shall not exceed 15% of the credit union's net worth. In determining the aggregate, the credit union may exclude any portion of a loan that is any of the following:

(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.

(b) Insured or guaranteed by any agency or subdivision of the state or the federal government.

(c) Subject to an advance commitment to purchase by any agency of the federal government, the state, or any of their political subdivisions.

(2) The borrower shall have a minimum of the following:

(a) 30% equity interest in the project being financed if the loan is for land development.

(b) 25% equity interest in the project being financed if the loan is for construction or for a combination of development and construction.

(3) The funds shall 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.

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

DFI-CU 72.05 Implementation of a member business loan program. (1) The board of directors shall adopt a specific member business loan policy and review it at least annually.

(2) In making member business loans, the credit union shall utilize the services of an individual with at least two years direct experience with the type of lending in which it will engage, except as provided s. DFI-CU 72.04(4).

(3) A credit union does not have to hire staff to meet the requirements of this section. However, credit unions shall ensure that expertise with the type of lending in which it will engage is available.

Example: A credit union may meet the experience requirement through various approaches, such as the services of a credit union service organization, an employee of another credit union, an independent contractor or other third parties.

(4) The actual decision to grant a loan shall reside solely with the credit union.

DFI-CU 72.06 Member business loan policy requirements. A credit union's member business loan policy shall include all of the following:

(1) The types of business loans the credit union will make.

- (2) The credit union's trade area.
- (3) The maximum amount of the credit union's assets, in relation to net worth, that it will invest in member business loans.
- (4) The maximum amount of the credit union's assets, in relation to net worth, that it will invest in a given type of business loan.
- (5) The maximum amount of the credit union's assets, in relation to net worth, that it will loan to a member or associated members, subject to s. DFI-CU 72.08.
- (6) The qualifications and experience of personnel involved in making and administering business loans.
- (7) A requirement for analysis and documentation of the ability of the borrower to repay the loan.
- (8) A requirement for the receipt and periodic updating of financial statements and other documentation, including tax returns.
- (9) A requirement for 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 policies. The documentation shall include all of the following:
 - (a) Balance sheet.
 - (b) Cash flow analysis.
 - (c) Income statement.
 - (d) Tax data.
 - (e) Analysis of leveraging.
 - (f) Comparison with industry average or similar analysis.
- (10) Collateral requirements, including all of the following:
 - (a) Loan-to-value ratios.
 - (b) Determination of value.
 - (c) Determination of ownership.

(d) Steps to secure various types of collateral.

(e) A schedule as to how often the credit union will reevaluate the value and marketability of collateral.

(11) The interest rates and maturities of the business loans.

(12) General loan procedures, including all of the following:

(a) Loan monitoring.

(b) Servicing and follow-up.

(c) Collection.

(13) Identification of those individuals prohibited from receiving member business loans.

(14) Guidelines for purchase and sale of member business loans and loan participations, if the credit union intends to engage in these activities.

Note: The Office of Credit Unions recognizes that all of the provisions of the policy may not apply to every loan.

DFI-CU 72.07 Collateral and security requirements. Unless granted a waiver by the director, all of the following shall apply:

(1) All member business loans shall be secured by collateral in accordance with this section, except for 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.

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

1. The amount of the loan or loans to any one individual does not exceed 1% of the credit union's net worth.

2. The aggregate of the unsecured business loans under this paragraph does not exceed 10% of the credit union's net worth.

3. The credit union has a net worth ratio of at least 7%.

4. The credit union submits reports to the Office of Credit Unions with its NCUA call reports providing numbers and such other details as may be required by the director to demonstrate compliance with this paragraph.

(2) For a member business loan secured by collateral on which the credit union will have a first lien, a credit union may grant the loan with an LTV ratio in excess of 80% only where the value in excess of 80% is as follows:

(a) Covered through acquisition of private mortgage or equivalent type insurance provided by an insurer acceptable to the credit union, and the LTV ratio does not exceed 95%; or

(b) Insured or guaranteed, or subject to advance commitment to purchase, by an agency of the federal government, state, or any of its political subdivisions, and the LTV ratio does not exceed 95%.

(3) For a member business loan secured by collateral on which the credit union will have a second or lesser priority lien, the credit union shall not grant the loan with an LTV ratio in excess of 80%.

(4) For a member business loan secured by the same collateral on which the credit union will have a first lien as well as other lesser priority liens, the credit union may grant the loan with an LTV ratio in excess of 80% only if sub. (2)(a) or (b) is satisfied. In no case shall the LTV ratio exceed 95%.

(5) For a member business loan secured by the collateral on which the credit union will have lesser priority liens but no first lien, the credit union shall not grant the loan with an LTV ratio in excess of 80%.

DFI-CU 72.08 Amount of loan. Unless the director grants a waiver for a higher amount, the aggregate amount of business loans to a member or associated members shall not exceed 15% of the credit union's net worth or \$100,000.00, whichever is greater.

DFI-CU 72.09 Calculating the aggregate 15% limit. To calculate the aggregate 15% limitation, the credit union shall do the following:

(1) Calculate the numerator by adding together the amount of the member business loans to a member and associated members, if any. From this amount, the credit union shall subtract each of the following:

(a) Any portion secured by shares or deposits in the credit union making the extension of credit or in other credit unions, or deposits in other financial institutions.

(b) Any portion insured or guaranteed by any agency or subdivision of the state or federal government.

(c) Any portion subject to an advance commitment to purchase by any agency or subdivision of the state or federal government.

(2) After completing the calculation in sub. (1), divide the numerator by the credit union's net worth.

DFI-CU 72.10 Available waivers. A credit union may seek a waiver for any of the following:

- (1) Construction and development loan requirements under s. DFI-CU 72.04.
- (2) Loan-to-value ratio requirements under s. DFI-CU 72.07.
- (3) Maximum loan amount to a member and associated members under s. DFI-CU 72.08.
- (4) Appraisal requirements under s. 722.3 of NCUA rules.

Note: A copy of NCUA rules may be obtained by writing to the Office of Credit Unions, P.O. Box 14137, Madison, WI 53714-0137.

DFI-CU 72.11 Obtaining a waiver. (1) To obtain a waiver under s. DFI-CU 72.10, a credit union shall submit a request to the director. The request shall contain all of the following:

- (a) A copy of the 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 the credit union's ability to manage this activity.
- (e) An analysis of the credit union's prior experience making member business loans, including each of the following:
 1. The history of loan losses and loan delinquency.
 2. Volume, and cyclical or seasonal patterns.
 3. Diversification.
 4. Concentrations of credit to a member and associated members in excess of 15% of net worth.
 5. Underwriting standards and practices.
 6. Types of loans grouped by purpose and collateral.
 7. The qualifications of personnel responsible for underwriting and administering member business loans.

(2) Upon receipt of the request for waiver, the director shall do all of the following:

- (a) Review the information provided in the request.

- (b) Evaluate the level of risk to the credit union.
 - (c) Consider the credit union's historical capital, asset, quality, management, earnings and liquidity ("CAMEL") composite and component ratings.
 - (d) Notify the credit union when the waiver request is deemed complete.
 - (e) Notify the credit union of the action taken within 45 calendar days of receiving a complete request.
- (3)** In connection with a waiver request under s. DFI-CU 72.10(1) through (3), all of the following shall apply:
- (a) The director shall provide a copy of the waiver request to the applicable regional director of the NCUA, and shall consult and seek to work cooperatively with the applicable regional director in deciding upon the request.
 - (b) The waiver shall not be effective until the director approves it.
 - (c) If the credit union requesting the waiver does not receive notification within 45 calendar days of the date the complete request was received by the director, the waiver request shall be deemed approved by the director.
 - (d) The director shall promptly notify the applicable regional director of NCUA of his or her decision on the request.
- (4)** In connection with a waiver request under s. DFI-CU 72.10(4), all of the following shall apply:
- (a) If the director approves the request, the director shall promptly forward the request to the applicable regional director of the NCUA for decision under 12 C.F.R. 723.12.
 - (b) The waiver shall not be effective until the applicable regional director of the NCUA approves it in accordance with 12 C.F.R. 723.12.
 - (c) The credit union may appeal the regional director's decision in accordance with 12 C.F.R. 723.13.

DFI-CU 72.12 Classifying non-delinquent member business loans to reserve for potential loss. Non-delinquent member business loans shall be classified based on factors such as the adequacy of analysis and supporting documentation. A credit union shall classify potential loss loans as either substandard, doubtful or loss. The criteria for determining the classification of loans shall be as follows:

(1) SUBSTANDARD. A loan classified substandard 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. The loan 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 as doubtful has all the weaknesses inherent in one classified substandard, with the added characteristic that the weakness or 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.

(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, that it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may occur in the future.

DFI-CU 72.13 Schedule of reserves. The following schedule sets the minimum amount a credit union shall reserve for classified member business loans:

Classification	Amount Required
Substandard	10% of outstanding balance, unless other factors indicate a greater or lesser amount is appropriate. <i>Example: An example of a factor is the history of such loans at the credit union.</i>
Doubtful	50% of the outstanding balance.
Loss	100% of the outstanding balance.

DFI-CU 72.14 Aggregate member business loan limit. The aggregate limit on the amount of a credit union's member business loans is the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets.

DFI-CU 72.15 Exceptions to the aggregate business loan limit. Credit unions that meet any one of the following criteria qualify for an exception from the aggregate member business loan limit:

(1) Credit unions that have a low-income designation.

(2) Credit unions that participate in the Community Development Financial Institutions program.

(3) Credit unions that are chartered for the purpose of making member business loans, as supported by documentary evidence.

Example: the credit union's charter, bylaws, business plan, field of membership, board minutes and loan portfolio.

DFI-CU 72.16 Obtaining an exception. (1) The exception under s. DFI-CU 72.15(1) and (2) shall be effective upon written notice to the director of such designation or participation.

(2) To obtain an exception under s. DFI-CU 72.15(3), a credit union shall submit its request to the director. An exception shall not be effective until approved by the director. The exception request shall include documentation demonstrating that the credit union meets the criteria for the exception. The exception shall not expire unless revoked for safety and soundness reasons by the director.

(3) The director shall promptly notify the applicable region of the NCUA of his or her decision on the request.

DFI-CU 72.17 Record keeping requirements. A credit union shall separately identify member business loans in its records. On its financial reports, a credit union shall identify member business loans in the aggregate.

This rule shall take effect on the first day of the month following publication in the Wisconsin administrative register as provided in s. 227.22(2)(intro.), Stats.

Dated: _____

Agency: _____

Ginger Larson, Director
Office of Credit Unions