MEMBER BUSINESS LOAN GUIDANCE

The following guidance was drafted based on information in NCUA's Member Business Loans Regulation as detailed in Part 723, and other applicable laws and regulations. It is intended only as a guide to help credit unions develop their own individualized policy.

Credit unions may originate NCUA defined Member Business Loans based on guidance provided in the NCUA's Member Business Loans Regulation as detailed in Part 723, and other applicable laws and regulations. The following should be supplemented by procedures that will provide additional direction on the lending practices outlined here. An approved policy should be reviewed and approved by the Board of Directors at least annually.

A. Types of loans made: The policy should address the types of business loans that your credit union will make (e.g., agricultural, loans to restaurants, etc.). In addition, this section should state the types of business loans that your credit union will not make (e.g., loans to businesses in existence for less than 3 years).

B. Trade area: Specify the geographical areas (e.g., county, city, or other area) that your member business lending program will serve. Remember that originated loans must fall within your credit union's field of membership.

C. Maximum member business loan portfolio: State the maximum amount (either an absolute amount, or as a percentage of assets, loans or net worth), your credit union will lend in aggregate secured and/or unsecured business loans. Section 723.16 of NCUA's Rules and Regulations limits a credit union's aggregate net member business loan balances to the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets. Of course, your Board of Directors may approve a lesser amount.

D. Maximum amount by each category or type of business loan: State the maximum aggregate amount (in relation to net worth, total assets, total loans, etc) that your credit union will lend in a given category or type of business loan. Also, state any aggregate lending caps on participation loans (especially if your credit union purchases participation loans nationally).

For example (not a complete list):

Type of loan	***Maximum permissible***
Unsecured	____%
Secured by real estate	____%
Collateral pledged on funds on deposit	____%
Secured by stocks and bonds	____%
Secured by titled vehicles	____%
Secured by business equipment	____%
Seasonal loans, agricultural, etc.	____%
Participation loans	____%
Construction and Development	____%

SBA loans ____*%*

E. Maximum net amount loaned to one member or group of associated members: NCUA section 723.8 limits the amount that can be loaned to one member or group of associated members to 15% of net worth, or $100,000, whichever is greater. Section 723.7(c)(2) of NCUA Rules and Regulations limits the total unsecured member business loans to any one member or associated members to the lesser of $100,000 or 2.5% of net worth. Your board may choose to set lower limits.

F. Personnel qualification and experience: NCUA section 723.6 requires personnel involved in making and administering business loans to have a minimum of two years of business lending experience. It is strongly recommended that you require no less than 5 years of experience. This experience should be relevant for the types of business loans offered. Your credit union may utilize the services of a contracted underwriter to assist in review and making business loans. Your board is responsible for setting the standards for qualifications and experience of business lending personnel. Member business lending personnel should provide a resume or curriculum vitae as documentation of their qualifications. In addition, the members of your credit union’s Business Loan Committee should have appropriate lending, business, or financial experience to be able to make lending decisions.

G. Loan approval authority: The Board of Directors is responsible for establishing the membership, roles, and authorities of the loan officers and a business loan committee. This should include authorization limits for all new loans, renewals, extensions, refinancings, and additional advances. Exceptions to the authorized limits established by the board, including loans over the established limits provided in “D”, should receive prior approval from the board and cannot exceed the regulatory limits. The creation of any new loan types not listed in section “A” requires the prior approval of the board.

Full underwriting packages should be made available to all Business Loan Committee members to review prior to the scheduled meeting. Due Diligence Reports from contracted underwriters/reviewers must be included with the information provided to the Business Loan Committee.

H. Credit decision analysis: Credit unions should use the financial analysis standards outlined in NCUA section 723.6(g), and in its own underwriting guidelines. The use of a “credit memo” is strongly recommended. The “credit memo” should cover, at a minimum: specific debt service requirements and demonstrate how those are met, a summary review of the collateral and its valuation, loan terms, and how the cash flow will meet the payment requirements, financial statement quality, as well as a “reconciliation” of any inconsistent information (for example, a discussion of difference between income shown on financial statements vs. that shown on the tax return). The memo should also discuss the strengths and weaknesses of the credit. Credit unions that purchase participation loans – especially when done nationally – should ensure that they are reviewed like any other member business loan, to include an analysis of the economic conditions of the trade area where the collateral/borrower is located. Credit unions should not make loans to support speculative ventures or loans based on collateral whose value cannot be determined.

I. Documentation requirements: As outlined in section 723.6(g) of NCUA Rules and Regulations, the Member Business Loan Policies section of the NCUA Examiner's Handbook, and your credit union's underwriting guidelines, appropriate documentation should be obtained or prepared for new loans, renewals, extensions, or additional advances.

In addition to the promissory note and security agreement (if any), documentation evidencing the creation and perfection of all security interests must be in the loan file. In addition, property insurance coverage should be verified and monitored for all types of collateral requiring insurance coverage. Business loan files may also include some or all of the following underwriting documentation, as required by the credit union's policy (not an exhaustive list):

- copies of financial statements (including guarantors), as well as periodic update;
- copies of tax returns (including guarantors);
- spreadsheet analyses;
- trend and structure analyses;
- ratio analyses of cash flow income and expenses;
- comparison with industry averages;
- insurance documents;
- corporate documents, such as corporate resolutions, attorney's opinions, etc.; and
- environmental impact assessments.

J. Collateral requirements: State the collateral that will be required on member business loans, LTV ratio requirements (not exceeding that allowed by NCUA section 723.7), determination of value and ownership, steps to perfect various types of collateral, and how often the credit union will re-evaluate the value and marketability of the collateral.

For example, your credit union may require all member business loans – except unsecured loans up to an established dollar amount – to be secured by either real estate and/or a combination of various types of business collateral (such as accounts receivable, inventory, or equipment), to a maximum LTV of 80%, unless there is private mortgage insurance, a government guarantee, or a written commitment to purchase in place, in which case the maximum LTV is 95%. SBA 7(a) loans can be exempted from this requirement, as long as the SBA has issued its commitment to provide at least a 50% Guarantee.

K. Appraisal requirements: Credit unions should adhere to NCUA Rule and Regulations Part 722 (Appraisals) and should perform and document an appropriate evaluation of the value of any non-real estate collateral. Credit unions should also refer to NCUA's Letter to Credit Unions No. 05-CU-06 for important guidance regarding standards for selecting appraisers, maintaining an approved appraiser list, ordering appraisals, accepting transferred appraisals, and other related topics.

L. Pricing and term parameters: State how pricing for business loans will be set. Loan pricing should be established in published rate sheets. However, the loan officer and Business Loan Committee may be provided the authority to modify pricing as long as it falls within parameters set by the board, and as long as the credit union's internal profitability model insures that overhead costs, the cost of funds, and adequate loan loss allowances are covered. (The components of the profitability model should be subject to analysis and recommendation through each credit union's ALCO process and subject to board approval.) Pricing should be risk-based.

   Loans to businesses will typically have terms of five years or less, and should have floating interest rates whenever possible. Loans secured by commercial real estate may occasionally have maturities up to ten or fifteen years (25 years on SBA loans), although typically most of these are re-priced/callable with a shorter term (e.g., five years). Specific term limits should be set at the product level in the underwriting guidelines.

M. Loan servicing: A description of how member business loans will be serviced (e.g., by credit union staff, serviced on a host system, etc.).

N. Loan review & supervision: In this section, provide information about how your credit union will monitor member business loans to ensure they remain in current payment status. Most properties securing a business loan will require an annual review and site visit. Collateral assessment should be one of the purposes of these visits. More frequent visits should be required in those cases where primary collateral reliance is placed on inventory. Lending staff, as called for in the loan agreements, should monitor covenants. Whenever any credit issues are discovered during the review, your credit union should request tax returns and an updated financial statement from the principals. Regardless, annual updates of financial statements and tax returns should be required on all loans (to include principals and guarantors). Additionally, an independent quality control administrator should review a sampling of all MBLs on a quarterly basis and report to the Business Loan Committee (or Risk Management executive, Internal Auditor, etc.). Copies of the "credit memo" for MBLs originated should be made available to the members of the Business Loan Committee on a periodic basis.

O. Loan collection: Your credit union should have collection procedures that are specific to member business loans; do not recycle your consumer loan collection procedures for use here. While there may be similarities (e.g., loans that reach 90 days delinquent may be placed on non-accrual status), your member business loan collection procedures should be tailored for the loan types, economic conditions, and environmental factors of your member business lending program. Delinquency status should be reported through management to the Supervisory Committee and the Board of Directors. Remedial action plans should be provided on those loans over 60 days past due.

P. Identification of ineligible management: In accordance with NCUA section 723.2, your credit union should not grant a business loan to your CEO or senior management employees, or to any associated member or immediate family member of the same.

Q. <u>Director/employee loans</u>: Loans to any director, official, employee, or associated member and family members of such individuals shall not be granted on terms more favorable than those available to credit union members in general. Additionally, none of the individuals identified here should receive any pecuniary consideration in connection with the lending, servicing, or collecting of a business loan.

Other Considerations

Credit unions seeking to make member business loans should also ensure that the following issues are considered and accounted for in their policy, procedures, or underwriting guidelines:

- ALM issues for the credit union relative to all loans (consumer & business) and relative to the deposit side of their business
- Loan concentrations (how much risk is pooled in specific areas and, even if that may not exceed the specified percentage for that loan type, it should be a consideration)
- Interest rate risk issues (are there a lot of long term loans in the portfolio?)
- The credit union's specific risk profile (overall, how safe are the consumer and business loans in the portfolio and what about other assets and liabilities beyond lending?)
- The policies need to be tailored to the specific circumstances of the individual credit union
- Quality control issues should probably include a rating of loans (e.g. 1-6, with 6 being the worst) and some idea of how each rated loan will be treated. For example, loans rated 1 or 2 may not need much ongoing supervision, while loans rated 5 or 6 require near-constant communication, guidance, and review. Also periodic review of the loan ratings is needed to assess changes in rating. Also, the ratings involve much more than just whether payments have been made on time. A loan rating could conceivably drop due to larger economic issues (a nearby base closing or a downturn in that economic sector) and that needs to be acknowledged.

While this document discusses loan participations in some areas, this is NOT intended to cover the needs of a participation policy. A credit union should have two distinct policies, one for granting member business loans, and yet another for setting proper parameters for purchasing loan participations.