

COUNTDOWN TO THE NEW MBL WORLD

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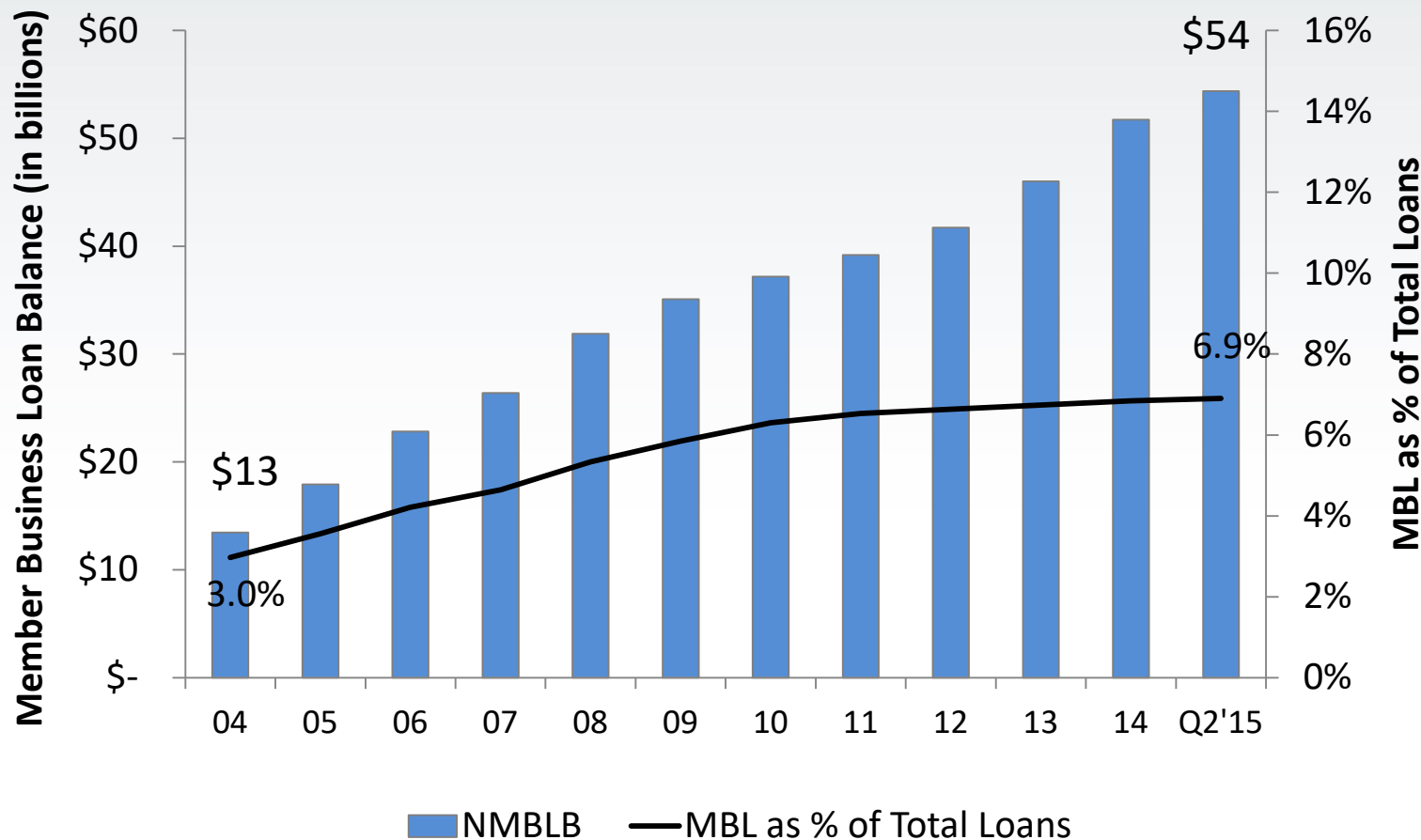
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INDUSTRY OVERVIEW

Thanks to Vin Vieten,
NCUA Program Officer Member Business Lending

Amounts and Percentages of Portfolio

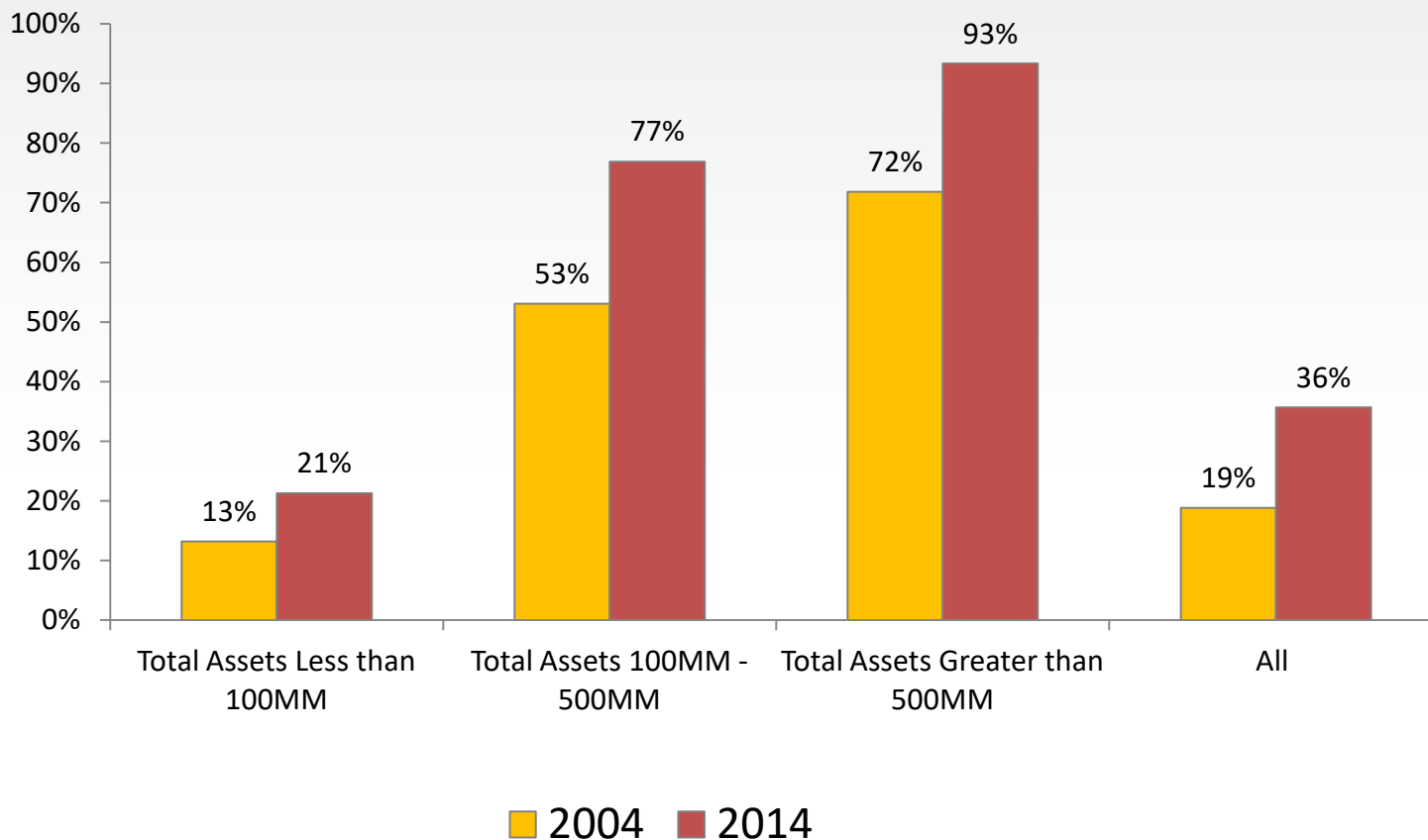
MBL Balance* and as % of Total Loans*



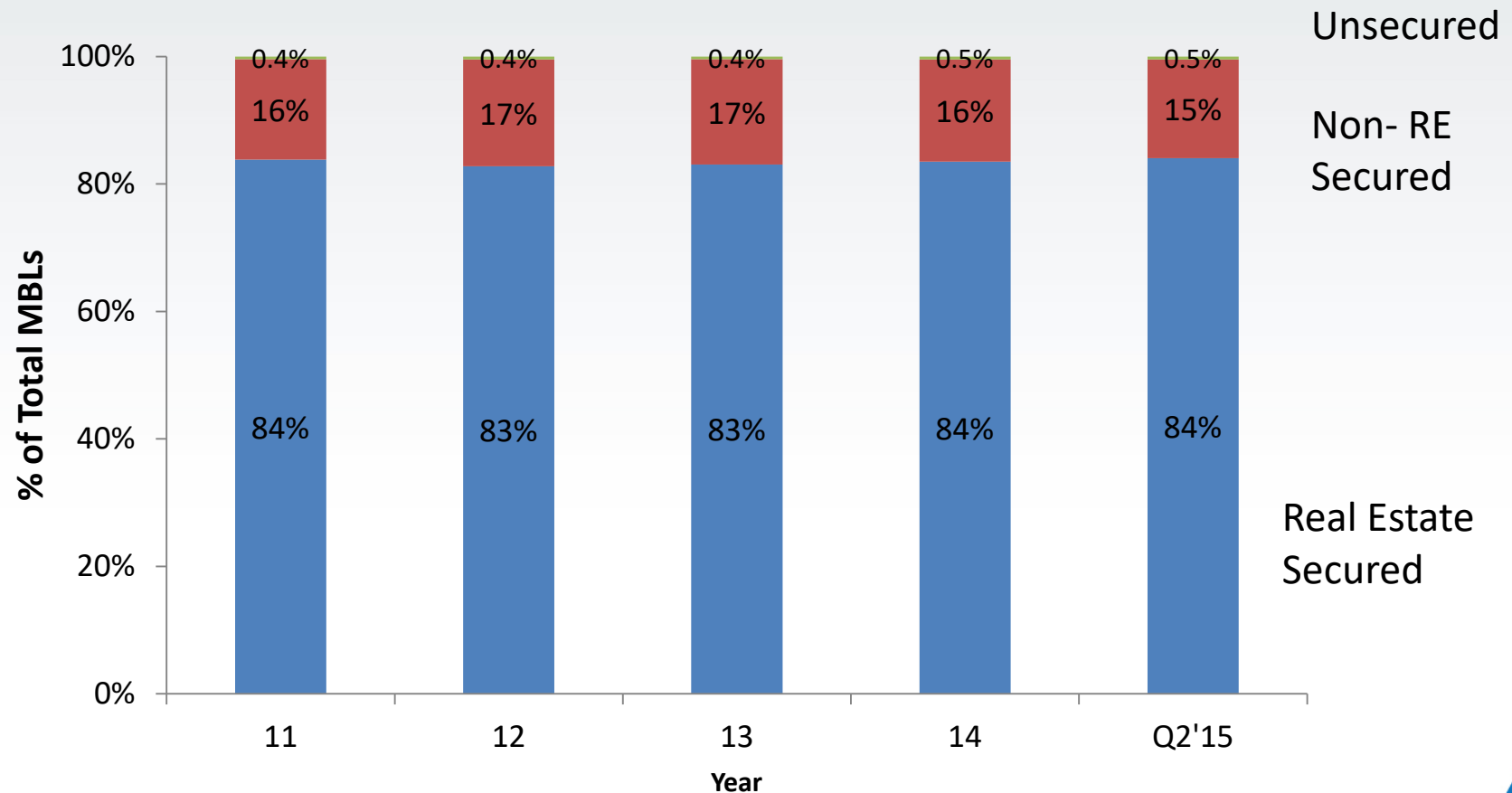
- NMBLB, including both member and nonmember business loans. Including unfunded commitments
- MBL as % of total loans are calculated using MBL loan outstandings.

Percentage of Credit Unions with MBLs

% of Credit Unions with MBLs



Type of Collateral



MBL Reg's and Guidance

Rules

- Part 701 Loans to Members
- Part 723 MBLs.
- Part 722 Appraisals.
- Part 712 CUSOs.

Guidance

- 14-CU-06 Taxi Medallion Lending and 15-CU-03 FAQ's Taxi Medallion Lending
- 13-CU-07 Participation Guidance.

MBL Reg's and Guidance

- 13-CU-03 Troubled Debt Restructure (TDR).
- 13-CU-02 MBL waivers.
- 10-CU-23 Best Practices in RE appraisals.
- 10-CU-07 Commercial RE Workouts.
- 10-CU-03 Concentration Limits.
- 10-CU-03 Risks in Business Lending.
- 08-CU-26 Evaluating Participation Programs.
- Acct. Bull. # 06-01 Interagency Guidance for ALLL
 - Specifically-Appendix 1 Loan Review Systems

Status of the New MBL Rule

- Approved unanimously by NCUA Board on February 19, 2016.
- Majority of rule becomes effective January 1, 2017.
- Personal guarantee requirement was eliminated on May 13, 2016.
- Supervisory Guidance due out by November.
 - NCUA will incorporate expectations regarding risk management practices, such as LTV ratios and portfolio concentration limits, into supervisory guidance.



CHANGE IS GOOD

The MBL Rule Does Not Apply to:

- Loans by corporate credit unions.
- Loans between credit unions.
- Loans to a CUSO.
- Loans secured by a borrower's residence (up to four unit structure).
- Loans fully secured by shares in the lending CU or deposits in other financial institutions.
- Loans to a borrower and associated borrower totaling less than \$50,000.

Carve Out for Smaller Credit Unions

- Exempt from having a commercial loan policy other than for the specific loans they grant and expertise sections of the rule if CU:
 - Has less than \$250 in assets;
 - Has a commercial loan portfolio plus loans sold and serviced that are less than 15% of its net worth; and
 - In any given calendar year has originated and sold and no longer services commercial loans that in the aggregate are less than 15% of its net worth.
- Affects 660 smaller CU's and 30% of all CU's with MBL's but only 1% of total outstanding commercial loans.

Change in Regulatory Approach

Prescriptive - Rules Based



Principles - Analysis Based



Principles Based Regulation

- Purpose is to give credit unions more flexibility to implement principle-based risk management processes and policies and staff to maintain a comprehensive understanding of the borrower's financial capacity.
- Credit unions must establish risk tolerances at the relationship and overall portfolio levels to ensure that the risks taken are consistent with prudent standards within the managerial and financial capability of the credit union.

NCUA's Unspoken Message to Larger CU's that Make Commercial Loans



**TIME TO PUT
YOUR BIG BOY
PANTS ON!**

It is all about risk mitigation.



Need to demonstrate competence.

Senior Staff Competence



- Staff experience directly related to the specific types of commercial lending.
- Demonstrated experience in risk and credit analysis.
- Demonstrated experience in underwriting, processing and workouts.
- Knowledge of law and documentation.
- Conforming loan policy

Lender Competence



- Overseeing commercial risk assessment and underwriting.
- Managing and administering a credit risk rating system.
- Managing a portfolio and being accountable for the risk in the portfolio.
- Managing commercial lenders and other risk managers.

Removal of Explicit Two-Year Experience Requirement

- Can use a third party if:
 - overseen by CU staff,
 - no conflicts, and
 - all credit decisions made by CU.
- Contingent Compensation Issue
- Control Exception

Avoid the Deer in the Headlights Response to an Examiner's Question



NCUA's Role

- Does not participate in underwriting decisions (e.g., waivers, setting ratios and making credit decisions)
- Does determine whether the risks were identified and reasonably mitigated.
- Implication: CU's will use third party portfolio evaluations and engage in dialogue with the examiners.

Waivers Will be History.



- Waivers are no longer needed as the CU will have the ability to customize the risk mitigation.
- Watch for safety and soundness conditions imbedded in waivers, they could survive.

List of Waivers that Will Disappear

- Aggregate C&D Loan Limit
- Minimum Borrower's Equity for C&D Loans
- LTV Requirement
- Personal Guarantee Requirement
- Max Unsecured MBL to one Member or Associated Members
- Max Aggregate Unsecured MBL Loan Limit
- Max Aggregate Net MBL to one Member Group or Group of Associated Members

Revising the MBL Policy

- Less lawyers and more credit analysts.
- “How” and “who” added to “what”.
- Expected Hot Points
 - LTVs (often viewed within context of amortization)
 - Unsecured lending
 - Recourse
 - Construction and development limits, eligible costs and monitoring and disbursement procedures

Revising the MBL Policy Regulatory Narrative

- Loan types, trade area, concentration limits
 - Experience requirements of executives, staff and/or partners
 - Loan approval authorities and processes
-

Revising the MBL Policy Underwriting Standards

- Underwriting analysis depth and content.
- Due diligence and risk evaluation requirements of principals of business borrowers.
- Financial projection analysis when historical results insufficient.
- No longer need to use industry ratios for real estate financing.
- Financial statement quality and verification expectations.
- Collateral perfection and valuation requirements, including LTVs appropriate for specific collateral type.
- No longer need to use industry ratios for real estate financing.

Revising the MBL Policy Risk Management Processes

- Use of loan covenants
 - Frequency of financial reporting
 - Frequency and depth of ongoing loan review and collateral value monitoring
 - A credit risk rating system, at inception and through life of loan
 - A process to track and report policy exceptions
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Key Definitions

- Associated Borrower
 - Direct Benefit
 - Common Enterprise
 - Substantial Interdependence
 - Control
 - 25% ownership or voting power

MBLs vs. Commercial Loans

Type of Loan	MBL	Commercial Loan
Loan fully secured by a 1- to 4- family residential property (borrower's primary residence)	No	No
Commercial loan fully secured by shares in the credit union making the extension of credit or deposits in other financial institutions	No	No
Business loan with aggregate net member business loan balance less than \$50,000	No	No
Business loan secured by a vehicle manufactured for household use.	Yes*	No

MBLs vs. Commercial Loans

Type of Loan	MBL	Commercial Loan
Member business loan secured by a 1- to 4- family residential property as an investment (<u>not</u> the borrower's primary residence)	Yes*	No
Commercial loan in which a federal or state agency (or its political subdivision) fully insures repayment, fully guarantees repayment, or provides an advance commitment to purchase the loan in full	No	Yes*
Participation interest in a non-member loan made by another lender	No	Yes*

New Flexibility with Collateral and Guarantors

- Overwhelming majority of loans will have collateral and personal guarantees but not required.
- Current rule: 100% guaranteed by 51% of the owners for the life of the loan.
- Flexibility in the use of guarantees
 - Can be waived entirely.
 - Can be pro-rata.
 - Can exclude the non-money owners.
 - Can have sun-setting guarantees

Loan-to-Value Ratios

- CU's will set its own loan-to-value ratios for collateral.
- Now excludes junior debt from other lenders and clarifies the valuation basis for the collateral.
- Better reflects how loan-to-value ratios are commonly calculated for commercial loans.

Raising of Limit on Single Obligor

- A CU's policy may increase the limit from the current 15% of net worth up to 25% of net worth if supported by readily marketable collateral.

Expansion of SBA Underwriting Exemption

- Expands the rule that permits a CU to use the underwriting criteria for an SBA guaranteed loan to the underwriting criteria for any loan that is guaranteed by the federal or state government.
- Note required versus discretionary rules.

Construction and Development

- Removes the 15% of net worth limit and 25% equity requirement – limits must be set in the CU's policy.
- Clarifies the definition of collateral values - lesser of cost and market value.
- More detail related to loan administration and the disbursement of funds to align more with industry norms.

Ineligible Borrowers

- CU senior management directly or indirectly involved in commercial lending services and immediate family members or associated borrowers of the same. (currently the CEO, VPs, Treasurer and CFO).
- A compensated director unless the board approves.

MBL Cap Calculation

- Loan Participations
 - Current Rule: Loan participations interests count against the cap unless a waiver is given.
 - New Rule: Loan participation interests do not count against the cap, no waiver needed.
- The cap is the lesser of 1.75 times the actual net worth or 1.75 times the minimum net worth per the risk based standards.

MBL Cap Calculation – Net Member Loan Balance

- Outstanding loan balance plus unfunded commitments.
- Reduced by
 - Lien on the member's residence,
 - Lien on shares,
 - Portion guaranteed by a government agency, or
 - A participation interest sold without recourse and “qualifying for true sales accounting under GAAP”

State MBL Rules

- OK to have if the Rule is at least as stringent as Part 723 and complies with the FCU as determined by NCUA.
- Grandfathers the current MBL rules in the seven states. Illinois, Washington, Texas, Wisconsin, Connecticut, Oregon and Maryland.

Prepayment Penalties are Still Prohibited as a General Rule.



A better MBL Rule supports my granddaughters.

